

Life Saving

Community Development Credit Unions

Mick Brown, Pat Conaty and Ed Mayo
New Economics Foundation, the National Association of Credit Union Workers
and the National Consumer Council





The New Economics Foundation and the National Association of Credit Union Workers gratefully acknowledge the support of Royal Bank of Scotland and NatWest.

The grant from Royal Bank of Scotland and NatWest that has been used to fund this publication, and associated events, and the direct work of the New Economics Foundation and National Association of Credit Union Workers is in no way connected to the National Consumer Council which has only contributed to the text of this report

Contents

Acknowledgements	2
Foreword by Ruth Kelly	3
Preface	4
Executive Summary	5
Lifeline Services	6
A Brief History of Credit Unions	7
The Dance with the State	
Development Dilemmas	
Community Development Credit Unions in the USA	10
New York State of Mind	
Competing with Predatory Lenders	
British Credit Unions – Growth Pains and Game Plans	17
1. Southwark Credit Union, London	
2. Northern Oak Credit Union, North Tyneside	
3. Enterprise Credit Union, Knowsley	
4. Riverside Credit Union, Liverpool	
5. Robert Owen Credit Union, Wales	
6. South East Birmingham Community Credit Union	
Community Development Conclusions	
Winning Market Share Against Predatory Lenders	27
Should Government Back Community Development Credit Unions?	30
Recommendations – A Lifeline Banking Service through	
Community Development Credit Unions	32
First ...Definitions	
CDCU Development Framework	
Recommendations	
Appendix A – List of Research Interview Sample and Case Profiles	37
Appendix B – The New York City Financial Network Action Consortium	38
Appendix C – Marketing Campaign for Community Development Credit Unions in Britain to tackle Financial Exclusion	40
Appendix D – Bushwick Co-operative Federal Credit Union	41
Appendix E – Work of the New Economics Foundation, the National Association of Credit Union Workers and t he National Consumer Council	43
References	45
Notes	47

Acknowledgements

The New Economics Foundation and the National Association of Credit Union Workers would like, first and foremost, to thank the Community Development Banking Unit at The Royal Bank of Scotland and NatWest for their strategic and financial support of this research project. The authors alone are responsible for the contents and any views expressed. In coming to the interpretation of the findings and in framing the recommendations we have been ably guided by a strong and experienced Advisory Group who we wish to thank for their practical experience and wisdom. The members were:

- Andrew Robinson, Royal Bank of Scotland and NatWest
- Matthew Pike, Home Office
- Geron Walker, Lloyds TSB
- Jim Dearlove, Birmingham Credit Union Development Agency
- Lucy Aldous, Community Development Finance Association
- Bob Brennan, Department of Trade and Industry Small Business Service and Phoenix Fund
- Fiona Price, Department of Trade and Industry
- Chris Stoddart, Financial Services Authority
- Will Paxton, Institute for Public Policy Research
- Niall Cooper, Church Action on Poverty and Debt on Our Doorstep Campaign
- Lesley Bird, Wales Co-operative Centre
- Glynis Sharpe, Community Wealth Credit Union Ltd, Doncaster
- Elaine Kempson, Personal Finance Research Centre, University of Bristol
- Gina Hocking, Oxfam UK

We would additionally like to thank over 100 US and British credit union practitioners that we interviewed or had contact with during the course of the six-month project. In particular, we owe a deep debt of gratitude to Cliff Rosenthal and his staff in New York at the National Federation of Community Development Credit Unions for organising our itinerary and giving us bundles of time to answer our questions. We also would like to thank Peter Bray of the New York City Financial Action Network Consortium for answering questions patiently and taking time out of his busy schedule to guide us through the New York subway networks, enabling us to interview community development credit unions in the South Bronx and Harlem. Additionally we are grateful to Jack Lawson of Bushwick Co-operative Federal Credit Union. His help was invaluable in gaining an understanding from a grass roots expert on how to start up a community development credit union from scratch, get fuelled up, and moving from 0 to 60, in less than a minute.

We would also like to thank all five British Credit Union trade associations and their representatives for their assistance, support and participation in the 10 March 2003 Focus Group. Lastly a special thanks is needed for the patient administrative, editing and design work of the artistic Lily Swan at New Economics Foundation who has put lots of heart and soul into this report to finish it off superbly.

*Mick Brown, Pat Conaty and Ed Mayo
July 2003*

Foreword

by Ruth Kelly

Britain has one of the most competitive and sophisticated financial service sectors in the world, but for many people, not least in my own constituency, access to financial services still means cheque-cashing shops and loan sharks. Access to basic financial services is a vital part of bringing people back into the mainstream of society. A job is not enough, freedom from crime is not enough, if you are marginalised from the financial system and ghettoised in a cash economy.

That is why this Government's approach to social inclusion and asset-based welfare acknowledges the central importance of improving access to financial services. The complexity of the issues which make up financial exclusion call for joined-up solutions. Credit unions that aim to tackle financial exclusion are part of the solution — providing access to savings and affordable loans. In Ireland and in the USA they are able to play a key part in improving access to financial services. We want to see strong growth in the credit union sector in this country, capable of meeting a wide variety of needs. I hope this report on community development credit unions stimulates discussion and debate about different approaches to development and how that growth might best be achieved.

Ruth Kelly
Financial Secretary to the Treasury
May 2003

Preface

This report marks an important milestone.

15 years ago, when the National Federation of Community Development Credit Unions first received credit union visitors from the United Kingdom at our New York offices, the British movement was small and scattered, labouring under an impossibly restrictive regime that all but foreclosed its growth potential. Five years ago, when I commenced a series of visits to England and began to share the community development credit union (CDCU) story with Treasury officials, bankers, and credit union activists, there were hundreds more credit unions, growing public interest, but only a hypothetical and controversial strategy for applying the CDCU concept to solving the problems of the financially excluded in the United Kingdom. In the past two years, I have observed the quickening pace of development of the credit union movement, as well as that of the nascent community development finance industry, of which CDCUs are an integral part in the US, though just beginning to be so in the UK. The National Federation's transatlantic collaboration has deepened through exchange visits and study tours with the National Association of Credit Union Workers, the New Economics Foundation, the Community Development Finance Association, the Scottish League of Credit Unions and credit unions from Birmingham, Wales, Yorkshire and elsewhere.

The "state of the art" in this cross-fertilization is richly evidenced in this report. The authors have studied and judiciously translated the US experience into the British context. More important: they have appraised a half-dozen credit union models operating today in England, analyzing their strengths and vulnerabilities. Their assessments and recommendations are not based on hypothesis or theoretical constructs,

but rooted in current practices. No single credit union in England may correspond to the Platonic ideal of a community development credit union – but then, even after 30 years or more of experience, few if any do in the US. Reading this report, it seems clear to me that there are enough credit unions with sound, effective practices of various kinds to show the way forward for scores, if not hundreds, of others. The time is ripe for public and private sector resources to nourish these seedlings.

There is no more difficult, or vital, work in the financial-services sector than promoting savings and providing legitimate, affordable credit to the financially excluded. The problems of economic disenfranchisement in developed countries are increasingly global; some of the same institutions and predatory lending schemes to drain wealth from poverty communities are found on both sides of the Atlantic – sometimes, under the same ownership. With the emergence of the CDCU movement in Britain, we can say that the responses to poverty and exclusion are becoming global as well.

Clifford Rosenthal
Executive Director
National Federation of Community
Development Credit Unions
USA

Executive Summary

In the face of market uncertainty, long-term savings have emerged as a major political concern. But uncertain pensions are an obsession largely for the better off. For the less well-off, ranging from the traditional poor to the aspirant lower middle-classes, that are above benefits, in work but far from comfortable in terms of access to housing or job security, there is a different crisis — which is short-term savings. Without savings and having typically to borrow at exorbitant rates, far higher than those charged to better-off Britain, the crisis in short-term savings is really a new form of poverty and social exclusion.

The report examines the scope for creating a lifeline banking service based on a new model of credit union, successful overseas. On current projections, credit union members will number half a million by the end of 2004. But the alternate tightening and loosening of state regulation has limited the sector. The most recent changes, with the transfer of regulatory powers to the Financial Services Authority are likely to lead to closures among the weakest credit unions. While the attraction of the credit union model is that it is one of the few financial services institutions that is relatively straightforward for a community to start small, it is the very lack of scale that can prove problematic.

In the USA, around one in three of the 220 'community development credit unions' (CDCUs) have received public investment packages from the Federal Government and other sources. As a result, credit unions serving the poorest Americans have grown dramatically, with increases in asset growth (in some cases up to 800 per cent), financial growth in net worth (up to 1,200 per cent) and membership growth (up to 500 per cent). Every year, in the USA, credit unions assist over 600,000 people in need, who would otherwise be preyed upon by down-market lenders.

The report recommends that the Treasury, and the devolved administrations in Scotland and Wales, initiate a programme of investment and support to develop a cluster of 100 CDCUs in the UK.

The goals for a lifeline banking service in Britain are two fold. Firstly to encourage savings among Britain's low-income households and thereby provide a localised way and means for the promotion of asset based welfare solutions including the Savings Gateway and financial literacy services to help reduce child poverty. Secondly to take 10 per cent market share from sub-prime lenders, the largest of which have up to 1.6 million customers.

Winning this market share over a five year period of assertive, direct competition would make a significant impact on the life of a large number of households. This report provides a quantitative estimate of the outcome of such an initiative. It would:

- inject around £227 million of affordable credit into many of the least well-off households in Britain;
- save an additional £36 million in interest payments from hard-pressed budgets;
- bring a benefit to wider society and the taxpayer from the capital invested directly in low cost loans, of £250,000 for an investment of £145,000 in each credit union.

The CDCU model represents a practical and positive development model for credit unions that wish to address financial exclusion and poverty. It also offers innovative policy solutions, and partnerships, to a government in search of ways to promote a more inclusive society.

Lifeline Services

School uniforms, paying the gas bill, unexpected repairs can have the same effect on a low-income family as a stock market crash on investors, hollowing out the few assets that they may have – whether a National Savings Bank account or funeral plan with the Co-op. But, whereas the stock market can bounce back within 24 hours and investors recover their ground, the everyday shocks of life on low income can fast become quicksand, as poor families are sucked into a vortex of debt.

This is why short-term savings and access to affordable credit (along with a safe place to deposit money, a way to cash cheques and make payments to third parties, and access to money and budgeting advice) represent a lifeline service, no less important than nurses or the local police. They reduce vulnerability and help people to cope with the risks of life in modern society.

Without this, as research study after research study has shown, people on low-incomes have to turn to borrowing at exorbitant rates, far higher than those charged to better-off Britain. This is true not simply for the traditional poor, out of luck and out of work, but also for Britain's new working poor. These are the aspirant lower middle-classes, from nursery teachers to cleaners and manual workers, that bear the brunt of economic risk – above benefit levels but caught in low-paid, 'flexible' and insecure jobs. Many are tenants, but just as many are modest home-owners, tied into long-

term debt, and yet routinely denied access to consumer credit or, in the South East, priced out of housing altogether, facing a daily commute of three hours and more.

It is a myth that loan sharks are the illegal operators, unlicensed by society, operating only at the roughest end of town. Many of Britain's flourishing 'sub-prime' lenders generate huge profits by lending at margins that are essentially asset-stripping the poor and low to moderate income households. They are Britain's very own financial disservices industry. Other countries have cracked down on exploitation or, as in Ireland and the USA, fostered alternatives that can win market share by competing for the business of those at risk.

This is the subject of this report. We argue that the UK can develop a framework for low-income savings, by supporting the spread across the country of a new type of credit union, dedicated, among other things, to serving those in need.

We call these 'CDCUs' – a term that can help distinguish and recognise credit unions that have a particular, while not necessarily exclusive, focus on the needs of the poor. Not all credit unions will have this. Indeed the proportion of credit union members without bank accounts is estimated by some researchers in fact to be no different to the adult population at large.¹ But credit unions do have a unique legal status. In return for

abiding by some key principles, such as a maximum interest rate for lending, they are exempt from many of the regulatory demands made of banks, meaning that they are the only organisation of its type that ordinary people at local level could feasibly set up to provide affordable and locally accessible financial services.

The report draws on an extensive set of national and international interviews, and the findings of credit union practitioners that visited CDCUs overseas.² Our proposal for the uptake of CDCUs is, however, not for any one body to implement. Rather, the proposal is designed for comment and discussion.

It is for this reason that we published an earlier version of this report for consultation as an 'exposure draft' in May 2003. The credit union sector is still young, has seen false dawns and its fair share of internal debate. There are other stakeholders too, such as community regeneration organisations, central and local government, banks and ethical investors that could play a role, and whose views will matter. Community development credit unions cannot be imposed. But the potential clearly exists for a wider constituency of support to come behind the idea of a credible national framework, backing the efforts of people on low-income themselves to get out of financial exclusion through access to a supportive local credit union, open five days a week in a convenient, High Street location.

A Brief History of Credit Unions

The first credit union in Britain was set up on 1 April 1964 by members of the West Indian community in Wimbledon. It was set up as a company, open to members from the local parish. Two more credit unions soon followed, in Highgate, London, and in Hove, Sussex. As there was no specific legal model for credit unions, they adapted existing structures to suit their purpose.³ By 1979, when legislation was passed, a further 51 credit unions had got going.

The Credit Unions Act was passed in 1979 as one of the last acts of the dying Labour Government. It was the direct result of work by the credit unions and the National Consumer Council and followed a pattern set earlier in Northern Ireland by regulating the size of loans and shareholdings, the rate of interest payable on loans and the dividend payable on shares.⁴

The Dance with the State

The first credit union to register under the Act was Skelmersdale, with Wimbledon registering soon after. The new credit unions included a number of activists, particularly among the West Indian population, who had previously been involved with informal extended family groups who clubbed together to save and give each other loans. This tension between formality and informality and between the capacity of members and the demands of regulators has proved to be an enduring one since.

Smaller credit unions soon found the registration fees a burden and argued that it prevented them from offering dividends on their members' savings. The need for an annual return and a professional audit also caused complaints of being 'paperworked to death'. In 1982, the regulator reported on the subject:

"Some credit unions were formed and registered in a spirit of optimism engendered by the provision of a specific statutory framework. Inevitably, in some cases, the euphoria present at the launching of a new enterprise has given way to the more sober realisation that the day-to-day responsibility of running the enterprise effectively and prudently involves a great deal of commitment and voluntary effort by individuals. Regrettably, not all of those involved had appreciated the scope and depth of their responsibilities to take care of the funds their members placed with them, or the time necessary to discharge them adequately."

In the previous 12 years, 24 new credit unions had started. But in the following three, six were closed, leading the regulator to impose new requirements. If credit unions were dealing with people's money, many of who were not rich, then they had an entitlement to a reasonable degree of protection.⁵ It was only by 1994 that regulation started to loosen up again, and in particular, accepted credit unions that aimed to serve a residential 'common bond' of over

30,000 population. The first rural credit union, the Robert Owen in Newtown, Wales opened during 1995 – the first eligible to residents dispersed over hundreds of square miles. Further deregulation in 1996 allowed credit unions to open out to members that worked in an area even if they did not live locally. Of the 690 or so credit unions now operating in Britain, more than half were first registered with a community common bond – that is, designed to serve a neighbourhood rather than a workplace (the so-called 'industrial' credit unions). However, since 1996, it has increasingly become the norm to register new credit unions with the 'live or work' mixed common bond.

Development Dilemmas

The credit union movement has matured in cycles of stronger and weaker growth. By 1998, after nearly 20 years of formal life, credit unions had recruited a quarter of a million members. On current projections, credit union members may number half a million by the end of 2004.

The alternate tightening and loosening of State concern has played a role. Regulation has tended to be one step forward, one step back. For each improvement, other requirements have been imposed from elsewhere, such as money laundering regulations.⁶ The most recent changes, with the transfer of regulatory powers from the Registry of Friendly Societies to the Financial Services Authority, are likely to have a

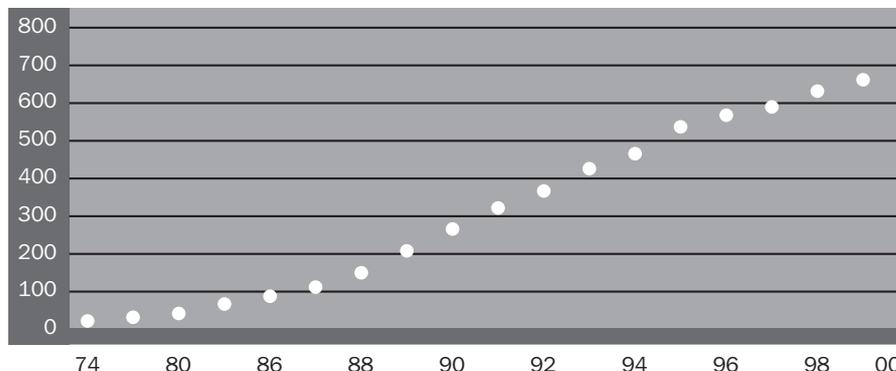
significant impact, with a number of closures expected among the weakest community credit unions.⁷

However, whatever significance regulation has in terms of barriers to entry, the growth of credit unions looks like a classic 'S' curve of innovation and diffusion, whereby the early adopters start, but find it hard to spread as they suffer from low investment or capacity. But as pioneers, they help win acceptance for the concept of credit unions, making it easier for the next generation in neighbouring areas to grow.

Community credit unions have been growing at a fast rate. In 1997 42 per cent of members were within the 382 community credit unions and 47 per cent in industrial unions. By 2001 those figures had changed to 38 per cent and 41 per cent. Additionally, alongside this was the rapid growth of community credit unions with the new live/work common bond. Over the same four years, new registrations and changes to existing common bonds created some 135 credit unions in this new category, accounting for 13 per cent of all new members by 2001. (see Table 2 below).

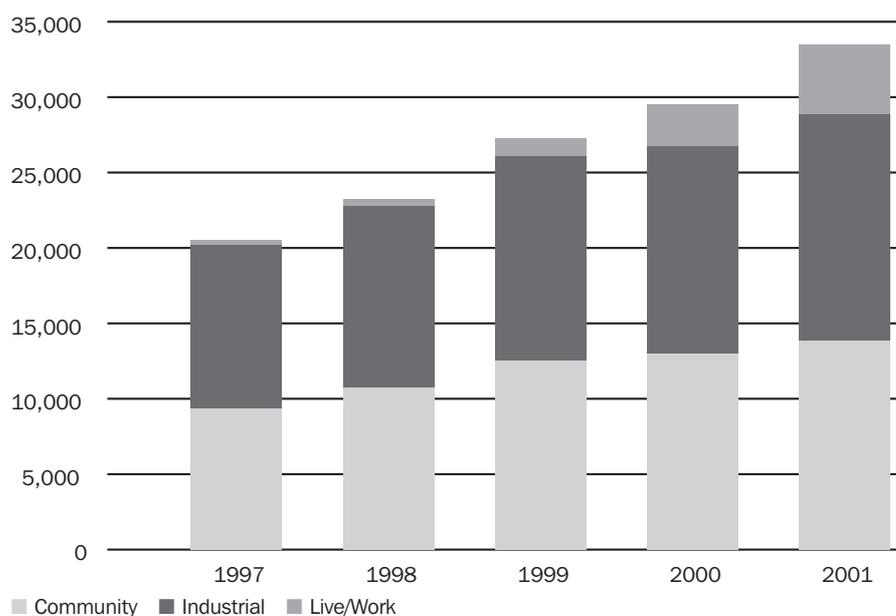
However, in the late 1990s, two research reports warned of the unsustainability of some of the credit union development models. A Commitment to People and Place: the case for CDCUs by the New Economics Foundation (NEF), for the National Consumer Council, in 1997 warned that at current rates of asset accumulation, most community credit unions were far too weak to reach the point at which they could

Table 1: Credit Union growth in Great Britain, 1974-2000



Source: Registry of Friendly Societies

Table 2: Credit union models, 1997-2001



Source: Registry of Friendly Societies

fund even one full-time worker from asset income. Written by two of the authors of this report, Ed Mayo and Pat Conaty, it called for a new focus on getting community credit unions to scale and sustainability and introduced the idea of CDCUs to the UK.

Two years later a Liverpool John Moores study⁸ argued that for credit

unions to succeed, they had to secure better facilities and resources. No longer could they be expected to compete for custom from the back of the church hall. Local authority funding and development models were criticised as focused on organising and start-up work rather than sustainable growth.⁹ In fact this report endorsed many of the proposals in the

earlier New Economics Foundation report, in respect of the need for strategic investment to help credit unions acquire high street premises, paid staff and more expertise within their management teams – all vital ingredients needed to achieve quicker growth.

The report spawned a ‘new model’ approach to development, where high initial subsidies are applied as the route towards securing long-term sustainability. Recently established ‘beacon’ credit unions are piloting this approach. While relevant as an approach for any credit union, the success indicators are largely based on passing the breakeven point on the balance sheet, so that social objectives do not form an explicit component of the new model.

Here is the central issue. Does there need to be a trade-off between financial sustainability and social objectives? If there is, then credit unions that wish to grow financially, as a priority, will tend to target members that are better off to start with, while credit unions that do serve a significant number of low-income members might find themselves unable to meet the extra costs, whether in terms of a lower asset base or higher risk, that might occur. The arguments below show that a trade-off is neither inevitable nor desirable. In the next chapter, we look at the evidence that exists from overseas, in the USA, where CDCUs have operated for many years and have shown how to achieve a street-wise balance of both social justice and business development goals.

Case Study - River Valley Credit Union

Manager Peter Kelly, describes the River Valley Credit Union as unashamedly ‘old model’, with roots firmly in their community. The credit union is 14 years old and boasts over 1500 adult members and 500 juniors. It covers a 90,000 population area of Salford, Manchester and its size in large part has resulted from a merger of three smaller credit unions. . They would also like to merge with the nearby employee credit union which would increase their membership significantly more again. The credit union is based in an old NatWest bank, an imposing building, the most impressive in the area. The credit union is professionally run with 5 staff, £800,000 in assets and over 100% of their savings out on loan.

They have a third of their members on a direct deposit basis – including around 150 members on payroll deductions and another 350 on standing orders. However two thirds of their members are on low incomes or on benefits with the bulk of payments as weekly cash deposits made over the counter. Some of the services that the credit union offers are specifically aimed at those on lower income. For example they provide a debt consolidation service linked with a local money advice agency and are prepared to take chances with some of their members, many of whom might be seen as too high a risk for other lenders to consider. The credit union has a partnership with a local broker to provide car and home insurance. They also offer a free cheque cashing facility to compete with more expensive private companies.

Last year they gave a 3% dividend on savings which was higher than most of the high street competition and something that they promote heavily.

Community Development Credit Unions in the USA

“We do not select members based on their potential to profit the credit union. Rather, we seek those whom we can benefit, whose lives we can enrich, and with whom we can strengthen the broader community. We seek to build our members wealth – to help them escape poverty, to improve their lives, and at the same time, to lift up the communities in which we liveinclusion is our mission and our passion. Our goal is to leave no one behind.”

National Federation of Community Development Credit Unions

With its notorious lack of a welfare state, the USA does not, in international terms, lead the way on preventing domestic poverty, nor indeed financial exclusion, but it does offer solid evidence of the positive large-scale role that credit unions can play – and that they can serve low-income communities at scale and on a sustainable basis. One of the building blocks for this has been a patient and enabling policy framework.

There are over 90 million credit union members worldwide but three in four are resident in the USA. Most American credit unions were organised around the workplace and only a few developed from a community base. The first American credit union was registered in 1908 in Manchester, New Hampshire. The first community credit unions started during the Great Depression – in the rural South, where African Americans were excluded from banking services due to segregation, and in some major cities, especially New York, where the numbers of urban poor had grown dramatically. Credit

unions played a role in President Johnson’s ‘War on Poverty’ in the 1960s, although the experience confirmed that government was better placed to play an enabling rather than a promotional role in building community institutions.¹⁰

However, over the past 20 years, the larger credit unions have operated increasingly like full service banks and the average membership in most credit unions, as with UK building societies, has become middle class. To balance the drift of credit unions upmarket, a dedicated trade association for credit unions catering for the needs of low and moderate income households was founded in 1974, the National Federation of Community Development Credit Unions (NFCDCU).

Around the same time, the new US federal regulator (National Credit Union Administration) recognised that credit unions serving a low-income membership deserved extra regulatory flexibility to achieve their aims. This came in the form of a change in the law to enable such credit unions to accept savings from people that were outside of their targeted membership constituency. This could include charitable foundations, banks and ethical investors willing to put money in on preferable terms. To secure eligibility, credit unions applied to the regulator for ‘low-income credit union’ designation.

The origins of the National Federation of Community Development Credit Unions lay in one of the many regulatory shifts that have characterised the credit union movement. When a new share

protection insurance scheme (of up to \$20,000) was set up, a 1971 inspection by the regulator showed that almost 1,000 low-income credit unions failed to meet the strict standards required to qualify. In 1972, though, a compromise was reached, which combined provisional insurance arrangements together with a concerted effort, through the formation of what became the National Federation of Community Development Credit Unions, to upgrade the quality and capacity of low-income credit unions.

The original name for the trade association was the National Federation of Community Credit Unions. The grass roots organisers could see the challenges involved in sustaining the viability of community credit unions. As a result the word ‘development’ was specifically added to their incorporated name to distinguish their unique approach to promoting credit unions in low-income communities. To spell out the nature and methods of this approach, the founders of the National Federation of Community Development Credit Unions, in January 1975, produced a ‘master plan’ for the CDCU movement: The Community Development Credit Union: a Proposal for Strengthening and Expanding the Impact of this Effective Low-Income Community Agent. From the colour of its cover, the plan became affectionately known by activists, as the ‘Blue Book’. The Blue Book indicates crucial ingredients for assisting low-income credit unions to be enabled to grow and flourish. A national investment programme was costed to achieve this with the following development tools:

1. technical assistance to credit unions to help develop their business plans and systems;
2. training services of a high standard – especially in ways to reduce costs through data processing capabilities;
3. strategic investment of deposit capital to enhance credit union assets for lending;
4. time limited subsidies for operating budgets and staffing.

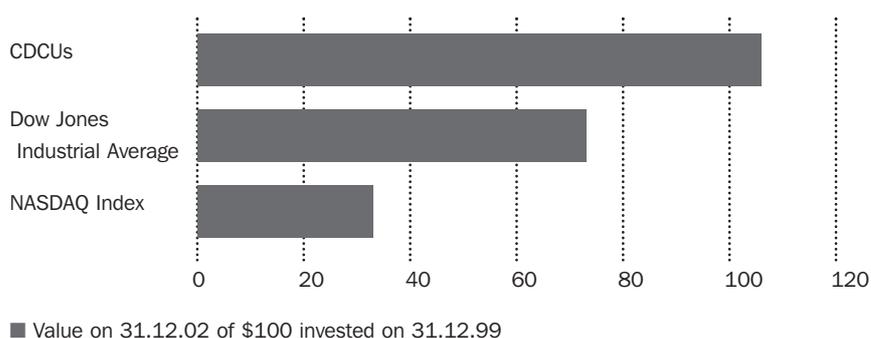
This programme won support from government, although not, over the subsequent years, with full consistency. The Federal Government under President Carter provided support in terms of the deposit capital and technical assistance.¹¹ This though was short lived as the Reagan administration dismantled the programme, closed the special Office of Community Development Credit Unions, set up by the regulator in the Carter years, and withdrew all federal funding in 1981-82.¹² After years of struggle with a tiny budget from membership dues, and little else, the National Federation of Community Development Credit Unions revived the tools of the Blue Book by securing support from charitable trusts and foundations. At last in 1989, the Ford Foundation funded the National Federation of Community Development Credit Unions to develop a National CDCU Demonstration Project which for the first time provided community credit unions a complete package of support including both deposit capital and time limited subsidies for operating budgets and staffing.¹³

By 1992, NFCDU membership had reached 100 and in response to an election pledge by Bill Clinton, credit union and non-credit union providers of financial services to disadvantaged communities came together to form the Community Development Finance Institutions Coalition in 1992. The Clinton administration reopened the Office of Community Development Credit Unions at the National Credit Union Administration and passed the Community Development Finance Institutions (CDFI) Act in September 1994 to provide a wide range of investment and financial support for the full spectrum of Community Development Finance Institutions. To date, around one in three of the 220 CDCUs have received public investment packages from the CDFI Fund managed by the US Treasury.

The tracking of success has shown dramatic increases in asset growth (in some cases up to 800 per cent), financial growth in net worth (up to 1,200 per cent) and membership growth (up to 500 per cent).¹⁴ As a result, CDCUs in the USA, over the year 2002:

- mobilised savings from their members of \$2.29 billion;
- loaned \$1.04 billion to their member borrowers;
- saved up to \$300 million in interest — otherwise payable to predatory lenders;
- recycled over \$34 million in dividend income to low-income communities;
- assisted around 600,000 low-income households to acquire assets and build wealth.

Figure 1: High Street vs Wall Street



Source: National Federation of Community Development Credit Unions, Annual Report 2002/3

New York State of Mind

An example of a CDCU that has benefited from this patient support is one first set up to replace a closed bank branch in lower Manhattan, New York. The Lower East Side People's Federal Credit Union (LESPFCU) came out of a campaign by local residents against the closure of the last local bank branch by Manufacturer's Hanover Trust. Under the terms of the US Community Reinvestment Act, passed by President Carter in 1977, banks have an obligation, as part of their banking license, to meet the financial service needs of the communities where they have branches. They can fulfil this responsibility to the banking regulators both directly and indirectly, i.e. through a non-banking intermediary that they may choose to support in a community delivery role. British and European banks have no such legislative responsibility, through such obligations have been considered in reports both to the British Treasury and the European Commission.¹⁵

The Lower East Side campaign brought one of the earliest Community Reinvestment Act test cases to positive fruition. In response to the Community Reinvestment Act challenge, the bank agreed to lease their vacant bank building to the Lower East Side People's Federal Credit Union for two years at a peppercorn rent, to make a social investment deposit in the credit union of \$100,000 and to provide grant support, for a limited period, for staffing.

In its first five years the Lower East Side People's Federal Credit Union built up a deposit base of \$2 million and reinvested more than \$1.8 million to low-income borrowers – mostly Hispanic and African-American. Today its assets are over \$9 million and its new loans issued are running at \$1 million a year – some three times the volume in 1991. Its membership level is over 4000 and it is presently developing a second branch office to expand its membership.

Across New York is a second CDCU success story. Bethex Federal Credit Union was founded in the South Bronx by the Bethany Lutheran Church. The credit union grew steadily over its first twenty years, but in the late 1970s fell out with its church sponsor, ironically because of the success of its work with black single parents on welfare. The credit union had to move from its church base and struggled until, in 1994, a housing association, Mount Hope Housing Company, provided an office in the basement of a multi-storey housing block. They charged a peppercorn rent of \$1 per year and helped to introduce their tenants to the services of the credit union.

Membership of the credit union rose from 700 in 1994 to almost 10,000 at the end of 2002, with assets also rising from \$700,000 to \$9 million and a net worth, secured over the same period, of £1 million. Through its active work with local schools, Bethex has recently built up 1,800 children's saver accounts.¹⁶

Yet, CDCUs in New York have not solved issues of financial exclusion. One in four New Yorkers (2 million people) are unbanked citywide. In the ten years to 1999, almost one in four bank branches (22.3 per cent) have closed in New York City and there are also more bank mergers on the cards. Consequently, cheque cashing firms and sub-prime lenders are proliferating. In the past four years, pay-day loan outlets in the USA have increased from a low base to over 10,000, offering long opening hours, widespread locations and quick access to cash.

Yet CDCUs have been able to take market share from predatory lenders in the neighbourhoods they are present in and so are now thinking big in terms of reducing financial services exclusion in a significant way. To help to do this collaboratively, CDCU regional networks are emerging, both in New York City and in the rural South. For example, five CDCUs, including both the Lower East Side People's Federal Credit Union and Bethex, have come together to form a partnership to spread CDCU services across the city (described in Appendix B). The success of these strategic networks suggests that they will be vital to watch, as early achievements are impressive.

What a Community Development Credit Union Looks Like

It is hard to generalize about community development credit unions as they vary in asset size from \$100,000 to \$700 million with corresponding membership ages as registered credit unions from 1 year to 70 years. Membership sizes among community development credit unions also vary widely from 200 to 220,000. Not all common bonds are community based. Many have faith based, associational, employee or mixed common bonds. All tend to be active partners with other organizations concerned with community development. This ranges from the active involvement in government-sponsored financial literacy services designed to promote savings (the Individual Development Account programme) through to active co-operation with social housing providers.

The profile of a 'typical' community development credit union might be:

- *Assets: \$1.5 million*
- *Average membership: 835*
- *Average staffing: 4*
- *Member profile: 80 per cent low-income, 61 per cent female and 78 per cent ethnic minority*
- *Net Worth (Equity): \$115,120 (9.77 per cent)*
- *Delinquent loans/total loans: 3.75 per cent*
- *Total operating revenue: \$130,150*
- *Return on average assets: 1.27 per cent*
- *Non-member deposits/total deposits: 5 per cent*
- *Average loan size: \$3,500*
- *Standard services: Savings, loans, checking/bill payment, automated social security payments transfer, financial literacy and financial counselling, and Individual Development Accounts*
- *ATM machines: operated by 25 per cent of community development credit unions and growing*

NFCDVCV members provide more than consumer loans. Purposes for borrowing include: Personal (98%), car or transport (79%), housing (62%), micro-enterprise and small business (32%), and community projects and social enterprise (16%).

Stages of community development credit union Assistance – Credit Path to Financial Inclusion

Transactor: *for those with limited income or in debt, payment and money transmission services are either extraordinarily expensive or unavailable. Community development credit unions need to develop affordable payment and budgeting mechanisms to help overcome this problem.*

Saver: *traditionally credit unions provide this as the first stage, but increasingly they cannot attract low-income members without first tackling the transactor problem. Savings can be incentivised by special programmes and by offering attractive rates of interest on even the smallest minimum account balances.*

Borrower: *most households need to borrow periodically if only to even out cash flow or to acquire assets. Also, effective borrowing skill builds up a credit rating and helps households gain experience for large commitments such as home purchase. Unlike conventional lenders that rely on credit histories and electronic credit scoring, credit unions specialise in 'character-based lending' where savings histories are focussed on. Credit unions also are unique in providing micro-loans that enable households to borrow sensibly and affordably at low rates of interest.*

Owner: *evidence shows that asset ownership is important in helping move households out of poverty. Community development credit union specialisation in loans for enterprise development and for low-income home ownership and repairs contributes uniquely where other lenders are unprepared to make credit available at low costs.*

Competing with Predatory Lenders

Bill Myers, Founder and Manager of Alternatives Federal Credit Union in Ithaca, New York has developed a process model for helping low-income households overcome disadvantage and the lure of moneylenders. He calls this CDCU strategy the 'Credit Path', with four stages of development, as set out on page 13.

Both Bethex and the Lower East Side People's Federal Credit Union have developed membership services along these lines, helping to take members from extreme vulnerability and the clutches of predatory lenders, to self-reliance. Their introductory services, for the 'transactor', for example include: personal checking accounts; money orders (for one-off payments) and money transmission internationally; electronic welfare benefit and pension transfer into credit union accounts; and cash payment service monthly for energy and telephone bills.¹⁷ In respect to money advice, Bethex provides a financial budgeting advisory service through a partnership with a credit counselling agency, Balance – a service that is free to members for initial sessions.

Both credit unions have played a significant role in assisting low-income households in the shift, driven by the US Treasury in recent years, from benefits paid in cash to benefits paid electronically. New England and New York States reached a deal with Citibank to handle state welfare payments exclusively and to issue

an electronic benefits transfer card to welfare recipients. But cash machines were not always accessible to low-income households, so subsequently Citibank moved to install such facilities with a number of CDCUs.

The CDCUs have demonstrated that providing financial services to the poor need not require exorbitant charging and interest rates. As they have grown, they have started to take on predatory lenders more aggressively. ASI Federal Credit Union in Louisiana, for example, has developed an emergency loan facility. This popular 'Stretch Plan' is a six-week loan service for a \$200 loan repayable at only \$222.15 – or one fifth the cost of predatory lenders. In the past two years, it has advanced 2,390 such loans for an average sum of \$300 each. Out of \$700,000 in loan advances in the initial period of operation, only 27 loans have been written off for a net loss of some \$4,000 (or 0.56 per cent of the funds advanced). This loan service includes one-to-one financial counselling and efforts to help people to break away from pay-day lenders. In Cleveland, Ohio, the Faith Community United Credit Union has developed a similar, 'Grace Loan'. They make no credit check, offer loans at an APR of 17 per cent and have faced only marginal losses to date.

North Side Community Federal Credit Union in Chicago began work on an anti-predatory loan system in 1995. Its 'Hot Funds and Cold Cash' service

provides \$500 loans at 16.5 per cent. Since 1995 it has advanced 1,800 such micro-loans. Initially, the loans required credit union membership for at least a year, but, thanks to a guarantee fund, grant-aided by Northern Trust Bank, this restriction has been waived.

The new Payday Alternative Loan is available with no waiting period or savings requirements. In the first nine months of lending from April 2002, 440 people with very low credit ratings have received loans, including 70 people with a prior bankruptcy. To date, nine per cent of those borrowers are slow payers, but given the high risk of the market serviced, this is below expectations and overall over nine in ten of the loans are performing and up to date. Loan product models like these are now being rolled out across USA, through the PRIDE (Predatory Relief and Intervention Deposits) programme launched by the National Federation of Community Development Credit Unions in 2002.¹⁸

Yet, it is also true that some services are more expensive to provide. Community development credit unions have been reluctant to provide cheque-cashing services, since such services offer no incentive for people to open savings accounts. Money usually goes in and out pretty rapidly and thus they are both labour intensive and expensive to service. Bethex in New York therefore concluded that they were not going to compete with

commercial cheque cashers, but as cheque cashers do not provide savings facilities or make loans, they would go into partnership with them. An experimental scheme launched in 2001 with two cheque cashers in the Bronx was controversial at the start, but so far is proving successful, allowing the CDCU to reach more of the most disadvantaged households in the Bronx.¹⁹

The lessons of the US experience suggest that countries affected by a polarisation between rich and poor will attract exploitative 'predatory lending'. Community development credit unions do not offer a complete answer, as they don't exist in every neighbourhood and they take time to develop. But with patient and proactive support from banks, the state and voluntary sector, CDCUs can achieve an outstanding track record, not simply in dealing with the deep-seated complexities of individual poverty and financial exclusion, but in developing as sustainable 'social enterprises' serving the poor on a continuous basis. To that extent, they offer the very best route to choice for low-income consumers, by competing directly with predatory lenders but on affordable rates alone, at a fraction of the cost.

But while CDCUs can boast wider positive returns, in terms of benefits to both the individuals served and the taxpayer in reducing the wider costs of poverty, they do require a degree of

Good Partners: Community Development Credit Unions and Banks

The first ever partnership between a commercial bank and a community development credit union was the one forged under the Community Reinvestment Act with the Manufacturers Hanover Trust Bank and the Lower East Side People's Federal Credit Union in New York in the mid-1980s. Since then many more partnerships have followed.

Under agreements struck, banks have made redundant premises available at pepper corn rent levels, have sold ATM machines at discounted prices and offered technical know-how. But there are two main ways in which banks have helped. Either they make grants or they make sub-market investments. What works depends on the age and needs of the community development credit union. So for new or young community development credit unions in start up mode during their first five years of trading, banks have assisted by providing grants for operating expenses and staff salaries and also contributed non-member deposits at rates varying from 0-1%. As community development credit unions grow, because they can not issue ordinary shares, they can run into liquidity problems and insufficient levels of reserves. So for fast growing or more established community development credit unions this increased capitalisation by banks is hugely important. This is often complemented with further secondary capital levered in through Community Development Finance Institutions such as the National Federation of Community Development Credit Unions and the National Capital Investment Fund (NCIF). This arrives as 'deeply subordinated debt' and at low margins of 1% or so for terms of up to ten years.

American banks win regulatory credit for such actions under the US Community Reinvestment Act and even public subsidy under the innovative Bank Enterprise Award scheme. The public support is important, but the business case for support also stems from the fact that partnerships have developed a track record for delivering not just a better reputation for the banks but market share, as consumers graduate from community development credit unions with a credit history and turn to mainstream finance.

support and subsidy to grow, particularly at the outset.

In the next chapter, we test these findings from abroad against the very practical experience of six credit unions in the UK.

A Rural CDCU in Vermont State:
“We don’t say no. We say when.”

Vermont CDCU is a relatively new credit union, established only in 1989 and initially restricted by the regulator to only taking savings and deposits for their first three years. Now with 10,000 members, 22 staff and over \$20 million in assets they have won many awards in their short history. They have around 150 non-member depositors ranging from the Shaw bank and churches to Ben and Jerry’s Ice Cream Company. These make up over 50 per cent of the assets allowing them to lend around \$16 million in ‘mortgages’ such as for mobile home loans, the main form of affordable housing in the region.

As a rural credit union they have developed products suited to the needs of a rural population. They apply a ‘counselling-based lending’ approach, a combination of lending and targeted planning with their members, many of whom arrive with an “un-bankable” status. For these they have created a ‘tracker loan’ to first help them build a positive credit history.

Of the 10,000 loans they made last year, the most popular were for car purchases, an essential commodity in a region with little public transport. They build partnerships only with local second-hand dealers who will guarantee the safety and quality of the cars sold to their members.

British Credit Unions

Growth Pains and Game Plans

There has been an active search underway in Britain over recent years for more effective ways for credit unions to grow. With less than one per cent of British households in membership, there is a recognised need for better models. The Association of British Credit Unions Ltd (ABCUL) has, for example, led the call for a far more business-like approach. As Shaun Spiers, their chief executive has, on occasion, put the need for business focus to his members, “if you do not believe in [financial] discipline, discipline will quickly believe in you!”

As one would expect, the research we have completed in England and Wales suggests not just one but many pathways for individual credit unions to grow, depending on local circumstances.²⁰ But the findings also reveal that there are many credit unions with no particular pathway in mind at all. For a good many community credit unions, and probably the majority, the sheer pressure of running the credit union, motivating the volunteers, and complying with the Financial Services Authority strictures and reporting requirements leaves little if no time to look ahead and figure out what ‘should be done’ to expand the business.

Indeed, the smaller community credit unions, some several hundred, which are run by volunteers with no paid staff may be happy just to survive. Discussing the future with a number of them, they report that they worry all the time about carrying on. Many say that they would welcome merger to gain strength from others like them, to cope better with growing pressures such as regulation. But for many, there are no local credit unions nearby to

merge with: this is particularly the case for credit unions in small towns, rural areas, or those on many outlying housing estates.

The six credit unions set out below have operated with more conscious ambition. Some are striving to win financially and others are determined to succeed socially. They illustrate the diversity of credit union growth, but also the real challenges that face a CDCU development path premised on both business growth and social impact.

1. Southwark Credit Union, London

Southwark Credit Union was founded in 1982 as an employees' credit union for Southwark Council. Growth was slow for the first 13 years until it took on a full-time manager in 1995, Lakshman Chandraskera, a former computer analyst and programmer with the Prudential who had been made redundant. When Chandraskera joined the CU had 400 members and £700,000 in assets. He developed a marketing strategy and promoted the credit union every month at different canteen sites for Council staff. He also used a prize draw, private lottery to attract interest. This strategy alone gained 1000 new members. To further develop the credit union he negotiated a merger with the Kings College Hospital Employees credit union in 1996 and then a subsequent merger was pursued successfully with the Borough and Bermondsey Credit Union (a community credit union) in 1999.

High street premises were acquired in 1995 through the purchase, from the Council, of a derelict shop front with

additional offices above. The credit union used its own assets to finance the purchase of the property on a mortgage and raised a grant from the Council for the refurbishment work.

The Camberwell Credit Union, the main community credit union in Southwark, had been established in the early 1970s before the Credit Unions Act 1979 but in 2000 had become insolvent. Southwark Credit Union was encouraged to come to the rescue. However, of the £100,000 that the Council and other bodies strove to raise, to pay for the take-over, they could raise only £45,000. Due diligence work revealed a loss of £155,000 due to poor record keeping, non-collection of debts and general mismanagement for many years. In taking over Camberwell Credit Union in 2001, Southwark had to use its reserves to pay for the acquisition of share capital of members of £650,000 but at the cost of £110,000. The key reason for the action was principally that of reputation risk to the credit union movement in Southwark should the credit union be allowed to fail and local people lose so much of their money. Southwark has seen its reserves, as a result, drop to only four per cent of its share capital base and was not able to pay any dividend to members in 2001-2002.

Southwark Credit Union today has total assets of £3.6 million – including three shops (the main one in Camberwell, one in Peckham and one in Bermondsey), two of which are open five days a week and the Bermondsey one is open two days. Share capital in the past eight years has grown to £3.2 million – about 75 per cent of which is

lent out. Seven in ten members are on payroll deduction from either the Council or Kings Hospital, about 16 per cent pay in by bank standing order or direct debit and 9 per cent pay cash through the shops. The cash payers are primarily the former members of the two community credit unions. A recent partnership to begin to widen access to those on low income, has been formed with London & Quadrant Housing Association under the Community Development Finance Institution initiative Change. This seeks to attract low and moderate income tenants to join Southwark Credit Union.

Chandraskera and his team of seven full-time staff have worked hard to build a very successful credit union that despite the challenging rescue of Camberwell Credit Union has continued to grow strongly. Systems are fully computerised, internet and telephone banking services have been developed and a good range of financial services are provided including car loans, home improvement loans and household insurance services.

Staff have been well trained, up to NVQ level 3, and are good at multi-tasking. However Chandraskera is well aware of the difficulty of lending to low-income households without bank

accounts. Without the advice and the support to do this, as in a CDCU model, Southwark Credit Union is unlikely to have a significant impact on financial exclusion.

2. Northern Oak Credit Union, North Tyneside

David Hodgson runs a chartered accountancy practice in the centre of North Shields, a few minutes walk from the Tyne. He is also a Director of the Mercantile Building Society which moved its head office from North Shields to Wallsend a few years ago. Hodgson came to learn about credit unions by doing audit work for the Northumbria Police Credit Union. In 1999, he joined a study group which was successful in forming the North Shields Credit Union. The North Tyneside area had a good number of very small community credit unions and the North Shields Credit Union group have developed a strategy to build a community based credit union by collaborative mergers with other smaller, volunteer run, community credit unions. This strategy is currently under implementation.

To prepare for this, Hodgson and the North Shields Credit Union have raised funding of £300,000 to

resource their business plan strategy which they have begun to deploy at a rate of £100,000 a year for two full-time staff (a full-time Chief Officer and Development Worker and an Administrator), office and equipment, and development of a high street shop front. They have also successfully recruited a full-time volunteer.

The shop in the centre of North Shields has been fitted out and opened in Spring 2003. Funding has been secured from the Tyne & Wear Community Fund and the National Neighbourhood Renewal Fund. The merger strategy has been agreed with the other community credit unions in the area and when complete they will have a share capital base of £300,000 and a membership base of 800.

Beyond these mergers, the business plan strategy is ambitious with targets set of achieving, by 2006, a ten-fold increase of assets to £3 million and a four and a half fold increase of members to 6,000. To do this, Northern Oak Credit Union (the name chosen for the new, merged credit union) has developed a marketing plan based on outreach through 10 weekly collection points each with a weekly target of signing up two new members



Community Development Financial Institutions (CDFIs)

It is useful to note that, in the personal lending field, community credit unions are not the only provider of affordable loans to the unbanked. Community Reinvestment Trusts are the brain child of Bob Paterson, former chief executive of Portsmouth Housing Association. The first was Portsmouth Area Regeneration Trust (PART). PART was set up in July 2000 and it employs seven staff plus volunteers. In the first two years, PART has lent over £375,000 to over 600 people rejected by mainstream lenders.

Credit unions and community reinvestment trusts are both examples of a wider field of 'community development financial institutions' (CDFIs), now recognised and supported by government's Phoenix Fund though, to date, primarily for its work on enterprise lending rather than in tackling household credit needs and financial exclusion.

a week. The credit union has entered into a partnership with Churches Acting Together (which organises furniture for the unemployed and a prison link service for families). The business plan seeks to develop membership for the poorest in North Tyneside and is impressive in its focus and no nonsense approach to the business. All the numbers add up, look realistic and if these targets can be secured, then the asset base can be developed.

Northern Oak Credit Union is one of the only credit unions in the country which has successfully applied to the Phoenix Fund to become a 'community development financial institution'. They initially applied for £500,000 but in the end were awarded just over half this sum — £250,000 in loan capital plus revenue funding for office overheads of £20,000. The way the arrangement works is interesting. The capital can be drawn down in quarterly advance amounts of £25,000 and more can be drawn down beyond this so long as the first sums have been loaned to the self-employed and micro-enterprises.

Whatever funds are repaid, Northern Oak Credit Union can keep this as its own capital. Average small business loan sizes are projected to be £2,500 and there are no savings required, apart from the initial membership fee of £2. Hodgson is confident that they can attract the target number of 150 new business customers over the next few years. From his decades of expertise advising family size businesses as an accountant, he has already developed a simple business start up course for the local Business Link, which connects the Credit Union loan service directly to the

work of enterprise agency advisors on North Tyneside.

The rigour of business planning and the marketing strategy of Northern Oak is hugely impressive. The benefit of the leadership of a talented accountant like Hodgson with the ability to raise funding on the strength of a credible set of numbers and targets highlights the skills based and hard headed approach that community based credit unions can benefit from.

Hodgson has resisted pursuing growth via payroll deduction pathways as he has not pursued the potential scope for a merger yet with the North Tyneside Employees Credit Union which has assets of over £300,000 and has a larger common bond area of 120,000 (including all of North Tyneside). In Hodgson's view, this merger prematurely would have held back the community based strategy that he feels credit unions concerned with community development need to focus on. Later on, a merger on Community Development Finance Institution terms with the employee credit union can be done he hopes. But for now until he can secure a self-financing capital base of a cool £3 million in share capital, Hodgson and his community credit union board are biding their sweet time.

3. Enterprise Credit Union, Knowsley

Enterprise Credit Union was founded originally as Huyton Central Credit Union in 1988 – a community credit union with a small common bond of only 10,000 people. In 1996, the credit union board were successful in raising regeneration funding and at the same time applied to re-register the

credit union with the Registry of Friendly Societies as 'live or work' common bond. This took 18 months to get approval for.

They employed a co-ordinator, in 1998, to manage the development of the Credit Union: Karen Bennett, who is from a retail background and was an active credit union volunteer. When she took on the job, the credit union had 500 members on its books but only 150 accounts were active. Turnover was low and there were only two collection points. Funding from the Single Regeneration Budget and European Regional Development Fund of £325,000 enabled the credit union to buy a building and renovate it, to create a shop front and conference centre, along with three upstairs offices.

In 1999, the credit union recruited a full-time administrator and, in 2000, a full-time fundraiser and development worker. The credit union is now open five days a week – including one late evening. In addition, a further seven collection points in the community are run by volunteers weekly and the common bond area has been extended to a population of 46,000. Membership has been built up to 1,900 adults and 800 juniors. The outreach and promotional work to the junior schools has been wonderful. As the co-ordinator explained:

"The minimum deposit we set for the kids was 10p and the first promotion we did we walked out with three carrier bags full of small change. This savings scheme is so popular with the schools, but you need the manpower to deal with it"

The credit union offers a range of services from standard savings and loans to insurance services, a budget account and a money management course. Enterprise Credit Union has made links with credit unions in Dublin and they have helped to develop a Money Advice & Budgeting Service (MABS), which is the first such service to get underway nationally. The Esmee Fairbairn Charitable Trust and North Huyton New Deal for Communities have funded a pilot over the past year, which finishes in Summer 2003. To date 120 people with money worries have been seen, there are 30 enrolled on the special budget account scheme and all have been helped with money and debt advice.

The pilot is supported by a £10,000 loan guarantee fund, made possible by the Health Action Zone which enables small loans to be advanced to those in debt, to help them avoid returning to money lenders and doorstep creditors. In a mirror image to Southwark Credit Union, 80 per cent of Enterprise Credit Union members pay in by cash and only 20 per cent pay by standing order. The minority of non-cash members alone though pay in collectively £12,000 per month. Enterprise plans to establish a payroll deduction service and target some of the larger employers in the area but, given scarce resources, the additional development work needed to achieve this is a challenge.

Share capital of the credit union has grown six-fold in the past five years from £45,000 in 1998 to £275,000 today. At present, £180,000 is out on

loan. Enterprise CU has advanced and grown by a friendly merger with one other community credit union in Knowsley. This merger will increase assets by £45,000 and total credit union membership by an extra 500. As a tribute to their rapid year on year growth from a low base, the Liverpool Daily Post and Echo awarded Huyton Credit Union the 'Social Enterprise of the Year' against stiff competition. As a result, the former Huyton Credit Union has changed its name to Enterprise Credit Union. It's clear all involved have earned it!

4. Riverside Credit Union, Liverpool
Speke in South Liverpool is one of the poorest wards in Britain. The Speke Credit Union was formed in 1989, grew slowly in the first five years and by the mid-1990s encountered problems with slow payers and delinquent loans of almost 30 per cent. The board of the credit union took tough action and in the end had 'to take some people to court' and also 'use debt collectors' to bring bad down to levels under three per cent. This experience strengthened the credit union management group and the credit union has grown well since then.

In 2000 the credit union changed its common bond to a larger 'live or work' area including both Speke and Garston. It also changed its name to the Riverside Credit Union and attracted regeneration funding for staff and to develop a shop front in an ex-TSB branch in Speke. With the investment for staff and premises, growth has been

very positive indeed, with membership growth of 25 per cent a year since 1999. Current membership is 3,500 and assets in shares have grown from £181,000 four years ago to over £750,000 today.

Loan demand is constant with over 100 per cent of savings lent out at Christmas and over 90 per cent out on loan normally. The Co-op Bank provides an overdraft facility to assist with seasonal demand peaks. Member savings levels are low and for this reason Riverside Credit Union struggles to pay a dividend as it needs to build reserves. Its current level of reserves is 3.5 per cent.

In addition to savings and loans, Riverside Credit Union provides household insurance and car insurance. It is constantly looking to develop new services to increase membership in ways to benefit its local community. For example, in partnership with the Health Service it has developed 'The Baby Barrel' service for young mums on the estate. It bulk buys goods for maternity needs and sells them at a discount. A full baby barrel includes £200 of goods for £150 loan and includes whatever goods needed from 'prams to carrycots to pushchairs and clothes'. In the credit union shop an online service is being installed so families can operate on a 'you choose and the credit union will purchase' for you basis. According to the Riverside Manager, Colin Strickland: 'In less than one year, we have handled over £25,000 in bulk purchased goods, and this is only the beginning!'

To take the service development for young families further and to help develop savings by direct deduction, Riverside Credit Union has negotiated with the Benefits Agency for Child Benefit to be paid directly into credit union accounts. Beyond this initiative it aims to have other benefits paid directly into the credit union. As Strickland explained:

“What the credit union can do best is to capture local money and recycle it over and over again. We get fed up though with the wasted funds that leave the area. We have seen for years millions of quid in regeneration money spent on consultants and other professionals and very little of it directly invested to improve the lives of our members.”

In their latest development project, Riverside has succeeded in its social enterprise bid to the Home Office backed Adventure Capital Fund for a project to develop new social business opportunities. A local skills register of the credit union has shown many members in the building trades. The project will establish an approved builders list based on checks for qualifications, insurance, and licenses. Home improvement loans will be made available and jobs carried out for fencing, minor repairs, decorating work, security systems installation and other odd jobs. Jobs will be checked before the loan disbursement is made. Riverside has secured £100,000 for this project on an investment basis as a ten year loan with a three year payment holiday and then repayments at one per cent a year over seven years.

The credit union is seeking to relocate its shop next year to the new shopping centre development in Speke near the Morrison superstore. Discussions are underway about a merger with the Earl Lawrence Credit Union in the Wavertree area of Liverpool. Should this be agreed, as looks likely, the wider common bond area would be more than 100,000 population and encompass more affluent areas of South Liverpool as well.

5. Robert Owen Credit Union, Wales

The Robert Owen credit union was founded in 1995 and was the first rural credit union in Britain. It originally serviced a 25,000 population living within the 200 square mile area around Newtown, a small market town in mid-Wales. The district council has provided, for a low rent, a small shop front located in the main shopping area and adjacent to a busy market. The credit union business plan was informed by the advice and encouragement of Michelstown credit union in County Cork, Eire, with which Robert Owen Credit Union has 'twinning'. This expert guidance ensured that from day one the Robert Owen opened with a high street shop, ran computerised accounts and had recruited a good management team.

By the year 2000 the credit union Board were aware that there was a wider rural demand and need for credit union services beyond their restricted boundaries. They therefore started to look at how they could cover the county district of Montgomeryshire, an 800 square mile area, with six

market towns including the historically independent and culturally different communities of Welshpool, Llanidloes and Machynllyth. The population here is sparse (one person per 10 acres) and totalling only 56,000.

The Board were faced with a dilemma. Extending a common bond is a comparatively easy process but with dispersed and impoverished communities, running costs are high and can easily erode profitability. The credit union was not interested in expanding unless these deeper rural areas where the greatest need resided could genuinely be serviced. Yet equally they were not prepared to take on the liability of having to service regions that were financially non-viable. The challenge was therefore to design a new model that ensured profitability and which could justify expansion.

The approach was an innovative one. With a credit union development worker, three local study groups were recruited and trained over an 18 month period. They were given targets and deadlines to work towards. The central team had identified a specific number of 'tests' that would need to be met if 'convergence' was to be possible. If the conditions for these were achieved, all the groups would then have the option of converging into a new large credit union. Otherwise they would each have the alternative choice of registering as a separate credit union of their own.

The tests were met and a new credit union formed in 2001, which has nearly doubled in size, approaching

1,200 members with around 400 junior savers recruited mainly from five local schools. Assets are currently around £200,000 with over 70 per cent of savings out on loan. The credit union has two new offices in the other main market towns, as well as part-time collection points in two of the poorest wards in Wales. On Maesyrrhandir estate they have built a partnership with the Housing Association Tenancy Officer and established good links with the local school recruiting many new members through that route. Once credit union staff have established a new collection they encourage local participation and volunteers to take over and run it in keeping with their bottom-up attitude to growth. They also have linked into the local Sure Start Initiative, in partnership with National Children's Homes to work with young mothers and single parents.

A high percentage of their loans are for business purposes. Around 20 per cent of stall holders in one of the local markets have loans from the credit union. These are mainly around the £1,000 to £2,000 level to assist the businesses to buy stock, for transport or other equipment. A member who runs an ethnic stall, for example, borrowed for a trip to India to buy new stock. For many stallholders the credit union offers short term loans below the threshold of what is possible or competitive at the bank. The market is the lifeblood of the town and the credit union offers valuable hidden financial

support to this vulnerable commercial sector in mid Wales.

On Oldford Estate in Welshpool, identified as being eligible for Community First support, some of the credit union volunteers have chosen to undertake door to door promotion, feeling it is the best way to compete with the increasing presence of Provident Financial. One of the Provident collectors has even joined the credit union, encouraging her customers to join as well. The manager comments, *"We instinctively went down this road as that is where our services are needed most. It is hard work in rural areas and things usually take longer. People need time to trust and feel confident in what are often much more unfamiliar initiatives. However we are not trying to establish services and facilities that are at the expense of more middle class/income members as we don't want to be viewed as a 'poor person's' bank either. In rural market towns every person counts and you have to aim for a variety of sectors."*

6. South East Birmingham Community Credit Union

Credit unions are co-operatives and one of the guiding principles set down for mutual organisations like it is that of "co-operation among co-operatives". Birmingham is the site of efforts to put this into practice. The city boasts 30 credit unions – three workplace, three associational and 24 community based. Total membership citywide is over

20,000 and total assets over £19 million. The three workplace credit unions cover separately city employees, the police and the fire service. All have paid staff and have grown rapidly since their formation. The community credit unions are run by over 400 volunteers and together account for over 7,000 members and about £3 million in assets.

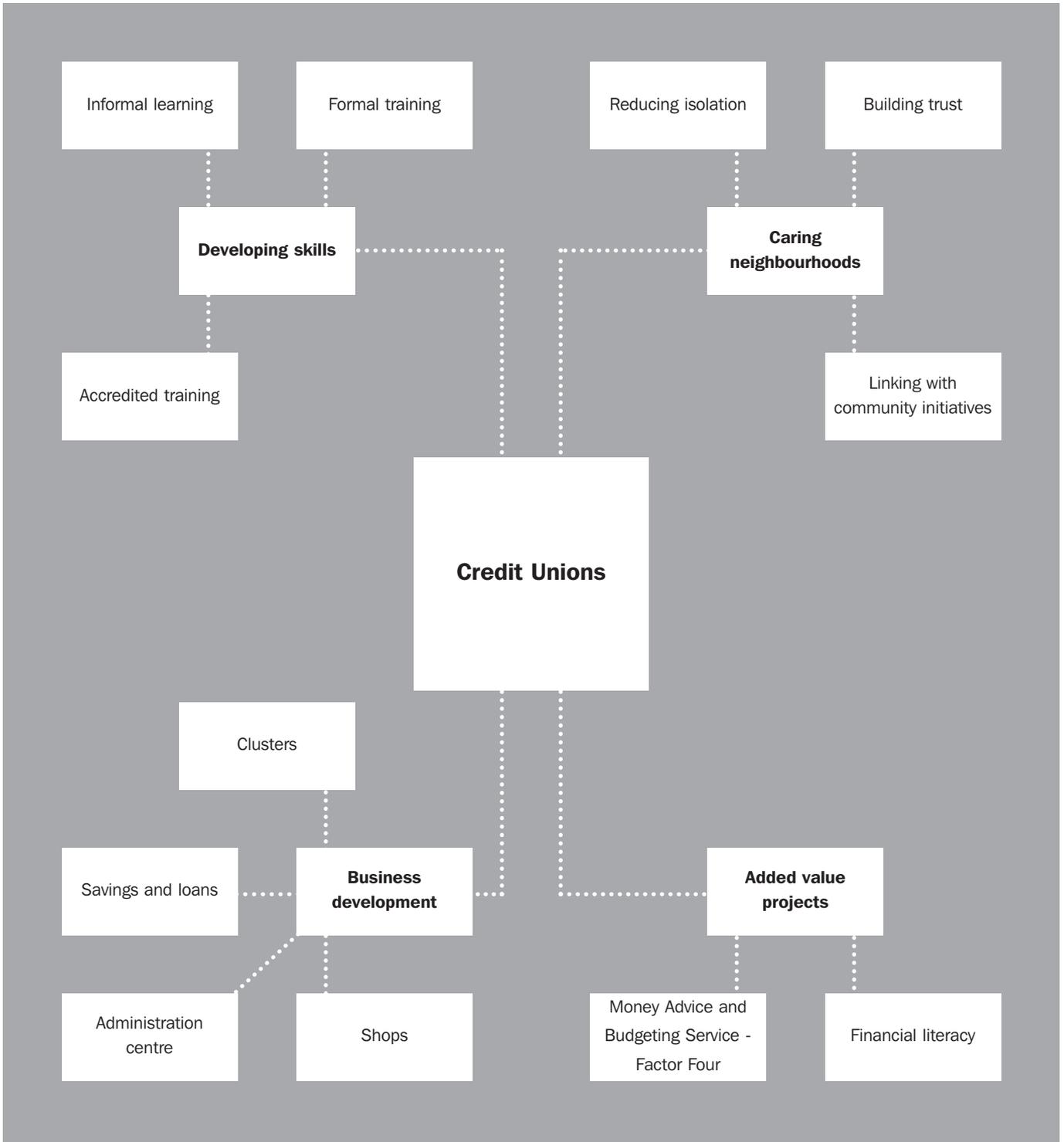
A Birmingham-wide survey of over 400 community credit union members in 1999 indicated that their primary financial service interests were:

- special savings accounts for Christmas and clothing;
- insurance services;
- budget and bill payment accounts;
- money and debt advice.

Members also wanted longer opening hours and larger loans. A citywide strategy was developed that has led to community credit unions clustering into six groups of four to five, in order to work together and provide common services. To reduce costs for all community credit unions, a central back office administration centre has been established to computerise all credit unions and offer central account servicing through the Birmingham Credit Union Development Agency.

In 2002, in line with this strategy, the first cluster group merged to form the South East Birmingham Community Credit Union (SEBCCU) and the first of two credit union shops for the network was established. The second cluster

Figure 2: Connecting Credit Unions to Community Development: the Birmingham Model



group in North Birmingham is now applying to the Financial Services Authority for merger and the second credit union shop has just opened to provide local services. The third cluster group in Handsworth (serving North West Birmingham) is moving forward and the third shop will be opened later this year. The full plan is for five to six shop fronts – one for each merged cluster group and all with common branding for citywide marketing on the buses and through local radio and regional media.

Like many other credit unions, South East Birmingham Community Credit Union identifies with a community development mission and has set its sights on becoming the first CDCU in Britain. Norma Maynard the credit union President made the announcement in a keynote speech at the National Association of Credit Union Workers conference in November 2002. She described the SEBCCU ambition in this way.

“Credit unions have always been part of my life since a child in St. Kitts. In the West Indies before credit unions were established in the 1960s, there was ‘the partner system’ of rotational and group savings. My grandmother was the local manager of the system. I have been involved for years in the Sparkbrook Credit Union but I am busy with my daytime job. This means approving loans in the evening, doing books at weekends and being worried about everything to keep the Financial Services Authority happy all the time.

‘We need investment to overcome this problem. We desperately need a CDCU in this poorest ward in Birmingham. I have seen the work of CDCUs in New York first hand, in Harlem in the Bronx and on the Lower East side. This is the community banking system we need with shop fronts, staff, bill payment, money advice, financial education, benefit transfer and other services for inner city people in Birmingham. When I saw Lower East Side Peoples Credit Union in action last year, I said immediately: ‘This is it, we need to get CDCUs going in Birmingham!’ Sparkbrook credit union is now part of South East Birmingham Community Credit Union and we are going to become the first CDCU in Britain!”

As a result of the merger of the three credit unions, assets of South East Birmingham Community Credit Union are near to £500,000 and membership is about 800. To achieve the CDCU goal, a joint bid by Maynard and the Birmingham Credit Union Development Agency has recently attracted funding from the innovative Home Office pilot investment scheme for growing social enterprise organisations, the Adventure Capital Fund.

The other five Birmingham cluster groups range in size from 900 members to 1,700 and from assets, when aggregated, of £270,000 to £800,000. South East Birmingham Community Credit Union and two other of the Birmingham clusters with support from the Birmingham Credit Union Development Agency will launch

the “Factor Four” service this year which includes bill payment, energy advice, debt rescheduling, and the take up of energy insulation grants. In practice, Factor Four is a CDCU based extension of the Irish MABS system.

Jim Dearlove, Co-ordinator of the Birmingham Credit Union Development Agency, sums up the way in which Birmingham is developing co-operation among credit unions.

“Credit unions lose the ‘people plot’ when they aspire to become banks. Banking seeks to save costs ruthlessly and as a result rigorously separates the economic and the social because the latter is costly. Joining back up the two and managing the tension between building reserves and paying dividends to credit union members on the one hand while being committed to service the unmet needs of the unbanked is extremely difficult. We are determined to manage this art by pioneering CDCUs in the West Midlands.”

Community Development Conclusions

All the credit unions highlighted above have walked something of a tightrope, in terms of running a business while developing its membership and diversifying services. While the attraction of the credit union model is that it is one of the few financial services institutions that is relatively straightforward for a community to start small, it is the very lack of scale that can prove problematic.

One way to address issues of under-capitalisation is through merger with other credit unions. This can reduce operating costs and make broader marketing more achievable. Examples such as Northern Oak Credit Union show how carefully-prepared and intelligent mergers can promise significant synergies, opening the way to a CDCU-style model of financial inclusion on a sustainable basis. In Birmingham, mergers have emerged from “clustering success”, and have been inspired directly by the examples of CDCUs in the USA.²¹ But as the case of South East Birmingham Community Credit Union suggests, the aspirations of merger need to be matched with development resources, if it is to move forward.

The example of Southwark Credit Union illustrates an element of a different approach – the “Beacon Credit Union” model promoted by the Association of British Credit Unions Limited, in which an employee based credit union absorbs community credit unions in order to create bigger scale and to secure a citywide or sub-

regional size credit union. In the case of Southwark, the benefit to the community credit union, which was at risk of failing, was immediate. But at the same time, the case of Southwark also offers a warning that growth alone will do little to ensure that a credit union targets people in need, an essential element of the CDCU model.

The pure business model of credit union development, by its nature, moves away from high transaction cost services. High transaction costs increase overheads, reduce profitability and hold back the build up of reserves. Yet high transaction costs often go with the territory of low-income communities. In many areas of the country, large areas of cities, entire towns and ex-mining regions are poor. The majority of people living in such areas are poor or moderate income and credit unions such as Enterprise Credit Union and Riverside Credit Union simply need to get on with the job. For them the “poor person’s bank” is nothing to be apologetic about but all the same, extremely difficult to do.

At the same time, the “beacon” approach, which is operating successfully in places such as Rochdale, Leeds, Tower Hamlets and Portsmouth, does confirm an important development lesson from CDCUs in the USA, which is the need for adequate early-stage subsidy. The Portsmouth City Savers credit union, for example, took four years to register but has started with the equivalent of two full-time members of staff and high street

city centre premises funded over five years from the Council and regeneration funding. The Leeds Credit Union has had similar large-scale funding for a “beacon” model, and more recently has stressed its efforts to promote financial inclusion, along the lines of CDCUs.

Subsidy can play a positive role. Riverside Credit Union left on its own with a mere volunteer base would not have achieved 3,500 members without funding for both staffing and premises to take them up to this stronger financial state. But while there is need for subsidy to get to a point of scale and sustainability, it makes sense to tie subsidy to some clear commitment of social purpose. In the North West, elements of the CDCU approach have been deployed to great effect, but have often not won the same level of strategic support and investment from the public sector that some other approaches have.

Paul Jones, Liverpool John Moore’s University Researcher and developer of the “new model” and the “Beacon” approach, has since visiting the USA steadily become more comfortable with the scope for CDCUs in Britain. He used his own Moneyspinner Credit Union as an example of the need for such a solution — in particular in poor sub-regions nationally.

“My own credit union was set up in 1989 in Hattersley – an overspill estate of Manchester in Tameside. Like many other community credit unions in

poor areas, there are no richer local areas to extend to easily. Hattersley is a place where those who get a decent paying job leave and the area has been losing population as a result for years. It is hard to see an easy way of expanding our common bond beyond the level of 10,000. We have since 1999 benefited from external subsidy from a Single Regeneration Budget grant. This has paid for two staff, an attractive shop front and the membership has doubled in a few years and we are doing all the things for our local members you would want from a community credit union — and 70 per cent are on benefit. But the population here is not diverse and we are not going to be self-financing in less than three years when the subsidy runs out. We will need to attract additional grant aid to keep up levels of service the local community deserves. Community development credit unions are impressive and because of what they have achieved, one can justify subsidy to grow and expand. The case can be made in Britain in places like East Manchester but we need to avoid dependency on the whims of an external funder. This is the challenge.”

Jones commented that the Moneyspinner Credit Union and its needs for careful investment and subsidy were the same as those for other similar community credit unions in Manchester such as River Valley Credit Union, Wythenshaw Credit Union and East Manchester Credit Union. But he observed from his visits to CDCUs in the USA that money needed to go hand and hand with high quality staff and management.

“What is clear from all my visits to CDCUs in America is that their success rests heavily on professional management, not just non-member deposits and secondary capital. Ed Jacob, the manager at Northside credit union in Chicago [who developed the alternative Payday loan] and Pablo DeFillipi the manager of Lower East Side People’s credit union in New York are exceptionally skilled and are not easy to find.”

The credit union sector will probably always be hard to classify. Its diversity reflects not just the need to respond to the differences of place, culture, ethnicity and circumstance, but additionally mirrors the value of trying things out and learning what works in an open and evolutionary way. This at least can be said though: there are clearly the seeds of a more ambitious approach to financial inclusion in Britain, and signs that elements of the US CDCU best practice – though clearly not yet all the elements brought together – are around us.

If so, this raises the strategic question. If some credit unions in Britain could develop along the successful lines of CDCUs, could they win market share from the high-cost lenders of the sub-prime market and make a significant contribution in doing so to tackling poverty and contemporary social exclusion?

Winning Market Share Against Predatory Lenders

In theory then, British community credit unions and the “new model” variants that have developed on a live/work common bond are well placed to develop and serve people that are financially excluded. They understand their members, and the community and local business base. They are able to call on voluntary input and support – after all, setting up a credit union is an arduous process, so that the driving motive is typically one of fairness and a desire to transform the community. They are well positioned to make risk assessments that “outsiders” would find difficult. Many individuals whom the banks avoid as being “higher risk” often prove themselves to be no more than average risk within a credit union.

The crunch question is whether, with the right enabling framework, they yet have the capacity, professionalism and support to grow large and sustainable social enterprises to serve low-income members. An analysis of the most recent Financial Services Authority figures, for 2001, on the 460 registered community credit unions suggest a positive answer for the majority. Many though are still too small for this role — either through structural weakness or immaturity. Over one third of these businesses are less than five years old. Nonetheless, even amongst this youthful section there are some rising stars that have attained sufficient capacity already.

Taking the 100 largest community credit unions by way of assets, there is a strong correlation with age, suggesting that with time, these

What a British Community Credit Union Looks Like

As with the American community development credit unions, it is also hard to generalize about what a typical British community credit union looks like. British community development credit unions vary hugely depending upon age, the levels of investment and the development support that may have been available. There are approximately 460 of them in Britain ranging from Dalmeir with over £5 million in assets and 5000 members to the new starters with just a handful of members and a few thousand of savings in their company accounts. With such a broad spectrum it is perhaps more helpful to look at the largest 100 community credit unions in terms of assets and compare these against the most youthful sector – the 100 youngest credit unions that are at least 5 years old.

The profiles of these ‘typical’ Community Credit Unions from the latest data reveals:

ASSETS: (5 yr min)	LARGEST 100	YOUNGEST
Average assets:	£400,000	£100,000
Average paid staffing	1	none
Total out on Loan	£300,000	£65,000
Average loan size:	£750	£500
Loans as % of Assets	70%	60%
Bad debt ratio:	1%	1.7%
Annual Surplus (profit)	£15,000	£3,000
Dividend	2%	0%
Total annual income	£50,000	£12,000
Annual expenditure	£35,000	£9,000
Grant income average	£12,000	£3,500

Source: Financial Services Authority

businesses find their route to growth. However with additional resources many of the younger and weaker credit unions can be nurtured up to a position where they too have the capacity to take on some of the initiatives identified in this report.

Regardless of age, the ability of community credit unions to make quality assessments on their lending is borne out by the statistics. Despite operating in what are classed as higher risk categories, the return on their lending is impressive and this

alone raises questions about other commercial lenders to low-income households, who try to justify much higher interest rates as compensation for supposed, disparate levels of risk. Even mainstream banks typically run higher bad debt figures on unsecured lending than the top 100 credit unions, which will achieve around a 99 per cent repayment rate, despite the greater selectivity and security they demand. Even less experienced community credit unions that are around five years old achieve better than 2-3 per cent bad debt.

Counter to allegations sometimes made, community credit unions do not appear heavily grant-dependent, from Financial Services Authority data and the fieldwork interviews conducted for this research. Certainly, as a group, the 150 newest credit unions receive around 40 per cent of their income as grants. Even new industrial credit unions with significantly lower transaction costs attract 20 per cent grant support. But once they are established, community credit unions are far less dependent upon external sources. Community credit unions that are more than five years old generate 80 per cent – 90 per cent of their income through their core businesses, according to data available.

If we assumed that there are at least 250 community credit unions in Britain that had the capacity and the desire to serve the lowest income sector, and that a supportive development framework was in place, what collective impact could they make?

One goal would be to take 10 per cent market share from sub-prime lenders such as Provident Financial, which even considered alone as the largest doorstep creditor has 1.6 million customers. Winning this market share

over a five year period of assertive, direct competition would make a significant impact on the life of a large number of households. Capturing over 16,000 new members in the first year, and 54,000 by year five would redirect £227 million of credit away from sub-prime lenders. This would earn many of the poorest households in Britain an extra £75 million, representing the savings to them in excessive interest charges. The growth figures for such a campaign are set out in Appendix C. These are indicative sums only and exclude the development support critically required to build capacity for CDCUs in Britain. But if half the current number of community credit unions were involved, it would present each with an additional average 650 members and provide an added gross income of over £100,000 during the first five years. Once captured, this additional market share would create income generation of £500,000 over a ten year period, positioning the credit union into sustainability

These figures alone fully justify investment into the community credit unions to initiate and support such a targeted campaign. The returns over a 10 year period are even more convincing. If this market share is

retained the overall saving to Britain's poorest households would accumulate to £200 million. This additional income within the pockets of this sector would impact significantly within the economies of their communities, contributing much towards regeneration and asset building.

As argued elsewhere in this report, the delivery of essential financial products to this sector is expensive. Such a campaign requires an external provision of capital, which could be government or ethical investors. A £12 million per annum support for this programme over a five year period would represent a 350 per cent return on this investment after 10 years, and leave a vibrant network of strong community businesses that can continue to compete with and eat into the market share of sub-prime lenders.

All this suggests that there is a strong social and economic case for CDCUs in Britain to be able to play the kind of role that has been seen to achieve scale in the past ten years, especially in the USA. It suggests that the business model for CDCUs can stack up in Britain, if they reach a sufficient point of capacity to innovate and serve their local market. But simply

Coventry Financial Exclusion Initiative

The local Credit Union Development Agency has initiated a number of projects across the city aimed specifically at members on low incomes and to those otherwise excluded from traditional financial services. They believe that the problem for many families is not so much the amount of money coming into the household, or rather lack of it, but often the difficulty many people have in effectively managing whatever that income is. As a result the local credit unions have introduced a 'Budgeting Account' to assist members with priority bill payments. In return for regular saving payments, the credit union sorts out and pays off specified household bills.

However despite its success in many ways, it has also proved problematic in the way it has been used, as well as in terms of costs and the complexity of administration. At present there is a disincentive for users of this service to take over responsibility for organising their debts, foisting this chore onto the credit union.

identifying point B does not tell you how to get there from point A. The real question is whether community credit unions will want to or be able to go down the CDCU route, and whether, as in the USA, there will be a concerted development framework available to help them do that.

The new regulatory regime for credit unions has brought home the need to increase efficiency and sound business practices. While change is slow and a shake-up is right, most are coming good and should be better placed if they were to choose to serve more demanding sectors. However, there are dangers in this process of change. Unthinking mergers and consolidation could lose local knowledge that is key to the strength of a credit union. If the mood inspired by regulatory change is that “to survive you need to be big”, there is a danger that potentially strong, community based businesses are then steam-rolled into giving up their autonomy. As the US experience shows, the introduction of share protection and closer regulatory scrutiny is a turning point that needs to go hand in hand with an active programme of support for credit unions that serve poor communities and want to professionalise.

If credit unions are to help address the needs of Britain’s worse off for lifeline financial services, a development framework for CDCUs is essential. First, however, it is important to ask whether such a framework is something government should back, or just leave to credit union members themselves, perhaps with the backing of banks and the wider voluntary sector.

The ‘Predatory Loan Scheme’

This initiative is targeted at customers of sub-prime lending companies, such as the Provident Financial in a particular area of Coventry, although the service is accessible to other credit unions throughout the city. Money Advice Project workers refer potential recipients onto the credit union, which buys out the debt from the company. A small initial fund of £18,000 has been established through monies from Sure Start, a Community Business Economic Development grant, a church charity, a bequest, and a donation from a local residents group. This non-members fund underwrites the loans, thereby protecting members’ savings.

This initiative recognises that many people have difficulty in calculating the real costs of interest rates and credit charges. This makes them more vulnerable to misleading or sophisticated promotional techniques. The credit union pays off the debt of the referred individual who then becomes a member of the credit union from which they borrow the equivalent sum. The new loan may be re-scheduled, but in any case will be at a much lower weekly repayment sum. The new member recognises this as being of an immediate cost saving benefit. The new repayment figure also includes a surplus that is swept into their new savings account. This represents the secondary benefit or incentive, and starts the process of helping the new member appreciate the benefits of a habit of regular savings.

Insurance Services and Health Plan

Another service that the Coventry credit unions have introduced for those on low incomes is a ‘Health Plan’. This has been set up in partnership with the Local Authority and Westfield Insurance Company. Whilst those who are in receipt of benefit are entitled to free dental and eye care, many who are marginally above this threshold find the costs of treatment prohibitive. Through the credit union they are able to pay weekly premiums of below £2.00 to receive a minimum cover service. The City Council deals with the administration side of the Plan to reduce the costs to the credit union.

Although in theory this is an admirable initiative that should prove popular, take up has been slow. Partly the cause for this has been insufficient funding available for adequate market research to be undertaken. With additional resources the community credit unions in Coventry feel they would be able to identify where demand might lie and target appropriate promotional resources for the scheme to take off.

Should Government Back Community Development Credit Unions?

The present government has set targets for reducing child poverty and neighbourhood disadvantage. In both cases, there are few quick fixes. These are endemic problems, forged over generations, and not likely to be solved in a sustainable way through single initiatives or services. In both cases, financial exclusion plays a significant role, so that, in principle, there is a public policy case for considering what if anything could be done to support CDCUs.

The landmark report on financial exclusion was published by the Treasury in 1999 (the Social Exclusion Unit's Policy Action Team 14).²² Since then, though a number of policy initiatives have been taken forward, in the past four years, support for credit unions to tackle financial exclusion, beyond regulatory change, has simply stalled. The most effective change secured is that the Government, in consultation with trade bodies, has updated and modernised credit union legislation, so that now, in fact, credit unions have more legal powers than ever before. Half the barriers to development have therefore been removed. But there is still an identifiable opportunity to invest strategically in community based credit union development nationally to demonstrate what really can be done with the right package of support and methods to widen access to affordable financial services. The failure of the 1999 Policy Action Team 14 recommendations on credit unions to be fully implemented means that it is now in urgent need of review.

But there are now good additional reasons to explore the wider roll-out of CDCUs. Firstly, the Government is introducing several changes in 2003 which will impact in diverse ways on low-income households – some positive but others potentially negative. The main change is the shift from cash book payments of pensions and social security to low-income households to Automated Credit Transfer into Basic Bank accounts. The experience in the USA of this changeover in the late 1990s to automated payment systems threw up many problems and in some instances in New York and elsewhere led to increased financial exclusion as cash points were unavailable in many poor neighbourhoods. Through the Universal Banking Service, this particular problem will not arise in the UK.

However a related problem could well arise as recent press reports have raised concern about as in the USA, the poor opted in the main for a plastic card like the Post Office Card Account rather than for a Basic Bank Account.²³ CDCUs, with their ability to respond to the changing needs of the communities they served, were well placed in America to play a positive role in this change-over and in doing so offered a third alternative, a credit union style "lifeline account" providing credit as well as bill payment facilities and access to cash. Thus CDCUs in offering small affordable loans as well are potentially superior providers of financial services to many of the poorest households intimidated by banks and by default opting into the

Post Office Card Account with limited functionality. A partnership between banks, the Post Office network and CDCUs could as, in the USA, help limit the attraction of the Post Office Card Account over time and save Government money in doing so in due course.

Second, the Treasury are also piloting the Savings Gateway to encourage low-income households to save with incentivised matched funds based on the innovative American Individual Development Accounts (IDAs). As many analysts have commented, to date attempts by Labour to reach low-income households with affordable financial services have struggled to achieve this objective in major programmes from Individual Savings Accounts to stakeholder pensions.²⁴ But here too according to research findings by Michigan State University and the Ford Foundation, US CDCUs have been arguably the best delivery partners for Individual Development Accounts and for devising relevant financial literacy programmes which are vital to secure optimum outcomes via such specialist savings accounts.²⁵

Thirdly, CDCUs would assist wider governmental efforts to engender an inclusive and entrepreneurial culture in disadvantaged areas. In recent years, the Government has supported the development of Community Development Financial Institutions (CDFIs) to widen access to financial services, but to date, since the Department of Trade and Industry Phoenix Fund was launched in 2000,

only those CDFIs providing business finance have been assisted. Given that the principle remit is regeneration and the provision of such Community Development Finance Institution funding is through the Department of Trade and Industry Small Business Service, this focus is not surprising. However both the concept and practice of Community Development Finance Institutions is an American one and in fact in the USA when the Community Development Finance Institution coalition was formed in the early 1990s in New York, community based credit unions providing access to both consumer finance and micro-credit for the self-employed were at the forefront of the US CDFI movement.²⁶ Indeed the National Federation of Community Development Credit Unions currently chairs the CDFI Coalition. Community development credit unions in the USA in many areas are excellent providers of micro-enterprise loans and in rural areas in particular as the Vermont Development Credit Union shows, they are simply the best delivery Community Development Finance Institution vehicle as they are so flexible.

Of course there are dangers in government getting involved in a bureaucratic way with activities that are essentially about participation and social entrepreneurship. In reality, government is already supporting credit union growth through an average of £12,000 of regeneration funding among the largest 100 community credit unions according to data available from the Financial Services

Authority. To date this funding and its impact has not been independently evaluated but as such funding is coming from several diverse Governmental programmes, it is certainly clear that such funds are not being deployed in a strategic or coordinated way, which builds on and learns from successes. By contrast with enterprise finance and Community Development Finance Institutions, the Treasury has ensured in working with the Department of Trade and Industry a clear and coherent strategy with joined up thinking. The failure to fully implement Policy Action Team 14 in the same way that Policy Action Team 3 was fully implemented is an issue that needs urgent examination by the Chancellor and his team.

The fact that CDCUs appear to offer an effective approach to financial inclusion, with its overlapping challenges of outreach, education and affordable services, does not mean that government alone is best placed to provide support. As with Community Development Finance Institutions for enterprise, there is a key role for a partnership approach involving other stakeholders such as housing associations, charitable funders and banks — all of which should additionally be involved. Indeed this research shows clearly how they have provided additional investment, grant funding and expertise so productively in the USA to fast track CDCU development.

For example, already here in Britain, Lloyds TSB has announced its support for a “credit union growth fund”²⁷ to

support CDCUs. The concept here is that private sector support would be intended initially as catalytic and act principally as a forerunner to more significant public sector backing.

At the least, it is clear that, if there is a support role that government is best placed to fill, then there are strong arguments for a degree of public investment to do so. Community development credit unions are a dynamic and flexible group of Community Development Finance Institutions (able to deliver both personal finance and some micro-enterprise finance as well) that the British state has not taken notice of properly thus far. Such an oversight is unfortunate from the findings here marshalled.

Recommendations - A Lifeline Banking Service Through Community Development Credit Unions

First... Definitions

There is growing recognition in Britain about the huge potential for CDCUs to develop, as they have done in the USA, to tackle financial exclusion. All five national credit union associations are impressed with the achievements of CDCUs and are interested in how they may work over here. Issues of demarcation though are sensitive because in Britain, unlike the USA, most credit unions have formed initially around a community common bond rather than an employment one.

There is no strict definition in the USA of a CDCU. The Community Development Finance Institutions Act in the USA, passed by the Clinton Administration in 1994, recognises Community Development Finance Institutions and among these, CDCUs are acknowledged as a specialist credit union targeting low-income households to widen access to savings and credit for personal, housing and enterprise needs.

“A low-income credit union” under US legislation is defined as a credit union where over 50 per cent of its members have income less than 80 per cent of the national median.²⁸ In the USA, low-income and low pay is generally regarded as less than 80 per cent of the local area median, and in the UK as 60 per cent of national median. But it must be remembered that Americans have to pay for health care privately, so in effect given the high cost of health insurance in the USA, the American levels are relatively lower than they appear.

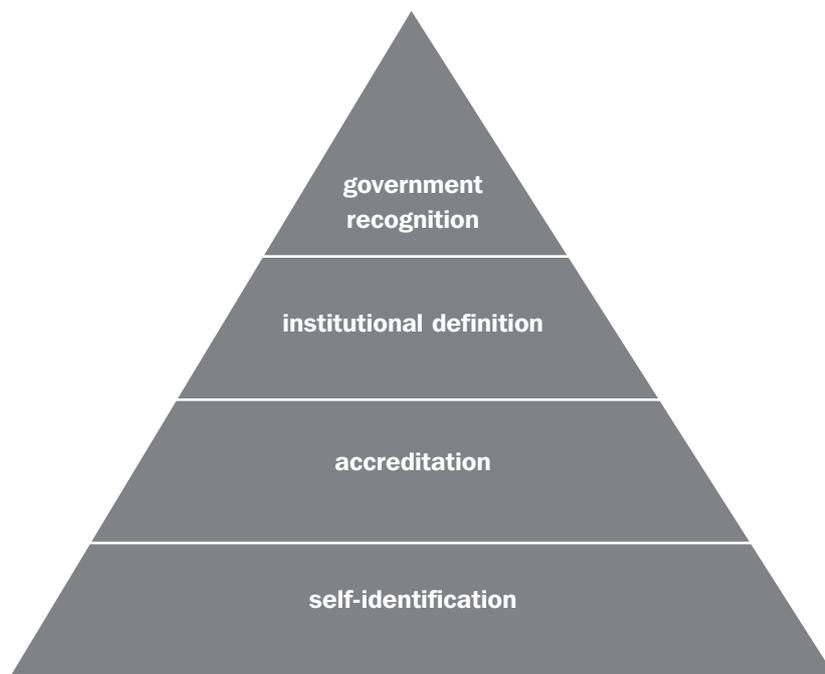
Community Development Credit Unions are defined and acknowledged in other ways too. This is both by the regulator²⁹, and also by the National Federation of Community Development Credit Unions which defines them as “credit unions whose primary mission is to serve low-income people and communities”.

In this report, we have focused on the mission of CDCUs, which is arguably no different to that of many community credit unions, and the organising strategies (such as the Credit Path to Financial Inclusion), some of which are being developed on an ad hoc basis in the UK, but nowhere brought together yet

as part of an integrated strategy to tackle financial exclusion on a more ambitious level. In the UK therefore, there might be four different ways of classifying CDCUs.

The first level would see the label of CDCU applied in the same way that the phrase “social entrepreneur” has emerged, as something that people identify with and self-select as how they wish to describe their work. The second level would supplement this, by reserving the status of CDCU for credit unions that wished to operate as CDCUs and had completed training or other development processes relevant to CDCU activities.

Figure 3: Pyramid of Definitional Levels



The third level would have a harder edge to it, by setting out clear, empirical criteria required for a credit union to be considered as a CDCU. These would include a socio-economic profile of members, such as the numbers in employment or income levels. As a low-income designation would be based, as it is in the USA, on an area's low-income profile, this would suggest that CDCUs are likely to be distinct from the generally large city wide common bonds. Thus such an approach would naturally, from demographic data, rule in more localised areas or small sub regions like South East Birmingham, Newham, West Newcastle, rural mid-Wales or Rotherham.

The final level would apply if government recognised, CDCUs as a distinct class of credit unions, for example by opening up powers to such credit unions such as the scope to raise non-member deposits.

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CDCU Development Framework

All credit unions require the following building blocks to develop and thrive:

- active leadership by a strong board of unpaid Directors;
- a strong and quite large group of committed volunteers (the sweat equity element);
- good business sense along with business planning, product pricing and marketing nous;

- efficient IT and management information systems;
- high quality and reliable services plus an attractive range of products;
- a strong sponsor body (e.g. an employer, church, local development agency, trade union or non-profit organization).

Employer based credit unions have by definition a strong sponsor and in such circumstances also benefit from contributions to the credit union leadership – not infrequently by allowances of paid time off to employees to enable the credit union to both operate and develop. Employer based credit unions also have marginal transaction costs on the savings and loan operations thanks to payroll deduction and assistance from the employer's accounts department. Marketing, for employee-based credit unions, is clearly targeted and not diffuse as it is for a community based credit union.

Community credit unions as a rule, by stark contrast, find all the building blocks harder to secure and nothing can be taken for granted. Costs are enormously higher and the more so when a community credit union chooses to target low-income customers without bank accounts and seeking local paying in points for cash transactions. Such community credit unions to thrive and develop need shop front facilities and collection points. Even where a strong

and committed group of volunteers can be found, supporting, managing and training such volunteers requires an enormous investment of time by the community credit union leadership group and securing the support of a strong sponsoring body is easier said than done.

In its 1997 report on CDCUs, A Commitment to People and Place, the New Economics Foundation looked at Birmingham and showed that with the inherent economies that all employee-based credit unions benefit from and with a reasonable business planning and good internal promotional work, employing staff, initially part-time and thereafter full-time, can readily be achieved within two years. This has been the experience in fact with Birmingham's three employee based credit unions: the local authority credit union, the police credit union and the fire service credit union. On the other hand, Birmingham community based credit unions, like the vast majority nationally, have not been able to readily achieve this. Paid staff on at least a part-time basis are crucial for significant credit union development to be secured and an ambitious business plan to be achieved.

The New Economics Foundation assessed from the empirical evidence available in 1997 that, at present rates of share capital accumulation, community credit unions could take 40 to 50 years to reach £1 million of assets, a level at which a small team

of paid staff could be afforded sustainably. This delay, now as then, is a non-starter if community credit unions are to play a significant role in addressing financial exclusion. Thus as with other Community Development Finance Institutions, the New Economics Foundation concluded six years ago that strategic investment by Government with assistance from banks and other financial institutions was vital for community based credit unions to graduate from “low-income credit unions” to CDCUs. The call then for a National Development Fund for CDCUs is thus even stronger now as a clear need.³⁰ The legislative modernization achieved since 1997 provides the necessary framework for CDCUs to develop and this was also called for in the first New Economics Foundation report. So how might progress on enabling CDCUs to emerge be achieved?

As with the development of the Department of Trade and Industry Phoenix Fund, there are four key things to be done:

1. piloting CDCUs through a national challenge fund to establish pathfinders;
2. establishing a specialist training programme for practitioners to learn CDCU techniques;
3. evaluation of performance and the development of accreditation systems;
4. legislative changes to allow key development tools such as non member deposits and secondary capital for CDCUs to access.

The US experience provides backing for the importance of each of these. With three decades of American experience in developing and refining a training, finance and support infrastructure for low-income and community based credit unions to grow and thrive, the UK will benefit from learning from the effective framework developed in the USA by the National Federation of Community Development Credit Unions. This is based on four principles: programmes, advocacy, capitalisation, and education (“PACE”)

Programmes: specialised support systems and investment systems tailored to develop low-income credit unions to become strong and self-reliant institutions;

Advocacy: dedicated support from a specialist CDCU trade association to change legislation, Government policy and bank behaviour to support the reduction of financial exclusion through community banking services to reach the unbanked and service the needs of disadvantaged communities in well targeted ways;

Capitalisation: a wide range of financing instruments to meet in flexible and dynamic ways the requirements of CDCUs for different forms of capital – from seed capital, sponsorship funds and guarantee funds, to lines of credit, ethical investment from non-members, secondary capital and policy related investment;

Education: to train CDCU staff and board members beyond NVQs alone,

to degree level and post graduate level master credits. Community development credit union work is far harder than City Fund management work with risk management skills that require intensive investment in training and skill development in a broad range of areas including setting up an office, negotiating a lease, business planning, regulatory compliance, effective marketing and media work, selecting and developing IT and management information systems, portfolio tracking and much more. Supplemental to first level knowledge bases are other product development specialisms from micro-credit and small business lending to real estate and property loans. Other areas like alternative financing mechanisms to deliver cost effective alternatives to payday loans and predatory finance organisations are more complex still.

An example of how this model is applied in the USA is set out in Appendix D. With strong support from NFCDCU staff, Bushwick Co-operative Federal Credit Union in Brooklyn, New York was launched in December 2000. Within two years of trading, membership reached 1,067 and total member savings \$627,021. Compared to the slow and uncertain growth of many, credit unions in the UK, Bushwick shows how to escalate the path to financial sustainability without resort to reliance on a majority of better paid members and payroll deduction strategies to achieve growth.

At the end of the day, you get what you pay for. Critical to CDCU success in the USA has been proper investment strategies that do not waste scarce tax payers or charitable funds on the one hand, nor are “penny wise and pound foolish”. As in the case of all social enterprises or businesses, undercapitalisation and underinvestment invite slow, paltry growth and, more often than not, poor performance and early failure. Getting proper “PACE” on the ball, as the National Federation of Community Development Credit Unions have proven, is crucial to success.

Recommendations

In the UK, CDCUs will only grow if credit unions emerge that see the potential to address financial exclusion on a sustainable basis, and they receive the support they require to fulfil this social business mission. The involvement of a range of stakeholders is needed to support CDCUs. It seems clear that the public sector is the only one that is strategically placed to resource the development framework required for CDCUs to play a significant role in promoting savings and addressing financial exclusion, whilst simultaneously meeting a range of public policy goals.

In the USA, CDCUs have been very good delivery vehicles for Government supported programmes such as Individual Development Accounts, (which in xxxxx savings xxxxx low-income households effectively), and financial literacy services that assist with the take up of the Earned Income Tax Credit. Both these programmes are similar to the UK Savings Gateway and Working Tax Credit – aimed to secure the Labour goal of reducing heavily child poverty.

The recommendations below cover the development of the CDCU sector. They do not talk to wider issues or current Department of Trade and Industry Consumer Credit Act review considerations for improving the regulation of sub-prime lending and reducing consumer exploitation in the licensed credit sector more widely.

Appendix F outlines a specific and complementary set of recommendations on these, drawing on The New Economics Foundation’s wider programme of work on predatory lending and on social enterprise.

Drawing on our research findings of the relevance and timeliness of the CDCU approach for the UK, we recommend the development of a lifeline banking service with two main goals: a) to promote savings and financial literacy and b) to provide affordable credit as a practical local alternative to high cost loan sharks and sub-prime creditors. This should be achieved through the following actions:

- 1.** The Treasury should establish a national challenge fund for CDCU development with lessons drawn from the Phoenix Fund process for setting up Community Development Finance Institutions for enterprise. The CDCU development should be phased with the first Phase seeking to fund a first round of 25 pathfinder CDCUs in Britain through a bidding process and a second Phase to roll out a 100 CDCUs nationally based on best models developed in Phase One for the diverse local circumstances of community credit unions — ranging from densely populated inner city neighbourhoods to dispersed rural areas. As part of any future round of legislative change, such as through a deregulation order, the government should introduce legal

changes to enable CDCUs, appropriately defined, to secure non-member deposits and to clarify powers for credit unions to accept secondary capital. Additionally this review should seek to explore the impact of raising the interest rate credit unions can charge to a new ceiling of 18 per cent APR (as in the USA) to facilitate both higher risk lending to small businesses and for refinancing high cost moneylender type loans.

2. Government should establish the mechanisms alongside its investment in CDCUs to review progress, including an inter-departmental review to assess activity since its PAT report in 1999 on financial exclusion.

3. Charitable foundations that have pioneered models of “programme related investment” to support enterprise-oriented activity in the public interest should experiment to assist credit union growth with non-member deposits, or their equivalent, in the form of patient, concessionary secondary capital.

4. The Treasury should explore the potential for a Bank Enterprise Award Scheme, based on the US model, to provide public recognition and financial support for banks that provide the most effective support and investment in CDCUs and wider enterprise lending.

5. A wider Community Development Finance Institution Coalition should come together to support the development of CDCUs — including the five credit union networks and the Community Development Finance Association, joint consideration should be given to other helpful reforms such as a VISTA style programme to support CDCUs and other Community Development Finance Institutions with secondments and postgraduate placements.

Drawing on US data for the development of CDCUs, such as Bushwick (Appendix D), each CDCU would require operating revenue support of around £125,000 a year, for three years, which indicates £37.5 million in subsidy required. In addition to this is the need for seed capital grants for reserves, equipment as well as training and programme development. This suggests a total programme of around £60 million over five years, or £12 million per annum.

This investment would bring a broad spectrum of benefits. It would retain £400,000 of loan repayments within the immediate community of each credit union. These returns would come specifically to those on low-incomes, to the credit unions themselves, and to the initial provider of capital, which could be government or ethical investors.

The lifeline banking service we propose is a complement to mainstream financial providers and the insurance

role of the welfare state. It will be different to each of these in that its purpose is to enable non-profit, value-based social enterprises to compete with sub-prime lenders and draw people out of social exclusion and a vortex of personal debt. Such a service would represent an authentic attempt to tackle one defining set of issues underpinning contemporary poverty and to promote life-saving alternatives.

Appendix A

List of Research Interview Sample and Case Profiles

United States

- Bethex Credit Union
- Union Settlement Federal Credit Union
- Lower East Side People's Federal Credit Union
- Citizens East Community Development Credit Union
- Vermont Development Credit Union
- Northside Federal Credit Union
- Alternatives Federal Credit Union
- Bushwick Co-operative Federal Credit Union

Further information was obtained from the National Federation of Community Development Credit Unions' senior managers and their published reports. During the US field trip, the techniques for developing CDCUs and their core services were learned about in considerable detail through attendance on three intensive days of training at the CDCU Institute at the University of South New Hampshire.

Specialist methods to tackle predatory lending and to develop affordable financing products was learned about through contact with managers of Northside Federal Credit Union, ASI Federal Credit Union (New Orleans, Louisiana), Self-Help Credit Union (Durham, North Carolina) and Faith Community United Credit Union (Cleveland, Ohio). Additional information on pioneering services to promote long term savings and financial literacy was obtained from Santa Cruz Community Credit Union (California), and Progressive Neighbourhood Federal Credit Union (Rochester, New York).

England and Wales

- Burnley Area Community Credit Union
- Rotherham Credit Union Network
- Enterprise Credit Union, Merseyside
- South East Birmingham Community Credit Union
- Morecombe Bay Credit Union
- Coventry Credit Union Network
- Community Wealth Credit Union Ltd, Doncaster
- Cornish Credit Union Development Project
- Financial Inclusion Newcastle
(four Community credit unions in West Newcastle)
- Robert Owen Montgomeryshire Credit Union
- River Valley Credit Union
- Northern Oak Credit Union
- Southwark Credit Union
- Builth & Llanwrtyd Credit Union
- Redditch Credit Union
- Moneyspinner Credit Union
- Riverside Credit Union
- Portsmouth Area Regeneration Trust

Appendix B

The New York City Financial Network Action Consortium

The New York City Financial Network Action Consortium is a novel network of four CDCUs with a fifth CDCU, to join in July 2003. The Birmingham administration centre for Community Credit Unions is moving in this direction, but without comparable levels of investment. New York City Financial Network Action Consortium, alongside the National Federation of Community Development Credit Unions and the North Carolina Minority Support Centre, has achieved recognition from the US Treasury as one of the first specialist Community Development Finance Institution intermediaries in the USA. The network is owned and democratically governed by Union Settlement Federal Credit Union, Bethex, the Lower East Side People's Federal Credit Union and Homesteaders Credit Union. Bushwick Federal Credit Union will become the fifth member in summer 2003. In practice the network consortium acts as a secondary co-operative system with six strategic objectives, to:

- create economies of scale thereby saving costs;
- develop new opportunities to generate more revenue;
- undertake research and development related to new products and services;
- co-ordinate marketing activity;
- define and move toward a unified vision of affordable financial services;
- finance their fixed asset needs so they can reach more of the target "low-income" client group.

In its first three years of operation, the New York City Financial Network Action Consortium has already delivered through the partnership consortium, the following results:

Branch Development and Improvement: branch construction and renovation projects have been carried out for three CDCUs with funds raised thus far of \$1.3 million. \$400,000 of grants was secured from diverse programmes to open a fifth Bethex Branch in 2001. Design work completed and shop fittings done on the Lower East Side People's Federal Credit Union second branch. Over \$600,000 has been raised and invested in the Union Settlement refurbishment project to double the size of its previous, inaccessible office branch and to establish with the investment in a store front branch.

ATM Network Development: special discounts on good quality, nearly new, ATM (cash) machines have been negotiated at a savings of \$15,000 per machine (i.e. at \$20,000 rather than \$35,000 each) and a strategy drawn up for locating these in each of the four CDCU areas of New York at their new branches and in major places of employment. Installation work for the Lower East Side People's Federal Credit Union has been completed and work with other CDCUs is underway.

Partnership with Community Based Organisations (CBOs): initiatives are now in operation to work with organisations specialising in financial literacy, money management training and debt advice. Community Based Organisation trainers and advisor experts in these fields deliver surgeries at credit union branches linked to specialist accounts, such as the Individual Development Account for home purchase or repair, business start up or financial education.

Shared Small Business Lender: Lending to the self-employed and small businesses is a challenge for CDCUs without specialist business lending expertise. This is a conundrum because until the volume of lending can be generated by an individual CDCU, hiring specialist staff is not viable. To tackle this for all CDCUs in the consortium, funding has been raised for a small business lender to service the needs of NYCfNAC members. In addition to undertaking credit analysis for small businesses, the shared lender will facilitate the participation of loans between the CDCUs to mitigate risk and permit them to make larger loans. Strategic partnerships are being developed with micro enterprise lenders to secure loan referrals and with a national CDFI to access a government guaranteed loan program, which provides an 85 per cent loan guarantee. The programme will assume a significant share of the CDCUs' marketing activities for small business loans.

Integrated Financial Services: a full-time Director of Product Development and Marketing is now working for the four credit unions. Additionally work has commenced on examining the achievable economies of scale between the four CDCUs and other New York CDCUs that will be invited to join the New York City Financial Network Action Consortium at a later stage, once the integrated model is

fully operational. Areas under development include: insurance services, central back office facilities, common data processing, joint marketing, common branding, inter-lending facilities, collaborative policy development, shared recruitment and training programmes and improvements to the Electronic Benefit Transfer system for welfare and pension payments.

Earned Income Tax Credit Education Project: a financial literacy project which seeks to inform 50,000 low-income households about their eligibility for tax credits, to promote the use of free tax preparation services and encourage them to become CDCU members to widen access to affordable financial services and specialist savings accounts like Individual Development Accounts.

The vision and commitment of CDCUs in New York are impressive and it is likely that, coming together in this way through shared back office and other secondary co-operative facilities like the above at a time of increasing inequality will enable them to make a significant future impact on the lives of poor people in the city.

Appendix C

Marketing Campaign for Community Development Credit Unions in Britain to Tackle Financial Exclusion

Table 1. Capture rate of new members, and income generated within each CDCU

Years	1	2	3	4	5	TOTALS
Capture rate/members	16,330	22,094	29,894	40,446	54,724	163,489
Accumulated members	16,330	38,424	68,318	108,765	163,489	
Capture rate per CDCU	65	154	273	435	654	
New loans of £564	£9,394,322	£22,104,841	£39,302,172	£62,570,161	£94,051,750	£227,423,245
Income	£1,127,319	£2,652,581	£4,716,261	£7,508,419	£11,286,210	£27,290,789
Income for 250 CDCUs per annum	£4,509	£10,610	£18,865	£30,034	£45,145	£109,163

Table 2. Financial benefits of captured custom within each CDCU community

Years	1	2	3	4	5	TOTALS
Total customers captured from Loan Co.	16,330	22,094	29,894	40,446	54,724	163,489
Interest charged @ 177 % APR	£5,986,578	£14,086,418	£25,045,502	£39,873,142	£59,934,939	£144,926,578
Interest saved via a credit union Loan	£4,859,259	£8,440,548	£13,286,032	£19,841,972	£28,712,158	£75,139,969
New members per CDCU	65	154	273	435	654	
Wealth retained within each CDCU community	£23,946	£44,373	£72,009	£109,402	£159,993	£409,703

Appendix D

Bushwick Co-operative Federal Credit Union

Bushwick in Brooklyn is one of the poorest New York city neighbourhoods. Similarities with Salford are strong. 38 per cent of the population live below the poverty line of 60 per cent median national income. The local population is 103,000 and there are only two bank branches for this large area. In general as in many parts of Salford, conventional financial services are invisible and in short supply. Small business loans from banks are almost unheard of. Down market lenders are rife. In the late 1990s, local affordable housing organisations and local politicians sought to develop a CDCU and a local, community based housing organisation, Ridgewood Bushwick Senior Citizens Council agreed to become a sponsor and provide senior management time to foster and incubate a credit union, with a well-planned strategy, to meet the needs of local people.

The stages of Bushwick's history highlight how a strong sponsor supported by a National Federation of Community Development Credit Unions style "PACE" based approach can quickly yield strong CDCU growth. There is no escaping the need for adequate resourcing at each stage.

Stage One – Organising pre-registration: with release of a full-time member of staff with community development nous and with business planning skills, the pre-registration work of the credit union was done intensively over 18 months. Grants were raised to resource the market feasibility work of \$32,000 from the New York Community Trust and the linked business plan of \$12,500 from Chase Manhattan Bank. A large market survey was carried out among 1,317 low and moderate income local residents. Of those surveyed, 827 pledged to become CDCU members. Investment commitments from the survey of \$193,455 were made and average savings per week indicated from the pledge form returns was \$30 per member.

Stage Two – Year One and Investment Resource Base: as a result of the comprehensive market study carried out and the business plan completed, promotional work to funders was successful in raising funding for five years to support a four person staff team including:

- Manager and Development Officer
- Loan Officer and Financial Literacy Programme Worker
- Office assistant manager (chief cashier)
- Cashier
- Marketing Officer

An additional relief cashier was funded on a one day a week basis initially, increasing to full time as membership levels increased. The Marketing officer was funded by the VISTA programme of the US Government. A grant based operating budget of \$193,500 based on a 30 page business plan was secured to pay for both staff and shop front lease costs. Funding for the operating budget was apportioned well with one third coming from three major banks (Citibank, JP Morgan, and FleetBoston), one third coming from state and Federal Government sources (Empire State Development, Fannie Mae and New York City Council) and one third from charitable foundations such as the New York Community Trust. The funding was scheduled to gradually taper yearly in a conservative way against business plan forecasts for income growth.

The shop front lease was carefully selected from market analysis work to be in a prominent, high street location with good footfall and near to the New York public transport stops. Concentration was not on direct deposit and payroll deduction customers but on the unbanked and reaching them through an outreach and financial literacy programme strategy.

Capitalisation was secured by attracting the aggregate level in the box below of non-member deposits by the end of the first year of trading.

It is important to note here that the Municipal Credit Union is a city employee credit union which is investing in the CDCU to foster development. It is also interesting to note that Green Point CDC is a non-profit affordable housing organisation in Bushwick – the equivalent of a British housing association. Both the housing body and the public employees credit union are investing long term at no financial return at all. Might large employee based credit unions in the UK and Registered Social Landlords do the same?

Brunswick Co-operative FCU - Non member Deposits (Year 1 Achievements)

European American Bank	\$100,000 @ 2%
Fuji Bank	\$75,000 @ 1%
Independence Community bank	\$50,000 @ 0%
Municipal Credit Union	\$50,000 @ 0%
US Trust Company of New York	\$50,000 @ 2%
Greenpoint Community Development Corporation	\$40,000 @ 0%

TOTAL	\$365,000
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Stage Three – Year Two Outcome: over the first twenty four months membership and savings growth has been impressive. On 31 December 2002 at the end of Year Two of trading, membership had reached 1,067 and total member savings of \$627,021 were almost double non-member deposits raised in the first year. New members joining are now signing up at the rate of 45 per month and the average savings level per member was at the end of year two, \$588. Of the members recruited, the financial literacy outreach work and the marketing strategy more broadly was hitting target with 40 per cent of members joining not having a savings account before and 75 per cent never having had a bank loan before.

On the loan side at the end of Year Two, 341 loans had been made totalling \$518,162. The average loan size was \$1,520 and the approval rate for new loans was 91 per cent. The two most common needs for loans were to buy household durables (fridges, washing machines, and second hand cars) or to refinance debt in a more affordable way. Delinquency and slow payment on loans was \$3,663 in aggregate – a slow payment percentage of only 1.16 per cent. It should be noted that 26 per cent of customers are on public assistance, the equivalent of Income Support.

The proactive financial literacy work at the end of the second year of trading had attracted over half the membership to participate – 531 people. The workshops in the programme included:

- (i) Building family budgets and strategies for savings;
- (ii) Understanding credit and improving creditworthiness; Understanding financial institutions (from check cashers and pawnshops to credit unions and banks);
- (iii) Avoiding predatory lenders;
- (iv) Income tax issues, including claiming tax credits and skills in completing returns;
- (v) Preparing for homeownership.

Bushwick Co-operative Federal Credit Union is now after two years of trading already a \$1.7 million Community Development Finance Institution showing transparently how to deliver financial service affordably and sustainably in one of New York's poorest and ethnically mixed neighbourhoods.

Most noteworthy, the balance sheet showing net worth is 14.28 per cent, which has been aided by grant contributions to reach this level to allow expansion and rapid growth from a strong base.

All services are also provided bi-lingually, in English and Spanish. They have initially concentrated on basic budget accounts, deposit accounts, higher interest savings accounts, consumer loans and organisational accounts as well for local tenant and community groups. Checking accounts have more recently been introduced. With strategic investment, by Government programmes, the banks and charitable foundations, Bushwick Co-operative Federal Credit Union have assembled "four legs to form a proper chair" to work from. As Bushwick Co-operative Federal Credit Union founder and manager, Jack Lawson summed up the vital requirement for the necessary strategic investment that needs to be mobilised to do community banking "for Real":

"You cannot do this type of work well with only a half start. The poor, just like anyone else, will not place their hard-earned savings in a rundown storefront with one overstressed manager, an under-qualified cashier and someone's old computer. The ability to put into place a solid operation — hire really good staff and bring in high quality computer hardware and software — was probably the single best reason for our success."

There are no CDCU blueprints. However Bushwick Federal Credit Union indicates well the scope for fast tracking credit union development to reach the financially excluded in the UK with a similar combination of dedicated and highly skilled staff, resourced by the right level of investment, to make the business plan implementation hum and move forward deliberately, rather than splutter and die like a clapped out car.

Appendix E

Work of the New Economics Foundation, the National Association of Credit Unions Workers and the National Consumer Council

New Economics Foundation

In 1997 New Economics Foundation (NEF) produced, *A Commitment to People and Place*, its first policy report on Community Development Financial Institutions. This report authored by Pat Conaty and Ed Mayo was the UK's first report on Community Development Credit Unions (CDCUs) and was commissioned by the National Consumer Council with funding from the Joseph Rowntree Foundation and additional sponsorship from Nat West Bank. A year later the New Economics Foundation report, *Small is Bankable*, launched by Patricia Hewitt MP proved seminal for the creation of the Community Development Finance Institution movement in the UK and provided strategic guidance for the UK Social Investment Task Force report which established the Phoenix Fund.

The 2003 New Economics Foundation report, *Profiting from Poverty*, highlights a range of ways that Predatory Lending can be tackled proactively in the UK. Here in particular key lessons from the work of both CDCUs in the USA and the Money Advice Budgeting Service (MABS) in Ireland should and can practically be taken on board. Both these approaches have benefited from strategic support by the American and Irish Governments and from their respective regulatory agencies as well.

A more detailed New Economics Foundation report, *Ending Fuel Poverty and Financial Exclusion*, set out in March 2002 a business plan to show how in Britain both CDCUs and MABS can be developed from lessons drawn from both these American and Irish models but also from emerging UK experience in the credit union movement here.

National Association of Credit Union Workers

Formed in 1992 the National Association of Credit Union Workers (NACUW) remains the voice of credit union workers throughout Britain. The activity of NACUW reflects the association's membership representing all sectors of the movement. Such a "broad church" enables The National Association of Credit Union Workers to be at the forefront of many initiatives that encourage the growth and development of credit unions. The National Association of Credit Union Workers has designed and run the only accredited training widely available in credit union. Its members have been responsible for the training and support given to the majority of credit unions in Britain and to their volunteers.

The National Association of Credit Union Workers were joint authors of *Growing the Credit Union Movement* published in October 2002. The Report identified areas where better co-operation between the movement's main stakeholders was advantageous. One of its key recommendations was for the movement to be allowed to develop models of structure and services that recognised the diversity of the British credit union movement and which supported the autonomy of individual Credit Unions.

The CDCU research project was launched at the National Association of Credit Union Workers' Annual Conference in November 2002. Research of this kind is central to the core activity of NACUW. Representing members who are employed directly by Credit Unions who are striving to tackle social and financial exclusion "head on", NACUW provide opportunities for those at the forefront of developing the British movement to discuss appropriate models and the design of resources to achieve successful delivery.

National Consumer Council

The National Consumer Council (NCC) is the independent consumer policy expert, championing the consumer interest to bring about change for the benefit of all consumers.

We do this by working with people and organisations that can make change happen – governments, regulators, businesses and people and organisations who speak on behalf of consumers – and by conducting rigorous research and policy analysis. The NCC works in an open and collaborative way, publishing research findings, and campaigning for change to advance the consumer cause. The issues of poverty and disadvantage are at the heart of the NCC's work, as often the most vulnerable people find it hardest to be heard.

The NCC played a significant role in the development of credit unions in the UK, including the promotion of credit unions in the 1970s, and preparatory work for the 1979 Credit Union Act. By the late 1980s, the NCC had initiated several projects to try and address the issue of the growth needed for a mass movement. The NCC's 1994 report, *Saving For Credit*, was the product of a working party the NCC convened to bring together the players in the credit union movement to address the key issues. The report concluded that credit unions should play a vital part in promoting savings and effective money management, as well as contribute to community activity. Its recommendations were partly addressed in the resulting 1996 Deregulation Order.

In 1996, the NCC launched a resource pack, *Credit Union Development: a new platform - raising the profile of local credit unions*, and in 1997 commissioned the first research on Community Development Credit Unions by Pat Conaty and Ed Mayo.

As part of its ongoing work in this area, the NCC has recently held seminars on 'Financial Futures' and 'Meeting Basic Financial Needs' – examining solutions to providing basic financial services for all consumers. As part of its 'Everyday Essentials' project, the NCC published a report analysing the government's Universal Banking and Savings Gateway initiatives. The NCC has also contributed to the Department of Trade and Industry's review of the Consumer Credit Act, 1974, and the draft Consumer Credit Directive, calling for government to support ways to address the credit needs of people on low-incomes, including business funding for community credit unions.

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Notes

1 Charles Ferguson & Donald McKillop (1997), *The Strategic Development of Credit Unions*, John Wiley and Sons Ltd.

2 Research centred on selective in depth interviews in the USA and in England and Wales with community based credit union practitioners. Just under 30 in depth interviews were undertaken — during October 2002 in the USA and from November 2002 through March 2003 in England and Wales. The framework to help support the pilot community development credit union experiment was developed with the assistance of a Focus Group consultation in London on 10 March 2003. This event involved 16 participants from all the British credit union associations and the Community Development Finance Association, from banks, from the Department of Trade and Industry Phoenix Fund and from debt advice and poverty groups.

3 Prior to the Credit Union Act of 1979 credit unions could exist in one of three ways, all of which presented obstacles to their development. They could register under the Industrial and Provident Societies legislation that was designed to regulate small co-operative ventures. But this prohibited lending except on 'the security of real or personal property'. Members were therefore unable to borrow above the level of their own savings, unless another member could be found to guarantee the loan on the security of his or her savings. The level of lending was limited by the number of guarantors who were prepared both to put their own savings at risk and to forego the opportunity to take out a loan themselves.

Another route they could take was to set themselves up as a limited company. This imposed few controls to ensure that members' savings were properly administered, but a union had to have permanent officials who would be liable for the debt of the company. The registration fees were large in relation to the turnover of these co-operative ventures and none of these requirements were compatible with a voluntary organisation. The final option was for a credit union to remain as an unincorporated association. This left them in a legal limbo, unable to sue or be sued. There was a lack of any safeguards or supervision and it did little to promote confidence among potential members.

4 No member could hold more than £2,000 in shares. The maximum dividend was set at eight per cent. No more than one per cent per month could be charged in interest on loans. A credit union could ask for 60 days notice before shares could be withdrawn. The Registry of Friendly Societies was given powers to require all credit unions to be registered. Qualifying for this involved demonstrating an appropriate common bond, the usual objects of a credit union and a set of acceptable rules. The Registry monitored credit unions by requiring them to submit an annual return. It could appoint an inspector to investigate the affairs of a credit union or suspend it from accepting savings or making loans. It could also cancel a credit union's registration or wind it up by court order.

5 There was a new obligation for submitting quarterly as well as annual returns. Sufficient information was required prior to registration to prove adequate basic management capacity and systems of control. The Registry was also concerned to establish the 'reality' of the proposed common bond and required proposed credit unions to submit detailed information especially those wishing to register a residential common bond. Overall there was a very restrictive approach to residential common bonds, and its emphasis on moral suasion was interpreted as requiring small tight knit communities.

6 Other legislative reforms that have affected the way credit unions operate include: Statutory Instruments Act 1946; Mental Health Act 1959 (Part VIII); Trustee Investments Act 1961; Income and Corporation Taxes Act 1970, Section 30; Insurance Companies Act 1974; Criminal Law Act 1977; Banking Act 1979; The Consumer Credit Act 1979; The Data Protection Act 1998; The Companies Acts.

7 Many of the changes are welcome in improving internal controls, reporting and accountability. A major benefit has been the introduction of the share protection scheme that will underwrite members' savings for the first time. This has been collectively called for by all sectors in the movement (see *Common Ground – National Goals for Improving the Laws Governing Credit Unions. A report from the Credit Union Movement in Great Britain*, 15 December 1997), and will increase public confidence in investing in their credit unions. Recent market research commissioned in North Nottinghamshire also reveals that the public are responding more positively to credit unions with the new status that Financial Services Authority supervision bestows. But some of the new demands are rigorous and may be problematic. A number of community credit unions are concerned that the vetting and approval process for all officers performing 'controlled functions' is beginning to deter volunteers, who are required to submit a 23 page application form of personal data to the regulators.

Following an influential 2002 Oxfam UK report, *Growing the Credit Union Movement*, that called for better co-operation between the various credit union stakeholders, a new National Liaison Committee has been formed to better represent the interests of all sectors within the movement. A specialist legislation group has also been established out of this, with the intention to consult and lobby to improve further credit union legislation.

8 *Towards Sustainable Credit Unions*, March 1999

9 While critical of public sector backing, the report provided documented evidence to back demands and applications for greater levels of investment. As a result, over recent years, credit unions and in particular community based ones have been more successful at securing subsidies towards achieving financial viability.

10 The first money for low-income credit unions came from the credit union association CUNA. They had invested \$50,000 to fund a pilot project for developing credit unions for low income, ethnic minority communities in Chicago, New York, Washington DC, Wilmington (Delaware) and San Juan (Puerto Rico). The Federal Government formed a partnership to develop this initiative under the War on Poverty and from 1965-73 over 400 community credit unions were registered. Only a very small number of the credit unions founded received direct subsidy, most were helped with donated office space or in kind support.

The vast majority of these credit unions failed once the War on Poverty programme ended. They failed for a variety of reasons including:

- many were not organised properly and failed to take root;
- loan policies and collection points were inadequate – leading to losses quickly;
- members were given Government emergency grants and loans at the same time and confused the two;
- the common bond areas of the credit unions were both small and restrictive – leading to an inability to include moderate income members as well in the credit unions.

The failure of this Government based approach led to acrimony and CUNA decided in late 1970 to wind up its involvement as soon as possible. In retrospect, while funding provided was often inappropriate in how it was used, the problem was not itself an investment one (National Federation of Community Development Credit Unions, 1999). In fact, the vast majority of these low income credit unions received no investment directly at all. What was really missing was a viable long term support structure and effective training services.

11 A sum of \$6 million was provide for a Revolving Loan Fund to make five year loans of about \$200,000 each at a rate of two per cent interest and quarterly repayments. To qualify for these investments, community development credit unions nationally had to prepare community needs plans and comprehensive business plans. The National Federation of Community Development Credit Unions received funds to help members with technical assistance and capacity building.

12 The National Federation of Community Development Credit Unions had to close its national office and make staff redundant as its annual budget was cut back from \$500,000 to only \$5,000. The Revolving Loan Fund was kept in existence but the interest rate on loans was raised to 7.5 per cent, in effect making it a liability rather than an asset.

13 The Demonstration Project centred on assisting community development credit unions in New York City, Chicago, Philadelphia

and North Carolina. Also from 1986 onwards, with a \$500,000 investment from the MacArthur Foundation, the National Federation of Community Development Credit Unions began attracting major funds from trusts and foundations of zero or very low interest funds for its Capitalisation Programme. These then invested strategically in member development as the Blue Book called for. By 1990, the National Federation of Community Development Credit Unions had \$2.3 million of such funds under management and was able to place non-member deposits of \$50,000 to \$100,000 to assist its community development credit union members develop. Alongside direct grants, other assistance has come in the form of low coupon investments, discounted loans, secondary capital and social investment deposits.

14 To assist community development credit unions with staffing, the National Federation of Community Development Credit Unions was also able to negotiate with AmeriCorps VISTA to enable graduates to be placed with community development credit unions for a year and assist as staff for business, product and other financial services development. Graduates are paid a wage by the US Government, administered by the National Federation of Community Development Credit Unions.

Subsequent support during the Clinton years included the opening up of community development credit unions to small business lending opportunities with support from the Small Business Administration and the Presidential Micro-lending Awards. Some have qualified for access to small business lending guarantee programmes. The National Federation of Community Development Credit Unions' own Capitalisation Programme has increased by over 350 per cent in the past five years to a fund of over \$25 million under management which places over \$5 million a year of new money with its members – including \$3.5 million in non-member deposits, over \$1 million in secondary capital to build net worth and reserves, and over \$330,000 in equity grants.

15 Evers, J. and Reifner, U, (1997) *The Social Responsibility of Credit Institutions in the EU*, Institut für Finanzdienstleistungen, Hamburg, 1998. Also, Cohen, R. (2000), *Enterprising Communities: Wealth Beyond Welfare*, report of the Social Investment Task Force to the Chancellor of the Exchequer, UK Social Investment Forum, London.

16 Bethex has also recently merged with four smaller low-income credit unions in the Bronx. As a result through one of these mergers and a community regeneration partnership with the Hunts Point Economic Development Corporation, it has expanded its branch network to four offices.

17 Among its 4000 members, the Lower East Side People's Federal Credit Union has 400 (11.5 per cent) on the cash payment service and 700 (20 per cent) on the chequing account. For those

with only one bill to pay, money orders are cheaper than the chequing account and credit union staff advise members on the most cost effective system. For the cash payment service, commission income to the credit unions from Consolidated Edison (for electricity) is 60 cents a transaction. Cash withdrawal can be obtained at the branch offices and through a steadily growing range of cash machines being developed by Bethex and the Lower East Side People's Federal Credit Union.

Chequing account services that Bethex operates are \$5 per month for unlimited cheques, but members need to have a minimum savings level of \$100. LESPFCU requires a minimum saving level of \$250 with 10 checks free per month. The minimum saving level is set to limit households from bouncing checks which cost \$20 to process. LESPFCU members with saving of over \$750 either in their saving or their chequing account (i.e. the combined total of both accounts) pay no chequing account monthly fee. The saver stage is thus an important critical one for community development credit union financial health and member well-being as accumulated saving balances assist the member in three main ways: (a) to avoid transmission charges for payment services; (b) to qualify for loans; and (c) to build up assets.

18 This national finance mechanism provides a partial loan guarantee to encourage community development credit unions to provide short term loan facilities to counter predatory lending practices in the ways the ASI Federal Credit Union (and, in Cleveland, Ohio, the Faith Community Credit Union) have shown feasible. By the end of 2002 the National Federation of Community Development Credit Unions had committed \$450,000 in PRIDES.

19 The cheque cashers agreed to accept savings payments into Bethex accounts, to withdraw funds, and to cash a Bethex cheque for free, with Bethex paying the fee.

20 Fuller and Jonas have previously argued for a more diverse approach to local development. See Fuller, D. and Jonas, A. E. G. (2002) *Institutionalising Future Geographies of Financial Inclusion: national legitimacy versus local autonomy in the British Credit Union Movement*, Antipode, 34: 1, 85-110.

21 A similar strategy has evolved in the past two years in Newcastle upon Tyne. Duncan Fuller and Mary Mellor of the University of Northumbria were invited to carry out some community based research with locally hired researchers on council estates in West Newcastle. The focus of the brief was to find out what financial services were required. The research involved consultation with old people, young families, teenagers and a wide range of ethnic minorities. Out of this work, a project called Financial Inclusion Newcastle (FIN) has emerged, bringing together money advice, debt help and credit unions in a collaborative way. Both the local Citizens Advice Bureau and the local credit unions in

West Newcastle have joined FIN to make it work. Services available through FIN include:

- money advice and debt counselling;
- basic Bank Accounts in partnership with the high street banks;
- insurance;
- business advice and micro-enterprise loans.

FIN has raised funds from the New Deal for Communities to fund the equivalent of 2.5 staff for the credit unions to operate front office provision and additional funds for a shared debt counsellor service through the CAB, a business advisor for all the credit unions to deliver small business loans and a shared administrator. Additionally funding has provided three of the community credit unions with shop front premises in good locations. Lloyds TSB has also provided a capital grant for a loan guarantee fund to help refinance high cost loans from doorstep creditors.

22 The Social Exclusion Unit's Policy Action Team 14 report, published in 1999, recognised the role that community credit unions could potentially provide in Britain in reducing financial exclusion. Following the recommendations of this report, the Government has taken action to reduce financial exclusion in several ways:

- requiring the introduction of basic banking accounts by all major banks and building societies;
- furthering the development of the Universal Banking Service to ensure that the Post Office network can operate more in future as a provider of financial services to all households;
- modernizing credit union legislation to enable faster growth in areas of disadvantage;
- ensuring, through the Housing Corporation and the Local Government Association, that Registered Social Landlords work with the insurance industry to promote low-cost household insurance that is integrated with rent payments;
- developing financial education and literacy initiatives: through schools, the Financial Services Authority and through the Community Finance and Learning Initiative;
- supporting through the Social Investment Task Force recommendations and the Department of Trade and Industry Phoenix Fund, the growth of Community Development Financial Institutions.

23 This is likely to be the case here as well in the UK – an outcome which will be financially costly for the Government once the subsidies from the banking industry for the Universal Banking Service expire after four years. The British Treasury have studied this experience but it has not been noted to date how community based credit unions in the USA have been helpful in tackling many of the problems with lack of cash machines in low income areas in many American cities and isolated rural towns. Quite literally, they

could provide in Britain a third and different way than either the Basic Bank Account or the costly Post Office Card Account.

24 The Financial Services Authority has also reviewed the experience to date with Basic Bank Accounts which have operated now for the past two years and the empirical evidence shows that these no frills accounts are being taken up but not reaching the most financially excluded very well.

25 Again the Treasury pilots are exploring the financial literacy aspects but have not closely examined the striking success of the community development credit unions with Individual Development Accounts as independently evaluated by Michigan State University. The Ford Foundation has funded community development credit unions to further develop these financial literacy programmes that uniquely reach the poorest American households.

26 The new Community Development Finance Association (CDFA) set up in April 2002 seeks to support the development of the following CDFIs including, because of their success in the USA, community development credit unions:

- Community Development Loan Funds;
- Micro-Finance Funds;
- Community Development Venture Funds;
- Community Development Banks and Social Banks;
- Community Development Credit Unions.

So in fact from a strategic perspective, the Community Development Finance Association during its incubation period over the past four years has long recognised the potential for community development credit unions to emerge and develop here in the UK.

27 This was a key recommendation of the 1997 NEF report for the National Consumer Council, *A Commitment to People and Place*.

28 Targeting only low income members would not work for community development credit union development as average savings levels would be too low and transaction costs unsustainable without ongoing subsidy or high charges to customers.

The regulator, the National Credit Union Administration, bases the 'low income designation' on data in the community development credit union business plan and public census data for the geographical area of the common bond. Employee based credit unions do not readily qualify in most circumstances for low income designation. There is no application form and the regulator decision is formed more on the area's median income level generally and the types of products and services offered. Thus if cash payers are not targeted, this would be an adverse factor limiting the chances

of low income designation. Community development credit union managers are certainly not required to monitor and means test their members but the regulator could require this if cause to do so was found.

29 The regulator has from time to time set up a special Office of Community Development Credit Unions to further community development credit union growth.

30 As with any enterprise, to grow fast, they will need adequate levels of capitalisation and start up investment. Unlike with CDFIs, (the investment agencies supported by the Department of Trade and Industry's Phoenix Fund for business lending), because credit unions can take deposits, the investment requirement is less for loan capital and more for 'people power', IT and other forms of long-term and quasi-equity or secondary capital.

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ISBN 1 899 407 68 5

© New Economics Foundation, National Association of Credit Union Workers and National Consumer Council 2003.

The New Economics Foundation and the National Association of Credit Union Workers gratefully acknowledge the support of Royal Bank of Scotland and NatWest.

The grant from Royal Bank of Scotland and NatWest that has been used to fund this publication, and associated events, and the direct work of the New Economics Foundation and National Association of Credit Union Workers is in no way connected to the National Consumer Council which has only contributed to the text of this report