Dormant Assets Spend Consultation

Response from the Association of British Credit Unions

1. Overview of response

This consultation response is being submitted by the Association of British Credit Unions, the primary trade body for credit unions in Great Britain. We strongly believe that dormant asset funding should continue to be dedicated to financial inclusion. This is on the basis that financial inclusion is a pervasive issue in England, and there is much greater scope to support the English credit union sector in promoting financial inclusion through further grant funding. However, we will note that our support for the continuation of dormant assets funding on financial inclusion is conditional on there being a more robust plan for supporting the credit union sector.

Our response will discuss the scale of financial inclusion issues in England and the work credit unions are already conducting to promote financial inclusion. We will then comment on the much greater scope to support credit unions in this work through the dormant assets funding.

2. The context of financial inclusion in England.

Financial inclusion is crucial for individuals to have a meaningful participation in society through access to appropriate and affordable financial services, as well as the knowledge and ability to make good financial decisions and build financial resilience. As the consultation paper highlights, financial inclusion is multi-faceted issue. Below we have captured the context of financial inclusion in the UK according to some of its key aspects:

> **Access to appropriate financial services and products:** Accessing appropriate financial services is crucial to being able to participate fully in contemporary society. For services to be accessible, the appropriate communication channels and support need to be made available to individuals. This is particularly important for vulnerable individuals, who often have particular requirements to access and fully engage with the financial products that meet their needs.
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> The FCA's Financial Lives Survey found that, in 2020, 46% of UK adults showed one or more characteristics of vulnerability. As low financial resilience is a characteristic of vulnerability, it is likely that the percentage has since grown substantially due to the onset of the cost-of-living crisis. The survey results indicated that many people struggle to interact with financial services. For example, that 57% of adults with low capability about money and finances felt nervous, overwhelmed, or stressed speaking to financial services providers or found it hard to find suitable financial products or services. A further example is that 33% of adults with a physical disability had difficulties getting to a bank branch, but at the same time 30% of these adults found dealing with customer services on the phone confusing or difficult.

Access does not just relate to the right communication channels being made available, but also ensuring that the right support and education is provided to enable individuals manage their financial lives and choose the rights products for them. Support is vital to ensure individuals are able to effectively manage their finances – the Financial Lives survey found that 34% of adults in the UK have poor or low level of numeracy involving financial concepts, which challenges their ability to make effective financial decisions. The right support is vital for helping vulnerable individuals understand their options: for example, 23% of UK adults who had a vulnerability characteristic related to their health were anxious to shop around for financial products and services in case of making a mistake.

Access to affordable credit: A core aspect of financial inclusion is access to safe and affordable credit. Whilst credit is not always the solution to an individual's financial difficulty, access to affordable credit can help individuals withstand financial shocks and unexpected costs, such as paying to replace a broken appliance. On the other hand, high-cost credit can contribute to pushing individuals into cycles of overwhelming debt that they cannot afford to repay. This has a profound negative impact on people's lives, with elevated levels of indebtedness associated with elevated levels of stress, anxiety, and further health issues.

Traditionally, many individuals have been excluded from mainstream credit from banks on the basis that they are too risky to lend to. In 2020, Fair4All Finance estimate that 11 million people in the UK struggle to access affordable credit. Furthermore, the FCA Financial Lives Survey 2020 found that 5.6 million adults held a high-cost loan in the last 12 months. This presents a significant value paid in excess interest and puts an unnecessary financial burden onto those with lower incomes.

There have been a number of market exits from high-cost payday lenders in recent years. Whilst this is a positive change, it leaves a large market of individuals that need access to safe and affordable credit. At the same time, the scale of illegal money lending is unprecedented – the Centre for Social Justice report Swimming with Sharks estimates that 1.08 million people in England are borrowing from an illegal money lender in 2022. Illegal money lending presents an array of risks, such as a lack of assessment to check the individual's ability to afford the loan and the risk of loan sharks resorting to threats and violence as a debt collection practice.

Financial resilience: An aspect of financial inclusion is ensuring individuals having the ability to save and build their financial resilience. The FCA's financial lives survey found that 27% of adults in the UK had low financial resilience in 2020. There is a significant and growing gap between savers and non-savers in the UK. In 2021, a survey by Yorkshire Building Society found that more than one in ten (13%) of UK adults have no savings at all, with 19% holding less than £100 in savings. The report found that Covid-19 exacerbated the gap in the savings buffer held between savers and non-savers, as whilst some individuals saved more during the pandemic, many depleted their savings. Given the current cost-of-living crisis, households' ability to save is being challenged at an unprecedented level, with it being likely that many will use their remaining savings to cover their rise in living costs.

A lack of a savings buffer puts individuals in highly risky position, where unexpected costs can force individuals to reach for high-interest credit. The Money and Pensions Service found that 24% of adults in England would have to borrow money if they had an unexpected cost of £300. A savings buffer can provide individuals with the peace of mind that they will be able to manage an unexpected cost or a change in circumstances.

3. What are credit unions and how do they promote financial inclusion?

Credit unions are co-operatives that offer financial services to their members. They are democratically controlled organisations that allow individuals join based on meeting the 'common bond' – a set criteria based on location or type of employment.

Though the scale of financial inclusion is significant, credit unions can effectively and broadly promote financial inclusion. To demonstrate that further dormant assets funding dedicated to credit unions would have a significant impact on wider financial inclusion in England, we will set out how credit unions broadly promote financial inclusion.

Credit unions primarily offer safe savings, affordable loans, and support to members in managing their financial lives. Credit unions in England are defined by their four statutory objects:

- Promotion of thrift
- Creating a source of credit at fair and affordable rates of interest
- Use of members' savings for their mutual benefit
- Educating members in the wise use of money

Credit unions serve individuals from all corners of the country, with around **150 credit unions** operating in England today. At the beginning of 2022, English credit unions had a total of over 900,000 members, who jointly held £1.2 billion in savings and £786 million out on loans. The global credit union movement is strongly associated with financial inclusion, and this reputation holds true for the English credit union sector. Their co-operative, not-for-profit structure, and range of products and services, put credit unions in a unique position to promote financial inclusion from multiple angles. Below we have highlighted some of the key ways credit unions promote financial inclusion.

Community-based financial services: the majority of credit unions have geography-based common bonds, where members must live or work in area to join the credit union. In practice, this means that credit unions are centred on the needs of their communities. This feature of credit unions is already allowing them to provide affordable financial services to a diverse range of individuals. For example, the Money and Pensions Service financial wellbeing survey 2021 found that UK adults from an ethnic minority were much more likely to use a credit union savings account than other demographics (11% compared to 5%). Furthermore, credit unions' focus on their local community uniquely positions them to provide accessible services, as they can provide individuals with local branches and in-person support they require. Their small-scale allows them to provide personalised support, tailored to the needs of individual members that they interact with day-to-day.

Providing affordable credit to all: credit unions offer low-interest credit. They are capped by legislation from offering loans above 42.6% APR, with most loans at a much lower interest rate. These loans are not just affordable, but they are accessible. Credit unions have historically served the sub-prime lending market that has been traditionally excluded from mainstream lending. Credit unions often have a close relationship with their members and are willing to work with them to understand their financial circumstances when assessing loan affordability. These factors make credit unions a safe and viable alternative to both high-cost lenders and loan sharks.

Turning borrowers into savers: it is a part of a credit union's statutory objects to encourage good money habits, and credit unions are dedicated to helping their members build financial resilience through savings. Credit unions encourage a savings habit both through providing financial education and targeted products. For example, many credit unions offer 'save as you borrow' loans, where a portion of the members loan repayments will go to building up their savings. Other credit unions may have a small monthly saving requirement as a condition of membership. Credit unions will often also provide payroll deduction services, where the member can put away regular savings from their wages automatically. These initiatives are innovative in helping to instil a savings habit in individuals. Credit unions will also provide financial education through a range of mediums to help individuals develop a budget and adopt habits that help them create a savings buffer.

Local partnerships: Credit unions establish relationship and work closely with local partner organisations to widen their reach in providing inclusive financial services. These partners commonly include local authorities and housing associations. These partnerships not only allows signposting of vulnerable individuals to accessible financial services with a credit union, but also opens up room for innovative schemes to promote financial inclusion. For example, we have seen instances of schemes where a local authority partners with a credit union to provide homeless persons with a low-interest loan to pay for a rental deposit, enabling them access to permanent accommodation. A further example of utilising partnerships is a credit union operating a scheme with a foodbank where individuals pay £1 to receive a food parcel for their household, with that £1 going direct into the individual's credit union account to build up their savings.

4. What can further grant funding for the English credit union sector through the Dormant Assets Scheme achieve?

Whilst we recognise that the consultation is not looking to address the specific use of funds, we must give an indication as to the potential projects and impact that further support for the credit union sector could have on financial inclusion through further dormant assets funding.

Credit unions are intrinsically a highly effective vehicle to promote financial inclusion.
They independently and sustainably set out to promote financial inclusion, with the provision of affordable credit and the promotion of good money habits sitting at the core of their business model. However, credit unions are not-for-profit organisations, often supported by

volunteers. This means they have limited capital to undertake projects to outside of the day-to-day running of the credit union. For this reason, grant funding can be provide extra resources to enable projects that would expand credit union's reach and service provision.

Whilst credit unions can grow independently, grant funding supports credit unions to thrive by enabling them to undertake expansion and development projects that they ordinarily could not afford. This can both be to reach new individuals that could benefit from credit union membership and develop services to the credit union's existing members.

There is much greater scope to increase credit union membership in England and expand access to inclusive and affordable financial services. The rate of credit union membership in England is much lower that in many other countries, where credit union membership is common – only 1.4% of the English population is a member of a credit union, compared to 37%, 42% and 59% in Northern Ireland, Canada, and the United States, respectively. Below we have a few examples of the kind of projects that could support in scaling up the credit union sector in England:

- **Funding for marketing and raising awareness:** There is a room for a much higher rate of credit union membership in England. The credit union movement historically struggled with poor awareness both in England and internationally. Credit unions struggle to have enough spare capital for substantial marketing projects. Efforts to improve awareness of credit unions, whether through marketing or targeted outreach projects through partner organisations, could help more individuals join a credit union for improved membership.
- **Funding for strategic mergers:** There is an ongoing pattern of consolidation in the English credit union sector, as mergers can in some cases be utilised to improve the services of the credit union through economies of scale. However, undertaking a merger involve significant extra work outside the day-to-day running of the credit unions. This comes at a financial cost that serves as a barrier to mergers in the credit union sector. Providing credit unions with the funds to support strategic mergers could help the sector in reaching in scaling up and developing their services in a number of cases.
- **Funding for financial education:** Credit unions already seek to encourage good money management and provide financial education but grant funding can provide the extra resource needed to carry this out at a larger scale and reach a wider audience. Many credit unions have expressed that they could provide much further financial education if they had funding to employ an additional staff member dedicated to this cause.
- **Funding for lending product innovation:** Credit unions offer ethical lending products and are keen to innovate in this space as well as expand the outreach of existing products. This includes consolidation loans and other products that could service the needs of consumers around household appliances and supporting new tenancies for example. Support to underpin some of the inherent risk in specialist loan products would be a hugely positive intervention.

Nevertheless, we must emphasize that our support for financial inclusion to remain a cause for dormant assets funding is conditional, as we urge for change in the way that this portion of the funding is used to support credit unions. This is on the basis that we have seen minor impact of dormant assets funding on the credit union sector to date.

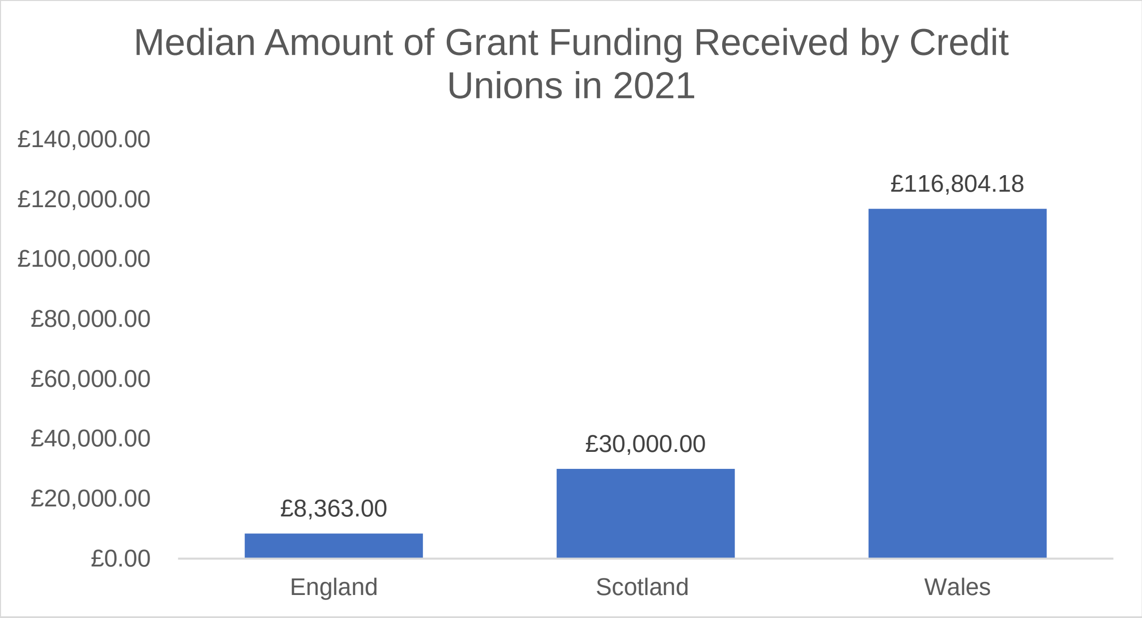
We appreciate that there has been some support so far for the credit union sector through Fair4All Finance. However, we stress that further monetary support of the credit union sector is needed in maximising its capability to foster financial inclusion. Nevertheless, we believe that there needs to be a more robust strategy for supporting credit unions with this funding.

Our primary concern around the use of dormant assets funding to promote financial inclusion so far is a lack of grant funding to the credit union sector. Though there has been some grant funding issued to credit unions from Fair4All Finance, the overall level of funding has been insignificant. The majority of credit unions in England have struggled to obtain funding, with their often being highly selective terms and criteria attached. Many of our member credit unions reported that they have been turned away when applying for grants, even though their common bond has a prominent level of financial exclusion or financial deprivation. This does not mean that the sector is opposed to necessary criteria and conditions being attached to grant funding. However, we have found that dormant assets funding for financial inclusion to-date has been inaccessible for credit unions.

To demonstrate this issue, we would like to highlight the disparity in the level of grant funding received by credit unions in England compared to Wales and Scotland. The devolved governments in Wales and Scotland are highly supportive of the credit union sector as part of their strategy to promote financial wellbeing and inclusion. From credit unions' annual returns data, we have information on the total level of grant funding received in the financial year ending in 2021 for 98 credit unions: 67 based in England, 26 in Scotland and 5 in Wales. It must be noted here that funding received does not just represent funding from Fair4All Finance or the devolved governments, as this data includes any grants or donations received by the credit union.

The mean grant funding for credit unions in England in 2021 was £26,740, which is just under half of average grant funding received by Scottish credit unions (£54,979). Welsh credit unions received even larger amounts of grant funding, with a mean of £116,804 per credit union. The annual returns data also indicated that 34% of English credit unions received no grant funding from any source in 2021.

However, the average level of grant funding for credit unions in England is skewed, as a small percentage of English credit unions received a significant amount of grant funding in 2021. As such, the average level of grant funding for credit unions in England is better represented by the median of **£8,363**. As shown in the graph below, the median grant funding for English credit unions is **less than a third** of the median in Scotland, and only a small fraction of the median grant funding for Welsh credit unions.



The median amount of grant funding received per credit union has been taken from the 2021 annual return data from a sample of 98 ABCUL member credit unions. This includes all grant funding and donations received from third parties in the financial year ending 2021.

This lack of grant funding greatly limits English credit unions' in reaching potential to promote financial inclusion on a larger scale. We believe there should be an emphasis on grant funding as the means to supporting the credit union sector, as well as collaboration with credit unions in identifying what would support them in scaling up.

There is much greater room for the support for credit unions to be determined in collaboration with the sector and tailored to the needs of credit unions. Credit unions have a unique structure, but with this comes a unique set of associated needs. However, the support provided by the dormant assets funding has not necessarily been fully responsive to the needs of credit unions. For example, credit unions are often conflated with CDFIs and are recognised simply as community lenders. Whilst there are certainly similarities with CDFI's, credit unions' offering is much broader than affordable loans and they also serve a wider demographic of individuals.

With the cost-of-living crisis already having a profound negative impact on both individuals' financial circumstances, there is a need for timely action to promote financial inclusion. Based on the outlined strategy for dormant assets spending on financial inclusion, however, we are not confident that credit unions will receive timely and appropriate support to respond to these extremely tough economic circumstances.

We believe that financial inclusion should remain a dedicated cause for the dormant assets funding through secondary legislation, as there is much greater scope to support credit unions in their mission to foster widespread financial inclusion through this funding. However, we urge that a more robust plan is adopted for supporting the credit union sector in building financial wellbeing and resilience in England. We are committed to supporting Fair 4 All Finance as a vehicle for dormant asset fund delivery through the Financial Inclusion objective subject to a much clearer understanding of the support programmes that credit unions can access for their growth and transformation objectives and that dedicated resources are assigned to truly understanding the unique business model components that underpin the success of the credit union sector. Credit unions must receive a proportionate level of support and investment opportunities that will function as a catalyst for true financial inclusion all across England.