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Transitioning high risk low income borrowers to affordable credit

BERR

Transitioning high risk borrowers to affordable credit

Revised draft research report

Executive summary

This study was focused on the higher risk borrower types among those without mainstream credit options, which we have defined as:

- Low income users of high cost credit[1] including heavy users and those with a significant degree of payment irregularity.[2]
- Those with no legitimate credit options because they either:
  - Live in an area not served by the high cost lenders.[3]
  - Are not served or no longer served by the high cost lenders on grounds of risk.
- Users of illegal money lenders.[4]

Aims of the study

The study rests on 60 in-depth qualitative interviews with high risk borrowers who were interviewed about their credit needs and experience of credit use and their attitudes to money advice and third sector lenders. It aims to provide a demand side perspective on the needs and challenges associated with high risk borrowers. It is intended to support both the BERR illegal money lending teams in the effort to introduce victims to affordable credit and the credit unions and CDFIs seeking to establish sustainable relationships with the financially excluded. The report also introduces a qualitative segmentation, intended as a first attempt to describe the characteristics, service needs and challenges represented by different types of high risk borrower.

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[1] There are approximately 1.15 million users of high cost home credit who have no mainstream credit options. Source: Policis estimates based on TNS research for Policis 2005 on the proportion of home credit customers with no other credit options and Competition Commission estimates of numbers of home credit users. Source: Competition Commission Home Credit Inquiry Final Report, 2006.

[2] Payment irregularity is endemic among users of high cost home credit customers. The Competition Commission found that for the top three lenders which together dominate the market, only between 2 – 10% of payments are made on time to contract term, that between 8 – 20% miss one in ten payments, that between 34% - 48% miss more than half of payments and that between 1 – 6% never make any payments. Source: Competition Commission Home Credit Inquiry Final Report, 2006.

[3] It is estimated that some 850,000 individuals live in post-codes not served by any of the high cost lenders, primarily on health and safety grounds. Source: Illegal Lending in the UK, Ellison, Forster and Collard, PFRC and Policis for the then DTI, 2006.

[4] There are approximately 165,000 users of illegal money lenders in the UK, approximately 6% of households in the most deprived areas (bottom 5% measured by the Indices of Multiple Deprivation) and about 3% of low income households overall (bottom 20% of household income). Users of illegal money lenders tend not to have any other credit options at the time that they borrow from an illegal lender. However, around half have used a home credit lender within the past twelve months, with many either unable to borrow further from their home credit lender or having defaulted on a home credit loan. Source: Consumer research undertaken to support Illegal Lending in the UK, Ellison, Forster and Collard, PFRC and Policis for the then DTI, 2006.

Characteristics and financial management of high risk low income borrowers

- Low income high risk borrowers have a distinct set of attitudes, behaviour and needs in relation to credit which are specific to those managing on tight budgets.
- Financial management is overwhelmingly cash based with finances managed week to week.
- This approach sits alongside an often deeply-felt resistance to bank-based financial management and automated payments, seen as incompatible with the common strategy of "robbing Peter to pay Paul" to resolve competing priorities on budgets which are too tight to accommodate all needs in any one week.

Credit use

- None of those in the study had mainstream credit options and some had no credit options at all.
- Those able to obtain credit were using a mix of high cost credit products including home credit, catalogue credit and "rent to own" contracts. Some of those with no legitimate options were using illegal lenders.
- The amounts borrowed and the terms over which debt was being repaid varied according to the lending model used.
    - Loans from home credit lenders were typically in the £100 – 500 range, most commonly being repaid on terms of a little more than six months or a year.
    - Those using rent-to-own retailers were buying expensive items, typically sofas or consumer electronics, over longer time-scales, commonly two or three years.
    - Users of illegal lenders included both those borrowing very small sums (£20 – 50) payable over terms as short as a week or two and those borrowing several thousand pounds repayable over many years.
- Repayments were being made weekly, to fit with cash inflows. Repayments as a proportion of income appeared to be lowest for short term credit types and were highest for victims of illegal money lending, where payments to lenders often hollowed out budgets to the point where they were barely viable.
- Borrowers from legitimate lenders were highly aware both of the total cost of credit and of the amount they needed to pay each week, with judgements on the manageability of borrowing made primarily on the affordability of weekly payments.[5] None had any sense of the relevant APR.

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[5] Home credit borrowers will repay £168 on a £100 loan (£3 p.w. payable over 56 weeks) and £840 (£15 p.w. over 56 weeks) on a £500 loan. In both cases this represents an APR of 183.2%. (Source: Provident Financial 24/07/08) Those buying large items of furniture, TVs etc. from rent to own retailers are commonly purchasing items over the course of a two to three year contract. A plasma TV available for outright purchase - from the rent-to-own retailer – would be priced at £598.18. It would cost £1324.44 on the basis of 156 weekly payments of £8.49 with service cover. A mobile phone priced at £118.80 would cost £207.48 on the basis of 52 weekly payments of £3.99 with service cover. APRs on this type of rent-to-own contract are typically 29.9%. (Source: Brighthouse 24/07/2008)

- The cost of borrowing from illegal money lenders was much higher than from licensed lenders[6] and victims had little idea either of the total cost of credit or the term over which they would have to repay.[7]
- The extent of repayment irregularity varied between credit models and appeared to reflect the customer management practice of different lender types.
- Among those using home credit, payments on debt service appeared to be among the first items to be sacrificed when funds were tight. Borrowers appeared to depend on the lenders' tolerance of uneven payment patterns in order to accommodate competing needs, with essentials or childrens' needs typically prioritised over debt service.
- Other suppliers are less flexible and appear to rely on the threat of sanctions to maintain payments. Rent-to-own retailers adopt a policy of removing goods rapidly in the event of account delinquency – a stance that results in these payments being prioritised within budgets.
- Illegal money lenders combat the tendency to irregular payment through intimidation and violence to ensure that victims prioritise payments to lenders over all other expenditure.
- Generally borrowers appeared better able to manage their cash flow when borrowing from lenders taking a flexible approach, albeit that this flexibility clearly comes at high cost.
- Multiple credit relationships were common among those with access to legitimate credit. Those missing payments to one lender appeared frequently also to miss payments to others, in some cases as part of a conscious strategy of alternating payments to different lenders.
- Whatever the lending model, payment irregularity appears to quickly become intractable arrears and default unless actively managed and rapid intervention made in the event of difficulties. Such interventions appear more likely to be successful if they provide a manageable route to account recovery and a future credit line.

That said, where lenders are inflexible on missed and late payments, this appears to make it more likely both that payment difficulties will lead to default and that borrowers will be unable to manage cash crises or fund essentials.

High risk borrower segmentation

We identified six key segments of high risk and credit excluded borrowers:

- Credit-resistant, modest-needs managers
- Traditional high cost credit copers
- Aspirational heavy credit users
- Mainstream-experienced, serial delinquents

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[6] Research undertaken to inform a study for the then Dti, suggested that credit from illegal money lenders averaged three times the cost of credit from the highest cost legal lender. Source: Illegal Lending in the UK, Ellison, Forster and Collard, PFRC and Policis for the then DTI, 2006.

[7] This was in part because sums putatively owed to the lender were frequently escalated by arbitrary and disproportionate penalties for late payment. Those taking very short term low value loans from illegal lenders were more likely to have a clear idea of the cost of credit from the illegal money lender (borrowers typically paid £40 on a £20 loan taken out a week or two earlier) but these low value loans could also be subject to disproportionate penalty charges if repayments were not made on time.

- Chaotic credit recyclers
- The profoundly excluded
- The various segments not only represent different degrees of risk but are likely to require different treatment strategies if sustainable affordable credit relationships are to be established.

Credit-resistant, modest-needs managers

- This segment has a bias to older women and those on long term benefits.
- Budgets rest on stringent economies but can be derailed by unanticipated expenses. Credit use is occasional and considered, undertaken only to support essential major purchases or to manage emergencies.
- Individuals lack confidence in dealing with financial institutions and are resistant to bank based management and direct debits.
- The key challenge in serving this segment will be building awareness of affordable credit options, creating the confidence to approach a third sector lender and the provision of a payment channel – such as Paypoint - that these low risk borrowers will be comfortable with.

Traditional high cost credit copers

- This group appear to represent a potentially large segment of relatively reliable credit users, albeit that payment irregularity is higher than third sector lenders would be comfortable with. The bias is to family households, with many single parents.
- Credit is central to financial management and thinking. Individuals are often all but continually in the market and have long established relationships with home credit and catalogue agents. Borrowers rely on being able to miss occasional credit payments in order to create some flex in tight budgets.
- The key challenge will be addressing the mind-set in which financial planning rests on a cycle of continual debt and creating a shift in thinking towards a saving mentality. There is a risk however both that these borrowers will treat affordable credit as simply one more credit line and that borrowers will find it difficult to cope with the regular payment assumed by electronic payment models.
- Appropriate treatment strategies may emphasise responsible rescheduling and the potential to progress to larger affordable loans if accounts are managed to an acceptable standard, which itself may counter the pull of incumbent high cost suppliers.

Aspirational heavy credit users

- This is a highly materialistic segment with a strongly felt desire to participate in the perceived norms of consumption. The bias is to family households and to long term benefit dependence.
- The acquisition of consumer goods, such as branded clothing, electronics or furnishings, is sustained by heavy credit use with budgets often deeply compromised by debt service. Use of multiple credit suppliers is common as is a

high degree of systematic payment irregularity, often finely judged to accommodate competing creditors and to maximise available credit lines.

- The segment is likely to be resistant to money advice and any effort to moderate the focus on consumption, primarily because being able to purchase consumer goods is a source of considerable pride and individuals see themselves as highly disciplined and effective money managers.
- Payment delinquency is so entrenched for this segment that it would not seem possible to serve this group within a low cost context without some means to moderate payment irregularity, such as priority deductions from benefits paid directly to credit unions. The risk is that any slack in the budget created by access to affordable credit will not result in increased funds for essentials but will rather be diverted to further consumption.

Mainstream-experienced serial delinquents

- This segment is biased towards men, couples with children and those in work, though income is often insecure.
- Credit - and poor management of it - is the connecting thread in a vicious cycle of financial problems, with this segment often having significant adverse mainstream history. Individuals may also have failed in the high cost sector and may now have no option but illegal money lenders. Individuals have typically had long exposure to the debt recovery process and may be both inured to the threat of sanctions and resentful of lenders.
- The experience of mainstream credit use means that individuals are more comfortable with electronic channels and bank based management. They are also more likely to seek larger loans than other high risk borrowers.
- The challenge will be breaking the cycle of delinquency and default and to building financial capability. It will be important to discriminate between those unwilling or unable to repay debt and those prepared to change. Treatment strategies may need to rest on small loans stepped up progressively, contingent on behaviour. The risk is that, where relationships break down, it will be difficult to collect outstanding debt from a segment that is relatively immune to pressure.

Chaotic credit re-cyclers

- The segment profile is young, sometimes very young, with a bias towards singles and younger single parents. Individuals tend to have poor financial skills and difficulties with setting priorities.
- Individuals typically have a history of failed catalogue and home credit loans which has left them with no legitimate credit options. The tendency is then to become trapped in a cycle of constant borrowing, both informally and from illegal money lenders.
- Informal borrowing, often not repaid, compromises family and social relationships, while use of illegal lenders hollows out budgets. Increasingly desperate for cash for essentials, individuals are often isolated, depressed and exposed to a series of risks.
- Such individuals will be hard to reach and will require significant support in building financial capability if they are to lay the foundations for a stable lifestyle and sustainable financial and credit management.

The profoundly excluded

- This segment has a bias to older men, particularly singles. Individuals have often experienced a disruptive life event, such as bereavement or the onset of disability or mental health problems. Individuals can have little in the way of social networks and may lack both financial skills and the ability to effectively negotiate interactions with the benefits system or officialdom more generally.
- Many are entirely credit excluded, with little access also to informal borrowing due to social isolation. Individuals can suffer real hardship with no means to manage emergencies or fund major purchases.
- The key challenge would appear to be reaching out to such individuals who are unlikely to approach third sector lenders. Borrowers are likely to be low risk but still may need significant support to stabilise finances and acquire financial skills.

Attitudes to third sector lenders and to the credit union instant loan proposition

- The most important barrier to use of third sector lenders appears to be low awareness. There was very low awareness of credit unions and no awareness of CDFIs in any of the research locations, chosen specifically because of the presence of local credit unions and, in one instance, a leading CDFI.
- There was also little sense that credit unions might lend either to those who would struggle to borrow from commercial lenders or those with no options other than high cost home credit.
- Where high risk borrowers were aware of credit unions, credit unions were assumed to operate on the traditional save-to-borrow lending model. This itself is a significant barrier to approaching credit unions in that the requirement to save before borrowing was seen as an insuperable barrier to those who felt unable to save even small amounts.
- By contrast, the idea of an "instant" loan from a credit union and third sector pricing, as offered by Growth Fund supported credit unions, was regarded as a compellingly attractive proposition.
- Borrowers had doubts about whether they would be able to maintain payment regularity to the standards likely to be expected and some aspects of the proposed payment channel mix also created concerns in this respect.
- Some of those with the greatest need for affordable credit appeared to be those least likely to approach a credit union, including those without any credit options at all and victims of illegal lending. Among such borrowers the most important reasons for not applying to a credit union would appear to be:
  - A reluctance to risk refusal, frequently because of a history of "bad credit".
  - Concerns around process and ID hurdles.
  - A wide-spread lack of confidence with forms and with financial literacy: numeracy issues were also a factor for a significant minority.
- Victims of illegal lending could feel too enmeshed in an ongoing relationship with the lender to be able to take on further credit, however affordable.
- For those dependent on high cost lenders, existing credit and rent-to-own commitments, particularly where these were long term, were a barrier also, as was the strength of relationships with high cost suppliers.

- Overall, however, despite the reservations about the manageability of borrowing from a third sector lender and concerns about eligibility and the application process, the idea of instant loans at affordable credit pricing was regarded as a potentially transformational development.

New-to-credit-union Growth Fund borrowers

- The trigger for approaching the credit union had been the experience of others in the community who had successfully obtained loans.
- At the point of first application, borrowers had been focused entirely on obtaining a loan, with little concern at this stage for the cost of credit nor any real appreciation of credit union pricing. Potential borrowers also had little or no interest in other aspects of credit union services.
- Those who were refused loans were not inclined to take up money advice or savings facilities as an alternative to the loan they had been seeking.
- Credit union reception and application processes were perceived as accessible, friendly and supportive. ID hurdles appeared to be difficult for some potential borrowers to meet and applicants appeared unclear on what constituted acceptable ID.
- Applicants had not always been entirely candid about the extent of alternative credit commitments, where these existed, on the grounds that this might prejudice their chances of obtaining a loan.
- New members were delighted with the cost of credit union borrowing. Borrowers clearly understood the Total Cost of Credit (TCC) on credit union loans and that it was significantly cheaper than high cost credit. Borrowers had little recall or understanding of the APR however, and were also unclear about the term of the loan they had taken on. This reinforced the tendency to judge “affordability” (as distinct from cost) on the basis of weekly payments, which were often compared directly with those that would be made to a home credit lender. The comparison tended to flatter home credit pricing in that loan terms on home credit products are much longer than for credit union instant loans.
- Repayment channels for all of the new-to-credit-union borrowers were either direct debits or deductions made from benefits paid into a credit union account.
- Those repaying their loans by deductions from benefit were happy with this arrangement, mainly because it removed the risk of the relationship failing and set them up for progression to higher value loans. However, there was some evidence that this approach made budgets less manageable in that there was less flexibility in the event of difficulty.
- A significant proportion of those paying by direct debits through a bank account had experienced payment problems. In the majority of cases, this was because of changes in circumstances or unexpected expenses arising. In some cases, credit union process inefficiencies were also a feature.
- The outcome of payment difficulties were mixed and appeared to rest on whether difficulties had been actively managed and communications established:
    - Few of those in difficulties had communicated pro-actively with the credit union and most reported that the credit unions were slow to respond to payment problems. Correspondence from the credit union about arrears appears to have been interpreted as sympathetic rather than as an urgent call to resume or make good payments.

- However, where borrowers did pro-actively communicate, all reported sympathetic treatment and that they had resumed payments.
- Where problems had not been dealt with at early stage, or where there was no direct communication with the borrower, difficulties had tended to deteriorate to the point of default.

- The use of other lender types in parallel or as an alternative to credit union borrowing was mixed:
  - Some of the new credit union members had no other credit options in any case.
  - Some of the new credit union borrowers had not borrowed elsewhere while others had taken on high cost credit in parallel to their credit union loan.
  - Those who had been refused credit union loans or who had failed to keep up payments had turned to high cost credit where they had the option to do so.
  - Some members who had previously used high cost credit, particularly those who had moved on to larger loans, planned to borrow only from the credit union in the future while others intended to use high cost credit in parallel to credit union borrowing to maximise their access to credit.

Policy implications and operational cues

Illegal money lending

- Clearly not all victims of illegal money lenders will be capable of managing a credit union loan and some will require considerable support and advice before they are able to take that step.
- Promoting instant loans and affordable credit to the wider community in the deeply deprived areas in which illegal money lenders operate is likely to be key to combating illegal money lending.
- However, third sector lenders may well require specific incentives, funding and performance measures to take on the very high risk borrowers most at risk to illegal money lending, some of whom they would otherwise be likely to reject.
- Transitioning victims to affordable credit will require active management and concerted partnership if it is to be sustainable.
- Support for victims of illegal lending will be required, both at the point of entry to a relationship with a third sector lender, and on an ongoing basis.
- Lenders are likely to require training and support to develop approaches which are appropriate to the specific needs of victims of illegal lending.
- It will be important to the overall success of the relationship between third sector lenders and the illegal lending teams that the illegal lending teams focus on cases that are likely to be successful and where victims are likely to respond well, while not promoting cases in which the borrower is so high risk as to be effectively un-servable.
- Given victims' scepticism towards advice and financial education as a means of addressing illegal money lending, it may be more effective to position these components of the effort to transition victims to affordable credit as a form of victim support rather than a means of building financial capability. Such an approach may go some way to encouraging take up and overcoming resistance.

Third sector service of high risk borrowers

- The critical first step in planning to serve high risk borrowers with affordable credit is to clarify target market definitions for third sector lenders. It will be important to recognise that some high risk borrowers cannot be served within the constraints of a low cost of delivery, low APR model.
- Overall, the most important barrier to take up of credit union loans by the financially excluded is being addressed with the move away from the save-to-borrow model and the development of the capacity to provide instant loans to higher risk borrowers.
- The low awareness of credit unions will require sustained marketing to address, while some of those most in need of affordable credit may require active out-reach to attract. That said, the underlying strength of demand is such that success in building awareness may create potential capacity and service challenges.
- Marketing activity which aims to create greater price discrimination among users of high cost credit might be effective in attracting the more reliable borrower types within the high risk spectrum.
- Service of high risk borrowers will need to be supported by an integrated and robust (i.e. quantified) market segmentation, which could usefully cover not only potential demand for credit but also for advice and financial capability services. The segmentation could also identify those that cannot be served.
  - Such a segmentation should include consumer needs and attitudes but also factors such as risk and cost of service. This will allow different segments to be prioritised and targeted with segment-appropriate treatment models, designed with a view to achieving a balance between consumer choice and an acceptable level of risk.
- The fundamental challenge lies with achieving sustainable relationships which will depend critically on the effective management of delinquency and default. A strong focus on pro-active management will be required, including systems to flag increasing risk or account deterioration and prompt communication and support for those encountering difficulty. Communications should emphasise that affordable credit lines can be recovered with responsible rescheduling.
- Default management may need to rest also on a realistic recognition that payment irregularity is an inevitable feature of lending to those on very tight budgets - for whom flexing debt service payments may often best be viewed as responsible cash flow management. The development of “consumer push” as distinct from “supplier pull” payment technology, potentially based around mobile phones, may represent a way forward in resolving the tension between consumers’ need for flexibility and that of lenders for certainty.
- A channel strategy which takes into account the realities of the demand environment will be key to the ability to serve as wide a spectrum as possible of high risk borrowers. Greater effort may be required to identify those likely to struggle with direct debits, while some segments may be too high risk to serve without some form of direct deduction from benefit.
- The evidence is that, where high risk borrowers are able to make the transition to affordable credit, the impact on both finances and confidence can be transformational.
- Other strategies will be required to meet the needs of those who cannot be served by the third sector.

Contents

Executive summary 2
Aims of the study 2
Contents 11
Acknowledgements 12
1.0 The policy background 13
2.0 Research aims and methodology 17
2.1 Research objectives 17
2.2 Research methodology 17
2.2.1 Method 17
2.2.2 Sample 17
2.2.3 Interview content 19
2.2.4 Consumer segmentation 19
3.0 Characteristics of high risk and credit excluded borrowers 20
3.1 Patterns of budgeting and financial management 20
3.2 The role of credit and debt in household budgets 22
3.3 Debt service and repayment patterns 28
3.4 Delinquency, default and the outcome of debt recovery 32
4.0 Attitudes to, and use of, credit unions and money advice 35
4.1 Awareness and perceptions of third sector lenders 35
4.2 Awareness of and attitudes to advice 37
4.3 Barriers to high risk borrowers approaching and using credit unions 40
4.4 Response to the new model and instant loan credit union concept 45
4.4.1 Instant loan concept 45
4.4.2 Response to outline concept and product pricing 45
4.4.3 Concerns on application and eligibility hurdles 47
4.4.4 Expectations on borrowing values 48
4.4.5 Preferences on delivery and repayment channels 48
4.4.6 Perceived benefits of access to third sector lending 53
5.0 The credit union experience and new-to-credit-union borrowers 55
5.1 Triggers for approaching credit unions 55
5.2 Joining the credit union 56
5.3 The experience and outcomes of refusal 57
5.4 Understanding of credit union pricing 58
5.5 The experience of different payment channels 59
5.6 The experience of credit difficulties and arrears recovery 61
5.7 Use of other forms of credit alongside credit union borrowing 62
5.8 Prospects for making a sustainable transition to affordable credit 64
6.0 Segmentation of high risk borrower types 67
6.1 Credit-resistant, modest-needs managers 68
6.2 Traditional high-cost credit copers 70
6.3 Aspirational heavy credit users 72
6.4 Mainstream-experienced, serial delinquents 74
6.5 Chaotic credit recyclers 76
6.6 The profoundly excluded 78
7.0 The implications for transitioning high risk borrowers to affordable credit 80
7.1 Policy implications 80
7.2 Operational development cues 87
7.2.1 Transitioning victims of illegal money lenders to affordable credit 87
7.2.2 Third sector service of high risk borrowers 89

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The opinions expressed and suggestions for ways forward contained in the report are however those of the authors, as is the responsibility for any inadvertent errors or omissions that remain.

1.0 The policy background

The broad policy background is the long-standing effort to promote Financial Inclusion and to extend affordable credit to the financially excluded

The policy background is the long-standing government drive to promote social and financial inclusion[8]. The key Financial Inclusion policy goals and the strategy for achieving them are most recently set out in the Financial Inclusion Action Plan for 2008 – 2011[9], supported by a new Financial Inclusion Fund of £130m for the period. The key goals of the strategy are to ensure that everyone has access to an appropriate mix of financial services, which enables them to manage their money on a day-to-day basis, to plan for the future, to cope with financial pressures and to know where to turn when they do find themselves in financial distress.

Major initiatives have included the expansion of basic banking, the extension of money advice services and the effort to improve access to affordable credit

Some of the key financial inclusion initiatives have included: the drive for increasing access to transaction bank accounts and the introduction of the basic bank account, led by the Financial Inclusion Task Force in partnership with the banking sector; the establishment of the Growth Fund[10], run by the DWP, which is intended to support the growth of third sector lending; the extension of affordable credit to financially excluded borrowers and the expansion of free face-to-face money advice services[11] intended to provide assistance to the over-indebted, administered and led by BERR[12]. Other elements of the Financial Inclusion strategy include efforts to extend access to affordable home contents insurance for those in rented property, to promote savings and to increase financial capability.

Tackling illegal lending is a key strand in addressing financial exclusion with transitioning victims to affordable credit a critical component of success

A further key strand in BERR's work on financial inclusion has been the effort to tackle illegal money lenders since victims of illegal lenders are among the most comprehensively excluded members of society. Two pilot projects tackling illegal money lending, established in Birmingham and Glasgow between September 2004

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[8] Social Exclusion Unit's Policy Action Team (PAT 14) 1999. Financial Inclusion Strategy 2004 Promoting Financial Inclusion 2004, which: established the 2004 Financial Inclusion Fund of £120m for 2005 – 2008; announced the formation of the Financial Inclusion Task Force; and set out the key Financial Inclusion priorities as providing access to basic banking, access to affordable credit and access to free face-to-face money advice.

[9] The Financial Inclusion Action Plan also announced the extension of the Financial Inclusion Task Force until 2011 and the Ministerial Working Group, the members of which are drawn from HMT, DWP, BERR, The Cabinet Office, Ministry of Justice and Department for Communities and Local Government.

[10] A Growth Fund of £42m, drawing on Financial Inclusion Funding, led by the Financial Inclusion Task Force and administered by the DWP, was established in 2006. The fund supported 100 third sector lenders from inception to the year end 2007. A further fund of £38m will support further expansion of the scheme as part of the effort to double the number of Growth Fund loans made by the third sector over the period of the Financial Inclusion action plan.

[11] BERR oversaw the spending of a £45m budget to train approximately 500 new debt advisers who advised over 90,000 indebted clients by the year end 2007. Further funding of £76m for advice services, to be again led and administered by BERR, was announced in December following the Comprehensive Spending Review.

[12] Now funded to March 2011.

and March 2007, had considerable success in removing lenders from the community and relieving victims of a significant payment burden[13]. As a result of this success, a new nationwide network of projects to combat illegal money lending was established in late 2007, each focused on areas of intense deprivation, supported initially by Financial Inclusion funding but with funding through BERR until March 2011. The teams are focused primarily on enforcement and on removing illegal lenders from the communities in which they operate but a key part of their remit is to seek to introduce victims to alternative forms of credit supply. The experience of the original pilot projects suggests both that transitioning victims to alternative sources of credit will be a critical element in combating illegal lending and that this aspect of the new teams' remit may prove particularly challenging. Difficulties included not only a lack of capacity to serve high risk borrowers among those credit unions local to the pilots but also a series of attitudinal and practical barriers for victims, including a lack of confidence, functional difficulties with literacy and access and a reluctance to move beyond the familiar.

The research sets out to understand the demand-side challenges for transitioning high risk borrowers to affordable credit

The research is focused primarily on how most effectively to transition high risk borrowers to affordable credit and the third sector. It sets out to provide an in-depth portrait of the needs of high risk borrowers, ranging from victims of illegal lenders and the entirely credit excluded through to those with no options but high cost credit. It seeks to draw out the challenges for the Financial Inclusion community and third sector lenders in serving such borrowers and to illuminate how the illegal money lending projects might most effectively support victims of illegal lending in making a sustainable transition to affordable credit.

Historically few third sector lenders have had the capacity to serve high risk borrowers

Historically third sector lenders have tended to concentrate on the lower risk end of the low income spectrum[14], for a number of reasons. The requirement to save before borrowing – which was until recently a feature of most credit unions' service proposition – resulted in unions focusing activities on those able or willing to make modest savings while the constraints of a low interest ceiling mitigated against serving higher risk borrowers. A business model with little consumer appeal combined with chronic long term under-capitalisation, a volunteer ethos and lack of skills, capacity[15] and resource typical of many credit unions, historically together worked to keep awareness and use of credit unions low and to frustrate efforts to up-scale and professionalise the movement.

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[13] Source: Ellison, Collard and Forster, Policis and PFRC for the then DTI, Evaluation of the illegal money lending pilot projects, 2007.

[14] Kempson and Collard, Affordable Credit: The Way Forward for Joseph Rowntree Foundation, 2006, Policis and PFRC, Illegal Lending in the UK for the then DTI, 2006. 'Membership counts: Who uses credit unions?' Sharon Collard and Nick Smith 2006 ABCUL Association of British Credit Unions Ltd. Kempson and Whyley Saving and Borrowing: Use of the Social Fund Budgeting Loans Scheme and Community Credit Unions. Department of Social Security Research Report 125, 2000.

[15] Goth McKillop and Ferguson, Building Better Credit Unions for Joseph Rowntree Foundation 2006.

Recent developments have focused on extending the capacity of the movement to serve financially excluded borrowers

Recent years have seen significant change in the thinking[16], vision, capacity and focus of the movement and its leadership. Change has been driven forward also by concerted government effort to address capacity, skills and capital constraints and to grow third sector lending and extend affordable credit to a wider range of higher risk borrowers. These developments are at a relatively early stage and capacity to serve financially excluded borrowers remains limited[17]. The sector is changing rapidly however, with considerable effort focused on achieving a step change in scale. The focus is now on capacity building, creating the technology infrastructure and skills necessary for growth and extending services to new borrower types.

A series of legislative, funding and practical initiatives have set out to support the growth of the third sector, to build capacity and enhance standards

A series of initiatives have set out to support third sector lenders' capacity to serve high risk borrowers. These have included: the raising of the interest rate ceiling for credit unions from 1% to 2% p.m.; the establishment of the Growth Fund, earlier referred to, which was set up specifically to provide seed capital to third sector lenders and to fund the further development of services for high risk borrowers[18]; a move to enable local authorities to fund third sector lenders; the facilitation of the payment of benefits direct to credit union accounts and a review of credit union legislation[19]. The review is being conducted with a view to introducing primary legislation, strengthening governance and raising standards and capability in the sector and removing barriers to growth and expansion while enabling credit unions to compete directly with other lenders. Further initiatives in the years 2008 – 2011 will include the establishment of new credit unions in areas where there is a high incidence of credit exclusion[20]. Community Development Finance Institutions (CDFIs) have also been the focus of significant government funding and support. Personal lending represents only a fraction of total CDFI lending however, with personal lending by CDFIs insignificant compared to that of the credit unions[21].

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[16] Given significant impetus with the publication of the then radical *"Towards Sustainable Credit Union Development*", Paul Jones, Liverpool John Moores University (1999).

[17] Financial Inclusion Task Force Credit Working Group found that, based on Growth Fund data and an additional telephone survey undertaken by Experian, only 11% of credit unions currently serve the financially excluded in 2007, with a further 29% described as having some potential to serve the financially excluded.

[18] Some 46,500 loans were advanced under the Growth Fund scheme in 2007. Lending has totalled £20.4 million since the scheme inception with over 80% of loans made in areas of financial exclusion. Source: DWP and Financial Inclusion Task Force, Financial Inclusion Action Plan.

[19] Review of the cooperative and credit union legislation: summary of responses to consultation, Dec 2007. Primary legislation is intended to: liberalise the credit union common bond; allow wider and more flexible membership of credit unions; allow credit unions to admit corporate members; to pay interest on member deposits.

[20] Financial Inclusion Task Force Credit Working Group 2007 reports planned new credit union provision in 25 areas: lending £10m p.a. to 25,000 people without access to affordable credit and an expanded Growth Fund; providing up to £50m of affordable credit to a further 125,000 people p.a; planning for a total of £60m in affordable third sector credit to serve 150,000 people p.a. by 2011.

[21] A small number of CDFIs do focus primarily on personal lending, examples include Scot-Cash and East Lancs Money-Line. However, personal lending remains a small part of total CDFI lending: £2.6m for personal loans written and balances outstanding of a little over £3.1 m for year end 2007 out of total lending by CDFIs for the period of £287m (Source: "Inside Out 2007" CDFA). This compares to circa £392m of personal lending for credit unions over the same period (Source: Credit Unions unaudited returns to FSA), of which ABCUL credit unions together represent some £331m (Source: ABCUL).

The research aims to provide some insight into how best to transition high risk borrowers to sustainable affordable credit relationships

Borrowers with no credit options or struggling to cope with high cost credit are likely to be significantly higher risk than those served by the third sector historically. Victims of illegal lending are likely to be some of the most disadvantaged in deprived communities, among the hardest to reach and most difficult to serve client groups, at the highest end of the risk spectrum[22]. Against this background, the challenge in serving such borrowers will lie in creating sustainable relationships that will genuinely function as an alternative to high cost lending, provide a route out of credit and financial exclusion and a source of alternative credit supply for those now trapped in a cycle of dependence on illegal lenders. The research seeks to provide some insight into the nature of the challenges and how best to create and sustain such relationships. It is hoped that it will help inform the efforts of the teams combatting illegal money lending in moving victims of illegal lending towards affordable credit and the thinking of third sector lenders and the wider financial inclusion community in planning for the service of excluded and high risk borrowers.

[22] Around half of victims of illegal lenders have either defaulted on a high cost credit line or been refused further credit having reached the end of a high cost credit line. Source: Ellison, Collard and Forster, Policis and PFRC for the then DTI, Illegal Lending in the UK, 2006.

2.0 Research aims and methodology

2.1 Research objectives

The research set out to:

- Identify, from the consumer perspective, any barriers to high risk borrowers accessing affordable credit through their local credit unions
- Understand, again from a demand-side perspective, how best to match alternative credit supply and advice[23] services with the needs of high risk borrowers
- Provide insight into how most effectively to support victims of illegal money lending in making and sustaining the transition to affordable credit.
- Provide development and communication cues for third sector lenders seeking to serve high risk and excluded borrowers and victims of illegal lending.

2.2 Research methodology

2.2.1 Method

The project rested on qualitative research undertaken with a range of high risk low income borrowers through the medium of some sixty in-depth interviews undertaken face-to-face in areas of intense deprivation[24] and / or credit exclusion[25] in Glasgow, Leeds, Cardiff and Liverpool. Beyond this, the research took place in locations where a variety of different credit union types operated. The credit unions were of varying sizes, with a more or less prominent position and more or less visible local profile, with some operating capacity based lending and others focused on the save-to-borrow model.

2.2.2 Sample

None of those interviewed had any mainstream credit products or were able to borrow from mainstream lenders currently.

The majority of the sample were on benefits, with the bias being towards women and family households, but it included also those in work, primarily in low-wage fairly insecure employment and single person households.

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[23] “Advice” in this report is taken to mean both money advice and debt advice, primarily on the grounds that the high risk borrowers under examination did not themselves make a distinction between the two.

[24] As measured by falling into the top 5% of IMD scores (i.e. the government measure of deprivation being the Indices of Multiple Deprivation.)

[25] Defined as areas not served by any of the home credit lenders on safety grounds, typically small and ultra-locally defined.

There was considerable cross-over between many of the categories within the sample. However, respondents were recruited on the basis of minimum quotas for each of the following categories. Minimum quotas are indicated by brackets.

The credit excluded and victims of illegal lenders

- Credit excluded individuals (i.e. those with no commercial credit options at all), in each of the following categories.
  - Previous users of mainstream or high cost credit who had become credit excluded because of adverse history. (4)
  - Those unable to obtain credit either because of where they lived or due to a lack of any credit record. (4)
  - Those who had defaulted on or reached the end of a home credit credit line and who could not obtain further credit from home credit lenders. (4)
  - Users of illegal lenders. (12)

Borrowers with no credit options other than high cost credit

Borrowers whose only credit sources were high cost credit, i.e. home credit, agency mail order or rent to own retail, in each of the following categories.

- Occasional users of high cost credit (4)
- Continuous users of high cost credit (4)
- Those paying high cost credit loans with either no or only minor repayment irregularity (6)
- Those with more or less serious payment problems on high cost credit: (6)
  - Those regularly missing payments on a current loan (2)
  - Those paying back their loan only over a greatly extended term or at much reduced payments (2)
  - Those who had defaulted on high cost credit (2)

New-to-credit-union “Growth Fund” borrowers

New-to-credit-union borrowers who had applied for or taken on a Growth Fund subsidised loan[26], in each of the following categories. (12)

- Those who had coped successfully with their credit union loans (4)
- Those who had struggled with repayments (4)
- Those who had been refused a credit union loan (4)

[26] Borrowers taking on such loans are not told by the credit unions that their loans are Growth Fund subsidised.

2.2.3 Interview content

The interviews explored budgeting and financial management practice and the role of credit within this. Interviews also covered perceived credit options, historic and current patterns of credit use, how borrowed funds are used, motivations for using different supplier types, the patterns of repayment associated with different credit models and the circumstances that surrounded payment problems.

Interviews then moved on to explore awareness and perceptions of credit unions and money advice. Respondents were then presented with an outline product concept for small sum lending from a credit union, together with associated pricing[27]. With respondents, interviewers explored responses to the concept, key product features and pricing, their perceptions and preferences around payment channels, the extent to which lending from a credit union would provide a fit with their needs and where it might sit with other existing credit relationships and commitments. Finally, interviews examined respondent perceptions of the difference that a source of affordable credit might make to standard of living and quality of life.

Interviews with new-to-credit-union borrowers who had taken on small sum loans also covered the experience of applying for a credit union loan, perceptions of credit union staffing and service, response to the product concepts, channel and service preferences, payment patterns, reasons for payment difficulties where these arose, and the experience of credit union delinquency management. Beyond this, the interviews explored the impact of access to affordable credit, the sustainability of the credit union relationship and whether new-to-credit-union borrowers had subsequently used other credit types.

2.2.4 Consumer segmentation

A consumer segmentation was developed based on qualitative analysis intended as a first step towards a typology of high risk borrower types. Consumer segments were identified which appeared to occur relatively commonly within the sample as identifiable discrete types, each of which shared broadly similar characteristics and needs and which appeared to be distinctive in comparison to the other types identified.

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[27] The credit union loan concept was presented in terms of: the sum borrowed; term of the loan; weekly repayment; and total cost of credit and APR, all based on an actual product details and pricing for small scale “Handiloans” available from Leeds City credit union at the time the research was undertaken.

3.0 Characteristics of high risk and credit excluded borrowers

This chapter describes the characteristics of high risk and credit excluded borrowers in terms of their approaches to budgeting and financial management, the role of credit and debt within this, how debt service is managed, how and where repayment problems arise and how borrowers respond to different approaches to collection management and debt recovery.

3.1 Patterns of budgeting and financial management

Patterns of financial management suggest a series of challenges for any transition to account based financial management or automated payment

Patterns of financial management among the high risk borrowers interviewed imply a series of challenges in transitioning such individuals to affordable credit, not least because of a reliance on cash management and a resistance to automated payment channels. The overwhelming majority of the high risk borrowers and credit excluded individuals interviewed lived on a week-to-week, hand-to-mouth basis. Budgets were very tight and, in most cases, very closely managed. Very few had even modest savings to fall back on in the event of a cash short-fall or unexpected expense.

Budgets are tight and closely managed, with essentials prioritised and purchased in cash immediately on receipt of benefit

Typically, cash is withdrawn weekly as soon as it is paid into a bank account, with budgets managed and commitments met in cash. Utilities, gas, electricity, television licences, etc. are bought before all other expenditure is incurred, purchased in cash in the Post Office or by Paypoint and typically immediately on encashment of benefits.

What is left thereafter is then applied to key weekly essentials; bus fares for school children, nappies and milk for babies. The balance of cash thereafter has to cover all other spending, including food and occasional purchases such as children's shoes and clothing. The former can be one of the few areas of elasticity within the budget, where funds can be stretched by economising on meal content or stratagems such as, where possible, eating with relatives.

> *"My electric is £10 a fortnight. Gas will be more now because it's winter. I pay my bills at the shop with the Paypoint. TV License, £5.50 a fortnight. That's the first thing you do. Then food. I don't go out to the pictures or anything. There's no money left over."*

> *"I have to budget obviously. On a Monday I pay my TV licence and I'm in arrears with the council for rent so I'm paying £15 of that and out of the £40 I pay £10 to Provident[28] so I'm left with pennies till Wednesday when I got to pay the gas, which is £8, water which is £8 and the electric token and with what I've got left I have to do a bit of shopping."*

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[28] Provident Financial, the largest of the "home credit" lenders, sometimes known also as "door-step" lenders. A form of high cost credit used primarily by low income consumers, usually in areas of social housing, in which small sum relatively short term credit is advanced in the home with payments collected weekly in the home by self-employed agents. Charges include the cost of the collection service as well as interest on the loan.

Financial management is frequently a matter of balancing competing priorities with "robbing Peter to pay Paul" a central budgeting strategy

Budgets are frequently experienced as chronically inadequate to the demands being made on them, so that even in the most tightly managed budget, there is often not sufficient to fund even the most pressing needs in any given week. For many, the day-to-day reality of financial management is one of managing competing priorities. Against this background, the central budgeting and cash flow management strategy of those on low incomes – "robbing Peter to pay Paul" – is brought into play, very often on a weekly basis. This pattern was most pronounced among family households.

> *"You've got to make it stretch more than it will do. That's how you make your money go round. Get what you have to have on the Tuesday, nappies, milk, all of that. Then who is shouting loudest and who you can get away with sweet-talking another week."*

> *"You got to spend so much on food, so much on bills. What you can and can't pay. Just try to work it out, what can be paid this fortnight and what can be paid next fortnight. And sometimes what you're not going to pay."*

Many had a history of problems with current accounts which itself was a factor in the reliance on cash based management

Despite the success of the government drive to pay benefits direct to bank or POCA accounts and increased banking penetration among disadvantaged groups[29], many of those on very low incomes prefer to operate in an entirely cash based economy[30]. This was the case with all but a handful of those interviewed. Respondents saw managing in cash as a means of keeping control over finances, with the discipline of having to work within the limits of cash available ensuring that there is no temptation to over-spend. Many had a history of problems with bank accounts, often arising from being unable to meet credit and other commitments. A significant proportion had only limited functionality Post Office Card Accounts, which most felt was adequate for their needs. This was primarily because most people were actively concerned to avoid direct debits and saw the key function of their bank account as a vehicle for the receipt of benefits.

Resistance to direct debits rests on the fear of penalty charges, with almost all of those with experience of direct debits having faced such charges

It is this need to retain control in order to balance competing priorities and to flex budgets that lies behind resistance to bank-based financial management and more specifically to a dislike of "pull" payments such as direct debits, which critically undermine control of cash flow. Almost all of the respondents interviewed who had, or at one time had, access to a bank account with which they had set up direct debit facilities cited examples of occasions when they had been unable to keep sufficient funds in the account to meet these commitments, resulting in penalty charges, often multiple, and usually disproportionate to income flows through the account. In some cases, these difficulties had been so severe that they had resulted in account closures. In most cases,

[29] FRS data commissioned by the Financial Inclusion Task Force indicates that between 2002/3 and 2005/6 the number of adults in unbanked households had fallen from 2.83 million to 1.97 million.

[30] NCC/Policis research undertaken in 2005 indicated that around half of all low income households preferred to manage their money in cash.

respondents had subsequently avoided direct debits as a means of payment, either reverting to, or switching to, cash based management.[31]

> *"If you're short one month, then you've got this big charge, £35, £25, whatever it is, and then every three days you get another charge and then it just mounts up and before you know it the next week my tax credit money has all gone on bank charges."*
>
> *"I went over my overdraft limit last month at the bank again, so I've got a letter from them to say I'm getting £60 just for going overdrawn and the same last month…So I have paid the £60 out of my £170 a month but then I am spending my spending money on that…so those two months have xxxxxxx me up basically."*
>
> *"I'm not a banker. I did have one at one time and because I wasn't paying they were charging me for overdrafts. So one day, I owed them £90 so I asked them to close the account."*

3.2 The role of credit and debt in household budgets

Most people took the view that borrowing was the only means of managing cash shortfalls or spreading the cost of larger purchases

Against this background, there was significant demand for credit, at least as measured by the need to borrow[32]. Some of the respondents interviewed saved on a small scale, particularly towards Christmas expenses, either informally or through savings clubs. Most took the view, however, that even modest savings were near impossible to achieve, with efforts to save always frustrated by the need to cover an unexpected expense. For most respondents, borrowing was seen as the only way to manage cash flow emergencies or to acquire high ticket items such as furniture, white goods and consumer electronics. All were aware, however, that for them credit comes at very high cost.

> *"Credit is the only way you get anything if you're skint. But just because you're skint doesn't mean you don't want the same things as everybody else. You just have to pay very high interest to get it."*
>
> *"At the end of the day if it wasn't for Provident, we wouldn't have anything."*
>
> *"If it wasn't for the Provident, I'd either have to go without or go shop-lifting or buying stuff off the shop-lifters because I wouldn't be able to buy clothes or trainers at normal prices."*

Those who had become shut out of the credit mainstream in the wake of an income shock frequently faced an enduring hangover of mainstream debt

None of the respondents were currently able to access mainstream credit. However, where the background to an adverse credit record was some kind of major income

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[31] Research undertaken by Policis for the National Consumer Council in 2005 indicated that a little over a quarter of low income consumers have been exposed to penalty charges for bounced direct debits on bank accounts.

[32] Research undertaken by Policis for the then DTI in 2004 indicated that some three quarters of households in the lowest income quintile could not raise £200 – 300 without borrowing and that some nine out of ten benefit dependent households would find it difficult or impossible to save £500 for a special purchase. Ellison and Forster for the then DTI, The impact of interest rate controls in other countries, 2004.

shock which had left individuals unable to service commitments on a much reduced income, there was often a hangover of mainstream debt. These cases had typically arisen as a result of a relationship breakdown, bereavement or the onset of disability or unemployment, and in some cases had involved significant downward social mobility.

> *"He walked out and he walked out on a lot of debt. It took me nigh on six years, getting letters. Lying in bed thinking what do I do? Will I sell this? Will I sell that? …I was borrowing from them (Illegal money lenders) just to live."*

> *"When he had to stop work, we still had a lot of things that we weren't finished paying yet. And they all wanted their money. So that was very hard and we really struggled. And it lasted a long time. I'm talking years of hassle. I've got bad credit because of that which I never had before. I can't get anything now."*

Some respondents relied on – or had no option other than – small scale informal borrowing which in some cases had compromised relationships

Some respondents borrowed only informally, from friends and family, typically small sums in the £10 – 20 range. This was either because they could not borrow from commercial lenders or because they were unwilling or unable to pay the price for high cost credit. Some informal borrowing appeared to be ongoing reciprocal borrowing between friends and family. In other cases, borrowing was one-way, with younger family members typically borrowing from an older generation or better off relatives. That said, lenders were usually on tight budgets themselves.

In some cases, informal borrowing had compromised family and social relationships or even caused relationships to breakdown. Some borrowers had found themselves trapped in a vicious circle in which a large part of their income was taken up with loan payments to various family members, friends and acquaintances. These individuals were experiencing considerable stress as a result of constantly re-approaching friends and family for a loan or having to find new prospects for borrowing. In some cases, individuals had been unable to repay their borrowing, and were now cut off from, or avoiding contact with, various members of their family or social circle. This syndrome was most likely for victims of illegal lending, and appeared to be a major factor in shaping their social isolation.

> *"Oh Yeah. Every week I borrow without fail. There's not a week that goes by when I don't have to. It's for gas or electric or whatever."*

> *"I borrow off my mum, my aunties, anyone I can. My nan…Then some of my family I've stopped speaking to due to borrowing and messing them about."*

> *"It's on my mind all the time. I get my money and it's gone. I'm tapping everyone all the time and they're avoiding me now. It's embarrassing. But I've got no other choice. I can't help it. "*

A minority did not borrow at all, either by choice or because they had no credit options, with some experiencing real hardship as a result

Other respondents did without credit of any kind, mainly older and single person households, either because they preferred to manage within the constraints of their limited budgets, or because they had no credit options, informal or commercial. In some of these cases individuals had gone without essentials – such as washing machines or beds – while in others unexpected expenses had de-railed budgets, with individuals having had to economise on fuel and food.

The only options for borrowers unable to access commercial credit were the high cost lenders, often used in combination

Almost all of the high risk borrowers interviewed would have failed a credit test, with many having County Court Judgements and defaults registered against them[33], so they had few credit options. The supplier mix for those using commercial credit was therefore home credit companies, catalogue mail order and rent-to-own retail, quite often in combination. Catalogues were frequently run by a close neighbour or family member. Outside the sample of new-to-credit-union borrowers, cash borrowing was overwhelmingly from the home credit lenders, though a handful of home credit borrowers, typically the older and most organised respondents, also had credit union loans. The heaviest credit users often had more than one home credit relationship.

> *"I can go home and phone my agent up and say 'You know, when you come tonight, is it possible you could do me another loan for an extra £100? He'll be like 'Yes OK'…I know that I won't get knocked back from Brighthouse[34] or Provident or Norton[35]."*

> *"It (interest) is an extortionate amount but because you want quick, fast money you'll do it. And if you've got kids and it's their birthday or Christmas, you go 'Yes. Alright then'."*

Some borrowers were using high cost credit alongside, or as an alternative to, Social Fund loans

Social Fund loans were frequently the first choice for credit, where individuals were on the appropriate benefits and qualified for a loan. In some cases, high cost credit was being used alongside interest-free Social Fund loans. In some instances this was because individuals had simply chosen to take advantage of as much credit as they were able to access, from whatever source. In others cases, however, home credit, was being used as an alternative to the Social Fund. In some instances this was because the individual had made an application to the Social Fund and had either been unsuccessful or obtained less than they had wanted[36]. In others, individuals had chosen to take on a home credit loan because weekly payments were seen as more manageable than higher automatic deductions on Social Fund borrowing.

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[33] Only a small proportion of the sample were specifically recruited as having an adverse credit record, though in the event an adverse credit record turned out to be a feature of the profile of a high proportion of the sample.

[34] Brighthouse, formerly known as "Crazy George" is a "Rent to Own" retailer, sited primarily in down-market locations and stocking high ticket white goods, furnishings, consumer electronics, etc. Customers are not required to pass a credit check but must provide proofs of address and ID. Customers rent goods for the duration the contract term, typically two to three years, and have the right to return them. Ownership of goods passes to the renter at the end of the contract term, with the total paid over the contract term typically very significantly higher than would be the case if bought on normal retail terms. APRs are quoted as typically 29.9%. A plasma TV available for outright purchase - from Brighthouse – priced at £598.18 would cost £1324.44 on the basis of 156 weekly payments of £8.49 with service cover. A mobile phone priced at £118.80 would cot £207.48 on the basis of 52 weekly payments of £3.99 with service cover. Source: Brighthouse 24/07/2008.

[35] A small regional home credit lender.

[36] Research undertaken by Policis for the National Consumer Council in 2005 indicated that of Social Fund users who had applied for a Social Fund loan and been turned down, six out of ten did without credit, a little under a quarter borrowed from family and friends, one in five turned to the home credit lenders while a little under one in ten resorted to illegal money lenders, with some using multiple sources.

"I put in (to Social Fund) for £800 and I got £150. Which was just stupid. I had no furniture. No nothing. So I went back to Provident. She (agent) came round with it the next evening."

"I know its skinting myself in the end because the Social you don't pay no interest. …But I can manage £5 a week and you can always miss. So it's easier in some ways."

"I got the letter (mailing from home credit lender) saying 'You qualify for this loan and you can have this and that'. And I already had my Social Fund going but I was tempted, you know. You always need summat."

Illegal money lenders were active on the various estates, most visibly in Scotland, and were used largely by the desperate and regarded as lenders of last resort

Respondents on the various estates where interviews took place reported that illegal money lending was widespread and that the lenders were relatively easy to identify and access. Users had usually been introduced to the lender via another customer. In a few cases, borrowing was related to the purchase of drugs, alcohol or shop-lifted goods[37]. In a couple of cases, borrowers had responded to an opportunistic offer from an illegal lender, with small loans taken on in parallel to a high cost loans (all of which had subsequently broken down under the pressure of payments to the illegal lender). The majority had simply had no other credit options.

"Well there is one (illegal money lender) on every estate you go to from here outwards for about three miles. It's all council estates…There is a lot of crime, a lot of gangsters."

"I know single mothers who are doing this (borrowing £20 to pay back £40 to the illegal lender the following week) because they haven't got food. I know quite a few people who are doing it."

"They're not hard to find. My daughter's boyfriend knew this guy and he made a phone call and he phoned me and it went from there really."

Life-stage and generational factors are an influence on credit use but the extent of borrowing is also a function of attitudes and financial capability

Life-stage and generational factors were an influence in the amount of debt individuals had taken on, but attitudes, financial capability and experience also played a part. Broadly speaking, mature individuals, who may have struggled to pay debt in the past, were more cautious in taking on debt and more willing to make sacrifices and do without, not least because they had usually already acquired basics such as furnishings and white goods. Younger people tended to expect more and to have a greater tolerance of debt. While the overwhelming majority of those running family budgets on a very low income were perforce highly disciplined, some very young mothers appeared to have greater difficulties budgeting and prioritising spending effectively.

[37] Previous research undertaken for the then DTI indicated that three in ten users of illegal lenders had a background in which drug or alcohol abuse or mental health problems were a feature of their household. Ellison, Collard and Forster for the then DTI, Illegal lending in the UK, 2006.

Some of those with the greatest appetite for credit were driven by the desire to provide their families with what they perceived to be material norms

More fundamentally however, as with more affluent credit users, some low income borrowers appeared to have a greater appetite for credit than others. This appears to be driven primarily by a higher sense of entitlement to material norms, greater expectations of consumption and aspirations to a higher standard of living. These borrowers were determined to provide their families with what they see as a nice home, consumer electronics, trendy clothing, brand name trainers, big Christmas presents, etc. and were prepared to go to very considerable lengths to do so.

> *"But you think just because I'm on a low whatever, why shouldn't I have it (Plasma TV)?"*
>
> *"I got a leather settee at £23 a week and it's over three years and you end up paying £3,000 and the settee only cost £1,000…but you want to have nice things in your place. And why shouldn't I?"*

Provision for Christmas is key to this mind-set with a disproportionate share of income spent on Christmas

Provision for Christmas was particularly important as a component of this mind-set, with a disproportionate share of incomes frequently devoted to Christmas and birthday presents. For many of the families interviewed, it would appear that borrowing from the home credit lenders for Christmas amounts almost to "tradition". Many parents and grand-parents living on very low incomes felt under significant pressure to deliver expensive Christmas presents, frequently a source of some anxiety. Much of this spending appears supported by use of high cost credit with few able to fund the season without borrowing. Several of those unable to borrow from legitimate lenders had turned to illegal money lenders to fund Christmas spending.

> *" At the end of the day. I'll do whatever it takes to get my kids what they want"*
>
> *"I'm dreading Christmas and people are saying 'It's only 13 weeks' and it's like someone is putting bags on my shoulders."*
>
> *"He was a money lender. I just couldn't bear for them to wake up on Christmas morning with nothing. It was just devastating. It's a never ending circle. My biggest mistake was doing it that first time."*
>
> *"Shopacheck[38]. All my family was with them. So just before Christmas everyone has the vouchers and the loans. And we all paid back together."*

For many a cycle of regular or continuous use of high cost credit appeared built into financial mind-sets

For long-standing and heavy credit users, borrowing, particularly from the home credit lenders, appeared to have become built into financial management, embedded in the financial landscape and the mind-set which borrowers brought to budgeting. Borrowers relied on the accessibility and convenience of home credit, and derived some security from the idea that, for proven customers, credit would be relatively

[38] Shopacheck is the second largest home credit lender and the only other home credit lender with a national presence and agent network. This is the home credit brand of Cattles plc., now effecting a gradual strategic withdrawal from the high risk home credit market, in favour of larger longer term loans distributed remotely with collections made by direct debit, targeted at less high risk borrowers under the Welcome brand.

readily available and rapidly delivered. Individuals were very much aware of the high cost of borrowing in this way, with most able to quote the TCC on loans of varying sizes, but valued the "affordability" of small weekly payments and flexibility afforded by the lenders' relative tolerance on missed payments.

"I think you get accustomed to being able to borrow money quick like. I ring and I get it the same day. You are used to it, you've done it for such a long time, it's an everyday reality". You just become accustomed to thinking 'Right, quick money' and pay over a period of time."

"It's something I've never thought about, I suppose, I've always been with Provident…sometimes I think I'm paying back a little bit too much, but it's always been a case of needs must…basically if I need anything that we can't save up for quick enough."

The cost of credit and the impact on budgets is fully understood but the ability to provide consumer goods is key to the sense of self as provider and parent

It is not that major purchases on credit were not carefully considered or that borrowers did not understand the price they would ultimately pay for goods bought on high cost credit. Indeed, the impact on household budgets was understood all too well, since these borrowers had to live with it on a relentless week in, week out basis. However, the ability to provide consumer goods and deliver a perceivedly high standard of living (as measured by material goods, consumer electronics, etc.) was, regarded as an achievement, of which individuals were clearly proud. It often appeared to be achieved only at the cost of iron discipline and self-sacrifice over the long term, involving not only constant economising but also a considerable degree of stress in that individuals were constantly juggling competing priorities and creditors, keeping all just comfortable enough to maintain open credit lines.

Those borrowing from illegal lenders had frequently been in desperate circumstances with no other options for raising funds

The majority of those without legitimate credit options did without credit or relied on informal borrowing. Those borrowing from illegal money lenders for the most part had no other credit options and some had resorted to this type of borrowing in desperate circumstances. Borrowings from illegal money lenders ranged from the very substantial (several thousand pounds) to the very small scale (£10 - 20). Some borrowers had been paying lenders over several years while other loans were being repaid the week following the cash advance. All these loans were very high cost, with debt escalated by disproportionate penalty charges for missed payments where victims were unable to keep up payments.

Some borrowing from illegal lenders was on a small scale week to week basis

Those borrowing smaller sums included several young mothers and singles with poor financial literacy or numeracy skills, borrowing to make ends meet, to fund a crisis or Christmas presents, or, in a few cases, for drugs or alcohol. Some of this borrowing was opportunistic and instigated by lenders.

"I'll just go and borrow £20 some weeks. I just never seem to be able to manage"

"It's £20 this week to pay back £40 next week. Which is stupid but if you've got no other choice, then that's what you do. Then you're up the creek when you get your money next time."

Some individuals had borrowed several thousand pounds from illegal lenders when unable to obtain credit elsewhere in times of crisis

Those borrowing the larger sums were broadly more capable financially, with several having a background of financial breakdown, business failure and significant downward social mobility. Larger loans from illegal money lenders had been spent on items such as the cost of funerals, putting children through university and pressing small business expenses.

> *"It was the fact that my son had died and I couldn't afford a headstone. I couldn't have lived with myself if I hadn't got him that."*

> *"It was to stop losing the house. And of course we lost it anyway. And I still have to pay him. That didn't stop when everything else did (i.e. when went bankrupt)."*

> *"He (son) needed books. They were really, really expensive. He thinks I've got money in the bank because there's no way I'd let him know I hadn't or he wouldn't have gone to uni. Somebody told me about this man and I was focusing on my child, so I thought, 'Right I'll do that then". He'd (son) go mad if he knew."*

3.3 Debt service and repayment patterns

Debt service is one more component of tight household budgets to be "juggled" within a framework of competing priorities

For the high risk borrowers in this study, patterns of payments on debt service and thinking around the management of repayment appears a long way from the automated regular deductions envisaged by most third sector lending models and their associated cost, credit risk and operational constraints. Debt service appears rather to be one more item to be juggled within the framework of competing priorities earlier discussed in section 3.1. Payments on loans and credit agreements were often the first item to be sacrificed, with borrowers appearing to take on credit in the full expectation that they would miss or make late payments. The facility to flex payments in this way indeed appears to be a key element not just in thinking around budgeting but also in the manageability of debt service.

> *"Life is not just straightforward. You just know you're going to miss and they (home credit agents) know you're going to miss. That's a fact of life. It's just down to how often."*

> *"Rob Peter to pay Paul, sort of thing. You don't pay one loan one week so you can pay the other loan and then you don't pay that loan the week after, you pay the one you missed last week, sort of thing."*

Essential spending and childrens' needs tended to be prioritised over credit repayments, particularly in the case of payments owed to home credit lenders

The more individuals had borrowed relative to their incomes and the greater the number of credit relationships they had, the more likely it was that they would miss payments, either to make ends meet or because faced with urgent expenses. Family households, and single parents in particular, appeared both more likely to need to borrow and more likely to juggle commitments. Home credit payments were those that were most frequently missed and indeed borrowers appeared to rely heavily on the relative tolerance and flexibility of the collectors. For those who had borrowed

from illegal money lenders, however, payments to the lender took precedence over all other expenditure.

"At the end of the day my priority is not Shopacheck, it's the kids getting food on the table…so obviously when things go wrong and I end up spending more, then I don't pay them."

"He's alright one week if you really can't afford it. If it's kids' birthdays and you really cannot afford to pay him. As long as you tell him that, he's fine. He'll say 'Alright. I'll see you next week, love'."

Payments to lenders are prioritised on the basis of the potential consequences of non-payment so that illegal lenders top the priority list

Illegal money lenders top the payment priority list because collection is sustained by threats and intimidation and borrowers fear the consequences of non-payment. Rent-to-own retailers, similarly, were paid in advance of other creditors, because borrowers feared the repossession of goods – often furniture or children's toys or electronics, bought as Christmas presents; these lenders having a reputation for the rapid repossession of goods in the event of missed payments. Prioritisation of payments to other creditors (such as weekly payments on rented TVs, washing machines and white goods or to home credit lenders) then largely depends, on the one hand, on the share of presence on the doorstep and the timeliness of collection, and, on the other, the importance placed on the relationship and the likely availability of a future a credit line.

"If it were my last penny, I would pay him (illegal lender)"

"Now Brighthouse. You just got to pay it every week so if you don't pay it every week your stuff gets uplifted so as I say basically that is one of the my bills I've got to pay each week like my gas and electricity. It's either that or the kids' stuff gets uplifted and I don't want that."

"Well, Shopacheck and that is not going to come round and do your windows but the loan sharks, to me, they could turn on you but you could get away with not paying Shopacheck. They're not going to do anything to you."

From the consumer perspective weekly doorstep collection, a feature of many lenders' collection practice, is a source of pressure but also discipline

Many lenders serving this market, including home credit and catalogue credit agents, but also illegal money lenders, fit their collection practice to the pattern of weekly budgeting and cash management and collect weekly in home, with visits timed to coincide with the arrival of funds. From the perspective of the borrower, this represents both a source of pressure and anxiety and a form of discipline and control.

"The night before I get my benefits, I can't sleep sometimes. Knowing they're all going to be at my door as soon as I get my money. And wondering what to do and who I'm going to pay and who I'm going to have to miss."

"You're glad to have given it them because then it's gone and it's not burning a hole in your pocket. Let's face it you could always find a better use for that money and if they didn't come and get it, you would."

Successful collection appears to require considerable low key "pester power"

Against this background, it would appear that the agents have to exert considerable low key pressure to keep collections up. Borrowers frequently reported that they pretended to be out when collectors called or that they had been cajoled into making part payments where they had intended to miss.

> *"Some weeks we just switch the light off and I keep the kids quiet and we pretend to be out. I've hidden behind the sofa before now."*

> *"He said, haven't you got anything in your pocket? Just give me what you've got in your pocket – £1.75 or something stupid. As long as they're back to the office and received something then they don't get grief."*

> *"He keeps on about he's got his own family to feed. They don't get paid if we don't pay them so they do get a bit ratty."*

One of the key considerations for borrowers in assessing how often payments can be missed is the need to keep a future credit line open

Users of home credit are conscious that a future credit line relies on the agents' good-will and so try and strike a balance between the agents' tolerance of occasional non-payment and the requirement to maintain an acceptable payment record. Some missed or part payments are made up but more commonly, the loan term is simply extended by dint of collectors continuing to call until repayment has been made. Collectors clearly operate a combination of carrot and stick in managing collections.

> *"I like to keep in with Tracey. Lovely girl. She's as good as gold if you miss. 'See you next week then'. But she wouldn't want you to do it too often or you might not get your loan back at Christmas."*

> *"Not a lot of payments you can miss. That will go against you when you're wanting a loan…Even if you don't pay your full amount, pay something. Then it's not a cross on your book and it doesn't go against you."*

> *"He says 'Now, look love. Just make sure you pay me now for the next few weeks and we'll see what we can do. Pay something so I don't have to put a cross in your book and then when it's coming up to birthday time, we'll see what we can do then'."*

Some high cost loans appear to being repaid over greatly extended terms

It would appear that some loans are repaid only over greatly extended terms, particularly where a change of circumstances has been the background to the arrears. Agents appear to be realistic in assessing what customers can or will pay and in some cases appear to be collecting very small sums, sometimes over years.

> *"I had quite a big breakdown so I couldn't work anymore. Then obviously my little girl came along as well…Then the actual person came to the door and I just said I can't afford to pay. I need to drastically reduce my payments. Either your office can take me to court and do whatever you do or just accept this because this is what I can do. I didn't get any comebacks with that."*

> *"I got my loan in 2003 and I'm still paying it off (2007) because I said, 'Do you know what? I can't do it. You can have just £2.50 a week' (should have been paying £15) and that's how we've gone on."*

Illegal lenders enforce and extend collection through a combination of implied threat, occasional violence and arbitrary charges

The illegal lenders operating in these deprived communities were unsubtle in ensuring that payments were kept up, relying on intimidation, numbers and a show of muscle to keep up collections. In some cases, victims had no idea of how much they owed, what it would take to pay off their loan or how long they would need to keep paying the lender, with a number of victims reporting loan terms and balances arbitrarily extended by unpredictable further charges.[39]

> *"You've got fear all through it, all through it. You've got fear because you owe these people money and there's no just one or two of them. There's a big crowd of them. You're frightened for your kids. They always say 'How' your wee one? She's six now, isn't she? That's their way of doing it."*

> *"It was down to about £160 and I missed a payment and they put it up to £280 and you've got no say in that. You've no got a book or anything. They tell you what you owe. And if they tell you one week you owe £200 and you know you only owe a £100, it doesn't matter."*

Users of illegal money lenders who were more confident and street wise or those who were well known or better connected within the community appeared more likely to be paying back an agreed amount (albeit at very high interest) on an agreed sum borrowed and to be less likely to be subject to threats of violence. In the case of small loans (£10 – 20) in Scotland, there appeared to be a standard tariff operating – which was reportedly enforced in the sense that under-cutting prices was discouraged – to which all of the lenders operating in an estate broadly adhered.

Difficulties in affording essentials appeared to be most closely associated with the least flexible lending models

Hardship and difficulties in affording essentials appeared to be more closely associated with the least flexible and longer term lending models, such as rent-to-own, particularly if used in combination with the Social Fund or large home credit loans. Those using the home credit lenders appeared least likely to encounter cash flow crises they were unable to bridge and appeared better able to cope with peaks of expenditure. However, budgets overall appeared significantly more restricted for home credit borrowers than for those using only informal borrowing or the Social Fund, which in part reflects the impact of high cost debt service on budgets.

> *"(making payments on)…that sofa is what doing us in. You have to keep them (payments to Brighthouse) up if you don't want your stuff lifted off you. I can never do a proper shop. Even with stretching it. I'm talking home made macaroni cheese without the cheese sort of thing. Not even that sometimes."*

> *"We have got nice things. I'm proud of that. The kids get what they want at Christmas. But it's been years. I just get a few tins and make do that way."*

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[39] Previous research undertaken for the then DTI indicated that in many cases lenders modus operandi was less to lend a specific sum over an agreed term than to seek to extend collection for as long as sustainable, thus maximising the take from the victim. Ellison, Forster and Collard for DTI, Illegal lending in the UK, 2006.

Victims of illegal lenders were under the greatest pressure, with budgets likely to be hollowed out and quality of life deeply compromised

Unsurprisingly, the most damaging impact appeared to be that created by borrowing from illegal lenders. Payments to illegal lenders were only missed in extremis, with the pressure to find weekly payments itself a source of considerable stress and anxiety. In several cases, the very high cost of such borrowing had hollowing out household finances to the point where they were barely viable. This was particularly likely where victims were socially isolated, less confident or capable or new to the community, and thus more susceptible to intimidation. Some victims were however fairly high profile and well connected within their community. These borrowers were less likely to have been subject to intimidation by the lender but budgets were equally compromised.

> *"And the kids. This lot have suffered the last six years having to pay £75 out of £155 before I start."*

> *"There was nights me and the elder boy never had anything to eat at all. You think in this day and age, that doesn't go on but it does. And he'd be like, Mum, I'm starving."*

> *"Some weeks I can't afford the electric and the gas even, not all the time. So we don't spend much time round mine. We (single parent and young son) go round my mum's and we eat there too. We have to walk because I haven't even got the bus fare."*

3.4 Delinquency, default and the outcome of debt recovery

If interventions are not made rapidly in the wake of payment difficulty or hurdles to recovery are set too high, irregularity can quickly become default

The research suggests that irregular payment can quickly become unmanageable arrears and lead to default if interventions are not made rapidly by the lender or if interventions do not provide a manageable route back to recovery and good standing. The tightness of household budgets make it very difficult to catch up arrears or to double up on payments, so that, from the perspective of the user, hurdles to recovery can quickly become insuperable. Respondents frequently reported that demands to make good missed payments or escalating debt in the wake of a missed payment made it too hard to recover from payment problems. A similar situation appeared also to arise in some of those instances where home credit agents pressured borrowers to "double up" payments following missed payments. The line of least resistance under these circumstances is then to let the situation deteriorate, particularly where individuals feel they cannot recover the relationship.

> *"Before you know it, they are sending you letters saying that they are taking court action against you and they want it paid in full. Where am I going to get £200? They were like, 'We cannot work around that, we need it paid in full'. And I'm, like, 'You're getting nothing then'."*

> *"Once you've missed one and then you should pay double next week and you can't and then you are starting to get into that downward spiral where you are missing a few weeks. I've done it myself thinking I'll pay double and you get away with it once and then pay double and because you've done that you miss a few weeks and then you're up the creek without a paddle."*

Debtors are reluctant to communicate and simply disengage from the debt recovery process where they feel unable to meet demands

Respondents who had faced arrears on personal loans, catalogue credit, credit or store cards described a syndrome in which they became increasingly disengaged from the creditor because hurdles to recovery were set too high for the debtor to overcome. Very few had pro-actively communicated with the creditor in any case. Communications from the creditor, in the form of phone calls and letters, tended to be responded to only in the early stages but were frequently ignored even then, on the grounds that the borrower was unable to meet the demands being made. Threats of court action, while undoubtedly worrying, were ultimately ineffective in that borrowers did not have the means to repay. With no solution in reach, delinquents tended to disengage, not answering phone calls from unfamiliar numbers and often leaving correspondence unopened.

> *"I've had companies and companies write out to me and they don't get nowt because I ain't got nowt. I've just left them (letters) I can't afford to pay them, what's the point? You just stress yourself out and you still can't afford to pay them."*

> *"It scares you - the thought of someone coming and taking your stuff…sometimes you just can't pay and it all adds up and gets worse and then you stop answering the door. And then you're looking at the letters. And with my depression, I can't deal with it. So I think if I just put the letters in the bin. It will go away. If it's not in my face, it's not happening ..It's the way that I deal with it."*

Those in arrears can quickly become resigned to escalating costs and "bad credit" if they feel powerless to prevent the situation deteriorating

Individuals are undoubtedly stressed by threats of court action and are only too aware of the consequences of getting "bad credit" but can feel powerless to prevent the situation from taking its course and ending in court sanctions and judgements. Once an adverse credit record has been acquired, individuals can then become resigned to credit exclusion and to escalating costs associated with bad debt, feeling that they can do little to moderate or control the situation they find themselves in. For those borrowers who had faced serious arrears on multiple commitments, often in the wake of an income shock caused by some form of negative life-event, the syndrome just described was amplified, not only by the numbers of creditors chasing payment, but also by the circumstances in which the arrears had arisen. Depression or illness had often been a feature in these cases, increasing the sense of helplessness and disengagement. While some borrowers had struggled to make repayments over many years, others had rather given up, becoming inured to both threats of sanctions and enforcement action.

> *"Put it with a debt collection agency. It ruins your credit though, doesn't it? But my credit is ruined anyway."*

> *"A couple of them have taken me to court. I've not actually gone to court. I can't remember which ones. It just gets transferred to a different debt collector. And then they put the price of the court on. If it were, like, £49, it would be, like, £249 by the time they finished taking you to court. But you still can't pay it."*

The most important consideration in motivating individuals to make good arrears appears to be the prospect of recovering their credit line

The most important consideration in motivating individuals to make good arrears appeared to be the prospect of being able to recover a credit line despite payments

having fallen behind. Conversely, where individuals judged that they were unlikely to regain their standing or to obtain further credit, debtors were less likely to engage with the creditor and more likely to see payments on other "live" credit lines as a higher priority. Similarly, where respondents were making payments on a loan or credit line which no longer had any utility for them (a store card at its limit or barred or a cash loan spent on electronics, jewellery or furniture no longer used or subsequently sold, for example), they were much less motivated to keep up payments. The home credit lenders appeared to utilise this aspect of the repayment mind-set with some success, particularly in the run-up to Christmas. Respondents reported receiving correspondence in which borrowers were urged to keep up or make good lapsed payments with the promise held out of a loan in time for Christmas. In several cases, this had served to focus minds and motivate individuals to maintain what had previously been a patchy payment record.

> *"He'll have a chat with you about the best way to go about getting it (loan) back again. He'll say 'What if you pay me for the next three weeks an extra £2 a week then I'll be able to get your loan back at the end of it, when you need it."*

> *"They write to you and say 'Pay us for twelve weeks and you can have your loan back in time for Christmas'. Even if you're behind. That makes you kind of get it together because you're going to need that loan."*

Taken together, the patterns of financial management, credit use, debt service, delinquency and default here described provide a comprehensive backdrop to the challenges likely to be faced by those seeking to introduce victims of illegal lenders to alternative sources of credit and for third sector lenders seeking to move borrowers away from high cost credit.

4.0 Attitudes to, and use of, credit unions and money advice

This chapter looks at attitudes to advice, credit unions and CDFIs, and examines the barriers to approaching and using credit unions. It then explores the appeal of the capacity-based “instant” loan concept, as offered by credit unions offering Growth Fund subsidised loans, and examines high risk borrowers’ perceptions of various aspects of the proposition.

4.1 Awareness and perceptions of third sector lenders

Spontaneous awareness of credit unions was low and for most simply not on the radar as an option for credit - There was no awareness of CDFIs

Outside the sample of new-to-credit-union borrowers specifically recruited to obtain a perspective on using a credit union for the first time and a small number of credit union users using credit unions alongside high cost credit, awareness of credit unions was low. These individuals aside, none of the other respondents spontaneously cited credit unions as a potential source of credit, even during an extended discussion of credit options that were or were not open to them. For these borrowers, credit unions were simply not on the radar of available sources of credit.

> *“I don’t know much about them. I don’t really know how it works. I’m not sure. I think they may be something to do with the nursery.” (Credit union less than 50 yards away from community centre respondent uses several days a week)*
>
> *“I’ve heard the name credit union but I’m not sure I know what it means. Is that the place where they cash cheques in town?”*
>
> *“Credit Unions…I don’t think they do loans do they? You put money in I think.”*

There was greater prompted awareness of credit unions with some respondents able to identify local credit unions

When prompted, a few over a third had some awareness or understanding of credit unions with several of these respondents then able to point to the location of their local credit union, particularly where it was in a prominent position or co-located with somewhere visited frequently, such as a school or health centre. In some cases, individuals frequently passed the credit union in the course of daily activities without ever considering further investigation. There was no awareness at all of CDFIs, either prompted or unprompted[40]. Quantitative research has also indicated low levels of awareness and understanding of credit unions.[41]

> *“Credit Union. Aye. I don’t know anything about it much. One of the girls said she’s going on holiday and she borrowed the money from the credit union or something.*

[40] The lack of awareness of CDFIs included awareness of the relevant CDFI brand in the one catchment area where this was relevant.

[41] This accords with research undertaken for the Financial Inclusion Task Force in catchment areas for the Growth Fund which indicated low penetration and awareness of credit unions and little understanding of credit union pricing. 1% of respondents were using third sector lenders with a further 1% having used them in the past. Of those were not using credit unions, 55% had not heard of credit unions. FIT Paper Access to Affordable Credit 2007. Earlier research, undertaken by Policis for the DTI in 2004, indicated that the most important reasons for not using a credit union were not being aware of credit unions (cited by a third of low income households who had not considered a credit union loan) and not knowing how to go about getting a credit union loan (cited by a fifth of low income households who had not considered a credit union loan).

She puts the money into it and then you get a loan from it. It's down the round. I've never been in there."

"Oh, I basically know about them. They do like a bank thing, and you can put money in and you can get a loan off them. Somewhere down near the market they are…but it's never really entered my head…Better the devil you know than the devil you don't…Probably you might not have to pay back as much maybe...I suppose I've always been happy with the Provident."

Most people who were aware of credit unions had only a vague understanding of credit unions' remit, modus operandi or target market

Most of the sample had either no, or only the vaguest, understanding of credit unions. Some people had a loose perception of some form of social remit in that credit unions were variously thought to be government sponsored, run by local authorities or housing associations. More people assumed that credit unions were for workers than had any sense that credit unions offered services to those specifically on low incomes, those on benefits or the financially excluded. None of the entirely credit excluded or the victims of illegal lending had any sense of credit unions targeting those who would find it difficult to get credit elsewhere, far less as offering an alternative to borrowing from illegal money lenders.

There was some understanding that credit unions lend to those on low incomes but borrowers were thought to be older people under less pressure

Credit union customers were seen as older people, with more stable and less pressured finances. Almost by definition, the ability to save was seen as implying a greater degree of control over one's life or more flexibility in one's finances than was the case with most of the respondents.

"I kind of think of that (CUs) as something for older ladies. Like my mum and my auntie is in it…They don't lend a £100 do they? You'd probably have to have £500 or summat."

The impression I got is that I didn't think they would go for unemployed people. I have heard that they do lend to some unemployed people but I thought it was on the basis that you have got to have money in there. In which case you wouldn't be needing a loan, would you?"

There was very little appreciation of the cost of borrowing from a credit union relative to borrowing from high cost suppliers

It was striking that, even among those who had some knowledge of credit union borrowing, there was little appreciation of the cost of credit from credit unions[42]. There was no real sense either of the cost differential between credit products with which respondents were familiar and credit union borrowing. Perceptions tended to be no more developed than, "cheaper than the Provident", or in some cases "low interest".

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[42] This accords with research undertaken for the Financial Inclusion Task Force by GFK NOP in Growth Fund catchment areas: 60% of respondents had no perception of the level of credit union pricing; 21% of respondents identified credit unions as low cost providers; 10% as medium cost providers; and 9% as high cost providers. FIT paper "Access to Affordable Credit" 2007.

Respondents knew family members and friends had benefited from joining credit unions and saw membership as aspirational but out of reach

In most cases where relatives or friends were using credit unions, often over a fairly long period, respondents reported high levels of satisfaction and even enthusiasm for the credit union concept. Indeed some of these relatives and friends were apparently real advocates for credit unions, urging their family and social network to join. Respondents recounted, often somewhat wistfully, how those they knew or members of their family had been able to save for holidays, a car or for Christmas and even pointed to the difference that a credit union had made to these members' lives. To this extent therefore, the credit union – and the idea of saving – was seen as aspirational but essentially out of reach.

> *"Two of my sisters are in it and they keep it for a family holiday and they think it is absolutely fantastic… they think it is the best thing that has ever happened…but they're not in my situation. They've got that money spare to save in the first place."*

> *"It (credit union) just didn't register in my mind (as a credit option). My friend's in it. She loves it…But I'm not working. I'd never be able to save…They are not going to be looking at people like me."*

4.2 Awareness of and attitudes to advice

There was a higher awareness of the availability of advice than of credit unions but advice was associated narrowly with over-indebtedness and debt management

There was much higher awareness and use of the availability of advice than there was of credit unions or CDFIs. People were largely aware that there was help available for those struggling with debt, but were less clear about the nature of the help available and the range of financial problems that could be dealt with by the advice services. There did not appear to be any awareness specifically of money advice as a concept distinct from debt advice.

There was less awareness of the range of financial problems which advice would be able to help with

In most cases, advice was associated with debt, with many aware that payments on debt could be renegotiated in extremis, mediated by the advice services. Though to a lesser degree, advice was also associated with sorting out problems with benefit entitlement. There was far less awareness of advice being about financial education and capability.

> *"If you're in trouble because you owe money and you can't pay it back, then they'll keep people off your back for you. Sort it out. I've heard they're good with that. But that's not really my problem because I can't get a loan from anyone anyway. So they wouldn't be able to help me."*

> *"In a way because I don't get that much money anyway, it seems like it's trivial…It's maybe not worth their taking their time over, I don't owe lots of money I just can't seem to manage."*

Some were either too proud to seek advice or took the view that advice would be unlikely to address their core problem of income being inadequate to needs

Many individuals were resistant to the idea of asking for advice, either being too proud to ask for help or feeling that money advice was unlikely to be helpful. In the latter case, people tended to take the view that their main problem was not having enough money rather than any lack of financial management skills.

> *"No to be honest, it's very personal. I wouldn't like it. It's hard enough having to live the way we do without going to someone to say 'well, I'm having money troubles. Can you advise me? I'm a proud person even if I am on the Social."*
>
> *"What could they tell us that we don't already know anyway? You like to deal with your own problems."*

A significant minority had used advice services, with mixed experiences – those who had benefited from debt advice were often very positive

A significant minority had approached or made some use of money advice services, with mixed views on their experience. Those who had really struggled to cope with onerous debt and been supported through debt management were the most positive about the experience and the impact it had had on their finances. Some of those people who had taken on what they now recognised as too much debt were candid that financial advice given in the context of debt management had laid the foundations for budgeting skills that had helped them manage their finances subsequently. This tended to be more typical of older people looking back at the experience of their younger selves.

> *"I got some advice and I do feel more in control now. I do feel that what I've got is what I've got. I've learned not to be bullied. They were sending threatening letters saying they were going to come and take my furniture and I was so frightened that I was turning the lights off and pretending not to be there…and they (debt advice services) helped me rebuild myself".*
>
> *"I was only young. Young and stupid. They showed me about sorting out my money and what has to be paid first and budgeting and that. And I've always stuck to that. It's helped me through the years."*
>
> *"They were brilliant when my husband died and with all the debts, sorting that out. They really took the pressure off at a very bad time, you know."*

In some cases, advice had had less resonance, being perceived as patronising and judgmental

Others had found the experience less positive, often resisting attempts at financial education delivered in parallel with debt advice and debt management. Advisers were seen as stepping outside their remit (perceived as sorting out the immediate debt problems and negotiating with creditors), and as being patronising and judgemental. This was most likely with those consumption-oriented borrowers who saw their determination to provide their families with material goods as a source of pride rather than a problem.

> *"There is one at the top of the shops here but the guy who saw me he was very judgmental towards me. Basically it was, sort of, you shouldn't be living the full life. You've got kids – you shouldn't be buying stuff that you can't afford. I thought, right, I'll sort it out myself then."*

"They was going on as if to say, you're more materialistic than you think of your kids, sort of thing. I just thought, forget it, I'll deal with it myself…It wasn't very nice. It made me feel bad. It was humiliating actually."

Those with the most entrenched and significant problems were among those least likely to seek advice or see their issues as amenable to intervention

Some respondents, including some of those with the most significant difficulties, had no idea where they might obtain help with financial problems. This included both individuals deeply entrenched in relatively large scale debt – in some cases debt owed to illegal money lenders but also commercial lenders and social landlords – and those whose chaotic life-style and constant cycle of small scale informal borrowing was in large-part a function of poor financial capability. Neither group had any real concept of their problems being amenable to intervention or potentially ameliorated by financial advice or education. Several of these individuals were, however, only too conscious that they lacked the skills and know-how to cope or progress and felt helpless to change their situation.

Victims of illegal lending tended to see money advice and financial education as not relevant to tackling the relationship with illegal lenders

None of the victims of illegal lending had considered seeking advice – or indeed consulting the authorities in any form – as a potential way out of their relationship with the lender or of tackling other financial problems. On prompting, advice services were not seen as relevant or helpful[43]. Most saw the relationship with the lender as simply not amenable to intervention, in that the advice services would be unable to moderate debts owed to the illegal money lenders or prevent the lender calling. Financial education and support similarly had little appeal in that, from the perspective of the victim, the key issue was not so much whether there were better ways to manage their money than the fact that their finances had been hollowed out by payments to the lender so that they had insufficient funds to meet their needs.

"You're having a laugh, aren't you? I can't see what they're (money advice) going to do for me. Not unless they're giving away free money this week. I mean, it's not that I can't sort out my money. I've just not got none. You can only stretch it as much as you can do. You can't work xxxxing miracles. Now that is something I'd like to see."

"It's hopeless. There's nothing anybody can do. They're (illegal money lenders) a law unto themselves and nobody gives a xxxx is the truth of the matter."

"I can't see how speaking to people about my money would help. What are they going to tell me that I don't already do? I couldn't economise any more than what I do do and they're not going to get me more money and he's (illegal money lender) not going to stop calling."

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[43] Quantitative research with victims of illegal lenders indicated that debt advice and financial education came last on a list of potential interventions that might make a difference in combating loan sharks, with debt advice being seen as helpful by slightly less than one in ten and financial education as helpful by less than one in twenty. Interventions that were seen as likely to help were primarily an increased supply of legitimate credit, more effective enforcement, and the facility to report loan sharks anonymously. Ellison, Collard and Forster, Policis and PFRC for the DTI, Illegal Lending in the UK, 2006.

4.3 Barriers to high risk borrowers approaching and using credit unions

The dominant element in perceptions of credit unions was the perceived requirement to save for some weeks before borrowing

For most of those who had some understanding of the credit union concept, this was mediated by the experience of relatives, usually from an older generation and in most cases better off family members. Perceptions of the credit union concept were dominated by the save-to-borrow model with virtually no awareness of the possibility of instant loans being available. Even in the estates close to credit unions lending successfully under the Growth Fund scheme, no respondents spontaneously mentioned instant loans when discussing the credit unions.

This requirement to save is perceived as an insuperable barrier to credit union use – reinforcing the conviction that credit unions are "not for me"

This association of credit unions with the requirement to save before borrowing was in large part the reason why credit unions were so far from the front of respondents' minds as a credit source. The majority of those interviewed found it so difficult to save that they simply had not considered the credit union as a possibility. For those whose key consideration in relation to credit was that it be readily accessible and rapidly available, the credit union model was also profoundly unattractive.

> *"I couldn't afford to put anything away.So a credit union is out for me. Even if I could save for a few weeks, I'd be needing something and having to take it back out again."*
>
> *"It's just not what I'm looking for. When I want money, I want it today or tomorrow not in three months time."*
>
> *"Well if I could afford to save I wouldn't be wanting a loan, now why would I?"*

Relatives and friends were seen as borrowing sums from credit unions which were out of scale to those to which the high risk borrowers were accustomed

As an extension of this view, for those who had relatives or social contacts using the credit union, borrowing and saving with the credit union was assumed to be on a scale beyond that achievable for most of those interviewed. Respondents mentioned friends and family creating savings to a level where they were able to borrow a £1000 or even £2000, which was significantly higher than the often very small scale cash borrowing (£100 – £300) which was more typical of the sums borrowed by the commercial credit users in the sample. Some of those borrowing from illegal lenders, especially in Scotland, were borrowing smaller sums still, typically in the £20 – 50 range.

The other key barrier to approaching a credit union was a default expectation of refusal, often because of "bad credit"

The requirement to save apart, the most important perceived barrier to using a credit union was an assumption that having "bad credit" would be a bar, a notion cited by many of the high cost credit users. There was no sense that, while a credit union might indeed undertake a credit check, that credit unions might adopt a different stance in evaluating a credit record to that taken by a mainstream provider.

“They’d do a credit check, wouldn’t they? I’ve got bad credit. You’re better off sticking with the Provident because they don’t knock you back. I’d be too scared to get knocked back.”

“I get quite humble about having to borrow anything. I really don’t like to do it. So I would be very nervous. I’m gobby when I’m nervous and I’d say the wrong thing. I’d have to see my friends getting them (loans). Then maybe.”

Many, in any case, lacked confidence in dealings with institutions and officialdom more generally, particularly if they had literacy or numeracy issues

When interviewers probed for feelings around applying for credit to other institutions, including banks and credit unions, many respondents clearly felt uncomfortable with the idea of risking rejection or humiliation. Indeed, a generalised lack of confidence in dealings with organisations or officials was also frequently a feature of respondents’ reported interactions with those outside their own community or social network. Bank, social services or agency staff are frequently regarded as intimidating, particularly where poor literacy or numeracy skills are an issue.

“I hate forms. And people asking you questions. And they always want what you haven’t got. It’s so hard even to open a bank account – I gave up. You’ve got to get a letter from the housing that you are who you are. I don’t have a passport. I don’t go anywhere…They’d check your credit as well and I’ve got that bad catalogue too.”

“I wouldn’t want to go and they say, ‘No you earn too little’ or whatever. I mean they may not be like that, but you don’t know. They might say I’m not the right sort of person.”

There were also practical barriers to investigating credit union services – with some unions being seen as inaccessible and inconveniently located

Other factors cited spontaneously as reasons for not using credit unions were more practical, though none was as powerful a barrier as those just described. These included the credit union being located at a distance or out of the way and being unsure of opening hours or how to locate a credit union. Of these, the requirement to travel any distance was a more important consideration in that it involved costs as well as inconvenience.

“It would cost me getting on £3 just to get there and back and I’ve better uses for that money.”

“You wouldn’t want to trek up there and then it’s not open. I don’t think it’s open all the time. You’d be sick if you spent the money and went up there and there was no-one there to talk to you anyway.”

“It’s getting up there with the children, on the bus and with the push-chairs. By the time you’ve got everybody dressed and you’ve got to pay out to get there and back. It’s an expedition, isn’t it?”

Some older respondents also took the view that their local credit union was dominated by a cliquey inner circle unlikely to be welcoming to outsiders

Some respondents additionally took the view that their local credit union, being small and locally run, was cliquey and dominated by an inner circle of members who were unlikely to be welcoming to outsiders.

Inertia, established relationships with high cost lenders and reluctance to move beyond the familiar also act as barriers

For those with commercial credit options, part of the barriers to moving high risk borrowers to affordable credit lie with the pull factor for existing suppliers. Despite the cost of home credit, many aspects of the home credit offer are actively valued by the customers, not least – for customers with a track record – the confidence that funds will be readily available and rapidly delivered. Faced with a need for credit, the path of least resistance will tend to be to opt for the familiar.

> *"Basically, I'm a lazy bugger. She's been coming for years. She's a good lass. It's convenient, you know. It's easy."*
>
> *"He's been coming here fifteen year has Keith. He called at my mum and dad's. He does all our family. He's a lovely man. He does his best for us."*
>
> *"The thing is you know you can rely on her. She won't let you down when you need it. You don't have to worry about whether you're going to get turned down. You've just got to not let her down and she won't let you down."*

The heaviest users of high cost credit and those with long term commitments to high cost lenders may feel in no position to consider a further credit source

In the case of some of the heaviest credit users, particularly those with long term obligations (such as credit on high ticket items obtained from rent-to-own retailers) alongside shorter term home credit loans, current credit commitments are such that they will in any case act as a barrier to taking on credit union lending or considering alternative sources of credit. The likelihood in these cases is that tightly stretched borrowers will tend simply to take on small incremental loans from the home credit lenders as each short term loan is paid up, thus locking themselves into an ongoing high cost credit relationship.

> *"No matter how cheap it was, I just can't lend any more. I've got too much owing as it is."*
>
> *"I could be very tempted (to go to credit union) because them is good rates…But then when you do need money, if you need something, you're not going to want to go somewhere new, are you? You want to know you can have it without any hassle."*

Those with significant or long term debt to high cost lenders saw these commitments as a major barrier to transition to affordable credit

Where commitments were long term – as in some rent-to-own contracts – this tended to push the prospect of moving to an affordable credit source well into the future. These borrowers tended therefore to think of taking on loans from the credit union as a complementary and relatively minor component of the overall credit portfolio rather than as an immediate alternative to other sources of credit.

> *"I'm still paying my sofas. That's the biggest chunk of my money right there. And that's another two years I'll be paying that. Maybe when that's done."*
>
> *"I couldn't afford to take on a big loan like that (sister's holiday loan from the credit union) because I'm still paying out on my TV and my Norton. Maybe start small".*

Victims of illegal lenders locked into damaging relationships with loan sharks face a further series of barriers to breaking away from the lender

Victims of illegal lenders faced a further series of barriers to the move to affordable credit. Users of illegal money lenders were often among the least financially capable and most isolated individuals. This was particularly true of those who appear to have become locked into a long term cycle of borrowing small sums or who had been the victim of an extended extortion in which highly disproportionate penalty charges for missed payments had been added to the "debt".

> *"It's a nightmare. You can't stop. You can't reason with them. They're not listening. They're not interested in what you've got to say or what you think you owe them or don't owe them. They just want their money each week. And there's no point arguing. You're wasting your breath."*

> *"You owe them what they say you owe them. End of story. And it is a never ending story."*

Victims' ability to break out of the lender relationship can be further compromised by depression and loss of confidence

Those who had become locked into a long term and damaging relationship with illegal money lenders had often had not only their finances but also their family and social relationships compromised. This had usually arisen because these individuals were constantly borrowing from friends and relatives and often failing to repay. Alternatively, finances had become so hollowed out that social interactions which involved any form of expenditure – the cost of bus fares to visit friends or family for example – could not be afforded. The resulting isolation, allied to constant worry about repaying the lender, was itself described as a factor in dwindling confidence and depression and a sense of loss of control and independence.

> *"You get to the stage, where you're just very, very weak. Thinking I cannae do this. Thinking I need to put my kids in care."*

> *"There's been some times when I've thought I can't do this no more. I can't go on. You just lose all your confidence. You don't want to get out of bed in the morning."*

Social isolation and exclusion were exacerbated where illegal lending was associated with drugs or alcohol, drawing victims into criminal life-styles

Where drugs or alcohol are a feature, as is frequently the case with small sum lending, particularly in Scotland, the syndrome of dependence on the lender and intensifying social exclusion and disadvantage was further exacerbated in that, on the one hand, credit was frequently taken on to purchase drugs or alcohol and, on the other, individuals could then be drawn into a cycle of petty crime – shoplifting or running errands for the dealers.

> *"Their way of doing it, if you've no got the cash, then you run around with the drugs for them. That's where they get their money from. It's mainly from drugs."*

> *"What are you going to do? You're just going to do what they tell you to do. You've got no choice."*

Some victims, particularly those borrowing larger sums, often had complex financial problems which would act as a barrier to a move to affordable credit

Some of those using illegal lenders were doing so because of a long history of problem debt, which in several cases remained unresolved. Some had significant debt to social landlords and a backlog of serious arrears on council tax. In some cases, these problems had arisen as a result of a change of circumstances and reduced income. Others appeared simply to have been unable to handle debt and to lack financial management skills. In several cases individuals appeared to have difficulties in understanding and negotiating the benefits system and indeed official processes and agencies more widely. Taken together, these various problems would themselves act as powerful barrier to being able to move on, over and above the specific difficulties associated with use of illegal money lenders.

Some thought in terms of paying off the loan shark off with the proceeds of a credit union loan

Some individuals thought in terms of using an affordable credit loan to pay the loan shark off, though some had doubts about whether they could borrow sufficient to do so. Others were unclear about whether there was a putative sum adequate to settling the "obligation" to the lender.

> *"And I'm not sure I could honestly say how much it would take to settle it. But it would be too much anyways, I'm sure of that."*
>
> *"How would I tell him I'm not going to be paying him any more? He's not going to go 'See ya around' and let it go, is he? I can't get a straight answer out of him so I don't know when that's going to be (when loan paid off), so that's out for now. (Going to the credit union for a loan)."*

Some of those who had borrowed large sums from illegal lenders felt that credit unions were unlikely to lend sufficient to pay off the illegal lender

Some people using illegal lenders had turned to a loan shark because the sum they wished to borrow was larger than that likely to be available from the high cost lenders. Some of these borrowers had suffered major income shocks and downward social mobility and had serious adverse credit records as a result and so were unable to borrow from mainstream providers more likely to lend on this scale. Borrowers who had taken on large loans from illegal lenders were more likely to have kept up payments, sometimes of relatively significant sums and in a couple of cases, sustained over several years. These borrowers had not been subject to violence and intimidation in the same way as some of the younger victims borrowing smaller sums. They were, however, under no illusions as to the likely consequences of non-payment and the extent of the lenders' influence and connections within the community. Credit unions were thought unlikely to lend sufficient to pay off their debt, from their perspective the only viable way out of the relationship with the lender.

4.4 Response to the new model and instant loan credit union concept

4.4.1 Instant loan concept

Spontaneous perceptions of credit unions were then followed by a session exploring potential responses to instant loans and accessible affordable credit. Respondents were presented with the instant credit union loan concept. This was presented as:

- Community based finance
- No requirement to save before borrowing
- Small loans available to those on benefits or in work
- Loan criteria based on ability to repay
- Affordable credit (later supported by examples of pricing and terms)
- Opportunity to build up credit line on basis of proven track record
- Opportunity to save

Table 1: Instant loan pricing as presented.

Loan amount	Total inc Interest	Weekly Repayment	No. of Weeks
£250	£268.16	£9.00	30
£300	£323.66	£10.00	33
£350	£379.41	£11.00	35
£400	£435.35	£12.00	37
£450	£491.44	£13.00	38
£500	£547.65	£14.00	40

Source: Leeds City Credit Union Handiloan

4.4.2 Response to outline concept and product pricing

The idea of an instant credit union loan available to those on benefits was an attractive proposition even without any knowledge of product pricing

The initial response to the outline concept, without detailed examples of pricing, was very positive, even excited, with most individuals picking up first on the lack of a requirement to save before borrowing, followed quickly – for those on benefits – by noticing that loans were available both to those on benefits and in work.

Respondents were often astonished by the low cost of credit union borrowing

After their initial response, interviewees were then provided with examples of pricing on a small instant credit union loan (based on a real example, see reproduction in Table 1) expressed in terms of credit advanced, TCC (Total Cost of Credit) and weekly amount payable over a term of a specified number of weeks. Respondents were often astonished at the low cost of credit potentially available from credit

unions. Indeed, the pricing was so far outside the respondents' experience that they usually sought to clarify their understanding, sometimes several times.

"My God! That's cheap. I am quite stunned actually. Well, it's very attractive actually is that. Yeah. I think I would go down and check that out. Yeah." (respondent has previously explained that they were happy with Provident and unlikely to go anywhere else).

"It sounds brilliant. I'm gob-smacked actually. Show me that again. £47 on £500? You sure you got that right?"

"Oh my God ! That's good. That is so much better…Where are these people and how come we don't know about them? How come they're not advertised anywhere and why are we taking things from Shopacheck when there are things like this?"

Those with high cost credit were quick to calculate the savings on the cost of credit but were more concerned with the weekly amount payable and flexibility

Those who had access to credit typically quickly worked out the difference between the cost of credit on their current credit vehicles and that of an equivalent affordable credit loan. Without exception, respondents thought first in terms of weekly payments, then in terms of the total that had to be paid back, with none spontaneously referring to APR as the basis for comparison. Although individuals were very much aware that the total cost of credit was much lower on the credit union loan, their main concern was with the affordability of weekly payments and the degree of flex available from the credit union.

"It's much cheaper than what I'm paying now in the long term. You're only paying back what you've lent and a little bit more. But what you got to give them each week is about the same, to what I'm giving Terry now."

"To me, what I look at is what it's going to be out of my money each week. That is what I go on. You do end up paying a lot with them (Shopacheck) so it would depend on that. If it (credit union) were more than I am paying now, I think I'd rather have Shopacheck. That probably doesn't make sense to you but that's how I work it out."

"It (credit union instant loan pricing) is good. Very good. But are you allowed to miss? Some weeks I really need to miss…I would be thinking about that as well, to be honest. What is it going to cost me each week and can I miss them if I need the money?"

Some respondents clearly found the concept so compelling that they would waste no time in checking out the possibilities

Once they had seen the instant loan concept, respondents tended to fall into two camps in terms of the likelihood that they would approach the credit union. Some respondents, usually either the most capable or the most credit hungry, found the concept so compelling that that they would likely check out the possibility of obtaining a credit union loan at the earliest possible opportunity.

"I'll be checking that out. Definitely. Like, maybe tomorrow. You don't have a leaflet on you, do you?"

"When I've finished this one, I'll look into it, definitely. That's got to be better. A lot better than what I've got now."

4.4.3 Concerns on application and eligibility hurdles

Positive responses to affordable credit pricing were quickly followed by concerns around eligibility criteria and process hurdles

For others, a series of specific concerns arose around access and eligibility and the application process. These were in part practical concerns about the nature of the hurdles they might be expected to surmount and the proofs or paperwork they would need to provide. Some were worried about the practicalities of the application process – whether they would be required to fill in forms or to have a formal interview and the kind of person they might have to explain their circumstances to.

Most took the view that their application was unlikely to be successful

Most took the view that they were unlikely to be successful in applying for credit. Indeed, in some cases, the low cost of credit reinforced the expectation of refusal – in that all previous experience was that cheaper forms of credit were not accessible. Some respondents took the view that there was no point in putting themselves through the ordeal of application when the likely outcome was disappointment and humiliation.

> *"I have asked my bank. I've been with them a long time and they still said no…And I had my catalogue turned down as well. So, personally, I don't think, I would, no (apply for a credit union loan). I wouldn't like to go there and have some stuck up cow look down her nose at me."*

> *"Provident don't check your credit. That's why it's expensive, because they know you don't have no choice. This is a lot cheaper than Provident so they are not going to give you anything if you've got bad credit."*

Despite the attractiveness of the concept, many simply lacked the confidence to approach an unfamiliar organisation and risk rejection

Even having seen the pricing and been told that credit unions were willing to lend to borrowers that other financial institutions might not consider, some potential borrowers were simply too intimidated by the prospect of approaching an unfamiliar organisation. The tendency in this case was to contrast the intimidating prospect of approaching the credit union with the familiar experience of applying to the home credit lenders or the Social Fund. It wasn't so much that individuals were always confident they would get the money they were looking for from these sources, but rather that they felt secure that they would not be judged or looked down upon and knew that, in the case of the home credit lenders especially, refusals were likely to be couched in terms that were face saving.

> *"I don't like going into places, offices and that, if I haven't been there before. I'd rather just ask Kevin (home credit agent). He knows me and he knows what I'm like. Even if he can't help me, he's not going to make me feel bad about it."*

> *"The thing is with this, you are probably going to get knocked back. Or they're going to ask you questions you can't answer or they're going to want paperwork. With Shona (home credit agent), she's more like a friend. She's not going to judge you or look at you. If she can do it, she'll do it for you if she can."*

Some victims of illegal lenders were among those least confident of making a successful application

Victims of illegal lenders were among those least confident of making a successful credit application. In part this was a matter of generalised lack of confidence and a lack of skill and experience in negotiating new and official situations. These borrowers were also more likely to have a seriously poor credit record if they had once had access to mainstream lending.

4.4.4 Expectations of borrowing values

Respondents' expectations were of initial loans in the sub £350 range though for some the prospect of progressing to larger loans was very attractive

Respondents' expectations on the scale of initial advances were broadly in line with their current borrowing, so fell typically into the £100 - £350 range. Some individuals were attracted also by the idea of being able to progress to larger loans in due course, borrowing £500, £1000 or even more.

Those with large credit commitments tended to see instant loans from the credit union as one component of a wider credit portfolio

Some respondents with larger credit felt that they needed a larger overall credit line than suggested by the scale of loans presented to them (See Table 1). As a result, they tended to see loans from the credit union as a potentially useful component of a wider portfolio of credit types rather than as an alternative to existing borrowing.

> *"I usually want a bit more than that at this time of year (table with £500 as the highest value loan example) so I'd have to keep up with the Provident and my catalogue."*

> *"Me, I like to keep up with one or two so you can always get something if you need it. So that (credit union loan) would be useful. If you needed a few hundred and you hadn't paid enough of your loan to get it back again."*

4.4.5 Preferences for delivery and repayment channels

The payment channel options presented were; direct debit, deduction from some element of benefit paid directly by DWP into the credit union, weekly payments to the local branch and Paypoint.

Paypoint was the most popular repayment option – though it was recognised as creating the potential for missed payments and the build up of arrears

The most popular repayment channel in spontaneous discussion was Paypoint, because this fitted with existing bill payment patterns. It was particularly popular with older people and those who had mobility issues. That said, those who were prone to payment irregularity quickly recognised that, without the pressure to make payments, the Paypoint channel was dangerously discretionary. Those with less stable or predictable finances felt that there was some risk that arrears would build up, potentially to the point where it would be difficult to recover.

> *"I think they should put it in a PayPoint. That would be absolutely fantastic. If that (Paypoint) came out I would definitely use it. So you could do it at the same time. That would be very convenient and it wouldn't cost you any more."*

"I think if you had that (Paypoint), you would get a lot more people joining it. Because if you've got an older person, by the time they came from wherever they stayed to the credit union, it's an effort. And you're not always going to make it so you're going to worry."

Direct debits were almost universally disliked on the basis that it would be difficult to avoid missing payments and incurring penalty charges

Most respondents with bank accounts took the view that, at some point, a direct debit failure was a near inevitability, which would then result in penalty charges from the bank. There were concerns that direct debit based channels would ultimately work against the sustainability of the relationship with the credit union, and thus access to an affordable credit line.

"I'm scared of direct debits. I've heard of so many people being charged twenty or thirty pounds when the money isn't there. I'd never do that. Never."

"One week alone I had £140 charges. I just said cancel them. Never again. That would stop me doing it, that would if it had to be direct debit."

Many respondents would agree to a loan conditional on direct debit but often in the expectation of some difficulty in funding the payment reliably

That said, when respondents were asked how they would respond if direct debits were the only payment option available, most respondents took the view that they would go with a direct debit arrangement simply in order to get the loan – albeit in the clear expectation that it would either be very difficult to manage or that some payments would fail.

"If you really wanted the loan, you would agree to anything, you'd go OK, if it has to be direct debit, then I'll go with that. But the trouble is that's more likely to go wrong if you haven't got the money when it should be there. Then you've got charges from the bank before you can sort your credit union loan back out."

"When you need the money, you'll agree to that, of course you will. Well, I'd hope I wouldn't because, you know, direct debits can get you into trouble but in my heart of hearts I know I wouldn't say anything because I would want to be getting my loan. I suppose it depends what it was for. If it was Christmas, you'd think 'I'll cope and we'll worry about that later'."

Many high risk and excluded borrowers do not have current accounts with direct debit functionality in any case

In many cases however, particularly in the case of credit excluded respondents or those whose credit problems had led to closure of a bank account, direct debits were not an option in that individuals only had a POCA account. This was particularly likely to be the case for victims of illegal lenders.[44]

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[44] Earlier quantitative research undertaken with users of illegal lenders indicated significantly higher levels of POCA accounts among users of low incomes than among the generality of residents of deprived estates. Ellison, Collard and Forster, Policis and PFRC for the DTI, Illegal lending in the UK, 2006.

There were mixed views on the appeal of opening a credit union current account

The prospect of opening a credit union current account, paying benefits into it and setting up a direct debit from the new current union account were also discussed. Switching to a credit union current account in isolation was of limited attractiveness to those with POCA accounts, mainly because they felt no need for any additional banking functionality and overwhelmingly managed their benefits in cash. There were mixed views on the appeal of a credit union current account among those who did have current accounts. Some individuals were reluctant to think in terms of moving an account on the grounds that credit unions were an unknown and potentially less reliable banking supplier. Others, particularly those who had had credit applications rejected by their current bank, felt that their account might be more valued by a credit union than by their current banking supplier.

> *"Well it's not like it's a big name is it? Like its on the high street and you know where your money is you're paying into. What happens if it goes bust, you know, like Farepak. I wouldn't like that (opening current account with credit union), I'd rather have my bank account."*

> *"I've been with my bank a long time but they still wouldn't entertain it (application for a loan). So maybe the credit union would be better. If they can see your money coming in, maybe they'd be more likely to lend to you when you ask them."*

Direct debits from a credit union current account were not necessarily any more attractive than from other bank accounts

The option of having a credit union account did not, of itself, necessarily make the idea of payment by direct debit any more appealing, though for some it moderated the risk of penalty charges being incurred[45].

Weekly payments to a local branch were liked only where local credit unions were conveniently sited and did not have limited opening hours

There were mixed views on the other payment options discussed. Making weekly payments to the branch was liked only where the branch was convenient and sited in locations which respondents would be likely to visit in any case. Where this was the case, respondents tended to prefer this option over direct debits because of the greater degree of control and discretion it would imply.

Where credit unions were inconveniently sited, borrowers were deterred by the costs of travel and the difficulty of getting to the office

Conversely, in areas where the local credit union was small, with limited opening hours, individuals who were aware of their credit union through relatives and friends, took the view that making payments via the branch could be difficult and inconvenient.

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[45] Credit unions seek to manage the challenge presented by direct debits on CUCAs in different ways, but all have measures in place to minimise the costs of default, including; lower charges than charged by commercial banks on current accounts, small scale flexi credit (intended to avoid default charges hitting customer accounts) and notifying customers in advance of potential charges being applied. It should be noted however, that, given the wide-ranging focus of the research, there was not sufficient time to explore the appeal of Credit Union current accounts or any of its features in detail.

Where the credit union was not conveniently located, individuals also tended to feel that the risk of non-payment was too high. There were also concerns around the cost of travel to and from the credit union. This was felt likely to be out of proportion to repayments or the benefit afforded by cheaper credit, with funds spent on bus fares better applied to other purposes. Those with a number of young children and the mobility impaired were particularly likely to feel this way.

> *"I'm always saying I will join it but then I'm further away, so I'd need to travel down here to come and pay it…so you would have to get a bus and that would cost you. £1 on the underground and then £1 back. That's £2 a week."*

> *"If you put £2 a week away for a year, that £100 that would be on fares to come and put £5 a week. For £100 I could buy something for my kids. That's a lot of money."*

Where the local credit union was popular, respondents pointed to long queues as inconsistent with the convenience needed in a payment channel

In those instances where interviews were taking place in locations where there was already a successful Growth Fund subsidised credit union, respondents were more diffident about the idea of paying into the branch – mainly because of the queues associated with their local branch. Here the thinking was that the hassle factor was too high and would work against keeping up regular payments.

There were mixed views on deductions from benefits paid into a credit union current account; some liked the security of knowing payments would be made

Views on deductions from benefits paid directly into the credit union were similarly mixed. Some people took the view that – as with the Social Fund – borrowers would be secure in the knowledge that the debt was being repaid. Here the attraction was, in part, the sustainability of the relationship and the notion that the borrower was "automatically" on a ladder to higher value loans and possibly even savings.

> *"You know, they just take it. So it's a lot easier. If you only got so much a week, you know, you learn to budget on that."*

> *"At least then you know it's getting paid. You've got no choice. And you know you can always fall back on them and it's (not paying) not ruining your credit…If you need it again and because you've kept to them payments, then they'll probably give it to you again."*

Some felt deductions would undermine the little flexibility available within budgets, potentially compromising spending on essentials

Some took the view that they would simply learn to manage on the reduced balance of benefits received. Others took the view that automatic deductions from benefit would compromise the flexibility that was critical to budgeting, forcing the borrower to cut back on essentials. Some took the view that the resulting shortage of funds might mean having to borrow again or more frequently to make ends meet.

> *"Nobody is knocking on your door harassing you all the time. And getting letters and that. I'm paying off my Social Fund loan off as well…so you are paying it, which is good, but you're not getting your proper shopping, which I never can anyway."*

"I'm always a bit dubious with people taking money out of your benefits sort of thing…You can't actually work around it. So you're a bit stuck when you need something."

Paying in benefits to the credit union was thought likely to involve both additional costs and inconvenience

Some individuals were also resistant to the idea of paying in benefits to the credit union because going to the credit union to pick up the balance of their benefits each week would likely involve additional costs, time and hassle. Where queues were a feature of the local credit union, this was also a consideration.

For home credit users, a home collected payment channel was an attractive option, particularly for the mobility impaired and those with small children

After the main body of discussion on potential payment channels, respondents were also asked how they would feel about a home collected not for profit credit union service[46]. For most home credit users, this was an attractive option – although, for some, part of the attraction of the credit union concept was freedom from having callers at the house. Even for some of those potential borrowers who needed credit but who were not prepared to pay commercial home credit prices, the idea of home collected credit was an attractive one. Those who were most attracted to the concept were the longest established home credit users, those with mobility or health issues and those for whom the local credit union was inconveniently located or had limited opening hours.

Some of those attracted to the home collected channel would trade off home collection in favour of cheaper credit

A small number of potential borrowers spontaneously reached the conclusion that a home collected credit service was likely to be more expensive than a branch based credit operation. When it was put to respondents that a home collection service, though potentially cheaper than a commercial loan, would be significantly more expensive than the affordable credit Handiloans concepts they had been shown, some opted for cheaper channels and lower prices[47].

"I would take the cheaper option. I would take the cheaper option every time because with that (home collection), it's easier because you know you've got to have the money ready for them but then you've got to pay their wages."

"I wouldn't want to be paying more out than I need to. If there's a cheaper way of doing it, I'd go for that."

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[46] At the time of writing, the feasibility of setting up a not for profit home credit service was being explored in a project sponsored by the Joseph Rowntree Foundation, *Not for Profit Home Credit; Building a Business Case, Kempson, Whyley, Ellison and Jones - Forthcoming 2008.*

[47] Quantitative data consistently suggests however, that a large majority of home credit customers actively prefer home collection over remote methods such as direct debits. That said, home credit lenders have not offered a choice of channels nor any prospect of a reduced price of credit for lower cost remote collection. The business model rests in part on achieving a critical mass of round density.

For other less price-sensitive respondents, convenience and the personal touch outweighed price considerations

For some people, usually those most wedded to the home collection service and those with reliable agents, older people and some of those with mobility issues, a home collection service offered the best of all worlds. For these respondents, in the trade off between cheaper credit and fit with service needs, convenience, the personal touch, accessibility and a familiar model were more important than cost. These respondents tended to be those who were least price sensitive in any case.

> *"Now that would be the best of both worlds, wouldn't it? I'd think they'd (credit unions) do very well if they did that (home collection)."*

> *"I can't be bothered. I just like the collector to come and get it and that way I know it's paid and I don't have to worry about it. If they collected the payments that would be best for me."*

4.4.6 Perceived benefits of access to third sector lending

The profoundly excluded thought in terms of gaining access to basics which others took for granted

For the entirely credit excluded, the prospect of gaining access to an affordable credit source was perceived in most cases as a highly desirable and even potentially transformational, development. These individuals thought in terms of being able to live a "normal" life, by which they meant gaining access to a basic standard of living which others took for granted. These were individuals who had done without basics such as a fridge, washing machines, hoovers, beds and furnishings and were among those who were least capable of negotiating the social services and benefits system.

> *"It would change my life. I'll get my washing machine at last – re-conditioned one, will do me. Maybe a hoover too. No more sheets in the bath and drying on the door all week and no more dust. Maybe even get a carpet for the front room."*

> *"Not relying on my mum or my family. Get me some independence. They mean well. They're only helping me. But it makes me feel like a child and I'm thirty five years of age. A life-line."*

> *"Do some of the things that other normal people do. Maybe have a wee holiday. Buy the grandkids a present or two. Ordinary stuff like ordinary people."*

Users of high cost credit thought in terms of being able to retain more of their limited incomes and thus of an enhanced standard of living

Those respondents able to borrow from the high cost lenders were glad to have access to credit. Nonetheless, they were also conscious that payments on debt service added to the stresses of living on a low income and were very much aware of the cost they paid for credit. Debt service, not just on credit agreements but frequently also on rent arrears or other non-credit debt, often represented a significant proportion of many respondents' budgets. In the minds of the respondents, access to affordable credit potentially represented more money to spend each week, a better standard of living and less worry about which of many competing priorities to service.

> *"I should imagine if we were paying back a lot less like that, it would make quite a bit of difference because I would probably be able to save and there would be little*

things each week extra that we normally don't have. If you're not paying as much out then obviously…(implication is that they would be better off)"

"I'd have more money through the week obviously for the things I need at home. So it would make a big difference to me."

Access to affordable credit was perceived as having the potential to reduce the prevalence of illegal money lending on estates

Respondents saw access to affordable credit from the credit union as benefiting individuals and communities in a number of ways. In those communities which were plagued by illegal money lenders, one of the most common responses to the credit union instant loan concept was that it was perceived as providing a potential alternative to the loan sharks operating on the estate. Combating illegal money lenders was itself also seen as likely to have a knock on effect on drug dealing, anti-social behaviour and crime more generally.

"It would be a good thing for people who are involved with these money lenders round here. It would stop them in their tracks."

"If I got a loan of them (credit union) then I don't think I would go back to him (money lender from whom regularly borrowing £20 – 50 on weekly term)."

"I mean, now, you're petrified of the money lenders. It was one of the biggest mistakes I ever done but that was my only choice. But this (credit union loan) would be a better option…They're not going to come to your door…You're not going to be under that pressure."

Victims of illegal lending perceived affordable credit as potentially offering the opportunity to acquire some control over their finances and their lives

Even though many of the users of illegal lenders felt they were unlikely to qualify for a loan from a credit union and, in some cases, could not see how they would get away from their existing relationship with an illegal money lender. They felt that access to affordable credit – or at least not having to find the money to pay the illegal lender each week – would not only relieve a continual source of anxiety and stress but, more importantly, lay the ground for regaining some control over their budgets – and, by extension, their lives. Absence from worry was seen as likely to be the key benefit but being able to get away from the constant debilitating and humiliating cycle of "tapping" friends and family for small sums was also perceived as a major attraction. Victims thought in terms of being able to lead a "normal" life – by which they frequently meant being able to afford essentials such as adequate food or heating or having a degree of independence from family. Others thought also of being able to break out of their social isolation.

5.0 The credit union experience and new-to-credit-union borrowers

This chapter explores the experience of new-to-credit-union borrowers taking on their first credit union loan under the Growth Fund scheme. It also covers that of credit-excluded applicants who have been refused a loan by a credit union. It examines the triggers for approaching the credit union, the experience of the applications process and of repaying the loan and building a relationship with the credit union. It also explores the experience of those who ran into problems with their repayments and examines the outcomes of these difficulties. Finally, it explores how far credit union borrowing has acted as an alternative to other forms of credit.

5.1 Triggers for approaching credit unions

New-to-credit-union borrowers with Growth Fund subsidised loans appeared to be less profoundly excluded and lower risk than the sample as a whole

The new-to-credit-union borrowers taking on Growth Fund subsidised loans included borrowers from both small and large credit unions. The sample included those who were paying by deduction from benefits paid directly into the credit union and those who had arranged to pay by direct debit from their bank account.

On the whole, these new-to-credit-union borrowers had less history of credit problems, and any background of arrears was less serious than was the case with those with credit problems in the sample overall. None had any experience of illegal lenders, either within their own household or their social networks, though some were aware of illegal lenders operating in local neighbourhoods.

The immediate trigger for action had typically been friends or relatives in similar circumstances to their own obtaining a loan from a credit union

Those interviewed had approached the credit union on the basis of information about instant loans gleaned from their social network. None had any recall of leaflets or marketing activity from the credit union. They had little understanding of who might qualify for loans or what the acceptance criteria might be, so had often been nervous when considering or making an application.

> *"I went because I'd heard about the loans that you could get within a couple of days of applying. It was from that lass at school. One of the lasses at school said, 'you go down there and you'll get a loan.'"*

> *"My sister got it. And I thought, 'If she can, go for it!' you know."*

Judgement on the potential for obtaining a loan tended to be based on whether others whom they considered to be in similar circumstances had been successful. Equally, prior to approaching the credit union, understanding of the credit union offer and pricing was mediated by the reported experience of family, friends or neighbours who had successfully obtained – or been turned down for – a credit union loan.

The key findings from interaction with those with some experience of the new credit union loans were firstly that access to credit was rapid, secondly that credit was available to people on low incomes and on benefits and, rather less strongly, that credit was cheap. Secondary findings were that credit union staff were friendly and approachable, but that offices and staff were also so busy that applications involved long queues or delays before appointments could be made.

5.2 Joining the credit union

New applicants had largely found credit union staff friendly, approachable and supportive and the application process straightforward

It would appear that, almost without exception, those approaching credit unions for a loan had found staff friendly, the application process relatively straightforward and staff supportive, both in making the application and explaining the loan and credit union concept and pricing.

> *"They are like a bank but a friendly bank. They made me feel at ease."*

> *"It wasn't as bad as I was expecting. I was dreading it but they were OK. Friendly and not patronising, which was maybe what I was expecting. There wasn't any need to have worried."*

There was some criticism of delays and process inefficiencies

The main criticisms of the application process centred around delays, processing inefficiencies and a lack of privacy when discussing loan applications. In some cases, where the credit union had been operating a system in which applicants needed to phone to set up an appointment, there had been some weeks to wait before an appointment could be arranged. In others, individuals had queued – for times reported as ranging from half an hour to close to an hour – before being able to speak to a staff member about the possibility of taking on a loan. In some instances there was a need to return to the credit union and wait in the queue a second time, either because further information was required or because inappropriate or inadequate proofs of ID and residential address had been supplied.

> *"Every time you walk past there's loads of people queuing, loads of people in there. I mean sometimes you walk past and they are queuing outside. It's just a pain in the bum queuing."*

Lack of privacy was also an issue for some, particularly those who had a background of credit difficulties that they needed to disclose

The lack of privacy for discussion of personal affairs was an important consideration in that individuals were not only talking about current financial or borrowing arrangements but frequently also about previous credit problems.

> *"I just can't believe there's people stood there, you know, hearing everything that you're talking about."*

Once loans had been agreed, borrowers reported rapid access to funds

Those successful in obtaining first time loans also reported that the funds had been available relatively quickly once the loan had been agreed, an important consideration to most borrowers whose yard-stick for comparison was frequently the rapid delivery of home credit loans.

Proof of ID and address hurdles appeared too onerous for some applicants

ID and address hurdles were an issue for a number of those whose applications had not been successful. This was a particular problem where individuals were living with

parents or friends – and so were unable to produce utility bills – or where they were unable to provide proofs such as a driving license or passport. Only one of those in the sample had a car and very few had a passport, having no opportunity to go abroad. In some cases, considerable ingenuity had been employed in order to obtain collateral to prove ID.

"I only had utility bills that week and they told me to bring them back in with a bank statement. Then when I did she told me I couldn't use them bills, they were the wrong bills, to bring some more bills in. So I just give it up as a bad job because I didn't think they wanted to help me."

"They were asking for documents that they needed and half the stuff I haven't got. It's like proof of your benefits. Everything goes in the bank account see, so I ain't got proof. It's hard to take proof down if you haven't got it. Like utility bills which I don't really get much of anyway because I got meters put in. Like stuff with your name and address on. Like passports. I ain't got no passport. Anything with a photograph. I ain't got none of that. So I had to go to housing benefit to get a letter from the housing to take in.

Potential borrowers had been so focused on obtaining a loan that they barely registered other aspects of credit union services

On prompting, individuals recalled staff talking about savings and about the availability of money advice services. None mentioned these services or saving spontaneously. Applicants appeared to have been so focused on the loan for which they were applying that they had barely registered other aspects of the credit union offer.

"They did tell you all about that. The savings and that and they can help you with your money. But I wasn't there for that really. I was just interested in getting the loan."

"I couldn't tell you actually (whether CU offered services other than loans). She did say about saving but I can't save so I wasn't really paying so much attention to that side of things".

5.3 The experience and outcomes of refusal

Those meeting refusals were not entirely clear on the reasons for their refusal

Those meeting refusals appeared to have little understanding of the reason for their refusal. Several suspected either that they had failed a credit check or that a credit check had revealed more adverse history than they had disclosed. Others who had failed to provide the appropriate ID and so had not got as far as making a formal application were unclear about what was in fact required in the way of documentation if they were to try again. In a couple of cases they interpreted the explanation of their paperwork being inappropriate as veiling some other reason for refusal.

Those who had been refused were disinclined to try again – largely because they had found refusal humiliating

None of those who had been refused was inclined to try again – despite their new awareness of credit union pricing and the advantages of borrowing from the credit union. This would appear to be primarily because individuals had found refusal a humiliating experience, particularly where it had occurred in public.

"They might laugh me out of the shop this time (if re-applied). It's dead embarrassing though because loads of people are stood behind you and it's not very private."

"I'm a very emotional person and I just wanted to go into a hole and cry because I don't like being humiliated in front of people. There were loads of people behind."

Offering money advice as an alternative to credit was ill received and much resented

Those offered money advice or savings facilities as an alternative to borrowing in the wake of a refusal were unreceptive and indeed tended to be actively annoyed by the offer of alternative services when they had clearly been seeking a loan. This was in part because they were overwhelmed by the rejection at the point of refusal and in part because they did not see advice or saving as relevant or attractive when their immediate problem was a requirement for cash.

"It was the fact that they had just refused you a loan and then they kind of went on about the saving scheme and advice and that. And you then you just wanted to tell them to stick it where the sun don't shine."

"If they'd done that about the advice and the saving scheme before the actual refusal then you might have taken it, you know, and gone 'I'll go that way then' but actually applying for a loan and then getting knocked back, it's embarrassing, you know, it was kind of in reverse."

Unsuccessful applicants had turned to high cost credit as an alternative

All of the respondents who had failed in their applications to the credit union had since taken on alternative high cost borrowing in the run up to Christmas, in the form of both home credit and mail order, in some cases in combination.

"I was pig-sick (at being refused CU loan) – cause my friend got one and I can't see the difference. Far as I can see we're the same. Got a Provident loan in the end. He (agent) always tries to help you out at Christmas but I'll be paying back £800 on that."

"I'll probably be doing the same-old, same-old. Get a Provi loan for Christmas. Would have been nice not to do that this year. But I guess that's just my bad luck. I expected to get knocked back and that was what happened."

5.4 Understanding of credit union pricing

The total cost of credit union borrowing was well understood but other aspects of credit pricing were not as well grasped

Credit from the credit union was seen as very cheap by comparison to all other options that might be available. Borrowers were able to cite the total cost of their credit and tended to compare this spontaneously with that that applied to home credit. Interest payments were often cited as being 2% – but most did not appear to appreciate that this rate was a % per month rate and none – either spontaneously or on prompting – translated the pricing into an equivalent APR. As a result, loans from the credit union were sometimes interpreted as "no interest".

"I got £100 the first loan and I had to pay £102 back. Or £105 or something like that. So obviously £5 is better than £50, which it would have been extra with

anybody else…I thought it were good, definitely, but I didn't know (cost of credit) definitely until I'd actually applied for it. It said on the slip that I was signing for."

"It's £14 a week now for the £500 one. I pay back £548. If you had got that one from Provident, you would have been looking at least £800 back. To borrow £500, you would have to pay £800 back. I would never go to Provident or anything like that now. Never. Not any more."

Few borrowers had any appreciation of the term of the loan which tended to flatter home credit lenders when comparisons of weekly payments were made

It was striking that none of the borrowers were able to explain even approximately the term over which the loan would be repaid. Most recalled that they had been told how many weeks they would pay and felt sure that they had been given paperwork describing the terms and conditions of their loan, but this element of the pricing equation was clearly so far from the front of their mind that none was able to cite the number of weeks or approximate number of months over which repayments had to be made. All knew exactly how much the weekly repayment was however, not only on the loan they had taken out, but sometimes also on larger loans which they hoped to take out in the future.

The syndrome underpinned comparison of credit union pricing with that of the home credit lenders, flattering perceptions of home credit pricing. As a result, although individuals tended to be aware of the total cost of credit for the two product types, home credit lending could nonetheless be seen as being as – or even more – manageable than credit union borrowing, particularly when the greater flexibility of home credit repayment was factored into thinking.

5.5 The experience of different payment channels

Actual experience of payment channels among the new-to-credit-union borrowers appears to confirm the expectations and concerns voiced by the high risk borrowers with whom the concept was explored, as described in Chapter 4.

Prospective borrowers uncomfortable with proposed payment channels had not necessarily appreciated that other alternatives might be available

All of the new-to-credit-union borrowers had the impression that the payment channel proposed (whether direct deduction or direct debit) was simply the way that the credit union operated. Even where potential borrowers were uncomfortable with the channel – as was the case with direct debits particularly – none had queried it or had the confidence to ask whether an alternative payment method might be available or acceptable.

Those paying benefits to the credit union and having payments deducted at source valued the security of knowing payments had been made

All of the new-to-credit-union borrowers interviewed in proximity to one large credit union had contracted to pay a part of their benefits into the credit union and for payments on their credit union loan to be deducted before the balance of the benefit concerned was paid to the borrowers. These borrowers valued the security of knowing that repayments were being made and that they were not subject to temptation to divert the funds to other priorities. Part of this thinking was that the

relationship with the credit union, and progress towards larger loans, was more sustainable as a result.

> *"Yeah. It's so much easier because you don't have to mess about going up to the Post Office or going somewhere else to pay it at a PayPoint. And you can't think, 'Well, if I don't pay that this week, then I'll do this or that'. But you don't because you can't. It's just easier, isn't it?"*

> *"I'm on my £500 loan now. I wouldn't have got that far if I hadn't not seen it every week. If you don't have it in your hand you can't use it for anything else."*

Views on the impact of deductions from benefits paid to credit unions were mixed with some coping and others finding themselves under pressure

Opinions were divided however on the impact of deductions from the benefits paid into the credit union on the manageability of budgets. Some felt that they had got used to managing on reduced receipts. Others, particularly where they had other commitments, felt under considerable pressure, having to economise in other areas and finding it difficult to fund items they would otherwise have regarded as priorities.

> *"I'm not sure. It's good because you can't miss. But because you can't miss, you're borrowing from someone else every week, because you're short, so that's not good."*

> *"It's OK as long as nothing goes wrong. But things do go wrong. And for me, I seem to be short every week somehow."*

Payment problems had arisen for a number of those on direct debits for a variety of reasons

The experience of those who were making payments by direct debit was more mixed and a number had run into problems with sustaining payments. These difficulties had arisen for a number of reasons. In some cases, the credit union would appear to have been suffering from some resource or capacity constraints in that that there was some time lag between obtaining the cash and setting up the direct debit. This had resulted in arrears building up, which borrowers then had difficulties in accommodating. In other cases, circumstances had changed resulting in an income shock so that funds were not available to meet direct debits as they fell due. Alternatively, competing priorities had taken precedence over loan repayments so that it was not possible to leave sufficient cash in the bank to meet the direct debit. Where this had resulted in penalty charges, problems were exacerbated.

> *"Well they were going to send this form out to the house. And my wife kept saying 'Well they've never sent nothing out.' I says, 'I might as well just take it down and pay ourselves.' And she says, 'I thought you had to wait for this form like?'…And in the end, we just needed the money and they still hadn't taken it."*

> *"Well he was put on short time and then I wasn't working so we just didn't have any money going in the bank account so it didn't get paid and it started from there. We had bank charges and it just went downhill and we didn't have any way of sorting it."*

> *"We had to have the car fixed so he could go to work. Because if he don't go to work, we ain't got nothing coming in. So that was what happened the first time and then I didn't get the money in in time and so we had bank charges two months running and that kind of ate up my money so I just cancelled it (the direct debit) so we could sort ourselves out."*

5.6 The experience of credit difficulties and arrears recovery

Those running into difficulties reported that credit unions were slow to respond - with initial communications seen as a low key reminder

Those running into credit difficulties reported some lag between arrears arising and the credit union responding to missed payments. Respondents reported letters urging borrowers to get in touch if they were having problems and asking them to make good missed payments. These were interpreted as a reminder – and a signal that the credit unions were aware of the problem – but not necessarily as a call to action. The tone of the letters appears not to have been sufficiently urgent for borrowers to divert funds from competing priorities or to fear that the credit union was about to take recovery action.

> *"I've got absolutely nothing bad to say about them, like. I mean they've been really patient because I've missed them for a good four months like, you know. And I think I've never had any phone calls. All I got was a letter. So they've been very good I think."*

> *"They've been patient like, you know. They haven't been mean and demanding. Just letting you know, like reminding you…Then nothing happened, like, for another couple of months until they just sent me a letter out just explaining, could I ring them up."*

Those who got in touch with credit unions reported sympathetic handling of repayment problems but others ignored communications

Those who got in touch with their credit union all reported that staff had been understanding and supportive about difficulties with repayments. However, only a minority of respondents appear to have communicated with the credit union at an early stage of their payment difficulties. Others had ignored a number of letters and allowed the debt recovery process to progress to an advanced stage, including court action and the arrival of bailiffs.

> *"I mean, really you know, to my way of thinking, if it was me lending money to people, I think I would have sent letters out and I thought I would have phone calls, but I've had nothing like that…After three months of not paying I went behind the counter and asked the lady whether I could see someone…and when I saw this person behind the counter, she was really just fantastic, you know."*

> *"Well thing was, I just got myself, uh, a Provident loan as well...And with the credit union loan and the Provident loan, I just couldn't make the payments, so, um, I basically just stopped paying (the credit union loan), just ignored them letters."*

Having missed one payment to the credit union, the tendency was to let others slide to the point where hurdles to recovery seemed too daunting

Borrowers in difficulties had registered that the credit union was potentially sympathetic but were reluctant to get in touch because they were not in a position to make good missed payments and did not want to negotiate a payment schedule they could not meet. Having missed one or two payments, the tendency was then to let further payments slide, because it seemed too difficult to recover the situation.

> *"I should have doubled up the next time (having missed a payment) but it wasn't possible because they have birthdays right close together and I was putting*

money away for her school trip and it just got to the point where I was embarrassed to go in and talk to them about it because I knew I didn't have the money."

"I'm just afraid they are going to want me to catch up with what I've missed. So I've been putting it off and there doesn't seem much point in paying back now because they're not going to be very impressed with me anyway."

Where borrowers had payment difficulties with multiple lenders, the tendency was to pay the lender pushing hardest for payment

Where borrowers had payment problems with multiple lenders, as was often the case where circumstances had changed or where borrowers had taken on more credit than they really had the capacity to serve, the relatively relaxed tone of the credit union communications were contrasted with the more immediate pressure to pay from other lender types.

"She was on the door, like, wanting her money so that was a bit different (implication is to the credit union)."

"I've got to pay them (Brighthouse) anyway because I don't want to lose my stuff. It's been hard paying for that. And the credit union didn't seem that fussed. I mean, they weren't writing nasty letters or anything. 'We're going to take you to court'."

By comparison to the home credit lenders, credit union pressure was felt to be less immediate and credit unions were thought less likely to revive credit lines

The home credit lenders not only had greater presence – in that they called at the door, but were also more likely to bring timely pressure to bear to prevent arrears building up. Part of the reason for favouring home credit over union payments was also the conviction that, given the repayment problems, no further credit was likely to be forthcoming from the credit union. From the delinquent borrowers' perspective therefore, payments to the credit union could be seen as dead money, better spent on maintaining a potentially live home credit relationship. The home credit lenders were frequently reported as holding out the prospect of further loans for Christmas if repayments were kept up for a minimum period, with this being a key motivating factor in keeping up payments.

"Well, they (credit union) haven't said anything, but I just get the impression that they wouldn't (lend again). I haven't actually been in to see them or anything like that, you know. I just thought that I wouldn't be able to get one now."

"Obviously I would like to get more loans sometime so you're not going to get any more from them (credit union) so you are paying back and paying back and it's not going anywhere because you have messed up. With the Provident, you will probably get your loan back if you keep paying for a wee while even if you did miss for a while."

5.7 Use of other forms of credit alongside credit union borrowing

A mixed picture with some new-to-credit-union borrowers having no other credit options and others having substantial high cost credit commitments

The picture of use of other credit products alongside credit union loans was mixed. A minority of the new-to-credit-union borrowers had no other credit options. Some of

those who had borrowed from the credit union had had other – high cost – credit commitments at the time they had taken on the loans, primarily to mail order catalogues and home credit lenders. Individuals had however not necessarily been entirely candid in describing the extent of their other commitments to the credit union, for fear of prejudicing their case for a loan. In some cases, these commitments were significant and could be long term – as in arrangements made with rent-to-own retailers.

Some borrowers had taken on parallel high cost loans in an effort to maximise available credit lines

Some new borrowers, including some of those who were coping successfully with their credit union loan, had taken on a high cost loan subsequent to borrowing from the credit union. In some cases, this was a matter of giving in to temptation, in that they had taken on another loan when a previous one finished and the agent had offered further credit. In others, this was part of a conscious strategy of maximising available credit lines and maintaining existing supplier relationships. This was a particularly important consideration in the run up to Christmas, just beginning as the fieldwork took place.

> *"It's good to have them (Provident) to fall back on. I like to keep them all going, me. That way you're covered when you need something."*
>
> *"I'm going to do my holiday with the credit union. I'm going to save towards that and all. But Christmas is going to be the catalogue and Provident."*
>
> *"I don't like to have all my eggs in one basket. That way if one goes bad, you're still OK and you can get what you need when you need it. You've got to be a little bit sussed and plan ahead. You don't know what is going to be round the corner."*

Some of those struggling to repay credit union borrowing had taken on new high cost credit to accommodate Christmas spending

Some of those who had run into difficulty with repayments of their credit union loan had subsequently taken on loans from a high cost credit supplier. In these cases, the motivation had been that they would otherwise not be able to afford Christmas spending.

> *"It's stupid I know. Because the credit union one is no interest and I should have got that one sorted out. But its Christmas isn't it? What can you do? I rang her (agent) up and she was, like, OK. I'll bring it round. And she was good as her word."*
>
> *"It's easier, isn't it? (borrowing from home credit lender) You've got to have money for Christmas. I was a bit surprised she give it me but that was a big load off my mind. You can't let your kids down at Christmas, can you? I'll have to sort out the other (credit union loan) later. If they're still speaking to me. Worry about that another day."*

Some new to credit union borrowers intended not to renew existing high cost credit lines and planned to source future borrowing from the credit union

Some of those borrowing from the credit union had not taken on any other borrowing outside of the credit union. In some cases, this was because individuals were generally reluctant to take on credit unless they really needed to. In others, individuals had taken the view that they would run down other higher cost borrowing and seek to borrow instead from the credit union in the future. Those taking this view

were overwhelmingly those who had not encountered payment problems, in some cases because their payments had been deducted direct from benefits.

> *"If I have a choice it will be the credit union every time. I'll never be borrowing from Provident again."*

> *"I only take credit when I really really need to. So I will take another loan from the credit union when I need it. But only the £250. I don't want £500. I don't need Shopacheck any more."*

5.8 Prospects for making a sustainable transition to affordable credit

The most capable and confident were most likely to think in terms of gradually paying down high cost credit and moving definitively to the credit union

Some of the new to credit union borrowers, broadly the most capable, less pressured and those most confident of being able to keep up regular payments, saw themselves as gradually paying down high cost borrowing and substituting affordable credit loans.

> *"I've still got a way to go but I'm running it (home credit) down. I've still got a couple big loans but my plan is to pay these off and then that's the end of it. I'll borrow from the credit union in time for next Christmas and work it like that."*

> *"I like her (Shopacheck agent). She's as good as gold and she's been coming to the house that long, she's like a friend. But it's a lot of money you pay back on top. So really there's no contest. I might keep her on with a small one but I'm going for the credit union from now on. They'll lend more as well."*

For those coping well with their loan, the prospect of progressing to larger loans was the key motivator in making the transition to credit union borrowing

Among those who felt more confident about paying their credit union loan, one of the most powerful motivators for making a definitive transition to affordable credit was the prospect of taking on larger loans at a relatively low weekly outgoing. Most of the new-to-credit-union borrowers had taken on initial loans in £100 - £350 range. Those who had been successful in repaying their first loans, and had moved on to a second higher value loan, were strongly motivated to continue borrowing and hoped to take on larger value loans still. For those who had their payments to the credit union directly deducted from benefits – in several cases struggling with credit commitments elsewhere – one of the key advantages of paying by the direct deducted route was that it set them up on an escalated progression towards taking on higher value loans. Some respondents with several high cost credit commitments even thought in terms of ultimately being able to borrow sufficient to pay off their outstanding high cost debt.

> *"Well the thing with this is, with this (credit union loan) you are on your way, aren't you, to being able to borrow maybe a £1000, maybe more than that even. Now with that you could buy your sofa or whatever with the cash and go where you want to get it. Your money is as good as everyone else's."*

> *"What I really like about it is they (credit union) will maybe let you have more than you could get from her (collector). Not straight-away, like. But if you stick with it. That's on my mind as well."*

Some borrowers were concerned that they would not be able to maintain regular payments and that this would compromise the credit union relationship

Not all borrowers were confident that they would be able to maintain the relationship however, mainly because they felt that they were unlikely to be able to keep up payments reliably and were unsure about how the credit union would respond. There were doubts also about whether the credit union would advance further credit if there had been missed payments on a previous loan. Where there were background social problems, new members were particularly doubtful.

> *"I'd like to think so that I'll be getting a bigger loan off them next time but I'm a little bit worried that I will be short when it's time (for the direct debit). That's a little bit of worry at the back of my mind."*

> *"With my state of health, with my depression and that, I'm ashamed to say it but I know it, the money's not going to be there to pay them back or he'll have drunk it. With the best will in the world, it'll be sure to xxxx up."*

> *"Just relaxing. Not having to be nice to people because you've got to tap them (for money). Just being a bit independent. Being your own person (describing the difference her loan has made)…but the big worry is what would happen if you couldn't pay? Because you couldn't pay them every week. Something would come up. It could all disappear and you'd back at square one."*

Very few had succeeded in saving with the credit union

It was striking that few of the new-to-credit-union borrowers had succeeded in saving alongside their credit union borrowing. While many aspired to save, if even on a modest scale, most simply did not have sufficient slack in their budget to do so, particularly where they still had other credit commitments.

Those who felt they might struggle to maintain their credit union payments could see maintaining relationships with a high cost lender as "insurance"

How far borrowers from high cost lenders saw themselves as likely to make a sustainable and definitive transition to affordable credit depended to a large extent on whether they felt confident about being able to keep up regular repayments. Where individuals were on tight budgets and had a long history of credit delinquency or an entrenched pattern of irregular payments on home credit loans, their expectation tended to be that they would struggle to meet the credit union standards on payment regularity. Against this background, they felt that it might be difficult to keep the relationship going in the long term. Some individuals took the view therefore that maintaining a home credit relationship would act as an insurance policy against the credit union relationship breaking down.

> *"The thing is you know you can always fall back on the Provident when you need it. It's nice to know that they're still there if you need them."*

> *"You'd like to think that you could run it down (Shopacheck) and just go with the credit union. But I know myself, I know that I'd be ringing them up when I needed something. And the credit union might not be OK when you need to miss, you know. Which would make it difficult."*

> *"I hope so. I hope that nothing does go wrong and I can keep up them payments (to the credit union). But you never know. Sometimes it is just beyond your control and there is nothing you can do. If I'm really honest, I've got my doubts (context is whether respondent can stay in the with credit union and not go back to Provident)*

– In an ideal world I wouldn't need Provident, but it's not an ideal world and I like to have some back up."

Despite some doubts about the manageability of borrowing, affordable credit was seen as likely to enhance both the ability to provide and quality of life

Overall, while there were some concerns about the long term manageability of credit union borrowing, all of the new-to-credit-union borrowers who had succeeded in maintaining the relationship saw affordable credit in a very positive light, as good value and as having enhanced their quality of life and standard of living. Those who had previously been credit excluded felt that they had been empowered as individuals, with the credit union giving them the opportunity to better provide for themselves and their families.

> *"You know you're paying back what you've actually lent…You can make sure you've got everything you need with your bills…Do a proper shop."*
>
> *"I feel more independent of my family, do you know what I mean? I don't need to depend on other people. Careful what you say to them all the time…You can breathe again, maybe even give the kids a wee holiday next year."*
>
> *"This Christmas, you know, I won't have to worry. That will be the first time. Normally I would have been panicking about this time and worrying about how I am going to get that money together. It's a nightmare every year."*
>
> *"The credit union. It's brilliant. It's a life-line. It's a step up".*

6.0 Segmentation of high risk borrower types

Discriminating between different borrower types and segmenting the market will be key to supporting and encouraging victims of illegal money lenders and those at risk of using illegal moneylenders to take up alternative sources of credit and in transitioning high risk borrowers more generally to affordable credit. This section describes a qualitative segmentation of high risk borrower types and their broad characteristics and potential needs in terms of treatment strategies. In describing the various borrower types, we have provided an indication of whether the segment is likely to be larger or smaller. A reliable sense of scale would require quantification however. It is important to bear in mind that the segmentation described is a tentative one, based on qualitative insights. By its nature (consisting of volunteer respondents) the sample is not necessarily representative nor complete. It will be less likely, for example, to include the most cavalier non-payers who would appear in a nationally representative sample of low income credit users. The segmentation is intended to provide deeper insight into the differences between sub-sets of borrower types rather than as a draft of the robust quantified segmentation that we discuss later in section 7.0 on the policy implications of the research.

The sample contained a wide spectrum of high risk borrower types, ranging from those who were totally credit excluded to those with excessive use of multiple sources of high cost credit. Similarly, the research revealed both constructive applications of credit and patterns of credit use which were clearly compromising standards of living and quality of life, most notably in the case of users of illegal money lenders. Some potential borrower types would appear much less challenging to reach and serve than others, while others would seem simply too poor to borrow or borrow further. Undoubtedly there are also some borrowers who, for whatever reason, are unwilling or effectively incapable of repaying debt or simply so high cost to serve as not to be viable customers of any social business. A quantified segmentation would seek to identify these consumers as well as to segment customers who can be served into identifiable categories of risk.

We identified six key segments of high risk and credit excluded borrowers:

- Credit-resistant, modest-needs managers
- Traditional high-cost credit copers
- Aspirational heavy credit users
- Mainstream-experienced, serial delinquents
- Chaotic credit recyclers
- The profoundly excluded

Of those who could be candidates for transition to affordable credit, some segments represent the proverbial “low hanging fruit” which could be served relatively straightforwardly with existing models and service practice, while others would require a significant degree of support and co-ordination between agencies and potentially even some adaptation of certain aspects of third sector lenders’ current modus operandi and service approaches.

Some segments would appear to represent relatively low risk – being excluded but not unreliable – while others are significantly higher risk than those who usually approach credit unions or CDFIs. Equally, there are segments that would appear to be relatively large – such as those coping effectively with high cost credit, albeit with more payment irregularity than third sector lenders are used to – while others, including those with a likely greater incidence of illegal lender use, which are likely to be much smaller. There are also some segments where there is a welfare and social benefit case for extending

affordable credit but which would be unlikely to be served within the normal financial parameters of a social lending business. Clearly the latter case has a series of implications, not least that of how any service catering for such borrowers might be funded.

Understanding the differences between the various groups and the issues raised for each is however key to operational application and to prioritising and focusing the effort to transition high risk borrowers and victims of illegal lending to affordable credit.

6.1 Credit-resistant, modest-needs managers

This segment is unlikely to be made up of heavy credit users but would nonetheless welcome access to affordably priced modest loans to help fund Christmas presents or major purchases. Individuals are likely to be strongly motivated to make small scale savings to enable some discretionary spending and provide the comfort of a safety net.

Key characteristics

- Strong bias to older women and the long term benefit dependent
- Disability, impaired health can be a factor
- Budgets relatively stable and predictable but very tight
- Live within means, no indulgences:
    - Careful shopping
    - Second-hand furniture, re-conditioned equipment, charity shop clothing
    - Modest gifts for children / grandchildren for birthdays, Christmas etc. often paid for by saving over time and degree of sacrifice elsewhere
    - Frequently economise on both food and utilities
- Social isolation often a feature – cannot afford participation in / travel to social events, family celebrations
- Strongly resistant to high cost credit on grounds that poor value and cannot afford repayments:
    - Catalogue credit first choice (cost of mail order credit not fully understood)
    - Some very occasional home credit use where no other option
    - Not likely to be tempted by illegal money lending, though may be part of history

Case study - Credit-resistant, modest-needs managers

Dawn

- Early fifties, divorced after long marriage
- Incapacity benefit, significant health problems
- Prior to divorce stable finances, orderly management of credit commitments which paid by direct debit
- Post divorce debt problems, lost access to banking, adverse credit record, became involved with illegal lenders and clearly scarred by the experience
- Lives close to family, significant child-care role for grand-children
- Very modest means and lives strictly within limited budget
- Frequent self-denial, fuel poverty a feature
- Only credit use for essential large purchases through relative's catalogue

The role of credit

A highly constrained lifestyle with frequent self-denial – small-scale credit is used only for absolute essentials

This segment have learned to budget within their means, although budgets can be de-railed by unanticipated expenses. The prevailing mentality on finances is very much careful management, stringent economy and self denial. Credit is taken on occasionally and only for absolute essentials. Some have arrived at this point having experienced debt problems in earlier years and are determined not to expose themselves to the associated worry and stress again.

> *"You get yourself into such a state (with debt). It's really nerve-wracking. And you're living a nightmare. But I'm past all that. It's in my past…Now, as long as you've got food you can sleep at night…So now, just the catalogue, that's through my niece, but she'll only let you have a certain amount, what you can afford…My washing machine broke so I got a new one and I'm halfway through paying that. I pay her weekly and she pays it every month…But not for clothes, oh no. There's the charity shop…My daughter understands with the (grand)kids, maybe four or five weeks before Christmas, I put £3 or £4 away. She knows I've not got it…If it was a christening or something like that, I wouldn't go to it if I couldn't afford to go, some things I just can't go to."*

Perceptions of the affordable credit difference

Affordable credit represents the prospect of a savings safety net and a modest family holiday, both of which otherwise are seen as out of reach

For this segment, access to affordable credit is perceived to mean being able to afford items and experiences that others take for granted and potentially even a degree of enhanced security from building up a savings safety net.

> *"It would make a big difference to me because I would like to go on holiday. A caravan or whatever. I would like to take the (grand) kids. And not worry about what we've got to spend and split it up on a daily basis. And enjoy it. Just to enjoy things that other people enjoy. A wee bit of pleasure."*

Treatment and service needs

These will be low risk borrowers likely to be conscientious payers, though there may be some risk of payment gaps arising from ill health.

Awareness of credit unions is low, as is confidence with institutions. It would seem likely therefore that such individuals would need some form of outreach or proactive communication to build awareness and encourage application to their local credit union. Individuals are likely to be cash managers, with banking facilities most likely POCA rather than current accounts. Direct debits are not likely therefore to be an appropriate payment vehicle. Repayments via Paypoint in the local Post Office would provide best fit with budgeting patterns and avoid the mobility/ health and cost issues likely to arise from making visits to a branch.

6.2 Traditional high-cost credit copers

This group appear to represent a large segment of potentially active, long term and relatively reliable credit users and are potentially one of the key groups to reach in the effort to scale up the third sector.

Key characteristics

- Bias is to family households, many single parents
- Budgets tight and closely managed
- Credit seen as the only means of acquiring major items of furniture, consumer electronics and meeting children's ambitions for Christmas
- Effectively continuous cycle of ongoing credit agreements
- Catalogues, Social Fund, in some cases credit union, used in parallel with home credit to maximise available credit lines
- Conscious of high cost of credit and credit decisions carefully considered
- Relatively conscientious regular payers:
    - Nonetheless also not infrequently miss or part pay in order to prioritise other spending
    - Collection channel and agent relationships underpin payment regularity
- Savings in form of Christmas clubs, formal and informal
- Ready access to credit so little risk of illegal money lending

Case study - Traditional high cost credit copers

Tracey

- Late thirties, married, three children, part time cleaner, husband in and out of insecure, low wage work
- Effectively more or less continual cycle of home credit loans with two different lenders, both relationships established more than ten years
- Home credit loans to fund Christmas and occasional expenses as they arise
- Rent-to-own retail for sofa, TV and children's computer
- Never miss rent-to-own retailer but miss occasional payments to both home credit lenders when children's birthdays or need funds for school trips, clothing etc.
- Saves with mother and sisters for Christmas in supermarket savings club

The role of credit

Loans are continuously renewed with repayments a quasi-permanent feature of budget to be managed week by week.

This segment will in many ways represent the backbone of the high cost lenders' customer base, in that relationships are frequently long term, borrowers are effectively all but continuously in the market and payment quality is relatively high, albeit not as consistent as third sector lenders would be likely to expect.

> *"I think, with them (home credit lenders), you think it's (loan) going to finish and then something comes in your head that you need something else from them so you end up getting another one just as that's finished. You don't really want to but you need something else…You think 'Oh it's Christmas, we could get a couple of extra things and you'll take that extra £150 and you don't think about it then till after Christmas and you think 'God, I've got to pay £20 to pay back every week now…I've kept up with them but there has been some weeks when I've opened the door and said, 'Sorry Mate, not today. I haven't got it.' It's not every single week. Just occasionally."*

Perceptions of the affordable credit difference

Cheaper credit is seen as likely to translate to less pressure and a weekly income that is more adequate to needs

For this segment, access to affordable credit is perceived as likely to translate to less pressure, to more income in the pocket and the ability to afford both essentials and discretionary spending more easily.

> *"It would be great just getting stuff I needed and paying a couple of loans off that aren't going to hassle through the week…the fact that there's hardly no interest, that's just fantastic. I mean you know you're paying back what you've lent instead of being charged obviously a lot more interest…You could make sure you've got everything you need with your bills."*

Treatment and service needs

The challenge will lie in addressing the mindset in which financial planning effectively rests on a cycle of continual debt – in effecting a shift in thinking and behaviour towards a saving as well as a borrowing mentality. The potential benefits for this segment – in terms of their savings on high cost credit – are self-evident in that this group is among the heaviest users of high cost credit. The greater risk is however, that these borrowers will simply treat credit union borrowing as one more credit line to be used in parallel with others, which would fall some way short of a sustainable transition to affordable credit.

Borrowers are likely to be resistant to direct debit, at least initially. If transition to electronic payment is to be successful, a degree of flexibility will be required if borrowers are not to be set up to fail. Some individuals would be able to cope with Paypoint as a repayment channel but with an increased risk of payment irregularity. It will be important to maintain the offer of potential access to new credit lines even in the event of payment irregularity and to be pro-active in promoting this feature in order to maximise the chances of recovery from delinquency.

6.3 Aspirational heavy credit users

This segment is among the most difficult to serve but also that which might potentially benefit most from affordable credit in that budgets are more heavily compromised by high cost credit commitments than other groups. These are significantly higher risk borrowers than credit unions have been used to serving, with borrowers likely to require correspondingly greater resource to manage if their habitual payment irregularity is not to become more serious delinquency or outright default.

Key characteristics

- Bias is to family households, many single parents
- Highly materialistic and strongly felt desire to participate in norms of consumption:
    - Brand and trend conscious
    - Latest electronics, upscale furnishings
    - Xmas spend can compromise budget for rest of year
- Budgets tightly managed but range and scale of commitments greater so higher incidence of account irregularity and some default
- Lifestyle depends on effective juggling of competing demands of creditors:
    - Often adverse credit on catalogues, store cards
    - Multiple home credit loans often with multiple suppliers
    - Pattern of irregular payments finely judged to keep credit lines open
    - Rent-to-own used alongside home credit
    - Gaps plugged with continual cycle of informal borrowing
    - Illegal money lending a feature for some as last resort

Case study - Aspirational heavy credit users

Kelly

- Early thirties, single parent, three children, income support
- Plans around cycle of Social Fund borrowing
- Multiple loans with home credit companies and with rent-to-own retailer
- Weekly budget inadequate to range of commitments despite disciplined budgeting and constant self-sacrifice
- Beyond scope of economising which already taken as far as can go
- Constant cycle of missed payments to door-step lenders and small scale informal borrowing with friends and neighbours

The role of credit

In order to acquire material goods and deliver a perceivedly high standard of living to their families, individuals in this segment have taken the pattern of constant economising and juggling typical of many of those living on tight budgets to an extreme, frequently involving high levels of discipline and self-sacrifice.

Eyes are open on the cost and impact of credit but individuals are prepared to pare spending to the bone to acquire material and consumer goods.

> *"I can't have bad credit because nobody has ever given me credit…We are paying extortionate amounts for either the cash or the items we've bought from Brighthouse or Crazy George or whatever it's called. But if it's the only place we can get them, that's what we've got to do…You'll do whatever it takes to get it for them (children), whatever it takes…you try and live to a certain standard – even though it doesn't really make sense because you skint yourself and you don't really have what's known as a weekly shop. I know it don't really make sense in what I do but I manage. I get by from week to week…I'm proud of what I've got."*

Perceptions of the affordable credit difference

The perception is that affordable credit is likely to bring an end to debt hollowing out budgets and potentially provide the chance to live a normal life.

Borrowing – often over-borrowing – as much credit as can be obtained from a variety of high cost sources has often resulted in household budgets being so compromised that spending on food and other essentials represents a week-in week-out struggle. A source of affordable credit is seen as likely to offer an end to this pressure and the chance to live a perceivedly more "normal" life.

> *"I'd be able to live a kind of life, really be able not to think this week will I be able to afford this, just be able to go and kind of do a proper shop and not try and live on £10 or £15 a week…There's got to come a time when I can live normally."*

Treatment and service needs

The likelihood is that this segment, being particularly credit hungry, will be strongly represented among those approaching credit unions initially. Patterns of payment irregularity and juggling which is characteristic of their financial management suggests that this segment are highly likely to struggle with direct debits and would regard Paypoint as an all too readily missable option. The most effective approach would seem to be direct deductions from some component of benefits paid direct to the credit union, but there is significant risk that this approach would force borrowers to compromise on essentials.

The segment is less likely than others to be amenable to money advice and financial capability initiatives, with individuals likely to be resistant to any effort to moderate the focus on consumer and branded goods or the disproportionate allocation of funds to Christmas expenditure. It will also be more difficult than for other segments both to achieve regular savings and to make a sustainable transition to affordable credit, in that any slack created by the reduced cost of credit is likely to be taken up by additional commitments.

6.4 Mainstream-experienced, serial delinquents

This segment is one that may be not only difficult to serve but also hard to reach. Individuals have often found themselves locked into a tightening downward spiral, in some cases arising from changed circumstances but often in combination with poor financial skills. Intervening in this syndrome with a view to slowing or arresting the vicious circle and providing a path back to the financial mainstream may be highly challenging and will probably require a sensitive, holistic and potentially resource intensive approach.

Key characteristics

- Greater bias to those in work or in and out of employment
- More men in mix and more married couples with children
- Often some history of change in personal circumstances / income shocks
- Adverse credit history resulting in being shut out of credit and banking mainstream:
  - Some relatively minor – catalogue credit failures ending in CCJs
  - Some more serious, multiple credit cards, repossessions, bankruptcy
- Often debt hangover and multiple commitments
- Long exposure to debt recovery has resulted in relatively thick skin to threats
- High cost sector:
  - Often dislike channel, find home collection intrusive, little affinity with model
  - More conscious of high cost than borrowers with no experience of mainstream
  - Frequently embittered and resentful of lenders
  - Relatively high incidence of delinquency and break-down
- Can have poor financial / money management skills
- Illegal money lending can be only option or may be part of history of debt problems

Case study - Mainstream-experienced, serial delinquents

Geoff

- Late forties, married, teenage children, low income worker
- Income insecure due to frequent periods off sick
- Reduced income inadequate to needs but finds difficult to adjust
- History of mainstream credit use, credit cards
- Serial delinquency and default, repossession
- Attempts to negotiate payments failed, now fatalistic, ignores correspondence
- Home credit taken on in response to canvass – fell out rapidly with agent, payments lapsed and case now progressing to court
- Now operates only in cash and within limits of funds available
- Only credit options now illegal money lenders

Role of credit

For this segment, credit – and the poor management of it – appears to have been the connecting thread in a vicious cycle of financial problems. Against this background, individuals can see themselves as victims. Individuals appear angry and resentful in their dealings with officialdom in general and lenders in particular. They may have poor communication skills and can be cavalier in their attitude to commitments. Most felt powerless to change their situation.

A history of delinquency has steadily reduced credit options and created a downward spiral - Poor budgeting has further compromised family finances

> *"Well, I'm not bothered (by debt recovery action). They (home credit lender) have ripped me off anyway. They can take me to court and at the end of the day, they (court) will say £5 a week. I know the court will agree to it. I've got a wife and three kids to take care of…I have tried (other forms of credit) and I can't get anything. My credit scores are not good enough…I think we spent £50 last night when we went out – when we should stay in and put some money aside. I just can't save for toffee."*

Perceptions of the affordable credit difference

This segment feel unable to move forward without support and would potentially be open to external interventions and money advice if individuals felt that this would offer a route to breaking out of a damaging cycle.

Some perception that affordable credit may help individuals regain control - with some open to money advice in the effort to break the patterns of the past

> *"There'd be some light at the end of the tunnel, get a fresh start…I don't want just to borrow and be forever paying back. I'd rather pay cash for things. I can't be bothered I've had enough. I would love to be able to save. I hate to have no money in my pocket. Financial advice – yeah, definitely, yeah. I would actually – because I can't save".*

Treatment and service needs

In many ways this segment is more comfortable with electronic channels and remote customer management than other high risk borrower segments. The issue is more likely to be around financial capability and the need for financial advice, particularly where there is a significant backdrop of multiple debts. Some individuals may have learned from the experience of over-indebtedness while others may find the long habits of delinquency and default hard to break. The risk is that, if that payment breaks down, it will be difficult to collect on outstanding debt because the segment is relatively inured to payment pressure.

6.5 Chaotic credit recyclers

This segment was among the most vulnerable of all the high risk borrowers interviewed and among those most at risk to illegal money lenders. They are likely to represent a small segment in terms of high risk borrowers overall but a significant segment within the universe of victims of illegal money lending.

Key characteristics

- Often very young, singles and younger single parents
- Frequently heavily dependent on family support
- Poor financial skills:
  - Problems with prioritising
  - Difficult to resist temptation
- Typically history of failed catalogues and home credit loans
- No engagement with creditors
- Budget entirely allocated on receipt so frequently left with nothing
- Sustained week to week by informal lending compromising family and social networks
- Series of risks as become increasingly desperate for cash to meet essentials
- Likely to use illegal money lenders and become long term victims

Case study - Chaotic credit recyclers

Mandy

- Twenties, single, on benefits, lives with grandmother
- History of catalogue and home credit delinquency and default
- Borrowed from loan shark when unable to obtain further credit from Provident
- Under pressure, obtained Social Fund loan to repay loan shark
- Subsequently trapped in cycle whereby borrows small sums from loan shark and repays double following week when benefits received
- Meals with family as otherwise barely able to eat and rarely goes out
- Constant borrowing from family and social network appears to have left her increasingly isolated and depressed

Role of credit

Within this segment, credit – mainly from catalogues and home credit but also store cards in some instances – appears to have been taken on on the spur of the moment and with little real consideration of the implications of the requirement to repay. Where difficulties arose in the wake of non-payment and pressure from debt recovery action, individuals appear to have avoided communications and tended to think in unrealistic terms about how they would resolve their debt problems. Poor financial and budgeting skills appear to exacerbate the difficulties of living on a very low income so that individuals were frequently unable to make ends meet, leading to a cycle of small scale borrowing, both from family and friends and illegal money lenders. In a couple of cases, individuals had been borrowing from money lenders on a very regular basis for several years.

Serial credit default has been followed by a continual cycle of borrowing from loans sharks and family which has left individuals isolated and vulnerable

> *"I give him my hole-in-the-wall card and my pin number so if I don't turn up on the day, he can get it…I did it once and cancelled my card and got a beating for it, because I needed the money. That was when I first started doing it about three years ago, so I never did that again… I'm not a mug, I know I am being ripped off. But then I'll do it again…it'll be about twice a month. So yeah, very trapped…I'm constantly tapping, my mum, my aunties, my friends…I've fallen out with one of my aunties – her and me was very close but she won't speak to me now."*

Perceptions of the affordable credit difference

Individuals in this segment have often become isolated socially, lack confidence and are ashamed of the position in which they have found themselves. It was usually difficult to engage respondents in a conversation about affordable credit and the potential impact of joining a credit union, mainly because individuals felt so trapped in their current position that they could not see past it. Respondents tended to take the view that an affordable credit relationship was no more likely to work out than arrangements made with other credit suppliers, or to feel that they would likely revert to borrowing from money lenders when short of cash.

> *"I know myself. I'd say I'd pay it and I wouldnae. Something would come up and I'd no have the money and that would be that down the pan too."*

Treatment and service needs

The segment will be hard to reach, probably requiring some form of pro-active outreach and potentially also partnerships with a range of agencies. Efforts to inject a degree of stability into lifestyles and to support these individuals in laying the grounds for a more manageable financial future are unlikely to be workable without a substantial element of financial education.

Direct deductions from benefits would seem the most effective route to ensuring that payments are kept up. Individuals are likely to require significant support, not just around finances but also housing and the development of independence more generally.

6.6 The profoundly excluded

These individuals are among those with the greatest need, not only for affordable credit, but also for support in enhancing financial capability and gaining greater access to available benefits and various forms of social support. They are however unlikely to approach credit unions and are less likely than other groups to be brought into the movement either through social and family networks or through referrals from other agencies.

Key characteristics

- Bias to men, single, often older
- Often experienced disruptive life-event:
  - Divorce
  - Bereavement
  - Accident or onset of disability
  - Business failure
  - Mental health issues
- In some cases downward social mobility significant
- Poor financial and social skills (wife may have managed money)
- Can have little family support or social networks, sometimes profoundly isolated
- Can find it difficult to negotiate benefits system or access Social Fund, so extended periods of being effectively destitute can occur if there's no access to informal borrowing
- Significant hardship, health problems, mental health issues, may arise as a result
- Likely to have little or no access to either commercial or informal borrowing but less likely than other excluded segments to be using illegal money lenders.

Case study - The profoundly excluded

Mark

- Late forties, divorced, incapacity benefits, serious health problems
- Mix up over benefits including housing benefit has left him in debt to housing association and repaying over-paid benefits, no sense of how to resolve
- Very little furniture, no washing machine, hoover etc. despite health condition
- Socially isolated, therefore no access to informal lending
- Reluctant to take on high cost credit because cannot afford payments

The role of credit

For this segment, the issue was complete credit exclusion, most often with individuals having no access to informal borrowing either. Several of these individuals appeared to have very little interaction with social agencies, very little meaningful experience of financial services of any sort and a limited social circle. As

a result, they had no means of managing emergencies or funding major purchases. In a small number of cases, individuals were virtually living rough in homes without basic furniture and equipment.

No access to informal credit or Social Fund and unwilling to take on high cost credit, so no means of purchasing big ticket basics

> *"I've not had nothing and I've never been able to manage things myself since I've been divorced. You know, I was always used to people doing things for me…my life's just a mess because I don't know how to do things…Oh, I've been living kind of rough in the house for a few years now. I just cannot get on top of things and I can't get money from anywhere…I've got arrears building up because I wasn't getting income support and I know it's all a mix up but the ordinary person can't manage to sort it out…I enquired about Provident and, like, if you're borrowing £100, you're paying about £150 back or something and I just thought it's ridiculous and I've looked at that, like, Brighthouse thing, but that's ridiculous and I can't save up (for a washing machine) so I'm using the bath at wash times for the sheets. I try and keep on top of things with the dustpan and brush…I'd rather have it tough than go to them (high cost lenders)."*

Perceptions of the affordable credit concept

The affordable credit concept was very attractive to this type of respondent, and was seen as a potential life-line - a means of acquiring basic items which others took for granted.

Affordable credit is perceived as a potential route to acquiring the basics, relieving relentless financial pressure and combating social isolation

> *"It would take pressure off you. It'd certainly take pressure off you. You'd be able to get the things you need – I just can't get the things I need just now…Maybe even go and have the occasional beer with my mates, right enough. Luckily I don't drink much but it's just me and the telly every night."*

Treatment and service needs

Reaching out to this type of borrower is likely to require some form of proactive outreach or targeted marketing activity.

This segment is likely to represent relatively low risk in that they would likely be sufficiently motivated and disciplined both to keep up repayments and to save. Cash payments via Paypoint would be the best fit with budgeting patterns and lifestyles.

Money advice and basic financial education would seem likely to be both important and actively welcomed. Support may also be required in negotiating the benefits system and the Social Fund, where appropriate, and in introducing individuals to agencies able to help in accessing services or the acquisition of basic items, such as furniture and white goods.

7.0 The implications for transitioning high risk borrowers to affordable credit

This chapter seeks to pull together some of the implications of the research in terms of both high level policy implications and the operational development cues for the illegal money lending teams seeking to transition victims to alternative sources of affordable credit and third sector lenders seeking to serve high risk and financially excluded borrowers. It is intended as a starting point for debate and represents the views of the research team.

7.1 Policy implications

The key to successful service of high risk borrowers is clear target market definition and the effective management of payment irregularity

The evidence suggests that the critical success factors in moving those with no legitimate credit options or struggling to cope with high cost credit to new sources of affordable credit will rest, on the one hand, on clearmarket definition and, on the other, on the effective management of delinquency. This applies as much to the broader drive to expand lending on the social business model to higher risk and financially excluded borrowers as it does to the effort to transition victims of illegal money lenders to affordable credit.

Delineating the limits of a sustainable target market for third sector lenders will be critical to success in the effort to widen the lending focus of the third sector

It will be important to delineate the limits of the market that can reasonably and sustainably be served by third sector lenders as social businesses. There is little point in attracting large numbers of applications for credit for which they stand no reasonable chance of success. Equally, there is no virtue in lending to high risk borrowers only to see them fail to repay their loan or do so with such irregularity that the costs of service and the resource diverted to delinquency management compromise the lender's service of, and appeal to, the majority of borrowers. The former will not only create unrealistic expectations among consumers but also significant appraisal costs for third sector lenders while the latter will undermine the sustainability of third sector lenders, act as a drag on the effort to build scale and reinforce rather than address exclusion.

The incidence of default among some high risk borrower types is likely to exceed Growth Fund targets and carries other risk for third sector lenders

Clearly a qualitative piece of work cannot provide a sense of scale. That said, the incidence of default among some of the high risk borrower types described in the research would likely be considerably in excess of the 10% implied by Growth Fund targets. This would itself pose problems for the integrity of the Grown Fund model and its associated funding but also undermine the effort to serve more of those borrowers who could cope with a credit union loan but who are currently dependent on high cost credit as their only credit option. There are, moreover, risks for the third sector in taking on borrowers who are likely to generate high levels of default and require a disproportionate amount of effort to serve. High delinquency rates and the diversion of resource to new and challenging customer groups will have a knock-on effect, not only on borrowers and their perceptions of what is acceptable in the way of payment irregularity, but also on core depositors who may be reluctant to lodge funds with an institution that is perceived to be struggling to control default.

It is important to recognise that some high risk and excluded borrowers cannot be served by a social business on tight margins and lending at 26% APR

One of the most important findings from the research is that some client groups may not be viable borrowers within a social business context, either because they do not have the income to service a loan or because their lifestyle, attitudes or financial management skills may be such that there is no realistic prospect of their repaying loans. Some of those who have a history of struggling and failing to make payments on credit may, with support and education, be encouraged to cope more effectively in the future. Others will require a level of support and hands-on customer management that simply cannot be accommodated within the constraints of a low APR tight-margin business, even with a significant element of subsidy.

There may be potential to serve high-risk borrowers on a not-for-profit basis with greater support and at higher cost but outside the credit union context

There may be some potential to serve high-risk borrowers outside the context of the credit union model and the lowest cost delivery channel on a not-for-profit basis but this may require a degree of support and resource which it is unrealistic to expect credit unions to deliver on a sustainable basis. Such a model is likely to require an APR considerably in excess of anything credit unions would be comfortable with offering or which could be accommodated within the regulatory framework within which they operate. Therefore, any such moves would need to be pursued as a separate development strand[48].

Where there is a social policy case for serving very high risk borrowers – such as victims of IML – subsidies may need to be increased and targets relaxed

There is an argument to be made, however, that in some instances there is a social policy case for advancing credit to borrowers who might otherwise not be served by the third sector. Victims of illegal lending are arguably one such case, with borrowers likely to require rather more support in both the transition to the third sector and on an ongoing basis than some other high risk borrower types. Even here it will be important that a degree of discrimination is exercised so that the illegal money lending teams promote cases where there is a real possibility of victims making a transition to sustainable use of affordable credit and avoid as far as possible introducing cases likely to fail without more support than the credit union and illegal money lending team is realistically going to be able to provide. Third sector lenders taking on such borrowers or operating in communities where illegal money lending is rife may potentially need a higher degree of subsidy for such cases or a more relaxed attitudes to targets on delinquency where victims of illegal lending are represented within the Growth Fund client mix.

Segmenting and defining the target market is the first step in planning for and managing the challenges inherent in serving high risk borrowers

Segmenting and defining the target market is the first step in planning for and managing both the challenges inherent in serving high risk borrowers. The key to success will lie with identifying priority segments and focusing activities and efforts

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[48] The Joseph Rowntree Foundation are for example currently sponsoring research into the potential for a not-for-profit doorstep lending service. Kempson, Whyley, Ellison and Jones, Not for Profit Home Credit: Building a Business Case. Forthcoming 2008.

around these segments. This requires a robust quantification and the development of a segmentation which identifies those who cannot be served as well as those who can, and which incorporates dimensions both of consumer need and the risk presented to the lender in the definition and profile of the segments. To be most effective any such segmentation should be capable of operational application i.e. it should provide not only the insight necessary for policy formulation and planning at strategic level but also support operational development on the ground – to inform, for example, decision making on credit granting and the most appropriate treatment strategy for different segments.

The key to serving as wide a spectrum of high risk borrowers as possible will be to adapt treatment and service strategies to different risk segments

Adopting a variety of lending approaches and adapting treatment strategies to the risk profile, needs and behaviour of different segments will be the most effective route to serving as wide a possible a spectrum of high-risk borrowers. It may be possible to serve some very high risk segments only with a specific treatment strategy – very low value loans with repayments deducted from benefit for example – while other segments could be offered higher value loans and a greater choice in payment and distribution channels.

The fundamental challenge is less about attracting the credit excluded and those now using high cost credit borrowers as sustaining relationships

Once some clarity on target market definition has been achieved, the key to effecting the transition to affordable credit lies with creating sustainable, long term relationships. The challenge in serving high risk borrowers will lie not so much in attracting the financially excluded and users of high cost credit – among whom demand is likely to be high as awareness of social lending increases - as in controlling delinquency and bad debt.

Effective management and adaptation of distribution channel strategy will be critical to meeting segment needs and moderating risk

Distribution and collection channels are likely to be key in making third sector lending models work for high risk borrowers. Success would seem most likely where repayment channels work with consumer needs and behaviour and existing patterns of budgeting and financial management. It would seem important also to recognise that different channels and customer management strategies will be appropriate for different segments of high risk borrowers[49].

Some segments are so high risk that they may be very difficult to serve without deduction made from benefits paid into the credit union

Some segments are so high risk that they may be very difficult to serve without direct deduction from benefits. Such borrowers might include those with inadequate financial management skills, those with chaotic life-styles and those likely to take on

[49] The segment descriptions in chapter six describe illustrative differences in the type of channel strategies that might be adopted for different borrower types. It should be noted however that these are not intended to be a draft of model segment treatment strategies that might later be developed on the basis of a quantitative, risk-scored segmentation.

competing debt indiscriminately. Victims of illegal lending may be particularly suitable candidates for such an approach.

Others may opt for deductions from benefits to secure access to an affordable credit line but a degree of flexibility may be required to prevent cash crises arising

Other less high risk consumers may choose to go this route to protect their ongoing access to an affordable credit line and avoid the temptation of missing payments to the lender when faced with competing priorities. In either case, some mechanism may be needed to allow for some flexibility in the system to minimise the risk of individuals facing hardship or being unable to afford essentials in the event of cash shortfalls.

Greater effort may be required to identify those likely to struggle with direct debits and to offer alternative payment channels to those at risk of failure

Greater effort may need to be taken to identify those likely to struggle with direct debits. Greater caution perhaps needs to be exercised where potential new borrowers have no history of payment by direct debit or where borrowers have run into problems with direct debits in the past. It may be helpful to examine the risk factors for a direct debit failing – where timing of inflows is unpredictable or where margins on budgets are so tight that there is a high risk that competing priorities will occasionally take precedence. Similarly, it may well be useful to ask borrowers about their attitudes to payment by direct debits. In cases where the likelihood of failure would appear uncomfortably high, new borrowers could be offered an alternative channel – branch payment, payment at the Post Office, direct deductions or Paypoint, with the range of alternatives informed – or dictated – by the risk profile of the customer type.

The closer the fit with consumer needs the more likely it is that a channel strategy will be successful but this needs to be balanced by risk mitigation

Channel strategy will be in part about consumer choice and matching channel to need but fundamentally, from the lenders' perspective, it is also about managing risk. This throws up tensions between the need for those on tight budgets for greater flexibility in the face of competing priorities and the requirement of the lender to maximise certainty and minimise risk and the cost of collection.

Payment irregularity may need to be accepted as a feature of the high risk landscape and respected as an aspect of responsible cash flow management

Repayment of an affordable credit loan should be more manageable than debt service on a high cost loan, at least to the extent that interest payments on affordable credit will take less out of the household budget. That said, payment irregularity is entrenched in high risk borrowers' budgeting behaviour and in patterns of credit use and debt service, not only as a cultural factor but as a function of necessity in that, for many of the most hard-pressed borrowers, effective cash-flow management requires it. The most appropriate way to view payment irregularity in this part of the market may indeed be simply as a feature of consumer behaviour; one which has to be accommodated and managed if customers are to be retained and developed and relationships sustained. Clearly there are limits to how far this approach can be taken in that too high an incidence of missed and late payments will increase operating costs to unacceptable levels if credit is to be offered at affordable prices.

The tensions between consumers' need for flexibility and that of lenders for low-cost delivery and risk management could be resolved with push technology

These needs collide most explicitly on the issue of direct debits, and indeed, direct deductions more generally. From the consumer perspective, direct debits, as a pull payment, represent a loss of control, undermining cash flow management[50]. From the lenders' point of view, some form of direct deduction (whether from benefits paid into a CUCA or some other bank accounts) is the means by which risk can be moderated and credit offered at a cost to the consumer that is affordable. These tensions might be resolved - and resistance to remote collection of repayments - and indeed to bank- based financial management more generally addressed - with the development of "consumer push" as distinct from "supplier pull" collection mechanisms. Such mechanisms would ideally be developed using technology and channels that are already widely used by the target market, mobile phones being the most obvious and promising example.

"Consumer push" as distinct from "supplier pull" payment technology may address resistance to bank based financial management more generally

Clearly such an approach introduces a degree of discretion which some consumers will find difficult to manage. However, if combined with communications which position consistent payments as the price of access to low cost credit and the means by which an ongoing – and potentially increasing – affordable credit line could be sustained, it could represent a viable solution; meeting the needs of those on tight budgets for flexibility and control while also representing a low cost repayment channel. The introduction of a degree of discretion also has risk management implications, in that payment irregularity will likely rise and the terms over which payments are made will likely be extended. Keeping this within acceptable bounds may require, on the one hand, that a push payment facility is offered only to certain consumer segments or is made conditional on other factors such as a minimum credit score, however that might be calculated, or a demonstrable payment track record in other contexts, potentially even on high cost credit. In this respect the new data sharing arrangements on home credit[51] may provide a useful new source of information.

A range of risk-driven or flexible approaches to payment channels will need to be backed up by pro-active treatment strategies for debt recovery

The evidence from this study suggests that the other vital strand in control of payment irregularity is a relatively high degree of pro-activity in communication around payment irregularity if it is not to develop into account delinquency and default. Prompt, sympathetic but firm communications would seem to be key. Here the emphasis could usefully be on encouraging a culture of two-way communication and of "responsible rescheduling" by both parties. The facility to use push payment technology could perhaps be tied to meeting agreed standards on communication and rescheduling.

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[50] This issue is not one that is only relevant to credit repayments but is fundamental also to resistance to bank based financial management more generally and thus to access to lower cost utilities and other services.

[51] One of the remedies that the Competition Commission put in place following the 2006 Home Credit Inquiry was a requirement for the home credit lenders to share data on the payment records of borrowers as a stimulus to competition in the sector.

The effort to segment the demand dimension for credit could be extended to take in an integrated perspective on needs and attitudes to advice

An approach which rests on developing segment-level, channel and communication strategies that acknowledge and work with consumers' needs as borrowers and respects the financial and cash flow management strategies of those on low incomes could usefully be extended to users and potential users of debt and money advice services, both for advice targeted at those in financial difficulties and the over-indebted but also money advice more generally. Different consumer types had clearly adopted different approaches to money management and taking on debt, had a greater or lesser degree of financial capability and had different attitudes to consumption and what they regarded as essentials or an acceptable standard of living. As a consequence, they responded differently to the idea and experience of debt and money advice, with the more consumption oriented groups likely to include the heaviest credit users and most indebted; these being the most likely to experience advice services as patronising and judgemental and therefore to respond negatively to advice. Similarly some of those with the greatest need for advice and support for capability building were among those least likely to see advice as relevant to their circumstances or their problems as amenable to intervention. The effort to segment the market for low income high risk borrowers could usefully be extended to incorporate their attitudes and needs in relation both to debt and money advice and potentially also to savings.

Approaches to debt advice and money guidance which work with the needs and issues arising for different segments would likely have greater resonance

An approach to advice and key advice messages could then be developed which acknowledges and works around the consumer perspective on financial management and the differences between segments in this regard. An approach, for example, which recognised borrowers' pride in their ability to provide consumer goods for their families even while it sought to moderate some aspects of financial thinking, support wiser choices and the development of new skills and budgeting strategies, would likely have greater resonance with those consumer segments that appear most likely to become over-stretched and have their budgets compromised by credit use but which are also those apparently most resistant to advice and support on money management.

Advice and money guidance initiatives could usefully focus on segments vulnerable to disproportionate – and credit fuelled – spending at Christmas

This is perhaps best exemplified in provision for Christmas which plays a disproportionate role in the budgets and financial management strategies of those on very low incomes in the UK – far more so than in other countries – and is itself a major driver of use of both high cost credit and illegal lenders and problems with debt. Some segments appear particularly inclined to heavy borrowing at Christmas time, with the result that the ability to afford essentials is undermined throughout the year, which in turn can lead to a further cycle of high cost borrowing. These kinds of attitudes and behaviour and alternative ways to approach funding Christmas could perhaps be tackled both in the context of debt and money advice services and in the FSA's Money Guidance initiative. Moderating the excessive diversion of limited funds to Christmas expenditure would of itself reduce risk, lessen dependence on credit and potentially even create room to allow modest savings.

For credit excluded borrowers and those now dependent on high cost credit, affordable credit can be a transformational development

Taken together, the research suggests that for excluded borrowers and those now dependent on high cost credit – provided always that they can cope with the credit union and CDFI model - the transition to affordable credit can be a transformational experience, increasing the funds available to the household and providing a stimulus to confidence and the ability to manage finances effectively.

From the perspective of many third sector lenders, the desire will be to serve the better off and more reliable among those using high cost lenders

The Growth Fund initiative has clearly been effective in extending credit union services to a new, higher risk and more excluded tranche of borrowers than has previously been served by the third sector. It will also, however, have focused lenders' minds on the many challenges and risks associated with increased delinquency and bad debt. From the perspective of many in the third sector, the immediate issue may be more about managing the scale of demand and building capacity and skills to service it than extending services to hard to reach and very high risk groups. As social businesses, the tendency will be to concentrate on the relatively better risks among the growing pool of borrowers now presenting. For some third sector lenders, a move to serve more high risk borrowers may be seen as holding the sector back, in that it will serve to reinforce the image of credit unions as being bankers to the poor, potentially creating some dissatisfaction among the better off credit union members on whose deposits they rely.

Success in transitioning better quality high cost credit users to affordable credit may leave the profoundly excluded and less reliable with no options

For the highest risk borrowers, access to even high cost credit is likely to continue to shrink[52] as high cost lenders increasingly diversify into new products and channels and focus on more reliable borrowers and those no longer able to obtain credit from mainstream lenders. Against this background, the most disadvantaged and highest risk borrowers will face increasingly constrained credit options even as the more capable credit users on low incomes gain greater access to affordable credit through the expansion of the third sector.

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[52] The number of high cost home credit lenders continues to shrink as Cattles and London Scottish Bank, the second and third largest lenders respectively, continue their strategic withdrawal from the sector in favour of a focus on higher value loans distributed remotely (home credit loans now represent less than 6% of Cattles loans business), secured lending, mortgage finance and debt recovery. Provident Financial, the home credit market leader with a dominant market share, increased home credit customer numbers by 5% in 2007, but this does not imply any reversal of the continuing move away from the highest risk borrowers. 2007 also saw a sharp reduction of credit impairment (by 29% as a share of revenue). This was achieved as a result of: success in expanding remote and direct response recruitment channels – and thus less dependence on agent and community referrals; an increased focus on a wider spectrum of "non standard" borrowers and those now being rejected by mainstream lenders; and a tightening of lending criteria and improved customer analytics, which enable greater discrimination between borrowers likely to be more or less reliable payers. As a result, one in three applications for home credit loans was declined in 2007, "many of which would previously have been accepted" (Source: Provident Financial Presentation of 2007 Results, March 2008)"

Policy makers may need to look beyond third sector lenders for solutions for the highest risk borrowers

Policy makers seeking to combat the illegal lending that may arise in the resulting credit vacuum, and to provide some form of safety net for those with no other means of managing cash emergencies or funding acquisitions, may need to look beyond third sector lenders for solutions.

7.2 Operational development cues

7.2.1 Transitioning victims of illegal money lenders to affordable credit

One of the most effective routes to encouraging victims to approach third sector lenders may be to promote affordable credit to the wider community

Victims of illegal lenders tend to be among the most disadvantaged and vulnerable individuals within deprived communities and often lack the confidence to approach unfamiliar institutions. It may be that one of the most effective routes to encouraging victims to view credit unions and CDFIs as a viable alternative to use of illegal lenders will be to promote affordable credit more widely within the communities in which the illegal lenders operate.

Awareness-building initiatives and communications that specifically encourage those who cannot get credit elsewhere to apply to third sector lenders is likely to attract a wider cross-section of the community, particularly in areas which the high cost lenders do not serve. As awareness and use of credit unions builds, users of illegal lenders and those at risk of falling victim will be encouraged by the experience of their neighbours to see third sector lenders as an accessible source of credit supply for the community. The growing numbers of credit unions offering instant access loans under the Growth Fund scheme is a key development in this respect, in that, as the research has shown, small sum affordable credit instant loans are likely to have wide appeal in low income communities, not least to those currently using illegal money lenders.

Encouraging victims of illegal lending to apply to credit unions will require pro-active intervention and support

The evidence of both this and previous studies[53] suggests that victims of illegal lending are not only among those least likely to present to credit unions but also among those least likely to be successful in coping with third sector credit. The effort to move victims into affordable credit is most likely to be successful if it rests on pro-active, practical intervention by the illegal money lending teams, working both with victims and with third party agencies. Victims and informants will likely require active support to approach new sources of affordable credit, while partner agencies and third sector lenders will need both training and support to understand the needs of this client group and develop approaches likely to result in sustainable relationships.

[53] Ellison, Collard and Forster, Policis and PFRC for the DTI, Illegal Lending in the UK, 2006, also Evaluation of the DTI Illegal Lending Pilot Projects, 2007.

Support is likely to be needed not just in gaining access to credit but also in preventing payment difficulties becoming breakdown

Introducing victims to credit unions and supporting them in taking on their first affordable credit loan is clearly an important step. Perhaps the greater challenge – and the biggest hurdle for a sustained transition to affordable credit – is helping victims to keep up regular payments without the impetus previously arising from constant pressure and intimidation. Borrowers with a history of using illegal money lenders may require specific monitoring and support on an ongoing basis, aimed at early intervention and quick recovery in the case of difficulties. The risk is that this type of borrower will otherwise tend to fail, cementing their exclusion and ultimately resulting in their return to use of illegal money lenders.

Building awareness of the background victims are likely to bring to third sector borrowing will enable lenders to better manage and sustain relationships

Lenders and money advice agencies will benefit from awareness of the likely context that victims will bring to any discussion of potential borrowing, credit problems or financial management issues. Victims have frequently had their finances hollowed out by payments to the money lender and may have done without essentials for an extended period. Some may also have built up significant arrears on household bills or unpaid debt. Similarly, individuals may be more likely than other borrowers to suffer from depression or a lack of confidence, to have become socially isolated or to have a history of family relationships that have been soured by informal borrowing that has not been repaid. Armed with this understanding, lenders may be prepared to take a longer term and more tolerant view of payment difficulties and the challenges inherent in transitioning victims to affordable credit.

Where there is a live relationship with an illegal money lender, communications messages could encourage victims to stop making payments

For some victims, the big issue in making any transition to affordable credit is the fear of the money lender and, in many cases, the perceived need to continue to make payments to him / her. Removing the lender from the community by enforcement action, will in most cases also remove this barrier. In others, associates may continue to press for payment even after the lender has been removed.[54] The financial inclusion officers with the illegal lending project teams will be in a position to identify and support victims that present to them but others may not come forward and may approach credit unions independently. As credit unions build their profile in deprived communities, other victims may come to the credit union with a current relationship with an illegal money lender. Clearly there is a very difficult balance to be struck in that, although lenders appear to rely primarily on intimidation, victims are clearly exposed to a real risk of violence if they stop making payments. That said, part of the communications effort to victims might rest on the message that they can stop making payments[55] and that the lender is committing a crime that will be taken

[54] The illegal lending pilot evaluation found some evidence of this syndrome.

[55] There is some evidence from Japan, where there is a large and sophisticated Yakusa-run illegal lending market, that encouraging borrowers to stand up to lenders and stop making payments is an effective strategy. Lenders are reported as tending to withdraw when they realise that the victim has some support from a consumer protection or law enforcement agency, primarily to avoid attracting unwanted attention from the authorities. This is the strategy, developed over some years, now adopted by the JFBA (Japanese Federation of Bar Associations) teams working with victims and combating illegal lending in Japan.

seriously by the authorities. This may be particularly pertinent in those cases where victims do not realise that the lender is acting illegally or where the transaction most closely resembles outright extortion i.e. where there is no clearly agreed price or term to the loan, where arbitrary penalty charges have been applied or payments have been collected for a greatly extended period.

Greater take up of money advice and financial education services might be achieved by packaging these elements into a wider support service

Money advice and financial education services could have a key role to play in helping victims to rebuild their finances and in addressing some of the contextual issues (ongoing debt, problems with benefit entitlement, social housing and council tax arrears) that have combined to trap individuals in a situation they feel unable to get out of. The issue, from the victim's perspective, is that advice services are not seen as relevant and that there is little appreciation of the range of problems that might be amenable to intervention. Advice organisations can also be seen as intimidating and official. It may be helpful in offering money advice services to victims to package money advice together with other forms of practical support. This would ideally be associated with something that is motivating to victims – obtaining a credit line, sorting out problems with benefit entitlement or Social Fund applications, investigation housing options etc. These services could then be positioned to victims more widely as victim support rather than focusing narrowly or explicitly on the advice or education element, as these latter components will tend to set up resistance and work against take up.

7.2.2 Third sector service of high risk borrowers

The key barriers are being addressed with the development of instant loans and the effort to scale and extend the capacity of the third sector

In seeking to increase access to capacity-based lending and develop instant access loans, the government – through the medium of the Growth Fund – are already addressing one of most important barriers to high risk borrowers using credit unions. Increasing the coverage of third sector lenders offering instant loans will then be key to reaching out to many who would be deterred by the save-to-borrow model

As yet, coverage of credit unions able to serve the financially excluded remains patchy[56] and only a minority of credit unions offer instant access loans. That said, all of the Growth Fund supported credit unions offer instant loans, as do a further 30 – 40 others[57]. The current efforts to scale the third sector, increase the coverage of credit unions offering instant loans and to grow the capacity and skills required to serve excluded borrowers, led by the Financial Inclusion Task Force, represent a major step forward in reaching out to high risk borrowers who would otherwise have no, or only very high cost, credit options.

[56] The Financial Inclusion Task Force has identified 25 priority areas for new provision where there is high demand for affordable credit and no effective third sector coverage.

See also Experian maps of the capacity gaps between third sector coverage and the need for affordable credit (developed for the FIT), and Policis maps of the capacity gaps between third sector coverage and concentrations of extreme credit exclusion (developed for BERR), and the Policis maps of concentrations of high risk borrowers and illegal lending.

[57] Source: ABCUL

Increasing awareness of credit unions may rapidly increase demand for instant loans; high profile marketing activity may create capacity and service issues

The research suggests both that there may potentially be significant demand for affordable instant loans and that the credit unions offering instant loans are already suffering some capacity issues. Any significant effort to increase awareness – in the form of concerted marketing activity – may therefore perhaps best be timed with due consideration for the potential capacity and service issues that may arise.

Where credit unions are offering instant loans, those likely to apply in the first instance may be groups with a tendency to chronic irregular payment

Those most likely to approach the credit union in the first wave of those seeking instant loans will include some of the most credit hungry, including frequent users of high cost credit. They will however be among the most difficult new customer types to manage, being most likely to have multiple supplier relationships and an entrenched pattern of irregular payments on credit agreements. For this reason, they will also likely be those least well equipped to pay by direct debit.

Reaching more reliable high cost credit users may require marketing designed to develop price sensitivity and increase price discrimination

By contrast, some of the most reliable payers among users of high cost credit would appear unlikely to approach the credit union. Borrowers with close and long established relationships with home credit agents are less likely to consider alternative pricing or forms of supply. Attracting these customers to the credit union is likely to require marketing activity designed to increase price sensitivity and thus break through inertia and existing supplier pull. Although not usually price sensitive, these individuals will be more likely to respond to price comparisons on both the total cost of credit and on the amount payable weekly if the true scale of the price differential can be effectively communicated. Success is most likely if comparison of weekly payments on affordable and high cost credit can be laid out over the same term. The price differential is then more likely to be perceived as meaningful – and potentially be seen as of sufficient order to prompt action.

For some of those most impacted by high cost debt service, the main barrier to the transition to affordable credit is the scale of their long term high cost debt

In some cases, the main barriers to any shift to affordable credit may be entrenched debt to high cost lenders, particularly where this is long term. The scale of existing commitments may be such that borrowers cannot afford to take on further credit until existing debt is paid down, which might be two to three years in the future in the case of commitments to rent-to-own retailers. Some consideration might be given to buying out all or part of this high cost debt, possibly in a staged process and potentially associated with various conditions, which might include behavioural factors (a track record of minimum standard repayments for example) or meeting various financial capability targets (attendance at seminars for example)[58]. Hard won experience of previous initiatives suggest that this would best be achieved through

[58] Previous work by Paul Jones of Liverpool John Moores University found that initiatives to buy high cost debt while transferring borrowers to affordable credit were unlikely to be successful unless allied to financial capability initiatives. Jones P.A. (2003). Credit Unions and Loan Guarantee Schemes. Barclays, London. April 2003.

direct dealings between creditor and the credit union rather than making payments direct to the debtor.

Some of most profoundly excluded groups are unlikely to be reached except by pro-active outreach and may require considerable initial support

Some groups most in need of affordable credit are unlikely to approach credit unions at all. For some of these groups, this will be a function of social isolation or health and mobility issues. For others, the more likely issue will be a generalised lack of confidence or financial capability, potentially exacerbated by difficulties with literacy or numeracy. In the case of those using illegal lenders, these same difficulties are likely to be compounded by fear of the lender and finances having been hollowed out by an extended period of extortionate payments. The only way to reach some of these profoundly excluded groups may be with some form of pro-active outreach, potentially in partnership with other agencies. In these cases, a successful move to affordable credit might require considerable support in the first instance.

Communications should emphasise the approachability of credit unions

To be most effective in addressing the barriers to approaching credit unions, communications with prospective borrowers should stress that credit unions are approachable and friendly and that staff are supportive and non-judgemental. In the same way, communication which offers specific information about the target market that the credit union is willing to consider for a loan will help to overcome doubts about personal eligibility and address fears of refusal. It would be helpful, for example, to offer reassurances that those on benefits or with adverse or no credit history could be considered for a loan, if this is appropriate, while also being specific about circumstances which would preclude consideration (such as being on a particular benefit). Communications might also stress the importance of being honest with lenders about adverse history.

Key messages around accessible and supported application processes will help to address fears about approaching an unfamiliar institution

Resistance to making the move to affordable credit will also rest on the perceived effort involved as much as the requirement to approach a new institution. Rapid access to credit, convenience and the absence of procedural “hassle” are all critical components of the appeal of home credit for those who have access to it. These features would likely also be attractive when promoting credit union services. For the entirely credit excluded, concerns are more likely to be around eligibility criteria and access and process hurdles. Communications which emphasise that loan applications are simple and form-filling is supported, that cash is available quickly and that payment channels are convenient, will all tend to work against potential new credit union borrowers succumbing to the line of least resistance and taking on high cost credit loans. For those without any current credit options, reassurances of inclusivity and an emphasis on accessible and simple processes will go some way to overcome the natural tendency to anticipate refusals.

Proofs of identity and address need to be appropriate to potential borrowers’ circumstances if they are not to prove a hurdle to accessing affordable credit

It would also be helpful for the detail of requirement for proofs of identity and address to be spelt out in communications, to minimise failure from inadequate

documentation. In this respect, it will be important, within the confines of compliance, to tailor requirements as far as possible so that proofs are appropriate to the realities of potential borrowers' circumstances.

Service issues arising from capacity constraints in fast growing credit unions may undermine the appeal of credit unions to new borrowers

The research suggests that both new applicants to credit unions and those subsequently collecting benefits resented having to queue for extended periods. There was also some evidence that process inefficiencies – as in delays in setting up direct debits – had also had a role to play in payment difficulties arising.

Demand for instant loans and credit union services may currently be such that service has yet to become a pressing issue for most credit unions. However, with time, the service issues evidenced in the research may have implications for the attractiveness of the credit union proposition, for established customers as much as new members. Indeed capacity-strain may already be having an impact on some new borrowers' ability to cope with their loan.

Prompt communication and active intervention as soon as payment irregularity arises is key to preventing arrears building and becoming default

In the early stages of a relationship with new-to-credit-union borrowers, a significant minority will be repaying affordable credit loans in parallel to debt service on other types of credit, with competing suppliers frequently better placed to exert pressure to pay. Against this background, it will be important to put mechanisms in place to respond to payment irregularity with measures designed to prevent missed payments becoming default. This will likely require a more developed infrastructure for evaluating and monitoring risk, but also new and more pro-active approaches to managing borrowers running into difficulty. Prompt communication and active intervention as soon as payment irregularity arises is key to preventing arrears building and becoming default. Equally, it will be important to discriminate between those who are genuinely unable to pay and have a good reason for missing their payments and those who are either too disorganised or simply unwilling to keep up their payments.

Reassurance that credit lines are recoverable, provided minimum thresholds are met, could be an important motivator to make good arrears

There appears to be a significant risk that, in the event of repayment difficulties, borrowers may favour payments to lenders judged potentially more likely to offer further credit over their credit union payments. In this respect, it may be worthwhile adopting a version of the home credit lenders' arrears management practice. Namely, reassuring borrowers who run into payment difficulties that they will not necessarily have compromised a future credit line, provided they communicate with the credit union and resume making an acceptable level of payments. This may well act to prevent delinquent relationships deteriorating into default. The key to the success of such an approach is to make any recovery hurdle achievable and appropriate to the circumstances of the borrower.

For those borrowers most inclined to payment irregularity, or where difficulties appear to be arising, a prompt before payment comes due may be helpful

For borrowers who are beginning to exhibit a pattern of frequent payment irregularity, account delinquency may even be moderated by pro-actively prompting payment with a reminder that payment is due on a certain date, perhaps delivered by text or mobile phone. This might perhaps be allied to some kind of motivational message where appropriate. For example, congratulations on keeping up payments to date, references to savings building up or to the minimum number of payments that need to be kept up before being considered for another loan. Pro-active prompts of this nature are a feature of a number of sub-prime lending models.

Home visits may be effective in countering a likely lack of communication and negotiating a way forward for debt recovery

Where the relationship appears to have deteriorated to the point where payments are not being made and communications go unanswered, the evidence of the research is that it is unlikely that communications will be resumed or arrears recovered without more pro-active outreach and / or collection management. A more positive outcome might be achieved with home visits as an alternative to handing the case to debt recovery or to allowing it to proceed without further intervention to the courts. This approach may allow lenders to understand the cause of difficulties and mediate a way forward. It will be important that any agreement is achievable, and does not require borrowers to meet payment schedules that are overly stretching. In many cases, a simple resumption of payments, even at low level, will be the most appropriate route to recovery.

A change in payment channel may help to manage payment difficulties

A shift to an alternative and more manageable payment channel may provide a way forward. Paypoint might be appropriate in some cases, while direct deductions may prove a solution for those who are struggling with direct debits. In the latter case, it will be important to ensure that genuinely informed consent is given, that an active choice is being made and that there are adequate safeguards in place to protect spending on essentials. This approach may also provide an opportunity to incorporate some element of financial capability work or debt advice with appropriate clients.

Home collection may be worth considering as part of a channel for debt collection or initiatives aimed at hard to reach groups

A home collected service could potentially be considered for debt recovery, as part of an outreach operation for hard to reach excluded borrowers or as a potential channel for delivery of financial capability or other inclusion initiatives. Clearly such a service will be costly to provide and may not be viable within the confines of a social lending business model.

Efforts to change behaviour or to encourage take up of other services may be more effective once a successful credit relationship has been established

Part of the third sector ethos centres around individuals taking responsibility for their own behaviour and many within the credit union movement feel strongly that part of their mission to the financially excluded is to encourage a greater sense of personal

commitment to making payments on time or to building up savings. The research suggests however, that both at the initial point of sale and in the early stages of the credit union relationship, new-to-credit-union borrowers are likely to be focused simply on obtaining their loan and building up a larger credit line. They are unlikely to be genuinely receptive either to change messages or to alternative service lines/ cross sales, unless these are in some way bundled with prospects of access to, or increasing, credit lines. With time, it may be possible to create openings for change messages and to effect a change in attitudes and behaviour. Therefore, it may be more effective to promote savings once a relationship has been established than to do so when borrowers first approach the credit union. Against this background, it may be worth considering how best to work with existing behaviour to combine affordable credit borrowing with a stimulus to modest savings. One route might be to extend the term of the typical short term instant access credit union loan by some weeks. A proportion of each payment could then be diverted to a savings account without increasing the amount paid each week, thus building a small savings pot over the course of the loan. Such an initiative might even be combined with, or followed by, a further kick start through a scheme such as the Saving Gateway.