NICVA

Centre for
Economic Empowerment

Full Report

Affordable Alternatives to High Cost Credit in Northern Ireland

NICVA Centre for Economic Empowerment

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Draft of final report

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June 2016

NICVA Centre for Economic Empowerment
Affordable Alternatives to High Cost Credit in Northern Ireland

Executive summary

Policy background and aims

- In 2013 NICVA convened a "round table" of key policy makers and stakeholders to discuss growing concern about high cost credit and illegal lending. The round table concluded that there was a pressing need to establish an "ethical"[1], affordable credit service to act as an alternative to high cost credit.
- NICVA commissioned Policis and Liverpool John Moores University to explore the options for an alternative affordable credit model. The project was structured as a collaborative development with an advisory board of key stakeholders.
- The project was informed by qualitative interviews with stakeholders, credit union leaders in Northern Ireland and the CEOs of various affordable credit organisations in GB and secondary analysis of consumer data on high cost credit.
- The project was originally conceived as an alternative to payday lending but on the basis of the evidence on the profile of payday lending users and the desire of the stakeholders[2] for an affordable credit model to serve the most disadvantaged, was reframed as seeking to provide an alternative to home credit[3] and illegal lending.

Stakeholders' perspective

- A new "social lending" model (i.e. a not for profit lending operation) was seen by stakeholders as embedded in a broader effort on financial inclusion, encouraging savings and building financial capability and resilience
- It was felt important that an affordable credit model would have high responsible lending standards. Stakeholders also felt it was important that borrowers did not take on impulse loans and that an ethical lender should not offer either instant or very short term loans.
- The original conception was that a new social lending operation would need to be self-sustaining, on the basis that there was little appetite within Government for funding on any scale, albeit some short-term, small-scale seed capital might potentially be found. As the project progressed, stakeholders moved on to take the view that the interest rate required to enable an affordable credit model to be sustainable would be politically unacceptable. This implies a requirement for both initial and ongoing public funding. The evidence is clear that the requirements for sustainability and for an APR that is meaningfully lower than that of high cost credit offered by the private sector cannot be reconciled.

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[1]The research explored with stakeholders the meaning of the term "ethical" in relation to credit provision. This was understood by stakeholders to mean a provider with a primarily social purpose that did not set out to maximise profit and which sought to avoid practices (such as irresponsible lending or continually refinancing loans) which could be potentially damaging to consumers.
[2]Stakeholders included both policy makers in Government departments, credit union leaders, domain experts and representatives of community and voluntary organisations.
[3]The "home credit" model (also known as "doorstep lending"), rests on small sum loans (typically a few hundred pounds) which are advanced in customers' homes by an agent who subsequently collects payments weekly, also from customers' homes.

Key demand side issues[4]

- There are a number of features of the private sector home credit market that have implications for the development of a not-for-profit lending model.
- Among the most important of these, is that private sector home credit customers are less disadvantaged or excluded than the target market stakeholders envisage for the new social lender.
- Moreover, as a result of both adverse selection and the best home credit customers' affinity with existing agent relationships and their current provider, the home credit borrowers most likely to present to a new affordable credit lender would have a higher risk profile than for the home credit sector overall.
- If a social lender seeks to serve a wider range of risk than the private sector will tolerate, as stakeholders envisage, this will have both cost and funding implications.
- The shift away from instant loans and a resource-intensive and relatively complex underwriting process and financial inclusion support envisaged for the affordable credit model may be a poor fit with consumer preference – and indeed need – for rapid delivery of funds and their desire for a convenient, minimal underwriting and approval process.
- Home credit users' tendency to miss payments to accommodate cash flow pressures may prove challenging for a new social lender if these patterns are transferred to repayment of affordable credit loans.

The credit union perspective

- The target market envisaged by stakeholders is some way from the current credit union member profile. A 2013 survey in NI[5] indicated that credit unions serve just 4% of Housing Executive tenants and many serve relatively few financially excluded borrowers. Credit unions initiatives which have specifically targeted the financially excluded have thus far been fully underwritten by a loan guarantee scheme. A 2014 survey of credit union members[6] in Northern Ireland suggests that just 6% have used home credit, 4% a high street loan shop and 3% an online lender in the last twelve months.
- Any affordable credit proposition resting on credit unions lending directly to financially excluded consumers would thus require CUs to serve a different and much higher risk market than that of their current membership.
- The barriers to credit unions in Northern Ireland lending directly to the financially excluded are significant, chief among which are risk aversion and an unwillingness to consider raising the interest rate ceiling that constrains credit union prices.
- Other significant issues include a reluctance to provide lending without borrowers' first establishing a savings track record, responsible lending challenges in serving the indebted and a lack of organisational and technological capacity.
- Credit unions took the view that it would be possible to collaborate to create a nation-wide network to extend affordable credit to those currently too high risk for credit unions to serve. However, they would be prepared to do so only if the risk were fully funded by Government or other agencies.

It is important to note that demand side analysis is based on GB data, with analysis extrapolated to NI. It is a possibility that NI will not follow GB patterns.
Jones, 2013
2014 Queens University Belfast

- One such collaboration involving a community organisation, a social landlord, and a credit union in Northern Ireland[7] succeeded in both moving borrowers away from high cost credit and encouraging them to save. However, such small community based schemes are difficult to replicate and therefore need careful targeting.

- Given the difficulties around risk and credit pricing, the most realistic and practical way forward in involving the credit union sector in a new affordable credit operation may be through collaboration with a CDFI on a referral basis. The research team has however developed variants on an affordable credit model, assuming both that credit unions would and would not participate.

Learning from the experience of other social lenders

- The research team examined the experience of the GB credit unions delivering the Financial Inclusion Growth Fund (2006 – 2011) which were supported to reach out to the financially excluded.

- The team also examined in detail the experience of various high profile affordable credit initiatives elsewhere in the UK :

- two CDFI's, Scotcash based in Glasgow, and Moneyline, with a national network of 18 branches;

- a CDFI, Headrow Money Line in Leeds, which operates as a credit union sister company; and

- London Mutual, a credit union which has pioneered a not for profit online payday lending service.

- With the exception of London Mutual, these social lenders have focused on lending to the financially excluded and acting as an alternative to home credit lending.

- The various lenders saw their mission as financial inclusion in the broadest sense and offer a range of services designed to facilitate inclusion, saving and financial resilience. However, consumers are primarily attracted to the loans proposition and achieving growth and scale is more likely if lending is emphasised in consumer-facing communications.

- With the exception of the London Mutual online service, the various social lenders examined had chosen to focus on face-to-face delivery which they saw as better facilitating customer engagement with financial inclusion propositions.

- Serving a hard to reach and financially excluded target market with a delivery model that is face-to-face and which requires manual underwriting is inherently very high cost, which impacts both credit pricing and lender sustainability.

- Where lending capital must be sourced from the commercial sector, this will be at high rates, which will in turn impact the pricing of affordable credit.

- Social lenders of necessity charge high APRs (for example 106% for ScotCash and 160% for Moneyline, which sources capital from the private sector) but nonetheless have required significant subsidy. Growth Fund loans were subsidised an average of £17 per £100 lent while personal lending by CDFIs is subsidised by an average of £23 per £100 lent.

- The circa 100 GB credit unions participating in the Growth Fund struggled to achieve sustainability. Similarly, Scotcash continues to be loss making and dependent on external funding while Moneyline is only now coming close to sustainability after twelve years.

[7] *See the Financial Capability and Affordable Credit Pilot – Final Report, Consumer Council for Northern Ireland, 2016.*

- In discussing social lending as an alternative to high cost credit it is important to recognise that even the most successful social lending operations represent only a very small share of the market. While social lenders offer both a valuable financial inclusion service and cheaper credit to their customers, none have achieved the scale to act as a realistic alternative to high cost credit for most high cost credit borrowers.

An affordable credit model for Northern Ireland

- The advisory board asked the research team to take forward three alternative affordable credit concepts for a detailed exploration of the potential scale and reach and likely funding requirements of each of the following: A branch-based model on the lines of Scotcash or Moneyline; a national online service, based on pre-qualified referrals from credit unions and social landlords; and a community-based, volunteer-led service. In all cases it was required that the models be sustainable and would break even within a six year period.

Northern Ireland version of Moneyline / Scotcash

- The first iteration of the branch based model suggested that it would be feasible to establish a Northern Ireland version of Scotcash or Moneyline, possibly on a franchise basis and with support from Scotcash or Moneyline. However, as with the other social lending models, the APR would need to be high (173%) on the assumption of a break even after a six year period) if the operation were to be sustainable.

Table A. Overview face to face branch-based affordable credit model for Northern Ireland

On assumption break even after 6 years

Cost of credit	
APR	173%
Cost of credit per £100 lent	£49
Savings to consumer*	
per £100	£21
per average loan	£104
Cumulative over 6 years	£2.5m
Scale	
Loans p.a.	5,400
Market share after 6 years	6.80%
Funding requirement	
At 173% APR	£1.7m
Subsidy per £100 lent	£12.53
Per typical £500 loan	£62
At 100% APR	£3.4m
At 48% APR	£4.95m
At 36% APR	£5.4m
Business risk	
If bad debt 15%**	£2.1m
If bad debt 17%	£2.7m
If loan volumes 4500 p.a.	£2.1m

* relative to private sector home credit loan ** rather than 12% assumed in model, funding requirement will increase to the level indicated

- Given that the intended target market is inherently higher risk that that served by either Scotcash or Moneyline currently, there is a real danger that performance in Northern Ireland may be worse than the indicative model outputs suggest

- However, while such a model could offer potential costs savings to consumers, these savings (equivalent to £2.36 p.w.) may not be sufficient to tempt consumers to move away from established relationships with existing high cost credit suppliers, particularly if the application process is time consuming and funds are not delivered quickly, as would seem to be implied by the proposed personalised underwriting, financial inclusion approach to appraising customer needs and the policy of not delivering instant loans.

Online service with prequalified referrals from social partners

- The perceived key advantage of the online model is that it would facilitate a national affordable credit service.

- As with other high cost models, however, the first iteration of the model suggested a high APR, would be required if the model were to be sustainable. The cost savings to consumers are potentially slightly greater than would be the case for the branch based model.

- Semi-automated underwriting and remote service will require that borrowers are lower risk than for a branch-based model, while provision for bad debt will nonetheless need to be higher, this being the nature of online lending. The online referral-based model is unlikely therefore to serve the most vulnerable and excluded consumer.

- The main limiting factors in the success of the model will be the effectiveness of the outreach and engagement with partner organisations and the quality of referrals. If the risk profile of referrals is inappropriate, costs, and potentially bad debt, will rise, with concomitant implications for the funding requirement.

Table B. Overview national referral based online affordable credit model for Northern Ireland

On assumption break even after 6 years

Cost of credit		**Funding requirement**	
APR	153%	At 153% APR	£0.5m
Cost of credit per £100 lent	£45	Subsidy per £100 lent	£17.54
Savings to consumer*		Per typical £500 loan	£88
per £100	£23	At 100% APR	£0.75m
per average loan	£117	At 48% APR	£1.06m
Cumulative over 6 years	£0.58m	At 36% APR	£1.1m
Scale		**Business risk**	
Loans p.a.	1,240	If bad debt 17.5%**	£0.62m
Market share after 6 years	1.50%	Referrals reduced by half***	£0.38m

* relative to private sector home credit loan

** rather than 15% assumed in model, funding requirement will increase to the level indicated

*** model heavily dependent on quality of referrals, reduced referrals would produce 620 loans p.a.

Community based model

- The strength of the community based model was seen by the advisory board to be its potential to reach and serve a small number of highly disadvantaged individuals who might otherwise find it difficult to access credit and who may be exposed to illegal lenders.
- The profile of potential borrowers is unlikely to support effective and responsible lending on any kind of viable financial basis, however. As a result, lending would be small scale, being circa 175 loans p.a.
- The first iteration of the model showed that costs to the consumer would be very high if the model were to be sustainable and cost savings correspondingly modest.
- Against this background, it would seem that grant finance and debt counselling may be more appropriate responses to the needs of these most vulnerable borrowers.

Table C. Overview Community-led affordable credit model for Northern Ireland

On assumption break even after 6 years

Cost of credit	
APR	300%
Cost of credit per £100 lent	£55
Savings to consumer*	
per £100	£7
per average loan	£25
Cumulative over 6 years	£26,250
Scale	
Loans p.a.	175
Funding requirement	
At 300% APR	£83,000
Subsidy per £100 lent	£28.33
Per typical £350 loan	£95

* relative to private sector home credit loan

Taken together, the relative strengths and weaknesses of the three models across the key considerations stakeholders bought to the development of the affordable credit model are summarised in Table D following.

Table D. Overview of the strengths and weaknesses of the three model types in relation to an affordable credit model for Northern Ireland

Key considerations in development of an affordable credit model for NI	Community-based model	Branch-based, face to face model	Referral based national online service
Target market			
Vulnerable financially excluded borrowers	*****	***	*
Current users of high cost credit	*	***	***
Those struggling with mainstream models	*	**	***
Potential users of illegal lending	*****	**	*
Added value social benefits			
Financial inclusion / capability / resilience	*****	****	*
Cost savings / enhanced residual income	*	**	***
Limitations			
Reach	*	**	*****
Serve both communities	***	***	*****
Serve urban and rural areas	*	*	*****
Cost of credit			
High APR	*****	****	***
Scale			
Potentially scaleable	*	***	****
Sustainability	*	**	***
Funding requirement	*	*****	***
Business risk	*	***	***

Key: the numbers of stars denotes degree of fit with each factor being rated, with 1 star being a poor fit and 5 stars being a strong fit.

Further iterations of the model on the basis of a 100% APR and greater scale and greater or lesser engagement from the social housing and credit union sectors

After the initial iterations of the models had been considered by the advisory board, the board took the view that the APRs indicated by their initial requirement for sustainability would not be politically acceptable. There was also some concern that the impact of the affordable credit initiative would be limited in that the potential scale of the operation was seen as small relative to the size of the high cost credit sector. Beyond this, there was little consensus among stakeholders.

Some stakeholders concluded that providing the most deeply financially excluded and vulnerable population with affordable credit, as originally envisaged was not viable on responsible lending grounds nor financially sustainable. This group took the view that a credit-focused national online referral-based service was the way forward and the only viable option given the funding limitations, albeit that it was recognised that such a service would not serve the most disadvantaged.

Among the proponents of this route, some individuals were keen to understand whether the online model could be grown more rapidly or further scaled by more pro-active engagement from the social housing sector. There were also some reservations about whether, given the requirement from the credit union sector for full subsidy for any lending to the financially excluded and their opposition to high interest rates, the model could be viable in the eventuality that such funding was not available or credit unions were reluctant to participate in a scheme offering relatively high interest loans.

Others took the view that an affordable credit service for Northern Ireland must be multi-channel, offering a face to face service in order to reach out to the most disadvantaged. For these stakeholders, the core premise of an affordable credit model for Northern Ireland was that it should take as its focus a broader financial inclusion proposition embracing banking inclusion, building financial capability and increasing financial resilience through encouraging savings. For this group, provision of affordable credit was only one element of the wider proposition, available only to the sub-set of disadvantaged would-be borrowers who could be served within responsible lending guidelines. While it was recognised that such an operation would require significant ongoing funding, the sense was that an affordable credit model that did not focus on the most disadvantaged and a broad financial inclusion proposition would not gain political support.

Against this background the research team created further iterations of both the branch based and online models. In the former case, a second iteration of the model assumed more branches and more rapid growth than in the original model,

In the case of the online model further iterations were developed on assumptions of greater engagement and higher participation in the scheme by the social housing sector. These included scenarios in which the NIHE were and were not involved and differing levels of commitment and referrals. Scenarios were also developed assuming both greater credit union participation and no credit union involvement. The outcomes of these further iterations are summarised in the table following which show the potential loan volumes and consumer savings associated with each of the different scenarios.

Table E. Loan volumes and consumer savings relative to private sector home credit pricing Key dimensions of branch-based and online lending scenarios

	Financial inclusion led		Lending led				
	Branch-based		National online referral based				
After 6 years of operation	Scenario 1. Base case: 3 branches	Scenario 2. Scaled up lending volumes	Scenario 3. Base case, credit union and housing association referrals	Scenario 4. NIHE referrals additionally alongside HAs and CUs	Scenario 5. Increased social landlords engagement alongside CUs	Scenario 6. No credit union referrals	Scenario 7. Increased credit union engagement
% of CUs, HAs and NIHE area office engaging							
Credit union participation rate			20%	20%	20%		30%
Housing Association participation rate			52%	52%	75%	75%	75%
NIHE participation rate				23%	75%	75%	75%
APR	100%	100%	100%	100%	100%	100%	100%
Default rate	12%	12%	15%	15%	15%	15%	15%
Scale							
Loan volumes p.a.	5400	9000	1239	1447	2759	1732	3273
Cost of credit							
Per £100 lent	£33	£33	£33	£33	£33	£33	£33
Total repaid on £500 loan	£665	£665	£665	£665	£665	£665	£665
Average consumer savings per:							
£100 lent	£31	£31	£30	£30	£30	£30	£30
Cumulative consumer savings £m	£4.3	£5.5	£0.84	£0.98	£1.87	£1.17	£2.21

- The research team further contextualised these projections with the scale of real-world loan volumes and penetration of social housing tenants achieved by affordable credit operations elsewhere.
- The upper limits of affordable loan volumes generated by other affordable credit providers elsewhere, represent the equivalent of a maximum 2% penetration of the local social housing population, with achieved loans often significantly lower, even after several years of operation.
- Referral and participation rates from social landlords and credit unions have largely been lower than assumed in the more optimistic of the scenarios explored. The evidence from the experience of other affordable credit schemes would suggest therefore that scenarios 2, 5 and 7 would represent the absolute upper limits of what could be achievable in Northern Ireland while scenarios 1 and 3 and 4 would seem to represent the most likely real world outcomes, provided that commitment from the social housing sector and credit unions would be forthcoming.
- Clearly none of these models is sustainable at an assumed APR of 100% and a 12% (branch) 15% (online) default rate. The associated subsidy and funding requirements of each model and scenario are shown in Table F below.
- An online model on the basis of the most likely outcome (scenario 3) in line with the experience of other models would require funding of £0.75m while the most ambitious scenario resting on significant commitment and engagement from both the credit union and social housing sector could require as much as ££1.73m of funding over six years. The three-branch face to face models would require cumulative funding of £3.4m over a six year period while the scaled up, rapid growth branch model scenario would require funding of £4.9m over the period.

Table F. Funding requirements of branch-based and online lending scenarios at 100% APR

	Financial inclusion led		Lending led				
	Branch-based		National online referral based				
After 6 years of operation	Scenario 1. Base case: 3 branches	Scenario 2. Scaled up lending volumes	Scenario 3. Base case, credit union and housing association referrals	Scenario 4. NIHE referrals additionally alongside HAs and CUs	Scenario 5. Increased social landlords engagement alongside CUs	Scenario 6. No credit union referrals	Scenario 7. Increased credit union engagement
Funding requirement							
Subsidy per £100 lent based funding and operating costs	£25.18	£27.30	£26.74	£26.26	£24.81	£30.11	£23.38
Cumulative funding required £m	£3.4	£4.9	£0.75	£0.85	£1.54	£1.75	£1.73

Conclusions and recommendations for an affordable credit model for Northern Ireland

Conclusions

- There are no easy answers in arriving at an affordable credit model for Northern Ireland. It is important however to be realistic about what can be achieved.
- It is clear that an affordable credit model would need to charge much higher APRs than would be politically acceptable if it were be sustainable in even the medium term. Any model that operates a pricing policy that would be politically acceptable (deemed by the advisory board to be a maximum of 100% APR) will require significant funding and on an ongoing basis and would have little realistic prospect of achieving sustainability, even where supported by patient and low or no cost capital.
- It is also important to recognise that no affordable credit models elsewhere have achieved the scale to be viable as an alternative to high cost credit for most borrowers using high cost models, even where they have been the subject of very significant investment and capacity building by Government.
- Nonetheless, affordable credit models have offered worthwhile cost savings in comparison to high cost credit and have also acted as a lever for financial inclusion for significant numbers of borrowers, albeit that numbers have been small relative to the private sector. The lack of scale relative to the private sector is not necessarily an argument for doing nothing. Rather it is important to be realistic about the limits of what an affordable credit model could achieve in acting as an alternative to high cost lending.
- It would seem likely that any affordable credit model targeting existing home credit users would need to recognise that it would probably attract higher risk borrowers than those using private sector lenders overall. This will have implications for bad debt and collections management, in turn impacting on cash flow and funding requirements and the potential for sustainability.
- Clearly the more expensive a model is to deliver the greater will be the funding requirements, both at start up and ongoing. A full service face to face branch based service with a wide focus on financial inclusion and financial capability building and targeting more disadvantaged individuals will be cost and resource intensive and thus will require concomitantly greater funding. Moreover relatively few of the deeply financially excluded and most vulnerable would-be borrowers, envisaged by some stakeholders as the target market for an affordable credit service in Northern Ireland, will be viable as borrowers on a"responsible lending" basis. For this type of individuals the benefits of the model may be greater financial inclusion and increased resilience rather than cheaper credit. Branch based models will of course also not necessarily have national reach and, in a Northern Ireland context, may require a degree of duplication in that branches may need to be sited to serve specific communities.
- An online service will be lower cost and have greater potential for national reach. It will however depend on automated underwriting and credit scoring and electronic collections and will need to serve a less disadvantage target market as a result. In so doing however it will have the potential to offer cheaper credit to those currently using high cost private sector providers. If a partnership can be forged between a new social lender operating online and relying for applications on a referral stream from social landlords and credit unions this may prove a route to lower cost credit particularly for social tenants who are currently under-served by the credit unions. Such a model will be cheaper to deliver and thus require funding on a smaller scale than a face to face model. The advisory board rejected the idea of a consumer-facing online service, as being expensive to develop initially and complex to deliver, in favour of a referral-based service, which was felt better placed to target social tenants and those in need of affordable credit. This model will however be critically dependent on the commitment to the scheme of the social housing sector and credit unions, the effectiveness of partnership working and the quality of referrals.

- The advisory board originally took the view that an Affordable Credit model for Northern Ireland would need to be sustainable and that there was, at the time of the project inception, no appetite within Government for substantial funding of such an initiative. It may be that the policy context has since evolved and that the challenges originally envisaged in raising funding may now be more tractable.
- The various affordable credit options that have now been developed for consideration by the board require funding at differing levels and will deliver differing levels of financial inclusion and affordable credit benefits. In deciding how to take forward an Affordable Credit model for Northern Ireland, the advisory board has had to balance funding considerations, a range of financial inclusion considerations and sometimes competing agendas within the stakeholder community. The recommendations made by the advisory board represent their view of the optimal way forward for an Affordable Credit model for Northern Ireland, given the complexities and challenges inherent in development and the constraints of the reality of funding and sustainability issues.

Recommendations for an affordable credit model for Northern Ireland

Against this background, the advisory board took the view that an appropriate Affordable Credit model for Northern Ireland would need to offer credit at an APR of 100%, recognising that while this represented a high APR that would be difficult for some to countenance in a "not for profit" model, that this would nonetheless represent significant savings for the target market of existing high cost credit users who would otherwise pay a much higher cost for their much-needed credit.

The board also felt that, in a Northern Ireland context, an Affordable Credit model would need to incorporate elements of both the online and branch based model, with the community based model seen as an optional add-on, albeit one requiring investment of significant resource relative to the scale of lending that could be achieved. It was felt that a significant element of the target market would require face to face delivery, particularly if borrowers – and unsuccessful applicants for loans – were to benefit from the financial inclusion and financial capability-building element of the proposition. It was felt however that the more realistic option would be to take an evolutionary, incremental stance and aim for the three branch model along the lines of MoneyLine or Scotcash in the first instance.

The limitations of the branch-based model were also recognised by the advisory board, and in particular the inability of a branch-based model to deliver national reach. For this reason, the board felt that the branch based model should be complemented by a national online service, able to reach both urban and rural borrowers and both communities.

It was agreed that an online service would need to be referral-based. It was felt however, that it was not feasible to look to Credit Unions as principal agents for a referral scheme, on the basis that the credit union representatives on the board felt that there were a number of key barriers to credit union participation. These included a likely reluctance on the part of credit unions to make referrals to a loan service at 100% APR, a lack of shared infrastructure and a relatively low level of declines for loan applications which would therefore form an insufficiently substantial referral stream for the new service. It was felt that referrals would need rather to rely on the social housing sector, both housing associations and the Housing Executive, among whose tenants there is relatively little credit union penetration and a high incidence of high cost credit use compared to the wider population. The board recognised that the population served by an online model would be less disadvantaged than that served by the branch-based model.

The advisory board acknowledged that there are clearly some disadvantaged individuals who may seek credit or need funding to address cash flow crises or spread the cost of essential major purchases whom it would not be possible for an ethical affordable credit model to serve on a "responsible lending" basis. It was felt, however, that some provision needed to be made for such would-be borrowers, albeit that this should be on a grant or guaranteed loan basis. The alternative of e some form of small-scale, community and outreach based provision, i, along the lines of the community model earlier discussed, was regarded as an option that could be adopted by specific communities or organisation willing to invest the funds and resource in lending to and building up the financial capability and financial resilience of a relatively small number of highly excluded individuals in those communities.

Taken together therefore the key dimensions of the recommended affordable credit model for Northern Ireland are as laid out in Table G following:

Table G. Summary key dimensions of the recommended affordable credit model for NI - cost of credit, loan volumes and consumer savings

Cost of credit	
APR	100%
Per £100 lent	£33
Total repaid on £500 loan	£665
Default rate	
Branch based	12%
National online service	15%
Loan volumes p.a.	
Branch	5400
Online	1732
Total branch and online	7132
Consumer savings	
Average per £100 lent	£31
Per average £500 loan	£155
Cumulative consumer savings £m over 6 years branch based and national online service	£5.47

Overall it is anticipated that the new Affordable Credit Model for Northern Ireland would, once established, make 7130 loans per year, This represents savings to consumers of an average of £31 per hundred and an average of £155 per loan. Cumulative savings to consumers over the six year period would be £5.47m.

The funding requirement for the model would be £5.15m representing a subsidy per £100 lent of a little over £25 for the branch model and a little over £30 for the online service, The outreach and community based grant funding scheme for those in need of emergency funds but without the means to repay a loan would require additional funding of £0.36m over the period.

Table H. Summary funding and subsidy requirements for the recommended affordable credit model for NI

Subsidy per £100 lent based funding and operating costs	
Branch based	£25.18
National online service	£30.11
Cumulative funding required branch based and national online service	£5.15
Additional funding that would be required for grant or loan -based community service £m	£0.36

NICVA will now take the recommended model forward and engage with stakeholders, policy makers and potential funders to make a new Affordable Credit model a reality for Northern Ireland.

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Acknowledgements

NICVA and the Policis and Liverpool John Moore University research team would like to thank the Advisory Board for their support, for sharing their thinking and insights and for their contribution in steering the project and providing advice and direction for the research team.

Advisory Board Members (original list – needs updating)

Bob Stronge	Advice NI
Cameron Watt	NIHFA
Carmel Morris	Irish League of Credit Unions
Eimear Duffy	Consumer Council for Northern Ireland
Gordon Smyth	Ulster Federation of Credit Unions
Harry McDaid	UCIT
Patricia Mulligan	DSD
Joanna Brown	OFMDFM
Jimmy Hughes	DETI
Sharron Carlin	DSD

The project team

Policis

Policis is a social and economic research consultancy focused on evidence based policy and service development, both in the UK and internationally. Policis has a specialist focus on social disadvantage and a financial services practice which has a long track record of research and consultancy around financial services provision to those on low incomes, with a particular expertise in credit. Financial Inclusion and credit related research and econometric modelling projects, including projects on high cost credit, payday lending and developing social lending, have been undertaken for BIS, HM Treasury, DWP, OFT, FSA, FCA, The Competition Commission, ABCUL, The Cabinet Office, The Payments Council, The Friends Provident Foundation, Joseph Rowntree Foundation, Save the Children and Barnardos.

Research Unit for Financial Inclusion

The Research Unit for Financial Inclusion (RUFI) at Liverpool John Moores University undertakes academic, action and evaluative research in a wide range of areas related to the development of financial services for low and moderate-income households, money and debt advice and credit union development. RUFI has been at the forefront of the development of social lending in the UK, having worked closely with The Association of British Credit Unions (ABCUL), Community Development Finance Association and DWP for many years on the strategic development of the sector. RUFI also recently undertook a study (for the Housing Rights Service and Consumer Council) on how most effectively to extend financial inclusion and affordable credit to lower income and vulnerable households in Northern Ireland. RUFI are thus well connected with the social lending trade associations and credit unions and a wide range of policy makers and stakeholders in Northern Ireland

The research team

Anna Ellison, Policis research director, has some twenty five years social and economic research experience. She is a domain expert in the provision of financial services to those on low incomes and has particular expertise in high cost credit. She has worked extensively on projects relating to high cost credit, illegal lending and the development of social lending alternatives, leading economic research projects in these subjects not only in the UK but also internationally in the US, Central and Eastern Europe, Asia and Australia.

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Tony Dignan is a Belfast based economist and an evaluation specialist with some twenty years' experience of conducting evaluations of a very wide variety of public sector initiatives across Northern Ireland. Tony has worked on research and modelling for a series of Policis projects around banking inclusion, high cost credit and illegal lending. Tony has extensive experience of conducting formal impact assessments using a range of methodologies to estimate the net benefits of interventions, assess savings to the public purse and benefits to consumers and communities.

Paul and Anna have worked together on the development of a strategic plan for scaling up social ending in London, for DWP, on a feasibility study for a national social lending alternative to home credit, for the Joseph Rowntree Foundation, on the potential for social lending to impact on use of high cost credit, for the Friends Provident Foundation and on a project for BIS, examining how best to support victims of illegal lending into use of legal affordable credit. Tony Dignan has worked with both Anna and Paul on studies looking at the scale and nature of illegal lending in the UK and on evaluating the impact of the national illegal money lending teams and of the effectiveness of the effort to migrate victims of illegal lending to affordable credit.

1.0 Policy context, research aims and methods

In this chapter we describe the policy background to the project, the project aims, the research methods and the development process by which the advisory board, working with NICVA and the research team, arrived at a new affordable credit model for Northern Ireland.

1.1 Policy context and project background

The policy context for the project was growing concern in Northern Ireland, reflecting that in the UK more widely, over consumer detriment arising in the high cost credit sector. This had been largely driven by the explosive growth of the payday lending industry, which by the end of 2013 had become a £2.5 billion pound industry in the UK, with the sector more than doubling in size in the five years from 2009 when total payday lending had been just £900m. This growth was in large part driven, on the one hand, by the shrinking availability of mainstream credit for those higher risk borrowers and those on low incomes more widely, and, on the other, by the entry to the UK market of a number of large, highly tech and information savvy lenders who invested heavily in high profile marketing and in building online distribution channels. The payday sector had attracted considerable media attention and had been the focus of significant scrutiny by both consumer advocates and regulators. The Office of Fair Trading, which at that time had regulatory responsibility for consumer credit, had in 2010, with BIS, conducted the High Cost Credit Review. This was followed by a 2012 investigation of the compliance of the sector with the responsible lending requirements, which in 2013 resulted in a highly critical report which referred the sector to the Competition and Markets Authority for investigation. In late 2013, the newly established Financial Conduct Authority, which took over regulatory responsibility for consumer credit in April 2014, outlined their proposed regulatory approach to the sector and a range of new requirements of payday lenders, with final regulatory requirements published in March 2014.

All of these concerns focused on payday lending sat alongside a wider policy concern around the high cost of borrowing for those on low incomes more widely, and particularly around the cost of credit in the home credit sector[8], used by some of the most disadvantaged citizens in Northern Ireland. Policy makers, consumer advocates and the voluntary sector were also concerned that vulnerable borrowers desperate for credit were turning also to illegal lenders.

Against this background Northern Ireland Council for Voluntary Action (NICVA), the umbrella body for the voluntary sector in Northern Ireland, and the Centre for Economic Empowerment undertook research into both high cost legal lending and illegal lending in Northern Ireland. NICVA then held a round table in the spring of 2013 with a range of key policy makers, consumer advocates and stakeholders to discuss the implications of the research. The consensus at the round table spoke to a pressing need for an alternative, affordable and ethical alternative to high cost lending in Northern Ireland.

NICVA and the Centre for Economic Empowerment subsequently commissioned research from Policis and Liverpool John Moores University to explore the options for an alternative affordable credit model for Northern Ireland to inform public debate and how most effectively to take the concept forward.

1.2 Project aims

The project, as originally conceived, focused on seeking affordable alternative to payday lending. During the opening discussions of the advisory board and through the consultation process with stakeholders, it became clear that board members were concerned with finding affordable credit alternatives for the most

[8] *See note 3 preceding*

disadvantaged and financially excluded credit users. The evidence presented to the board by the research team demonstrated, however, that payday users, while primarily those on low incomes, are not drawn from the most disadvantaged sectors of society. This is because payday lenders require borrowers to be both banked and in work.

Similarly, most payday borrowers do have access to mainstream credit, albeit that this credit use has often been problematic (see following chapter three for details).

It was also felt that the payday landscape had changed significantly in any case since the project had been conceived in that reform and new regulatory requirements had addressed much of the detriment previously evident in the sector.

For both of these reasons, the project was reframed to focus primarily to affordable credit alternatives to home credit, a form of high cost credit used by a lower income and more disadvantaged group than payday borrowers.

Accordingly the project aims were re-framed as follows:

- To provide a sense of scale for the high-cost personal lending market in Northern Ireland;
- To provide an overview of the consumer dynamics of high cost credit use;
- To estimate the likely scale of demand for affordable credit as an alternative to other high cost credit types;
- To identify the issues arising and lessons that can be learned from the experience of others who have sought to develop affordable credit models;
- To identify the limits of the target market that could be served by an affordable credit product; and
- To develop a business model focused on an alternative ethical and more affordable high cost credit product.

1.3 Research methods

The research methodology had a number of strands:

- Secondary analysis of UK data sets drawn from two existing Policis surveys covering a series of financial inclusion and high cost credit related issues. These were undertaken, in 2011 and 2012 respectively, with a nationally representative sample of 1886 UK low income households and 1000 social tenants. In the absence of Northern Ireland specific data, scale estimates for Northern Ireland were extrapolated from the UK data set. It should be noted however that there is always a possibility that NI does not follow GB patterns and trends.
- Structured qualitative interviews with policy makers and other stakeholders in Northern Ireland;
- Structured qualitative interviews with credit unions in Northern Ireland;
- Structured qualitative interviews with senior executives in organisations that had developed affordable credit lending operations targeting low income borrowers and users of high cost credit products; and
- The modelling of three alternative affordable credit concepts in order to understand the financial dimensions and funding requirements of different business models and their potential scale and reach.

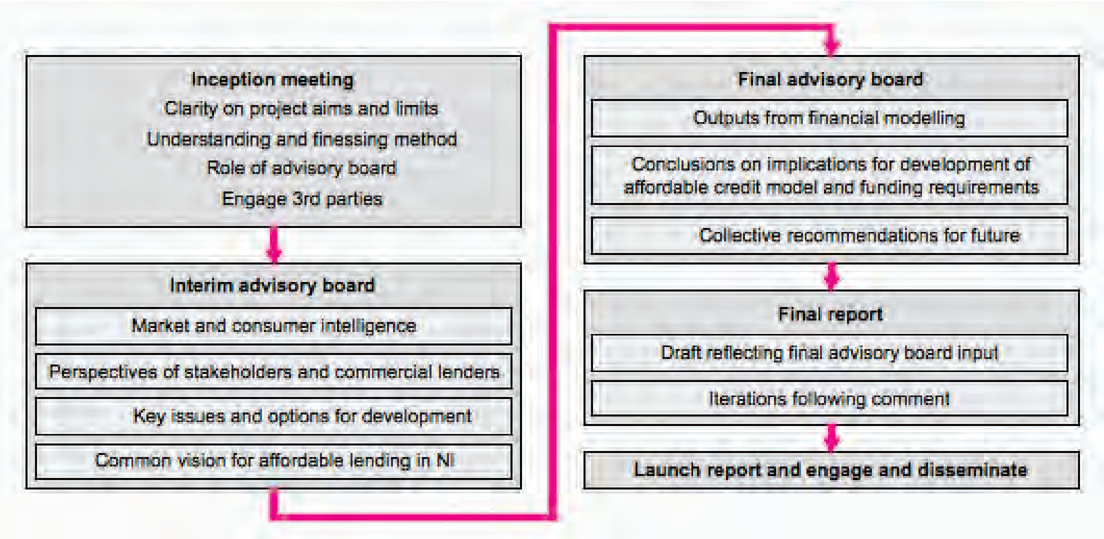
The topic guides for the various interviews can be found in the appendix.

Throughout the analysis where we refer to “low-income” households, we refer to households in the lowest 50% of household incomes unless we refer to those falling into specific income deciles.

1.4 Project structure and the development process

The project was envisioned from the outset as being a collaborative development effort by key Northern Ireland stakeholders, with Policis and LJMU providing expert input and evidence to inform the board's deliberations. NICVA convened an advisory board, comprising representatives from Government departments, credit unions and the voluntary sector (see page 8 for a list of the organisations and Government departments represented on the advisory board), to which the research team presented evidence at various key stages during the project. The process by which the advisory board and research team worked together to develop a vision of an affordable credit model for Northern Ireland is captured diagrammatically in Figure 1 below.

Figure 1. The development process and the role of the advisory board in the development process



The original intention was to develop a single model in detail to be taken forward as the basis for a new affordable credit model for Northern Ireland. A number of alternative affordable credit concepts were considered by the board. In the event the advisory board took the view that it would make sense to explore the financial and scale dimensions of three of these concepts. The various options considered by the board and the outputs of the three concepts which the research team modelled are described in chapter six. On the basis of the model outputs, the board chose one as representing the most appropriate and promising basis for a new affordable credit service for Northern Ireland. The model and the rationale for the advisory board's selection are described in chapter six and seven.

2.0 The stakeholder perspective

In this chapter we describe the attitudes of the various stakeholders, including representatives of Government Departments, credit union leaders and representatives of various community groups, who participated in the consultation process around how an affordable credit model for Northern Ireland should be developed. We describe their perceptions of the appropriate target market for a social lending model in Northern Ireland, how such a model should be positioned and delivered and how it ought to be differentiated from private sector high cost lending alternatives. We also discuss expectations on funding and sustainability and Government and stakeholder's appetite for funding and partnership with a new affordable credit operation.

2.1 The perceived target market for an affordable credit model for Northern Ireland

A clear consensus that an affordable credit model for Northern Ireland should focus on the most disadvantaged and financially excluded

The research team first explored with stakeholders what they saw as the target market for an affordable credit model for Northern Ireland. There was a clear consensus that social lending should focus on the more disadvantaged and financially excluded consumers without access to the credit mainstream. There was particular concern also that affordable credit should reach social tenants, who were seen as not well served by credit unions[9] (see detailed discussion in chapter four). An affordable credit model was seen primarily in terms of a lower cost alternative to home credit and illegal lending.

"The demographic that is not being served, you know, are the single mums on benefits in social housing…it is social tenants are particularly under-served."

It was felt that an affordable credit model should act as an alternative to home credit and illegal lending rather than to payday loans

A number of stakeholders, including those from the debt advice sector, felt also that the focus on payday lending as the driver of problematic debt had been overdone in the media and policy discussions. Here there was a sense that an affordable credit model should rather aim to act as an alternative to high cost home credit and to the illegal lenders believed to be operating in the more deprived communities.

"We've come to the conclusion that there's a lot of media attention and payday-lending is very visible. Now I'm not saying it isn't as much of a problem here as it is in Great Britain but the anecdotal evidence we're getting from debt counselling and stuff is that payday lending works for a lot of people…so what we're looking at is high cost credit across the range and that takes in the likes of Provident, illegal lending."

Some stakeholders believed that an affordable credit model should pro-actively seek out the most disadvantaged, excluded and those under financial pressure

Some stakeholders went further in feeling that, an affordable credit model should not simply seek to act as an alternative and cheaper lender for borrowers currently using high cost lenders but that a new social lender would pro-actively seek out the most disadvantaged and excluded borrowers, not being served by even the high cost lenders and thus at greatest risk of resort to illegal lenders.

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[9]For data on credit unions service of social tenants in Northern Ireland see "Towards Financial Inclusion The expansion of credit union financial services for low income households in Northern Ireland", P.A. Jones, Liverpool John Moores University for Housing Rights Service (2013)

A minority also saw an affordable credit model also targeting the working poor currently struggling with mainstream credit

There was also some sense that mainstream credit was not necessarily working well for the working poor and low-income families and that these groups could potentially be a secondary target market for affordable credit, in this case acting as an alternative to revolving credit and overdraft finance, which was seen to be enmeshing some borrowers in a cycle of continual borrowing.

2.2 The ethics of an affordable credit model for Northern Ireland

Affordable credit model should aim not solely to be a lender but rather a facilitator of broader financial inclusion

There was a strongly held view among many stakeholders that an affordable credit model for Northern Ireland should seek to be actively transformative, going beyond lending to facilitate wider financial inclusion. Lending to those currently excluded was seen as a way to facilitate entry to the banking system. Engaging with the excluded and social tenants was seen also as opening up opportunities to strengthen financial capability, stimulate a savings habit and thus enhance financial resilience.

"You need some encouragement of establishing a savings account at the start of the process so you're encouraging and supporting that financial resilience. I think linked provision of more affordable credit to money advice and savings I think would be ideal."

"Ideally, where people don't have a fully functional bank account…whatever, trying to work with a commercial bank to get fully functioning bank accounts for people whilst they take out loans…To facilitate the collection of the money but also broader financial inclusion."

Distinction between private sector lenders and ethical social lender seen to lie in emphasis on higher standards of responsible lending

Stakeholders also held strong views on how an ethical, social lender would conduct itself and how it would be differentiated from private sector high cost lenders. Here thinking centred around high standards of responsible lending and a strong emphasis on loan affordability and avoiding cycle of debt issues.

Strong sense that ethical lender would not offer instant loans

Responsible lending was seen also to stretch to the core consumer proposition. Stakeholders felt strongly that an ethical lender delivering affordable credit would not deliver "instant" loans nor would loans be repayable over the very short term.

2.3 Delivery and business models

Some felt strongly that the target audience required local, community based delivery and face-to-face service

Here there were a range of, fairly divergent views. Some policy makers favoured local, community-based delivery led by the voluntary sector.

"I think that you need local…in Northern Ireland you need local solutions within the communities…I think it is local knowledge that will help identify and target those people that need the assistance…the most effective models are where housing associations and local charities are getting together and sorting this out at local level."

Others thought in terms of a national, online service

Others took the view that the only way to achieve any reach and scale was to deliver a single national service. This was felt essential both on grounds of equity but also as a way to reach both communities.

"I think it has to be a single offering for the whole of Northern Ireland that has cross community support…accessible whether you live in rural or an urban area, online, and depending on the costs, maybe with outlets in some urban centres…that would be strongly preferred, both for reasons of scale but also ensuring equity and fairness across the community."

There were also a range of views on appropriate delivery channels. Some stakeholders were comfortable with the idea of a remote-delivered, online service and felt that an online national service was the only way to achieve scale and equity of outcome between the two communities and between rural and urban areas.

Others felt strongly that a face-to-face service would be the best fit with the target market and possibly the only way to realise the broader financial inclusion and financial capability goals which were seen to be a core element.

Consensus that an affordable credit model should be linked to – and possibly co-located with – financial inclusion and debt advice services

In line with the broader thinking on lending being a pivot to banking inclusion and enhanced financial capability, there was also a view that a new affordable credit operation should be linked to, and potentially also, co-located with other financial inclusion services and debt advice. The latter was felt by some to be an important component of any new service, in that those ineligible for a loan could then be referred to debt advice and financial capability counselling. Stakeholders saw an affordable credit operation actively seeking to offer savings accounts and banking facilities as an inherent component of the model. This was felt to require partnership working with private sector banks. A minority of stakeholders went further and felt that banks should be compelled to provide accounts for all under some form of universal service obligation.

Credit unions were seen as unlikely to deliver an affordable credit model and to be largely resistant to any increase in loan pricing

The research team also explored with stakeholders whether credit unions would be an appropriate route for delivery of a new affordable credit service. Here there was a broad consensus that credit unions in Northern Ireland are not well placed to reach out further to the financially excluded. In supporting this position, stakeholders pointed both to the relatively low penetration of credit unions among those on very low incomes and social tenants and to credit unions' resistance to increasing their pricing.

2.4 Funding and sustainability

Consensus that substantial Government funding would not be forthcoming in the current financial and political climate

Stakeholders were not at all sanguine about the possibility of raising substantial funding from Government for an affordable credit model. Against the background of austerity, the political climate was seen not to be conducive to fund-raising.

"It is no longer the case as it has been in the past and you can say 'Oh I need £2.5million or we need £22.5 million. Don't worry, the Government will pick up the tab. I don't think that was ever the case but it certainly isn't any more...You'd have to look to the politics first."

Clear requirement that the model be sustainable and be self-financing within a relatively short period

Stakeholders initially felt it would be essential for an affordable credit model to be self-sustaining and designed from the outset to be so. There was a clear view that there would be no political appetite for continual funding but some felt that, provided there was a clear route to sustainability, it could be possible to arrive at creative financing solutions in which public sector finance could have a role to play. Policy makers were also clear that any funds provided would be both limited and could be provided also only over a comparatively short period.

"It might be that the public sector provides either a guarantee or is willing to sort of roll over until you get something which is self-sustaining…so there probably isn't an appetite I wouldn't have thought for continually ploughing public money into it."

Securing funding felt to require strong leadership and a committed sponsor but both politicians and potential partners felt likely to be wary of reputational risk

Securing funding was seen to require both strong leadership and a committed sponsor. Some took the view that many politicians and some potential partner organisations would be wary of either leading on or partnering with an affordable credit model targeting the most disadvantaged while also charging realistic rates.

Political risks of charging the rates that would be required to support sustainability were felt likely to amplify the funding challenges

Potential challenges around funding were felt amplified because of the political risk that might be associated with an affordable credit model that would likely need to charge higher interest rates than would be politically acceptable. The potential for reputational and political risk was also raised by various stakeholders who might potentially act as primary partners for a new social lender. Some of those in the debt advice and social housing sector felt that there could be some reputational risk arising from association with a lender charging higher rates than public opinion or some politicians might feel acceptable.

"The other thing I think we have in Northern Ireland is politicians who would be naïve in thinking that any solution is going to be less than 25%...and whatever it is also has to be sustainable…and I think they have to acknowledge for any solution to be sustainable, the interest rate would have to be high even if not as high as what is out there at the moment…So I don't think there is the appetite here in Northern Ireland."

"Because Northern Ireland has been feather-bedded with huge levels of public subsidy in every area of public service, there is a real concern that there will not be sufficient political buy-in to support any new offering that is pricing for risk."

As the project progressed and it became clear that sustainability would require very interest rates that would be unpalatable politically, views began to shift around the balance of importance of sustainability and an acceptable cost of credit. At the same time there was also some sense that there some thaw in Government attitudes to funding an affordable credit model. Overall the consensus shifted so that the collective view became that an acceptable interest rate – seen as less than 100% APR – would be more important to getting the project off the ground than the issue of sustainability. From this there followed some acceptance of the need for external funding, howsoever sourced.

Thereafter there was some divergence of views. Some took the view that against this background, a relatively modest online service that would aim to offer cheaper credit to credit worthy high cost credit users among social tenants would necessarily have to be the way forward, given the constraints on the availability of funding. Others rather felt strongly that the original vision of serving the deeply disadvantaged and creating a broad based financial inclusion proposition delivered face to face – of which affordable credit would be only one element – was the only way forward, regardless of the funding implications and hurdles.

2.5 Key take outs

The stakeholders perspective – Key take outs

- Stakeholders and policy makers are clear that an affordable credit model for Northern Ireland should focus on the most disadvantaged and financially excluded and act as an alternative to home credit and illegal lending rather than to payday lending.
- A new social lending model was seen by most stakeholders as embedded in a broader effort on financial inclusion, encouraging savings and building financial capability and resilience.
- An affordable credit model is seen to differ from private sector lenders not only in offering cheaper credit but in having higher responsible lending standards and in not offering either instant or very short term loans.
- There are mixed views on delivery models, with some favouring a national, online service to achieve scale and reach and others thinking in terms of small scale community-based models targeting the deeply excluded and most troubled.
- Credit unions are not seen as a realistic way forward in delivering an affordable credit operation, both for structural reasons and because of resistance to offering loans at prices higher than their current rates.
- The original view among stakeholders was that a new social lending operation would need to be self-sustaining and that there appeared little or no appetite for Government funding on any scale.
- The view was also that the funding challenges will be amplified by the political risks that will be associated with delivering lending at the rates required to support sustainability – but which may be unacceptable to politicians and public opinion.
- As the project progressed, however, it became clear from the evidence presented to the board that achieving sustainability would require very high interest rates. Stakeholders relaxed their views on sustainability, moving rather to the position that a politically acceptable interest rate would ultimately be more important than sustainability.
- Thereafter there was some divergence of views on the implications of funding challenges, with some seeing a scaled back online service offering cheaper credit than the high cost lenders – and without a broader financial inclusion remit – as the only viable option and others viewing a full scale financial inclusion offering delivered face to face as essential, whatever the funding challenges.

3.0 The consumer perspective

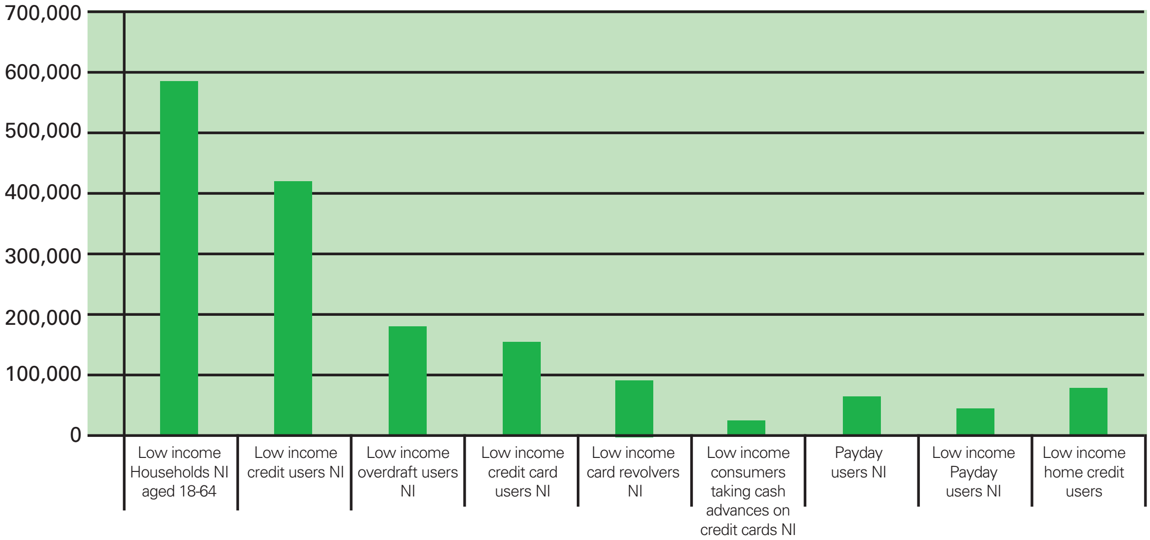
Policis drew on both their existing body of work and secondary analysis of consumer data to provide the advisory board with a sense of the dynamics of high cost credit use and the likely scale of the high cost credit market in Northern Ireland. In this chapter we draw on this evidence to describe the profile of high cost credit users and the differences between low-income users of different types of mainstream and high cost credit. We also discuss the drivers of high cost credit use, the demand-side dynamics and the features which consumers value in a provider and provide an estimate of the scale of high cost credit use in Northern Ireland. It should be noted that the survey data is for Great Britain and there is always a possibility that Northern Ireland may not follow the same patterns as Great Britain more widely,

3.1 The scale of high cost credit use in Northern Ireland

We estimate, based on an extrapolation from UK data, that there are approximately 50,000 low-income payday users in Northern Ireland and approximately 80,000 low-income home credit users out of total of a little over 400,000 low-income credit users overall. As can be seen from Chart 1 following, low-income borrowers overall are more likely to be using overdrafts and credit cards than high cost credit.

We estimate that there are circa 50,000 low-income payday users and a little over 80,000 home credit users in NI

Chart 1. Estimated numbers of low-income credit users in Northern Ireland by credit type



Note: Low income households = lowest 50% of household incomes
Estimates for NI credit users extrapolated from UK data
Base is population of working age
Source: Policis estimates based YouGov debt tracker 2013

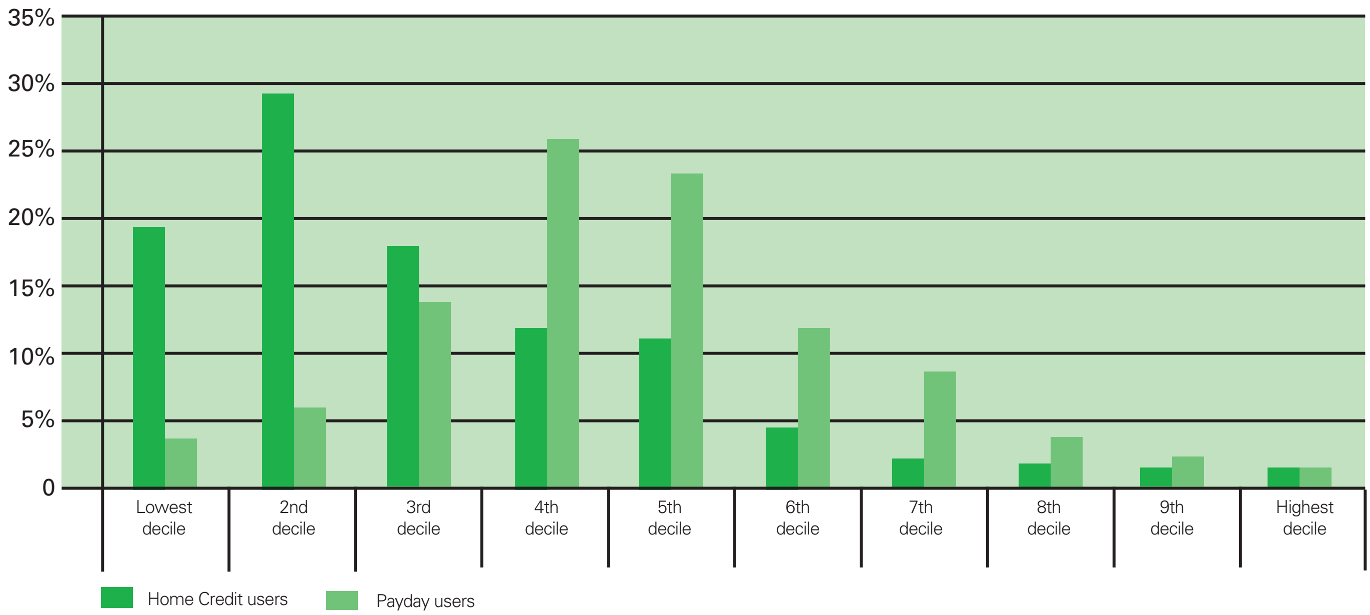
3.2 The profile of high cost credit users

Payday and home credit lenders are serving different market segments with different market dynamics

Policis analysis demonstrated that payday users and home credit users had very different profiles and that there was in fact very little cross over in use of the two product types.

As can be seen from Chart 2 following, home credit users cluster primarily in the lowest income deciles, with 48% falling into the lowest two income deciles (for the most part those living on benefits or moving in and out of low paid work) and 89% falling into the lowest 50% of household incomes. Payday users, by contrast, cluster primarily in the fourth, fifth and 6th income deciles, with just 10% in the lowest two income deciles. Very few payday users borrow from home credit lenders and there is minimal use of payday loans among home credit users.

Chart 2. Income profile of high cost lending users by decile of household income



3.3 The drivers of use of high cost credit

For most home credit and payday borrowers, use of high cost credit is not driven by lack of access to other forms of credit

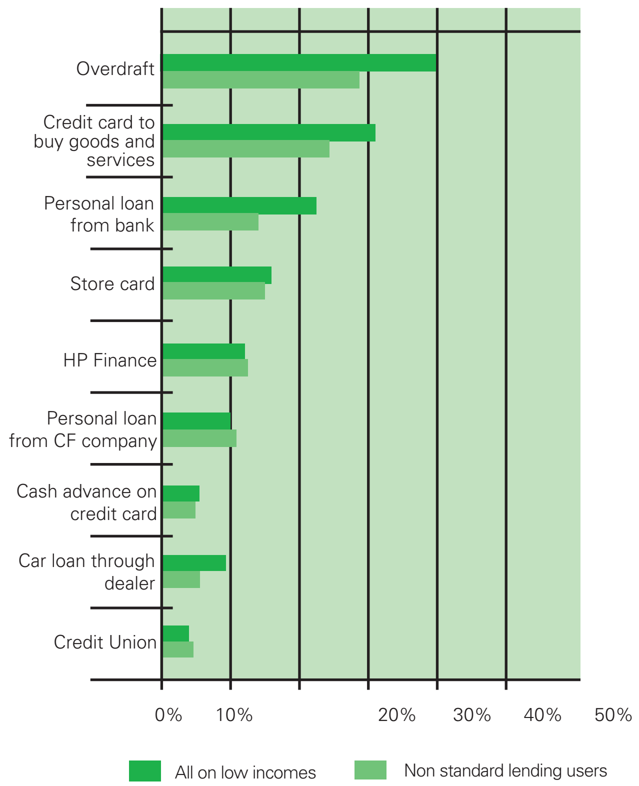
It is frequently assumed that users of non-standard lending products (such as payday, home credit, pawn, sale and buy-back, rent to own and auto title loans) do not have access to mainstream credit products. However, only a minority of users of either payday loans (29% of payday borrowers) or home credit borrowers (25% of home credit users) use payday or home credit because they do not have access to any other form of credit.

There is a significant degree of cross over between high cost and mainstream credit use, albeit less so for home credit users than payday borrowers

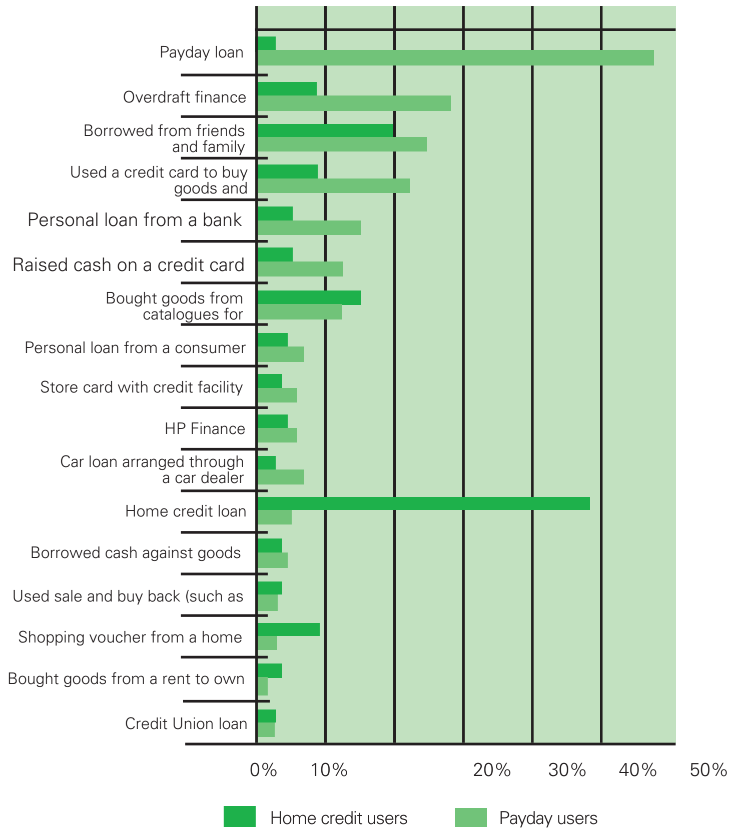
There is in fact a significant degree of cross-over between mainstream and high cost credit use as can be seen in Chart 3a. Chart 3b demonstrates that home credit borrowers are less likely than payday users to have access to mainstream credit, but again a significant proportion of both groups use mainstream credit products. Some 52% of payday users borrow on overdrafts and 47%% use credit cards to buy goods and services, with 26% taking cash advances on credit cards. Some 16% of home credit users borrow on overdraft, 17% use credit cards to buy goods and services with 9% taking cash advances on credit cards.

Non-standard lending users are using a wide range of mainstream credit products, most importantly overdraft finance and revolving credit

Chart 3a. Credit repertoires for low-income non-standard lending users
Chart 3b. Credit products used, mainstream and high cost by payday and home credit users



Base: Non Standard Lending users (home credit, payday, pawn broking, RTO, sale and buy back, log book loans) in lowest 50% household incomes



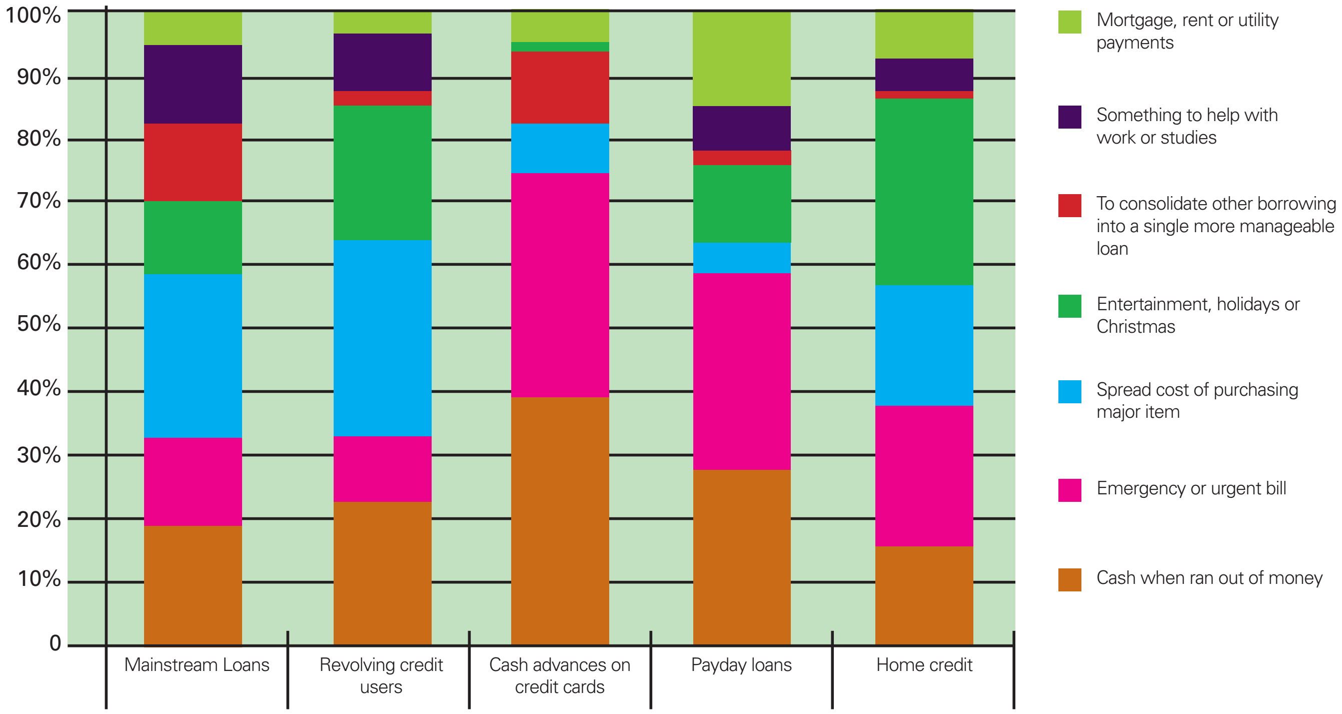
Base: 502 payday users and 499 home credit users

Distress plays a role in use of high cost credit but for home credit users, Christmas and spreading the cost of large purchases are the major applications

There is also a perception that high cost credit use is driven primarily by distress borrowing, to solve a cash flow crisis or pay an urgent bill, and that this in turn drives a cycle of continual borrowing and problematic debt. Distress plays a role in borrowing by those on very low incomes but it is not the primary driver of borrowing, particularly among the poorest home credit users. Broadly speaking, those on low incomes borrow because they lack savings safety nets and because budgets are so tight that it is frequently not possible to cover all competing needs in any one budgeting period, particularly at times of high expenditure (such as children returning to school or Christmas) or when faced with unexpected expenditure (such as essential equipment breaking down). It is notable, however, that while distress borrowing is particularly important as a driver of both payday use and taking cash advances on credit cards, distress borrowing to address cash flow crises is much less a feature of home credit use. As can be seen in Chart 4 following, among home credit users, the drivers of borrowing are much closer to those of mainstream credit users, with Christmas and spreading the cost of major purchases much more important than a cash flow crisis or the need to pay an urgent bill.

High cost borrowing is more likely to be distress than mainstream credit but more so for cash advances on credit cards and pay day than home credit

Chart 4. Application of borrowed funds by different credit types



Base: Credit users in bottom 50% of household incomes

It is becoming trapped in continual cycling of mainstream credit lines – not high cost credit which is the key driver of problematic debt for those on low incomes

Credit use among those on low incomes is primarily focused in those of working age and peaks among family households, where financial pressures are greatest. Some three quarters of those in the lowest 50% of household incomes are credit users. Among both mainstream and high cost credit, most borrowers are able to manage their credit use effectively and have a low incidence of problematic debt service or unmanageable debt. Where stretched affordability and unmanageable debt is a problem, it is most likely to occur among those using both mainstream credit and high cost credit. In these cases, a key driver of high cost credit use is that mainstream credit has proved problematic, with individuals at the end of mainstream credit lines, trapped servicing card balances on minimum payments or in a constant cycle of overdraft debt that is difficult to pay down turning to high cost credit as an alternative. Almost three in ten (29%) of credit card users in the lowest 50% of household incomes are making minimum payments on their credit card balance and some 17% of low-income households are "cycling" either overdraft debt which does not get paid down or making minimum payments on revolving credit or both.

Many social tenants manage their credit use effectively whether using mainstream or high cost home credit

The segmentation of a nationally representative sample of UK social tenants shown in Chart 5 following clearly illustrates the dynamic just described. A little over a third of social tenants (35%) are non-credit users, with this segment being older and less likely to be family households. What borrowing there is among this group is informal borrowing, with a sub-segment of this group having been Social Fund borrowers in the past. A little less than a third of social tenants (32%) fall into a group of mainstream credit users, who manage their mainstream credit use effectively and do not use high cost credit, other than catalogue credit. There are low levels of both affordability stress and problematic debt among this group. A much smaller group, representing 14% of social tenants, use high cost credit, overwhelmingly home credit, and also manage their credit use effectively, albeit that they pay a very high cost for it. While this group experience some affordability stress, they have low levels of problematic debt.

It is those using a mix of mainstream and high cost credit who are most troubled, often at the end of mainstream credit lines

Problematic credit use is concentrated in one segment, a little short of one in five social tenants (19%), with high levels of problematic debt across both mainstream and high cost credit. This group experience high levels of affordability stress, tend to be cycling mainstream debt that they cannot pay down, with high cost credit use often driven by a lack of access to mainstream credit because credit lines have become compromised or exhausted. There is in fact very little cross over between payday use and home credit use, with very few social tenants using payday loans

Credit segmentation of UK social tenants

Chart 5. Segmentation of social tenants

Low Risk
Medium Risk
High Risk

Troubled cross-sector heavy credit users **19%**

Heavy mainstream credit use, especially cards and overdrafts
Active in high cost sector
High levels of adverse credit
Half have CCLs or bankruptcy
High levels of missed payments and exposure to penalty charges
High Levels of rent arrears

Untrubled mainstream credit users **32%**

Primarily mainstream credit and catalogue credit
Loe levels of high cost use
few credit payment difficulties or credit affordability stresses
Low levels of rental arrears

Coping high cost credit users **14%**

No mainstream credit
High cost credit key component of budget
Credit managed effectively - flex key
Low level credit payment difficulties - some affordability stresses
Low levels of rental arrears

Minimal credit social lending users **35%**

No mainstream or high cost credit use
Cash managers who use little credit
Some social/informal lending
Low levels of rental arrears

Base: All social tenants 1002.

4% of social tenants in NI use credit unions. In UK just 2% of social tenants use payday and 14% use home credit

A segmentation of home credit users shown in chart 6 illustrates how these dynamics play out for home credit users. The segmentation of home credit users demonstrates that the home credit customer base includes mainstream-excluded groups, those using both mainstream and high cost credit and those who have moved into home credit use as a result of credit impairment and the shrinking availability of mainstream credit for higher risk borrowers. It also demonstrates that the home credit user base includes both those coping effectively with the home credit model and those who are struggling, both to keep on top of home credit payments but also more widely.

The target market for a new affordable credit model envisaged by stakeholders is more disadvantaged and excluded than the home credit user base overall

It is worth noting from the segmentation of home credit customers just described that the target market which stakeholders envisage for a new affordable credit model for Northern Ireland is significantly more disadvantaged and excluded than that served by private sector home credit lenders. Previous research[10] has shown, however, that it may be much closer to the profile of those served by illegal lenders operating in deprived communities. Those using illegal lenders have frequently either been declined for a loan by home credit lenders or previously compromised a home credit line of credit through excessive delinquency or default.

Home credit customer base includes mainstream-excluded groups, mainstream cross-over segments and new influx of credit-impaired

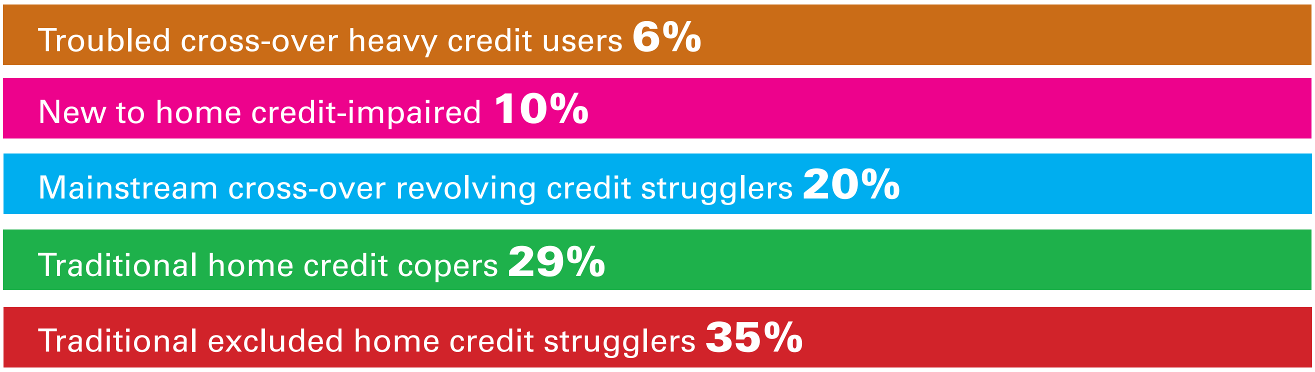
Around three in ten (29%) home credit users fall into a segment which has a strong affinity with the home credit model and which values home collection and the discipline inherent in a weekly collection highly. The segment makes low and considered use of home credit and manages their home credit use effectively, being reliable payers. A rather larger segment (35%) of home credit users is more stressed financially and more likely to be struggling to manage competing commitments on a limited budget. This segment relies heavily on home credit to manage their cash flow but are much less reliable in terms of their payment record, frequently missing home credit payments. They also use a range of other high cost credit models, including catalogues and Rent to Own but have limited access to mainstream credit.

Another large segment, accounting for 20% of home credit users, are returnees to home credit, having experienced difficulties in the mainstream sector, primarily with revolving credit. They have comparatively high levels of outstanding mainstream credit debt but are reliable payers on their home credit loans. Their credit use is considered and well controlled, albeit that they struggle with a hangover of mainstream debt and debt service.

One in ten home credit users are those entering or experimenting with a range of sub- prime markets, having lost access to mainstream credit in the wake of tightened lending criteria. They are looking for larger loans than has been traditional for home credit users and are much more inclined to remote channels and digital payment than most home credit users.

Finally, there is a small segment (6%) of deeply troubled heavy credit users, using both mainstream and high cost credit models and struggling with both.

Chart 6. Segmentation of home credit users



[10] *Policis and PFRC for DTI, Illegal Lending in the UK, 2007 and Policis for BIS, Interim Evaluation of the National Illegal Money Lending Team, 2010.*

The segmentation suggests that a new social lender is likely to attract home credit users that are higher risk than for the sector as a whole

The segmentation provides important insights around the nature of the customer base that an affordable credit model would likely serve. As just discussed, the borrowers the target market stakeholders envisage for a new social lending model are more disadvantaged than home credit users overall and so would be high risk as borrowers. The home credit model relies both on good payers cross-subsidising the less reliable and on the enforced discipline and personal relationships inherent in home collection. However, it would seem likely that the new affordable model would tend to attract some of the less reliable payers among current home credit customers, and therefore less able to cross-subsidise higher risk borrowers. This effect would seem likely reinforced in the absence of home collections

The most reliable home credit payers – which cross-subsidise higher risk borrowers for home credit lenders – are least likely to migrate to a new lender

The segmentation suggests that a large group of traditional home credit customers with a good payment track record and with a strong affinity with the home credit model (the "Traditional Home Credit Copers") would be unlikely to move away from the home collection service which they value. There is another group of relatively reliable payers (The "Mainstream cross-over revolving credit strugglers") who would likely be easier to attract, albeit that their relatively infrequent home credit use might mean that they represent a small proportion of customers at any one time. Given this segment's history of problematic revolving credit use, reliance on their home credit borrowing history would be a better indicator of their propensity to repay a new social lender than a conventional credit check. The segments perhaps most likely to be attracted to a new social lender would to be those that already use a variety of lenders and lending models (i.e. The "Traditional Excluded Home Credit Strugglers", the "Troubled Cross-over Heavy Credit Users" and the "New to Home Credit Credit Impaired". The first two of these three segments are comparatively troubled, with the second seriously so. This would seem to imply that a degree of adverse selection[11] will likely arise for a new lender, with the customer base of the new lender likely to be higher risk than that of the established home credit lenders.

Demand for high cost credit significantly exceeds supply; adverse selection and a high level of declines imply a high cost base

In considering the potential risk profile of likely borrowers from a new social lender and the implications for the business model, it is important to emphasise that, perhaps contrary to many perceptions, demand for high cost credit very significantly exceeds supply and a social lender is likely to have to decline a high proportion of applications on risk grounds. In the payday market, even before the recent regulatory reform, close to nine in ten applications were declined while in the home credit market, approximately three out of four applications are declined. Given that applications are likely to come from a borrower pool that is inherently higher risk than that of established market suppliers, it would seem likely that a new affordable credit lender will potentially need to turn down an even higher proportion of applications than if operating on a commercial basis. This will have implications for the cost base of any new social lenders, a high decline rate, particularly where underwriting is not fully automated, implies also that the new social lender could also be significantly higher cost than is the case for other lenders in the sector.

If a new social lender were to take on a wider range of risk than the private sector, this would imply a higher level of bad debt and increased funding needs

Alternatively, if a new social lender were to take the conscious decision to serve a wider range of risk than the private sector will tolerate, as part of a social mission, this will imply a higher rate of account delinquency and default and thus a greater funding requirement.

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[11] *i.e. it is likely that a new social lender will disproportionately attract higher risk borrowers*

Serving a highly stressed and high risk customer segment may pose challenges for responsible lending and affordability

Given both the target market envisaged by stakeholders for the new social lender, the relatively troubled profile of the segments most likely to turn to a new lender for credit, there may also be issues in squaring the high standards of responsible lending and the emphasis on affordability envisaged for the new lender with the highly stressed nature of the finances of a significant proportion of those most likely to apply for a loan.

The demand dynamics that drive choice of home credit lender may not sit well with the vision of an affordable credit model that moves away from instant loans

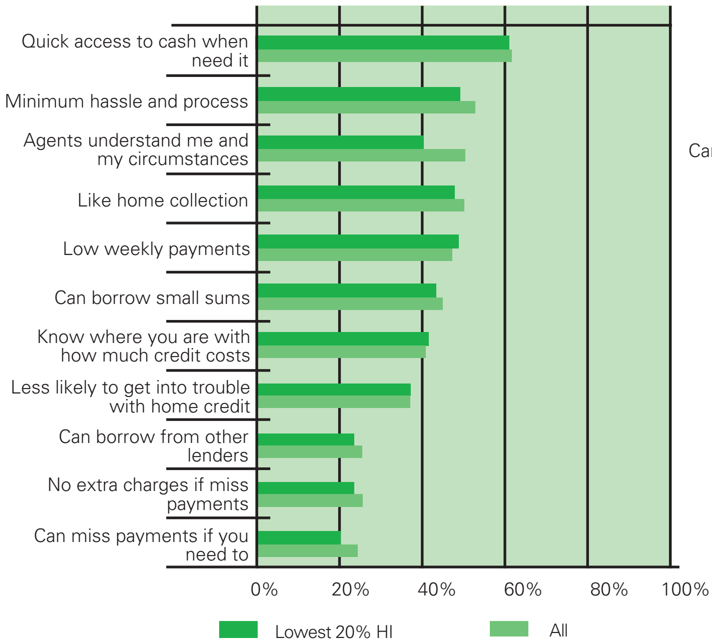
The segmentations just discussed and the previous sections on the dynamics of use of high cost credit together paint and important picture of how and why borrowers use high cost credit and the likely nature of the customer base for a new social lender.
In order to round out this picture of the demand side it is also important to understand more about the dynamics of choice of lender and what borrowers value in a lender.

Users of high cost credit are not price sensitive – speed of decision making and rapid delivery of funds are more important than cost

As a number of studies have demonstrated[12], despite the very high cost of credit, neither payday users nor home credit users are particularly price sensitive. For both payday and home credit, borrowers value speed of decision making and fast delivery of cash over the cost of credit. Payday borrowers further value convenience and ready access to credit, particularly to repeat borrowing, over cost.

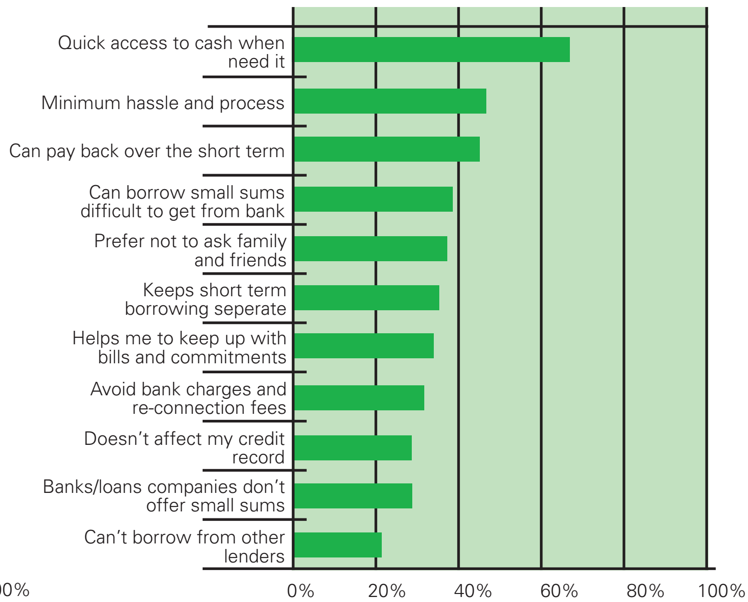
The most important factors that high cost borrowers seek in a lender are quick access to cash and minimal process hassle in obtaining loans

Chart 7a. Home credit motivations for using home credit



Base: Home credit borrowers in bottom 50% of household incomes

Chart 7b. Payday borrowers' motivations for using payday



Base: payday borrowers in bottom 50% of household income

[12] *FT High Cost Credit Review 2010, Competition Commission Home Credit Inquiry Final Report, 2007*

There may be tensions between what consumers are seeking of a lender and the underwriting and capability building processes envisaged by stakeholders

For both payday borrowers and home credit users, speed of delivery of funds and minimum process and hassle are the key requirements of a lender. This would not appear to sit well with the resource-intensive, possibly face-to-face, underwriting process, envisaged by stakeholders for the new lender. The high-touch financial inclusion counselling and capability building which stakeholders feel important to incorporate into the customer interaction process would seem likely also to require a significant amount of time and resource to deliver. From the consumer perspective, the requirement for detailed consideration of affordability or referrals to financial inclusion support may be experienced simply as process hurdles to obtaining a loan.

Consumers are likely to choose rapid delivery of cash over reduced cost and to favour lenders that offer minimum process hurdles

Similarly, the stakeholders' conviction that the new lender should not aim to deliver instant loans may not sit well with consumers' desire for rapid cash. Here, the credit union, London Mutual's experience of delivering a not-for-profit payday loans service is instructive. Customers are offered an option of paying an additional £11 fee (on an average £500 loan) to receive their cash the same day. Eight out of ten borrowers take up this option, significantly increasing their cost of credit.

Home credit borrowers also value lender tolerance of missed payments, and are used to being able to flex cash flow by missing home credit payments

Home credit borrowers additionally value flexibility in their lenders' collections management and their tolerance of occasional missed payments over cost. They also value the manageability of small weekly payments over cost and, for some segments, the discipline implied by the home collection service. These factors are more important to borrowers than cost.

In considering what this means for a new social lenders' cash flow, examination of actual patterns of missed payments on home credit loans is instructive. The importance of flexibility and tolerance on payments to home credit users is well illustrated by the actual pattern of missed payments for home credit borrowers. In 2006, during the course of the Home Credit Inquiry, the Competition Commission reported that:

For the top 3 home credit lenders in 2006:

- Between 2% – 10% of payments were made on time to contract terms
- Between 8% – 20% miss one in ten payments
- Between 34% – 48% miss up to half of payments
- Between 29% – 44% miss more than half of payments
- Between 1% – 6% never make any payments

Source: Competition Commission Home Credit Inquiry

A collections pattern that resembled that of the home credit providers could prove very challenging for a new social lender to manage. It could also have significant implications for cash flow and funding requirements.

3.4 Key take outs

Key take outs

- It is clear from the profile of home credit users and payday users that it is home credit users, not payday borrowers, who correspond more closely to the target audience which stakeholders want to serve with a new affordable credit model.
- Existing home credit customers are however much less disadvantaged or excluded than the target market stakeholders envisage for the new social lender.
- Home credit borrowers are primarily not those with no other credit options. Just 25% of home credit users have no other credit options.
- Home credit borrowing is primarily used for Christmas and spreading the cost of major purchases, with distress borrowing in line with that for the credit mainstream.
- There is a significant degree of cross-over between mainstream and high cost credit, albeit less so for home credit users than payday borrowers.
- Among social tenants and those on low incomes, it is use of mainstream credit, and in particular a pattern of cycling overdraft and revolving credit debt that cannot be paid down, that is most closely associated with problematic debt and financial stress.
- Home credit users include the mainstream credit excluded borrowing solely on home credit, those who have fallen out of mainstream credit and have a hangover of problematic mainstream debt and those using both mainstream and high cost credit.
- Among home credit users, the most reliable payers are deeply wedded to the agent and home collection model and are unlikely to migrate to a new social lender, implying less potential for cross-subsidy of high risk borrowers than is the case for existing private sector lenders.
- Those current home credit borrowers most likely to present to a new affordable credit lender will have a higher risk profile than for the home credit sector overall.
- Declines on high cost credit are high, with three in four home credit loans declined sector-wide. The combination of the high-touch underwriting process envisaged for the new lender and a higher than sector borrower risk profile implies that a new social lender may have a cost base that is significantly higher than is the case for the private sector lenders with which they will compete.
- If a social lender seeks to serve a wider range of risk than the private sector will tolerate, as stakeholders envisage, this will have both cost and cash flow implications. Higher levels of bad debt and greater resource allocated to debt collection will have a significant impact on costs relative to the market, the potential to achieve sustainability and on funding requirements.
- The shift away from instant loans and a resource-intensive and relatively complex front end process envisaged for the affordable credit model may be a poor fit with consumer preference for rapid delivery of funds and a minimal underwriting and approval process.
- Home credit users' tendency to miss payments to accommodate cash flow pressures may prove challenging for a new social lender if these patterns are transferred to repayment of affordable credit loans.

4.0 The credit union perspective

This chapter covers credit unions' views on their capacity and willingness to serve low-income borrowers and financially excluded consumers in Northern Ireland. It draws primarily on the qualitative interviews with the credit union representatives from the Irish League and Ulster Federation of Credit Unions. It describes the credit unions' experience in reaching out to financially excluded and more vulnerable consumers, credit unions' appetite for serving higher risk borrowers, the barriers and potential levers for credit unions serving a wider spectrum of risk and ways forward in credit unions' working with a new affordable credit model. The chapter also explores at the experience of the Growth Fund in Great Britain, which supported selected credit unions in extending their operations to serve the financially excluded, and draws out the lessons that can be learned for the development of an affordable credit model for Northern Ireland.

4.1 Credit unions in Northern Ireland

4.1.1 Credit unions' experience in serving low-income communities and the financially excluded

Credit unions in Northern Ireland are a significant force in Northern Ireland serving more than a quarter of the population

Credit unions in Northern Ireland were not established primarily to serve the financially excluded, but rather to meet the financial needs of the local community. That said, many credit unions arose within low-income areas and have had wide experience of providing financial services to people excluded from mainstream providers.

Credit unions operate in many low-income communities but there is very low penetration among the financially excluded and social tenants

However, despite the fact that 28.7 per cent of the NI adult population are members of credit unions[13], a 2013 research study into credit union services for low-income households in NI (Jones 2013) found evidence to suggest that certain financially excluded sections of NI society were still not being reached by credit unions, particularly among Housing Executive tenants, only 4% of whom are members of credit unions.[14] Against this background, use of high cost credit is also lower than for social tenants, being rather broadly in line with the population as a whole. A recent survey of credit union members in Northern Ireland by Queen's University Belfast found that 3% of credit union members had used an internet lender in the past twelve months and that just 4% and 6% of members had taken on a loan from a high street store or from a home credit provider respectively over the same period. The target market envisaged for the affordable credit proposition would thus represent a significant departure from the current credit union membership profile, and a considerably higher risk pool of borrowers.

Credit unions are keen to extend their services to the financially excluded but are unwilling to consider incurring significant cost or take any risk in doing so

The 2013 research study by one of the authors of this report revealed that most credit unions considered that the small savings accounts and affordable loans products that they already offer were appropriate to meeting the financial needs of people on low incomes.

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[13]Source: PRA 2015 indicates that there were 534,230 adult members of credit unions.

[14]The Continuous Tenants' Omnibus Survey (CTOS) (HE 2011) of Housing Executive tenants undertaken by the Northern Ireland Housing Executive found that of 3,400 tenants surveyed only around 4 per cent had a credit union account. This figure, however, is indicative only as many tenants may not have revealed to researchers the fact they possessed an account. However, it seems reasonable to conclude, that there is a lower percentage of members of credit unions among the Housing Executive tenant population than among the NI population as a whole.

However, many credit unions were also keen to expand products and services specifically to serve financially vulnerable people, so long as this could be done without great cost or risk to the credit union. Actively being considered were greater access to instant loans, money and debt advice and budgeting and bill payment accounts.

Partnership with other agencies seen as the way forward in reaching the financially vulnerable

Credit unions also were considering reaching out to the financially vulnerable through partnerships with other agencies. One such partnership project was the pilot emergency loans scheme in Cookstown in 2014.

Credit unions have worked with other agencies to deliver an emergency loans scheme in Cookstown

This pilot loans scheme brought together nine credit unions in Cookstown with the St Vincent de Paul Society (SVP), a charity that works to alleviate the effects of poverty on individuals and communities, and Women's Aid which offers services to women and children. The aim was to provide an alternative, affordable short-term credit option to families and individuals who were struggling financially and to assist them to avoid resorting to high-cost lenders when in need of a loan in an emergency.

Individuals and families in financial difficulty were identified though contact with the SVP or Women's Aid. The SVP would meet and carry out an income and expenditure assessment with the potential borrower and, if it was felt that a loan would be appropriate, a referral was made to a credit union in the area where the person lived. Under the scheme, the credit union could grant an emergency loan of up to £250 over a repayment period of six months.

Credit union participation was made possible only because all of the loans made were fully backed by a loan guarantee fund

For credit unions, the critical factor was that these loans were made with the support of a SVP loan guarantee fund. The borrower was unaware of this fund and thus was not stigmatised by seeking a loan "for the poor". But, importantly, the credit union did not risk its own capital in making the loans as they were 100 per cent covered by the fund. In cases of default, the SVP would cover the loss to the credit union.

For the most part, credit unions were positive about this scheme. It enabled them to reach out to vulnerable and high-risk individuals in financial need and make instant loans without any fear of risking their members' money. If the borrower, repaid according to the agreement, and also saved in the credit union, the idea was that the scheme would function as a pathway into regular credit union membership and longer term financial stability. Subsequent loans, of course, would not be underwritten by the SVP.

However, some credit unions were uncomfortable with the "instant access" nature of the scheme which ran counter to the traditional savings ethos

It has to be added though that, even with the loan guarantee fund, some credit unions remained sceptical of the effectiveness of the scheme. For them, the instant access to credit seemed to undermine the process of new members building personal credibility and trust through undertaking a period of saving before being able to apply for a loan. Some credit unions in the group of nine were hesitant about moving away from the requirement of a prior savings period, even with the support of the external fund.

4.1.2 Credit union appetite for serving more higher risk and financially excluded borrowers

Interviews were conducted with representatives of the Irish League and the Ulster Federation of Credit Unions. The aim was to explore thoughts on the credit union appetite for serving greater numbers of high-risk financially excluded borrowers and on the issues that would arise in developing a practical solution to expanding access to affordable credit in NI.

A significant appetite in principle for developing products that could compete in the sub-prime market

Trade association representatives in the interviews asserted that there was a significant appetite among credit unions for the development of loan products that could increasingly and effectively compete in the sub-prime credit market.

Credit unions also saw development of new loan products to fit needs of those on lowest incomes and financially excluded as highly challenging

Representatives were clear, however, that the development of loan products appropriate to the needs of financially excluded and vulnerable borrowers would not be easy for credit unions. Interviewees identified a range of barriers that would have to be faced in the development of affordable loan products for the financially excluded, some of which would significantly constrain the contribution that could be made by credit unions.

4.1.3 Credit unions attitudes to risk and risk management

As custodians of their members' savings, credit unions have a profound aversion to risk

The barriers to credit unions engagement are multi-dimensional (see following section 4.1.4). Key among these, however, are issues around risk appetite and management.

Trade association representatives were keen to stress that credit unions were only likely to be able to expand significantly within the sub-prime credit market if financial risk was fully mitigated by Government or other external agencies.

Credit unions see lending to and financially excluded borrowers as entailing significant, financial, operational and reputational risk

All interviewees agreed that, in general, NI credit unions have a low appetite for risk and tend to be risk averse. Credit unions are conscious of being the custodian of the savings of their members which normally would be the only funds they would have to lend. The move to expand lending to financially excluded individuals is regarded by many credit unions as entailing significant financial, operational and reputational risks.

Any expansion of affordable credit through credit unions was seen as only feasible if Government took on all of the associated risk

Interviewees considered that the expansion of affordable credit to financially excluded groups through credit unions would depend on government or other agencies covering the risks involved through the creation of a loan guarantee fund.

There was a call from interviewees for the NI government to establish such a fund to support credit union lending in financially excluded communities. This fund could be administered and staffed centrally and could operate either by capitalising credit unions to expand lending or by underwriting loans to cover losses as and when they occur.

To mitigate the risk to government it was suggested that, in case of borrower default, a charge could be made on welfare benefits through which the loan could be repaid.

4.1.4 The barriers to credit union engagement with low-income and financially excluded communities

Clearly an absolute intolerance of risk and a requirement that Government take on all of any risk in lending to more vulnerable or financially excluded individuals is a significant barrier to expansion of credit union services to low-income communities and those outside the credit mainstream. It is however only the most significant of a number of other important barriers.

Credit unions in Northern Ireland's resistance to being allowed to charge higher rates precludes the development of products suitable for high risk borrowers

The most significant of these is credit unions' attitude to the potential need to raise interest rates to accommodate higher risk borrowers and enable the development of appropriate new products that would fit the needs of such borrowers.

A constraint to developing products in the sub-prime market is the reluctance of credit unions to move away from the one per cent a month cap on interest rates on loans (12.68 per cent APR). Legislation change to allow credit unions to charge up to 3 per cent per month (42.6 per cent APR), as in GB, is resisted by most NI credit unions. Given the increased costs involved in serving financially excluded developing new products for this market at no more than 12.68 per cent APR would be a considerable challenge.

Financially excluded individuals and those using high cost credit seek instant credit which runs counter to the credit union tradition of saving before borrowing

Financially excluded individuals can present a high demand for instant credit, often without the capacity or willingness to save or seek money advice, many have past debts and impaired credit histories, often finding it difficult to maintain regular repayments and many borrow simultaneously from multiple credit sources.

Migrating people from high-cost credit into credit union membership can be challenging, given the credit union ethos of self-help, mutuality and personal responsibility.

Traditionally credit unions have insisted that new members save for several months before they can apply for a loan. This practice is to mitigate risk as it enables a credit union to get to know the character and reliability of new member before making a decision on a loan.

Interviewees said that the majority of credit unions, but not all, are reluctant to move away from this practice, which would be a significant constraint in developing instantly accessible credit options.

Traditional credit union recruitment networks can create access barriers for those not already connected to the credit union

Recruitment to credit unions is often through existing family and community networks, with new applicants traditionally requiring a sponsor to vouch for their character and good standing. In some credit unions such a barrier to membership still exists. However, many credit unions now have more open and inclusive access policies.

Credit unions are likely to face responsible lending challenges in considering applications from borrowers with significant debt or on very tight budgets

Credit unions can only lend to people with a capacity to repay. There would thus be limits to any credit union's capacity to serve financially-excluded individuals who present with significant prior debt problems.

As was illustrated in chapter three covering the demand side dynamics of high cost credit and mainstream credit exclusion, many of both the financially excluded and users of high cost credit have a hangover of mainstream debt or are servicing mainstream credit that cannot be paid down. Some of the most vulnerable borrowers who might benefit most from lower cost of credit and debt advice may have multiple high cost loans. Typically, users of home credit in particular, are living on very low incomes and managing competing priorities on budgets with very tight margins. Under these circumstances borrowing is often driven by income that is inadequate to needs in any one budgeting period. Against this background, arriving at a view on responsible lending and affordability can be both complex and challenging.

Few credit unions were believed to have the organisational capacity or technology to support lending to financially excluded communities

Credit unions in NI vary in size and capacity, from fully staffed professional financial institutions to small community initiatives run entirely by volunteers. There would be wide variation in the capacity of credit unions to respond to a new credit initiative.

It was felt that it would be very difficult for volunteer-run credit unions to significantly reach out into financially-excluded communities and offer the level of service and support that would be needed. However it was felt that there are a number of credit unions in NI that do have the capacity to reach our further within their local communities.

Lack of access to technology and an organisational culture that not supportive of greater use of technology also a barrier to new lending solutions

It was also recognised that solutions to the expansion of affordable credit would depend on the increased use of information technology both to facilitate easy access to credit products and to drive down costs. Interviewees saw three specific challenges in relation to the introduction of information technology in credit unions. The first concerned accessing the appropriate technology, the second related to the cost of transformation and the third was the inevitable change of organisational culture that a greater use of technology would entail.

Some sense that effort to bring in more vulnerable and excluded borrowers would undermine credit union ethos and principles of self-help and mutuality

A concern was expressed that some credit unions might consider that initiatives to widen access to affordable credit for financially excluded groups could undermine the principles on which credit unions are founded.

Credit unions are member-owned, self-help, mutual financial co-operatives in which members have both rights and obligations. They cannot be seen as just vehicles to implement third party policies on maximising access to affordable credit in low-income communities. Any initiative involving credit unions must be founded on bringing people into a mutual, self-help organisation as members.

Key barriers to credit unions engagement with high risk and financially excluded borrowers

- Requirement that Government or other agencies underwrite all risk
- Resistance to increasing loan interest rates
- Lack of flexibility in loan products and reluctance to offer instant loans
- Focus on saving before borrowing
- Responsible lending challenges
- Access barriers
- Lack of organisation and technological capacity
- Fears on fit with credit union ethos and principles

4.1.5 Potential for partnership working

Given the many constraints, partnership was seen as the most practical way forward for credit union's participation in an affordable credit initiative

Given many of the constraints, especially in regard to loan interest rates and costs, it was considered that a partnership approach with another social lender was potentially the most realistic and practical way forward. All interviewees agreed it would be important to present this in a way that credit unions saw as a positive contribution to enabling the financial stability of financially excluded individuals and in which they would have a role as a referral agency.

Credit union representatives felt that credit unions could collaborate to develop a nation- wide service targeting the financially excluded

The credit union representatives interviewed felt that partnership working between credit unions on the development of a shared service targeting those on low incomes and the financially excluded could ultimately be possible, provided always that the risks in developing such lending were fully underwritten.

If Government not able to fund the underwriting risk, credit unions could partner with a CDFI or other agencies on a referral basis

If it were decided, that a major expansion of an affordable loans service targeted at the financially-excluded was not possible through credit unions alone, there remains the possibility of their working in partnership with a CDFI or other social lender. A CDFI could offer the loans service but also offer a pathway into credit union membership.

Differences in the capacity of different credit unions seen as likely to pose some challenges for collaboration

However, it was also felt that there would be significant challenges associated with such collaboration between credit unions, because of wide variations in policy and levels of service delivery between credit unions

Interviewees also took the view that any new affordable loans initiative directly involving credit unions would have to be delivered through a network of credit unions collaborating together in a Northern Ireland-wide partnership. Given the nature of the common bond, no credit union could serve the whole of Northern Ireland on its own. It was also thought unlikely that the regulator would agree to one or two credit unions to cover the whole of Northern Ireland.

Mixed views on the appeal of partnership – some saw a new lender as competition while others felt would enable credit unions to extend reach

There were mixed views in interviews on the possibility of such an arrangement appealing to credit unions. It was felt, on the one hand, that many credit unions would see the entry of another social lender into the market-place as direct competition and some would be reluctant to engage in any positive way. These credit unions would feel that they should be serving this group people and indeed would not be comfortable in supporting any organisation making loans to people on low incomes at much higher rates of interest.

On the other hand, the view was also expressed that there would be other credit unions who would regard such an intervention positively. It was considered that these credit unions would value participating in an intervention that could lead to the longer-term financial stability of people struggling with the consequences of having to use high-cost lenders.

4.2 Learning from credit union services for the financially excluded in GB

4.2.1 The Growth Fund

The Growth Fund aimed to build scale in the credit union movement and extend access to affordable credit, investing £100 million over five years to 2011

The most significant intervention into expanding access to affordable credit in financially-excluded communities through GB credit unions was the UK Government funded Financial Inclusion Growth Fund which ran from 2006–2011.

The government invested nearly £100 million into the Growth Fund which provided credit unions and CDFIs with capital for on-lending and revenue to cover administrative costs. The result was that 405,134 affordable loans to financially-excluded individuals were made, to a total value of over £175 million. Around 90 per cent of all Growth Fund loans were made through the circa 100 credit unions contracted to deliver the programme. Importantly, loans were made on an instant access basis with borrowers not required to save before they could borrow. This was critical to the ability to serve the financially excluded.

Widely regarded as a successful intervention, building capacity and growth into the sector and extending credit unions' reach into low-income communities

Unlike some public subsidies of the past, the Growth Fund was tied to credit unions to meeting defined targets and operating standards. Contracts were awarded only to credit unions that were assessed to have the organisational capacity to deliver affordable credit to large numbers of financially-excluded people.

Overall, the UK Coalition Government, credit unions and other stakeholders regarded the delivery of the Growth Fund to be a success. Some important lessons were learnt however; several of which may of importance to any new development in Northern Ireland.

Loans were comparatively high cost and required significant subsidy

First, there was a cost to delivering small loans to financially-excluded individuals, Credit unions charged 2 per cent interest on loans (26.9 per cent APR) but still, according to independent research carried out by

Bristol University and Ecorys still lost £77,20 on each loan (Collard et al., 2010). This study calculated that an APR of 71.2 per cent would be required to cover operational costs and financial risks associated with such lending if no subsidy was available. It was this consideration that led to the raising of the interest rate cap on credit union loans to 3 per cent per month (42.6 per cent APR) in 2014.

Despite the increase in interest rates and subsidy, the delivery of affordable credit did not enable credit unions to become sustainable

Secondly, even with the rise of the interest rate to 3 per cent per month, the delivery of this form of affordable credit is still not economically sustainable for credit unions without driving down operational costs and significantly building the income generating aspects of the business.

Partnership working was critical in reaching the financially excluded

Thirdly, GB credit unions learnt that to reach out to hard-to-reach financially excluded individuals and groups they had to work in partnership with other agencies, whether these are housing associations, trade unions, community organisations, churches or local employers. For it was through the agency of such organisations that people not in contact with the credit union could be reached and encouraged to benefit from credit union services.

The initiative lent £175 million over five years, but was nonetheless too small to make a significant impact as an alternative to high cost credit

It is important also to make the point that even with the support of the Growth Fund and the commitment of near 100 credit unions, the impact on the financially-excluded population in GB, although real, was miniscule in comparison with the size of the sub-prime market. Irrespective of achievements, still much remains to be done.

However it is important to remember that the credit union movement in GB is different to the movement in NI, which is larger, financially stronger and longer established. It is in a good position to reach out further to hard-to-reach financially excluded individuals and groups.

4.2.2 Other credit union initiatives targeting higher risk borrowers

In GB some credit unions have established specific initiatives to reach out to the financially vulnerable

Some credit unions in GB have set up initiatives targeting the financially excluded or to act as an alternative to high cost lending. These include Leeds City Credit Union, which created a CDFI, Headrow Money Line, in order to expand access to credit to people the credit union was unable to assist, and London Mutual Credit Union, which has pioneered an online loan facility to compete in the payday lending market and which aims to serve members in need of instant credit. Qualitative interviews were conducted with the managers of both of these initiatives.

Leeds City Credit Union has set up a CDFI to serve higher risk borrowers which cannot be served by the credit union itself

Leeds City Credit Union participated in the creation of a social lender to serve people it is unable to serve with loans at its maximum rate of interest of 42.6 per cent APR. Headrow Money Line (HML) is a registered charity and aims to serve higher-risk financially vulnerable with loans that are cheaper than other forms of credit available to them. It charges between 60 to 70 per cent APR on loans. In all cases, applicants are considered for a credit union loan, and only if the credit union cannot help are people referred to HML. As an independent company, HML is a corporate member of the credit union and borrows funds from the credit union to on-lend to customers.

Indications are, however, that take-up of loans through the CDFI is relatively modest. Nevertheless, there have been examples of HML borrowers successfully paying loans and progressing to standard credit union borrowing.

A not for profit online payday lending service set up by a London credit union serves financially over-stretched individuals on higher incomes

In order to meet the borrowing needs of people attracted to payday lenders, London Mutual Credit Union created a fully automated, online "payday" product, branded CUOK. However, contrary to some initial perceptions, this product is not available to financial excluded individuals on low incomes. It is only open to people who are employed, who earn more than £12k per annum and have a functioning current account, In fact, it tends to serve financially overstretched individuals on higher incomes with 84 per cent of all customers on take-home salaries higher than £13k after tax.

The service has attracted new borrowers to the credit union

Nevertheless, CUOK has responded to a clear gap in the market and over its first 34 months of operation has served 6,319 members with £3.72 m in loans. Approximately 1,600 of these borrowers were new to the credit union.

The service has been loss-making and is only sustainable because of an increased interest rate and the additional fees charged for same day delivery of funds

However, operating costs have been high and, over the first few years, CUOK, operated at a loss. It was only with the introduction of the increased credit union interest rate of 42.6 per cent in 2014 that a slight profit has been generated. But this depends entirely on the fact that over 80 per cent of borrowers elect to pay an additional £11 on top of loan interest to fast track the loan into a bank account the same day. This optional fee is not factored into the APR rate; if it were it would increase the rate significantly. For example, a £400 CUOK loan costs £12 for one month (42.6% APR) but costs £33 when the fee is included, this is the equivalent of a 160 per cent APR rate.

4.2.3 Looking to the future: The Credit Union Modernisation and Expansion Fund

For the future credit union sustainability and growth will require driving down costs and increasing income generation

In GB credit unions and the Government see the future of the movement as resting on greater efficiencies through greater use of technology and collaboration between credit unions sharing common back office facilities. This was the reason that in March 2011 the UK Coalition Government announced the creation of a new credit union modernisation and expansion fund. The new fund of up to £38 million would not provide further capital for on-lending but rather would build an electronic operating platform and modernise service delivery so that credit unions could gain efficiency savings, build the business and extend products and services to many more people on low-incomes through more electronic delivery channels.

In GB credit unions have moved away from an explicit focus on the financially excluded and seek to widen their appeal to the mass market

It is worth noting also that in GB credit unions, and those participating in the modernisation project in particular, have moved decisively away from approaches which look like "banking for the poor" or which overly target the very poorest and financially excluded. Rather credit unions are now setting out to widen their appeal with products and services which will attract a wider cross-section of society, with a wider member base and more sources of income enabling cross-subsidy of more disadvantaged members.

4.3 Key take outs

Key take outs

- Despite the strength of the credit union movement in Northern Ireland, it serves very few Housing Executive tenants or financially excluded borrowers.
- The target market stakeholders envisage for the affordable credit proposition is significantly more disadvantaged than the current membership and has a considerably higher risk profile than current borrowers from credit unions.
- Credit unions believe they could collaborate to create a nation-wide network to extend affordable credit to those currently too high risk for credit unions to serve, but only if the risk were fully funded by Government.
- The barriers to direct participation by credit unions are formidable; the primary barriers are risk aversion and an unwillingness to consider raising the interest rate ceiling that constrains credit union prices.
- Other significant issues include access barriers, a reluctance to provide lending without first establishing a savings track record, responsible lending challenges in serving the indebted, a lack of organisational and technological capacity and cultural issues around credit unions' ethos.
- There were mixed views about whether collaborating with a CDFI on a referral basis to deliver affordable credit to the financially excluded and transfer successful borrowers to credit union membership would be attractive to credit unions. Some saw a new social lender as competition.
- The experience of the Growth Fund in GB suggests that social lending by credit unions can achieve significant scale, but needs to be supported not only by funding, but also capacity and skill building and partnership working.
- Growth Fund supported lending was both high cost and heavily subsidised, but nonetheless credit unions were not able to achieve sustainability.
- In GB credit unions are seeking to drive down costs and achieve greater efficiencies of scale through better use of technology and collaboration between credit unions sharing back office systems.
- Credit unions are seeking to widen their appeal to the mass market with new products and services, with the intention that a wider membership base and new sources of income will enable the cross-subsidy of the most disadvantaged.

5.0 Learning from the experience of other social lending models

This chapter begins with an overview of what has been achieved by various social lending models targeting the financially excluded in terms of scale and reach, loan pricing, cost savings to consumers and the funding required to deliver more affordable borrowing. It then goes on to describe in detail the experience of a number of selected social lenders, drawing on qualitative interviews with their CEOs, and seeks to draw out the key lessons for setting up an affordable credit model in Northern Ireland.

5.1 Overview of achievements of other social lending models

5.1.1 Scale

Even the most successful alternative social lending models have not been of a scale to act as a realistic alternative to high cost credit for most borrowers

In seeking to provide an alternative to high cost credit in Northern Ireland and to learn from the experience of other social lending models, it is useful to compare the scale of social lending models with private sector high cost lending. Lending by credit unions in GB, despite a solid growth trajectory in recent years remains, substantially lower than private sector high cost lenders, albeit that the payday lending sector has shrunk significantly in the wake of regulatory intervention. Growth Fund supported lending specifically targeting the financially excluded, widely regarded as a success, nonetheless reached only a small fraction of high cost credit users. Operations such as Moneyline and Scotcash remain very small scale in comparison to private sector lending.

Social lending has been small scale relative to private sector high cost credit

Chart 8a. Lending volumes p.a. High cost lenders, credit unions and social lenders

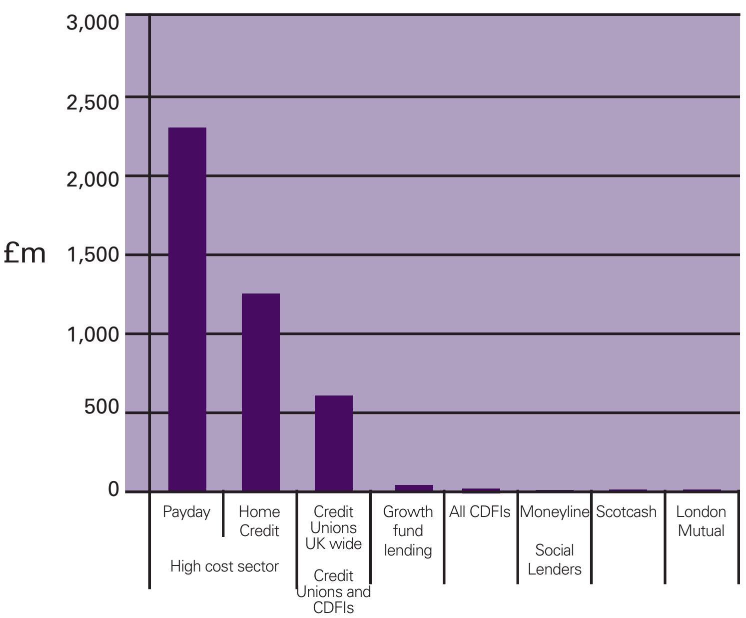
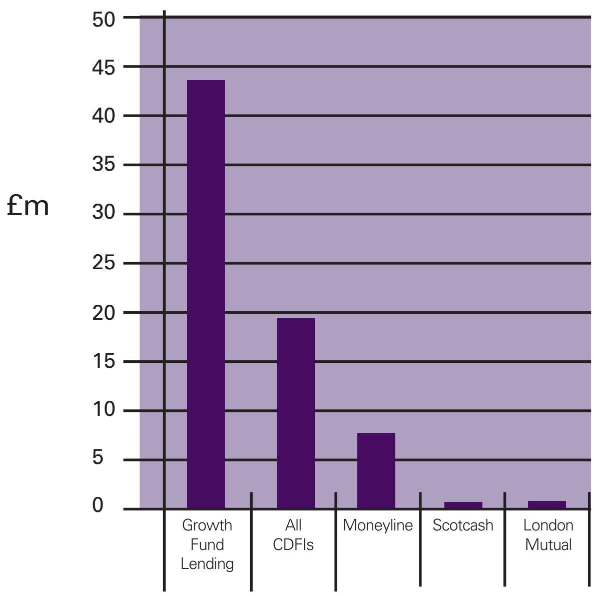


Chart 8b. Lending volumes p.a. Social lenders



Source: ABCUL end Dec 2013, FCA, DWP Growth Fund Evaluation 2009/10 Table 7.1 and 7.2, CDFA Inside community finance 2013, Scotcash annual report 2012/13, Moneyline annual accounts 2011, London Mutual estimated from current loan volumes and ratio of loans to customers from first year evaluation

5.1.2 Credit pricing

CDFIs and credit unions lending to target market similar to that of the home credit or payday lenders are charging high APRs

It is important to recognise that affordable credit models elsewhere serving the same target market and thus high risk borrowers are charging high APRs, albeit that these have been substantially lower than those charged historically by private sector lenders, prior to the introduction of the price cap on payday loans.[15]

Table 1. Cost of credit for various credit high cost and social lending models – APR

The leading high cost providers			Social lenders				
Online payday (Wonga)	Storefront payday (Money Shop)	Provident	Moneyline	Scotcash	My Home Finance	London Mutual payday*	Growth Fund**
5853%	**4516%**	**272%**	**160%**	**106%**	**70%**	**43%**	**27%**
Source: web-sites of named providers 04/11/14							

** Plus same day delivery of funds charge of £11 taken up by 80% of borrowers, which would significantly increase APR*
*** APR if charged at not for profit market rates consistent with loan costs (i.e. excluding subsidy) 71.2% APR.*

The cost of credit from CDFIs targeting high risk borrowers is similar to that offered by payday lenders – but is much cheaper than home credit lenders

When the cost of credit is presented in terms of the total cost of credit (i.e. cost to the consumer per £100 borrowed) it is clear that CDFIs targeting a similar target market to the home credit lenders are charging similar prices to the payday lenders but that they are charging significantly less than the home credit lenders. Moneyline and Scotcash both charge a little over £32 per £100 borrowed for a typical loan over 32 weeks while a Provident Loan, provided over a typical 52 week period, would be £82 per £100 borrowed. Growth Fund loans were priced to deliver very substantial savings to consumers, at £13 per £100 borrowed. Had consumers paid the full cost of the loan, however, Growth Fund loans would have been £31 per £100 borrowed.

Table 2. Total cost of credit (TCC) per £100 borrowing

The leading high cost providers			Social lenders					
Online payday 18 days (Wonga)	Online payday 35 days (Wonga)	Store Front payday 30 days (Money Shop)	Provident 52 weeks[5]	Moneyline 32 weeks[2]	Scotcash 52 weeks	My home Finance 52 weeks	Growth Fund 52 weeks[3]	London Mutual Payday[1]
£22	**£37**	**£30**	**£82**	**£32**	**£32**	**£28**	**£13**	**£3**
Source: web-sites of named providers 04/11/14								

1 If the cost of the same day delivery charge of £11 paid by 80% of borrowers is included cost rises to £6 per £100.
2 If borrowers repay over short period (say 18 or 30 days) will be significantly cheaper than payday.
3 If borrowers paid full cost of loan (i.e. without subsidy) cost per £100 would have been £31.
4 If loans rolled over cost rises to £57 if there is one roll over and to £75 if there are two roll overs.
5 If missed payments charge stays the same.

[15] From January 2015 new rules for the payday lending sector from the FCA introduced a price cap and ensured that payday borrowers would never have to pay back more than double what they originally borrowed. An initial cost cap of 0.8% a day was introduced. A fixed default fee must be capped at £15 with the total cost of credit, including default fees and interest, capped at 100% of borrowing.

The differential in cost between the not for profit lenders and the private sector payday lenders has been reduced by new regulatory requirements on price

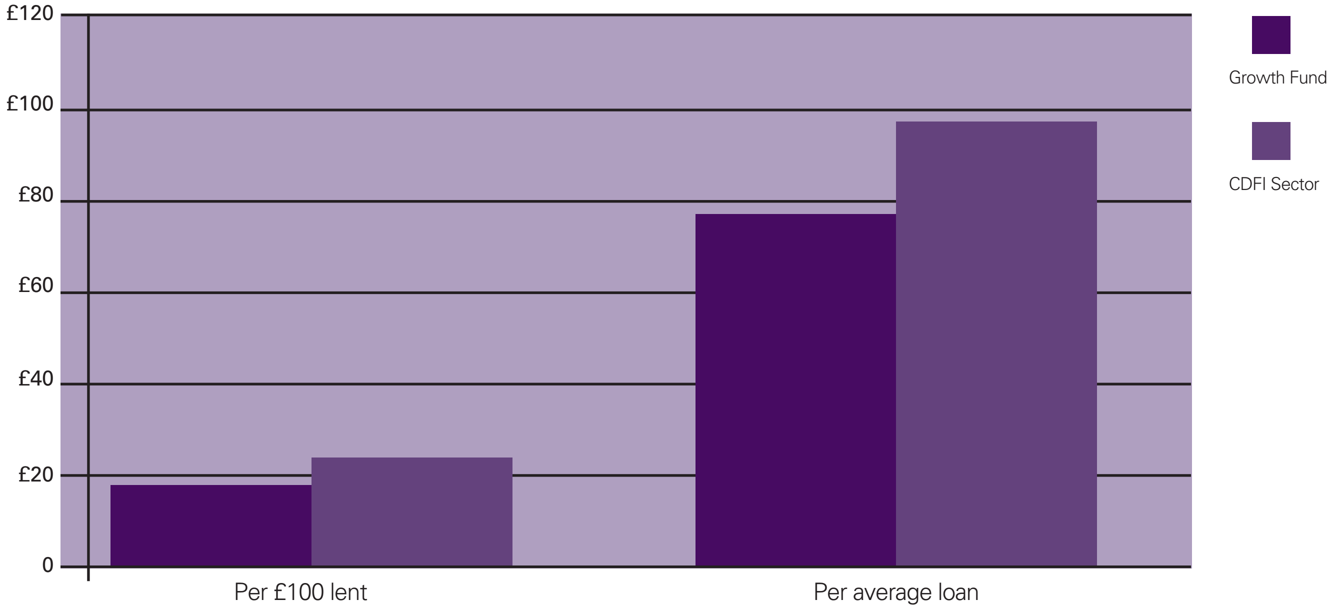
New rules from the FCA now mean that someone taking out a 30 day loan from a payday lender and paying back on time will not pay more than £24 in fees and charges per £100 borrowed.

5.1.3 Subsidy

Personal lending by CDFI sector is heavily subsidised as was Growth Fund lending to the financially excluded

Discussion of social lending pricing and the experience of other social lending models needs to recognise that lending has been heavily subsidised. Growth Fund loans were subsidized by £17 per £100 borrowed and an average of £77 on the average loan of a little over £400. Taking all CDFI personal lending in 2013, lending was subsidised by £23 per £100 lent, and a little short of £100 on the typical loan.

Chart 9. Subsidy per £100 lent and subsidy for average loan Growth Fund credit unions and CDFIs



Source: DWP Growth fund evaluation Table 7.8, page 58
CDFA, Inside Community Finance 2013.

5.2 The experience of other social lending models

Interviews were organised with the CEOs of two community development finance institutions (CDFIs) and of two GB credit unions which have specific initiatives to reach out to the financially vulnerable. The aim was to highlight the issues that social lenders face in serving the financially excluded communities. The CDFIs were Scotcash, which serves the Glasgow region, and Moneyline which operates mostly in the north of England and as Moneyline Cymru, in South Wales. Even though there are practical differences in the way Scotcash and Moneyline are organised, they both follow a broadly similar model of service delivery. They both offer a local, community-based, face-to-face financial service to people on welfare benefits and on low-incomes, most of whom are excluded from the financial mainstream.

5.2.1 The Scotcash and Moneyline social lending models

Moneyline (est. 2002) and Scotcash (est. 2007) were both created with local authority support in direct response to the needs of people who lacked access to affordable financial services. At the time, there was a major concern both in local authorities and in housing associations about the level and impact of high-cost sub-prime lending to low-income families particularly on social housing estates.
Moneyline and Scotcash were established in areas where credit unions already operated; in fact there were 34 credit unions in Glasgow when Scotcash opened. Yet, the argument was made for a different sort of financial provider; one that could reach out to individuals who had neither the disposition nor the wherewithal to join a credit union.

5.2.1.1 The target market

Scotcash and Moneyline both target a market that is similar to that envisaged for an affordable credit operation in Northern Ireland

Scotcash and Moneyline are clear that their specific target market is financially excluded people living on incomes in the lowest income decile. Moneyline estimated that 85 per cent of its customers were wholly or partially benefit dependant with the vast majority living in social housing. They were generally female (70 per cent of customers), typically lone parents with multiple dependants, and in the 25 to 45 age range. Like Moneyline, Scotcash mainly serves benefit dependent households living in social housing.

Scotcash and Moneyline customers have generally been customers of home credit, rent-to-own stores, buyback stores, pawn shops, catalogues and sometimes of illegal lenders. Some might have taken out payday loans in the past, when affordability checks were not so rigorous. But in general they were not payday loan customers.

Payday lenders were seen to be operating in a less disadvantaged sector of the market with neither organisation competing directly with payday lenders

The CEOs of both organisations were clear that the payday lending market, which had been of interest to the research project consultation group, was quite different from the one that they targeted. The perception was that the payday lending market embraced people on higher incomes, always banked and digitally included, often in work and younger.

Neither organisation offered payday-type loans at the time of the interviews. However, as one CEO explained, with the introduction of new loan management systems, it could be a market that they could consider serving in the longer-term. However, they were conscious that it would involve significant and additional technological challenges, as well as taking on customers with a different risk profile to those currently served.

5.2.2 Mission, services and processes

Both Scotcash and Moneyline stressed that their aim was to deliver a holistic financial service to the hard-to-reach and vulnerable borrowers

Both Scotcash and Moneyline stressed that their purpose was not just to provide cheaper credit, but to support the financial inclusion and stability of their customers so that could better manage their finances, sustain their tenancies and avoid over-indebtedness. These organisations' mission is thus aligned to the vision of stakeholders for an affordable credit model in Northern Ireland and their experience is particularly pertinent in considering how best to establish an affordable credit service in Northern Ireland.

Both organisations aimed to offer a holistic financial service which includes assistance in opening a basic bank account and/or a savings accounts, money and debt advice and access to affordable credit (mostly loans <£1,000). Scotcash also offers energy advice to reduce food bills, discounted white goods packages and vouchers for local food banks.

The range of financial services offered by Moneyline and Scotcash reflects the focus on financial inclusion and building financial resilience

Access to affordable credit is central to the customer proposition

Scotcash and Moneyline present themselves as "an integrated financial inclusion model" but central to their offer is access to affordable credit. In nearly all cases, the reason that customers first approach Scotcash or Moneyline is to obtain an accessible and affordable loan.

Loans are made mostly for small sums, around £500, over a period of a year or less. Scotcash and Moneyline are not limited by an interest rate cap as are credit unions. In order to ensure the sustainability of the business, both lenders set a rate of interest which is significantly higher than that charged by credit unions but which is much lower than that charged by sub-prime lenders (see section 5.1 for overview of pricing and comparison to private sector lenders).

Facilitating banking inclusion is a key step towards both enhancing financial resilience and enabling electronic collection of loan repayments

Enabling people to access a bank account is central to the Scotcash and Moneyline model, for banking inclusion assists people to engage long-term as economic members of society. However, it also enables them to access credit as Scotcash and Moneyline loan repayments are by direct debit. In rare cases repayments can be made by debit card over the phone or even in cash, but the norm is by direct debit. For people without a bank account, basic bank accounts are provided through arrangements with partner banks. Both organisations act as banking intermediaries and their staff members are able to complete the paperwork and undertake the relevant identity checks on their own premises and then submit the application on the customer's behalf directly to the bank's processing centre. With the agreement of the banks, there is no need for photographic ID, as many customers do not possess such documentation. A welfare benefit letter or utility bill can be accepted as ID.

Encouraging saving is built into the collection process by default

Scotcash and Moneyline are not licensed deposit takers and cannot accept savings directly. However, they do receive savings from customers and transfer these immediately to a bank or credit union in which the customer has an account.

Both organisations encourage all customers to save. To assist in this, as people repay loans, from the one amount deposited into Scotcash or Moneyline, a proportion is normally transferred into savings. This service is offered as seamlessly as possible so that the customer is practically defaulted into saving as he or she repays a loan. Of course, the customer can also use the accounts solely for saving, in which case they can deposit money directly into the bank or credit union.

At Moneyline, through a special relationship with a bank, additional deposits and withdrawals can made directly through Moneyline, which has an electronic interface with the bank enabling it to see customer balances online. Of the current 17,000 Moneyline customers, 15,000 have savings accounts.
Declines are high, reflecting a rigorous approach to responsible lending with those declined referred to money and debt advice

Scotcash and Moneyline operate a rigorous credit assessment process and will not lend to people who are already over-indebted. At Scotcash, for example, 60 per cent of applications are turned down following an income and expenditure analysis. For this reason, access to money and debt advice is built into the delivery model.

At Scotcash, on a contractual service level agreement basis, in-house debt advice is provided by Citizens Advice. Two full time debt advisers are permanently in the Scotcash office which enables declined applicants to see an adviser near immediately. This is seen by Scotcash as essential if a cycle of debt is to be broken.

At Moneyline people who are declined a loan are offered access to money and debt advice through a warm referral to StepChange, the national debt charity.

5.2.2.1 Delivery Model

Face-to-face delivery is seen as critical to customer engagement and the best fit with the needs of those who have previously used home credit lenders

Scotcash and Moneyline prioritise service delivery though a network of branches or service points situated in local communities. Being close to the people they serve is central to the business model of both organisations as they endeavour to provide a personalised, face-to-face service in direct response to the financial needs of customer. As one CEO stressed, *"customer engagement is absolutely key to our model"*.

If customers were going to migrate from high-cost credit to Scotcash or Moneyline, CEOs argued that they had first to trust and feel secure with their new provider. Many customers have been used to home credit where a personal relationship with a collector characterised the service. CEOs stressed that people would only be attracted as customers if Scotcash or Moneyline was able build a positive, non-judgemental relationships and offer them a personal and supportive service. It was a relationship that had to be built on respect, and as emphasised by one CEO, was without a hint of patronising condescension. As she stated,

"Face-to-face contact has been the vein of our business. Many of our customers will know the staff on first name terms, come in regularly, and feel comfortable."

Scotcash and Moneyline customers struggle on low-incomes; they often have other debts and require personal support in thinking through their capacity to repay a loan. Personal contact with a loans officer was seen as the most appropriate way to ensure that people borrow realistically and have the confidence to approach the organisation if and when they find it difficult to keep up repayments.
Once customers have established a relationship with Scotcash or Moneyline and have taken out and repaid a number of loans, future applications and assessments may be done over the phone. But customers still have to come into the branch and sign the paperwork and, in so doing, remain in direct personal contact with staff members.

The delivery model is resource intensive and high cost but regarded as key to customer relationships, even for established customers and repeat loans

It is acknowledged both at Scotcash and Moneyline that this face-to-face model is demanding on staff time, and expensive to operate. Even though both organisations are exploring the possibility of greater use of phone and internet applications, face-to-face service forms the core of the delivery model and is envisaged as doing so into the future.

Scotcash operates through housing association premises while Moneyline operates through fully staffed, branded branches

Scotcash operates through a city centre main office and eight service points throughout the Glasgow region. However, apart from the city centre office, it has no branches of its own, all its service points are in local housing association offices. It is through these local service points that Scotcash is open to housing association tenants and to all who need its services. It is managed by thirteen full-time staff and employs two in-house money advisers through a collaboration with Citizen's Advice.
Unlike Scotcash, Moneyline does not operate through the premises of other organisation but through eighteen of its own shops. It regards a defined, unambiguous physical presence in local communities as important in the development of confidence and trust in the Moneyline brand. The Moneyline head office and branch offices are staffed by 85 full-time employees.

Intermediation through partnership with social landlords and other agencies is critical to both organisations' reach into communities

Scotcash and Moneyline have strong partnership relationships with housing associations and it is through their intermediation that they reach many of their customers. It was a group of housing associations that funded Moneyline's move into Wales, where it is now established as Moneyline Cymru; and Scotcash works closely with seven social landlords through whose premises it delivers its service.
Scotcash also has a close link with the local authority, and forms an important element of Glasgow Council's financial inclusion strategy.

Two-way referral process through partnerships with credit unions creates a pathway for successful borrowers to migrate to lower cost credit union lending

In the interviews it was stressed that Scotcash and Moneyline are committed to building effective partnerships with credit unions. The rationale of both organisations is to promote a pathway into financial stability for their customers and credit union membership forms a part of that strategic goal. Scotcash has working relationships with three credit unions in Glasgow, and is able to offer all its customers into credit union membership. Moneyline has a similar relationship with a credit union in Birmingham.

This partnership relationship is two-way and credit unions are able to refer people they are unable to serve with loans to Scotcash or Moneyline.

Key features of the Scotcash and Moneyline operating model

- Targeting financially excluded and home credit users
- Integrated financial inclusion service
- Affordable credit as gateway to inclusion
- Face-to-face delivery with resource intensive underwriting
- Reach relies on partnership working and referrals
- High decline rates
- High APR lending
- Referrals to money and debt advice built into process
- Successful borrowers transferred to credit union borrowing

5.2.2.2 Credit pricing

The real APR on Scotcash loans is in excess of 100% APR but is nonetheless significantly cheaper than loans offered by private sector lenders

The costs of operations and service delivery results in both Scotcash and Moneyline charging interest rates on loans which are significantly higher than credit union rates in GB or in Northern Ireland but much less than those charged by sub-prime lenders.
The Scotcash baseline interest rate is 60 per cent, but because it adds a £6 per £100 administration fee to successful loan transaction (£24 for a typical £400 loan)[16], the actual APR rate is much higher depending on the amount and period of repayment.

A £400 loan from Scotcash over a period of 52 weeks would cost £158 in interest and administration fee, which is in an APR rate of 108.2 per cent. A similar loan over the same period from a home credit provider would cost £328, which is an interest rate of 272 per cent APR. So even with an APR rate over 100 per cent, Scotcash is able to offer a much better deal to its customers than they could obtain from sub-prime lenders. Of course, if the loan were over a shorter period, the APR would be higher, at Scotcash a £400 loan over 26 weeks would cost £89 in interest and fee which is an interest rate of 134 per cent APR.
To assist people struggling on a low-income, Scotcash will offer borrowers payment holidays without the levy of any additional charges. When customers are in real financial difficulty, are unable to pay and have taken up the option of money and debt advice, Scotcash will also freeze interest on the loan.

A typical Moneyline loan will cost circa 170% APR but is nonetheless cheaper than similar loans offered by home credit providers

Moneyline with its larger infrastructure, its lack of external funding and its need to pay for capital, has to charge higher rates than Scotcash. A typical interest rate on a £300 loan repaid weekly over 26 weeks is 170 per cent APR. A £300 loan repaid weekly over 52 weeks at Moneyline would cost £150.24 at £8.37 a week. The same loan over the same period from a leading home credit provider would cost £246 at £10.50 per week. Again this results in a real saving for customers, savings on a typical loan being around £2 per week or a little less than £100 over course of the loan.

Moneyline is conscious that the loan interest rates it charges can be regarded as unacceptable by some organisations and agencies. However, it is unapologetic about the need to charge these rates as they just about cover the costs of running a staff-intensive, face-to-face service that responds to the needs of its customers. Moneyline regards itself as a commercial service, albeit with a strong social focus, that has to make ends meet through its own business activity. It can no longer depend on external grants and subsidies. Undoubtedly Scotcash will ultimately have to face the same economic realities, given the likelihood of the continuing reduction of external subsidies in the future.

5.2.2.3 Impact and reach of the service

Moneyline has some 20,000 customers a year and a loan book of £6m – but represents only a fraction of the home credit market

Since 2002, Moneyline has made 97,000 loans to a value of £52 million and has opened 20,000 savings accounts in which £5 million has been deposited. Nationwide, it currently has 20,000 customers and a loan book of £6 million. It currently makes around 20,000 loans a year to a yearly value of £9 million.
A first sight these figures look impressive, but Moneyline readily admits that the impact and reach of

[16] *See the loan calculator at https://www.scotcash.net/apply-for-a-loan/1-personal-information/.*

its service is very modest when compared with the extent of the sub-prime credit sector. It estimates that nationwide there are about 12 million sub-prime credit customers of which its 20,000 customers represent a mere 0.16 per cent.

Scotcash remains very small scale with a loan book of just £0.5m, making less than 2000 loans per year. Transition to credit union membership is minimal

Scotcash estimates that there are 45,000 people in Glasgow who borrow from high-cost sub-prime credit providers. Currently Scotcash makes about 1792 loans per year (2013/2014 figures), with an average value of £484. The total number of borrowers at any one time is around 1,670, representing 3.7 per cent of the sub-prime market in the Glasgow area. The current loan book at Scotcash is £0.5 million.

In the period, 2007 to 2014, Scotcash made 9,497 loans to a total value of £5 million, opened 2,214 basic bank accounts for customers and 507 savings accounts: 249 of which were in a credit union. In the same period, 29 customers progressed to become borrowers within a credit union.

5.2.2.4 Funding and economic performance

Both organisations have required ongoing funding over many years and have struggled to achieve sustainability

Establishing Scotcash and Moneyline as going concerns has demanded significant investment and both organisations have struggled to achieve economic self-sustainability.
The initial start-up investment into Scotcash was about £2.3 million. This was raised from a variety of sources but mainly from Glasgow City Council, Glasgow Housing Association and a number of Scottish and UK government funds including the DWP Growth Fund.

Scotcash continues to be loss-making, remains small scale and is dependent on external funding

After eight years of development, Scotcash is still making an annual operating loss of over £134k[17] on business activities. It depends on ongoing annual subsidies of around £210k[18] from the council and other sources to cover around 35 per cent of its operating costs.

Moneyline experienced significant growth as a result of Growth Fund investment but struggled with losses after the scheme came to an end

Moneyline also required significant initial and ongoing investment. It was initially established with grant subsidies through the Single Regeneration Budget (SRB) and the European Regional Development Fund (ERDF) facilitated with the support of the local authority. These funds provided capital for on-lending and covered running costs. However, it was the DWP Growth Fund that brought large scale investment into Moneyline. This was not a grant but a contract to deliver loans in certain areas, but it brought in significant capital investment into the organisation as well as covering much of its running costs.
At the start of the Growth Fund in 2005, Moneyline had four shops and just under a £1 million loan book. By the end of the Growth Fund, in 2012, it had fourteen shops and just under £5.5 million out on loan (increased to £6 million in 2014).

However when the financial support of the Growth Fund ended, Moneyline was faced with some harsh economic realities, as income on lending did not cover the costs of running what had now become a large

[17] *Scotcash Annual Report 2013/14*
[18] *Scotcash Annual Report 2013/14*

organisation. In the two years after Growth Fund, Moneyline sustained heavy losses. In year ending 2012, it lost £500k, and then again in the year ending in 2013, it lost a further £750k. Some of this would have been bad debt (Moneyline writes off about 10 per cent of its loan book each year), but mostly included losses on operations, given its high expense to income ratio.

Moneyline subsequently benefitted from social investment but has had to look to the market to raise lending capital and now borrows at relatively high cost

Apart from the original SRB and ERDF funding, and the investment through the Growth Fund, Moneyline has had some modest financial support and donations from housing associations. It also has about £200k of share capital mainly raised from housing associations, banks and other supporting organisations. However, it was clear after Growth Fund that such support and donations would provide insufficient capital to build the business in the longer term. Moneyline moved therefore to seek and take on social investment. It borrowed £1 million each from the Royal Bank of Scotland microfinance fund and from Big Society Capital / Big Issue Invest and an additional £500,000 separately from Big Issue Invest. For the first two it pays seven per cent APR in interest and for the Big Issue Invest it pays ten per cent APR. This latter is only drawn down as required, however, which lowers the interest payable.
No longer being able to depend on subsidies and free capital, Moneyline is conscious that it will have to succeed or fail as a commercial company, albeit it one with a social goal and focus. But the move to accepting social investment significantly increases costs as now capital for on-lending has to be paid for. Moneyline expects that the cost of social investment is likely to rise beyond ten per cent in the future, when funds are channelled through social investment finance intermediaries (SIFIs).

After twelve years Moneyline is approaching sustainability without external subsidy but has had to raise interest rates significantly to achieve this

However, even with these challenges, and only now after 12 years of development, Moneyline is beginning to see the possibility of operating as a self-sustaining business without the need for external subsidies. The business is beginning to just break for the first time without external support. But in order to do this, it has had to increase significantly its interest rates on loans.

A number of key factors affect the economic performance being the high costs of the operating model, lack of scale, the cost of capital and levels of bad debt

Face-to-face delivery, resource intensive underwriting and inefficiencies in channel strategy and customer management work to increase costs

The costs of a face-to-face service operated through local branches are high. Scotcash endeavours to reduce costs by using housing association premises but still the model depends on a high amount of staff time interviewing and supporting each customer.

In order to drive down costs and, at the same time, improve the quality of service to its customers, Moneyline is investigating how it can modernise its technology and delivery channels. It is committed to a face-to-face delivery model but the focus is now on introducing a more sophisticated channel strategy in which repeat customers could be served more efficiently by phone and through the internet.

Scotcash is also planning to introduce greater efficiencies through the introduction of new technology and the greater use of the phone and internet. However, it is still committed to the branch model and is also planning to open new branches in partner offices throughout the Glasgow area.

Cautious underwriting, a lack of scale in the loan book, sensitivities on rates and the focus on responsible lending all act to constrain growth

Both organisations have endeavoured to increase the income from lending by the raising of interest rates but both recognise too that there is a limit to what can be charged and remain a social lender. Scotcash, even though it charges lower rates than Moneyline, considers that it is already at the limit of what is politically acceptable to charge.

Another way to generate income from lending is to expand the loan book. However, Scotcash in particular is a cautious lender. There is not only a strong focus on not lending to people who lack the capacity to repay resulting in 40 per cent of all loan applications being rejected, there is also a lack of a culture of selling loans. This has resulted in Scotcash having a relatively modest loan book of £0.5 million, which at the level of loan interest charged is insufficient to generate enough income to cover costs. This is not a result of the lack of capital, as Scotcash is cash rich and has at least £1 million on deposit in the bank. According to the CEO, Scotcash needs to become a more effective lender, if it is to ever to become fully sustainable. The loan book would have to be at least double in size to go anywhere near to covering costs.

A clear focus on lending more likely to attract consumers than an emphasis on financial inclusion or money advice

Moneyline does appear to have a more commercial focus to the selling of loans. Loans are what attract people to the organisation, and Moneyline has no hesitation in vigorously marketing itself as a credit provider. Its branch windows predominantly advertise loans. But it recognised that not all social lenders will be comfortable with a similar approach.

The cost of capital on the commercial market must feed through to credit pricing in the absence of grant funding

Expanding the loan book will depend on identifying capital to support on-lending to customers. The cost of capital and the impact on sustainability at Moneyline has already been discussed above.

Scotcash also recognises similar challenges on the horizon. It is unlikely, with the squeeze on local authority and other funding, that grant funding will be available in the future. At the moment, Scotcash is cash rich, but as lending increases, sourcing capital will become an issue. As at Moneyline, Scotcash will be forced to borrow on the commercial market. The additional cost will be considerable as the microfinance funds that are offered by some banks currently are already charged at seven or eight per cent APR, or, as Moneyline explained, at an even higher rate.

A highly cautious approach to lending is reflected in levels of bad debt which are very low relative to the sector

In many credit providers high costs are also associated with bad debts. However, in the interviews, it appeared that this was not the case at Scotcash or Moneyline. At Scotcash loan net write-off is about 4 per cent, after recovery via direct deductions from benefit via an arrangement with DWP, but with actual write-off of 7.8%. It is somewhat higher at Moneyline where write off is about 10 per cent overall, with 14 per cent on new customers and 5 per cent on repeat customers. This is broadly in line with many GB credit unions serving low-income communities[19], which serve a less high risk customer group.
Bad debt and loan write off has been kept relatively low by a rigorous, intensive and manual credit assessment process. This entails high staff costs and thus impacts on the organisations' bottom lines. It could be argued, however, that, given the risk profile of the target market relative to credit union borrowers more broadly, that lending policy has been over-cautious. It may have acted both as reaching the financially excluded and as a significant brake on scale and reach.

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[19] A 2012 study of credit unions serving low income communities in the North East of England found that bad debt write off was 13 per cent of the loan book (Strategies for Growth. Jones P.A. Northern Rock Foundation). However, overall annual bad debt provisions and write off in the credit union sector is much lower. In 2014, it was 2.5 per cent in England, 3.2 per cent in Wales, 1.5 per cent in Scotland and 1.6 per cent in Northern Ireland (Credit Union Annual Statistics 2014 Prudential Regulation Authority).

Key factors influencing economic performance

- Inherently high cost of operating model
- Insufficient scale in the loan book
- Cost of capital
- Level of bad debt

5.2.2.5 The potential for franchising and replication of the model in Northern Ireland

Both Scotcash and Moneyline offer the potential to roll out the model in Northern Ireland on a franchise basis

Scotcash has developed its model in way that can be franchised and established in other cities and locations. It offers the possibility of creating a subsidiary company in other locations, which is financed locally, but which receives advice and support in the development of systems and processes directly from Scotcash. It would therefore be possible to create a Scotcash model solution to affordable credit in Northern Ireland without the new organisation having to go through all the initial challenges of setting up the business on its own.

The CEO of Moneyline was also convinced that it would be possible to create a Moneyline Northern Ireland just as there is a Moneyline Cymru. However, this would take significant investment in capital, operations, technology and business development.

The Moneyline model depends on a network of branches. These could be in partner premises so long as this did not compromise a commercial and attractive brand image. Moneyline estimates that a network of three shops would be the minimum to create a feasible and commercially feasible operation. Each shop would need to be staffed by a team leader and at least two other loan advisors. A general manager would be required to oversee the entire network.

Sourcing capital for lending would be key challenge

The largest investment, however, would be the capital required for on-lending. This would depend on the business and financial strategy of the new organisation, but certainly would need to be in millions rather than thousands if it were to support a professional branch network structure. There may even be a cost to raise the capital which could be significant within the overall financial plan.

Investment in technology and CRM systems would be a major cost but there are a number of off the peg systems which could be utilised

A further major cost would be the technology as the network would require and effective Customer relationship management (CRM) and underwriting systems. Moneyline use the software system that is available from Street UK, which is a complete loan administration and systems support application that can be accessed via a web interface.

Even on a franchise basis, establishing a Moneyline style operation likely to take time and to engender significant losses before reaching sustainability

The CEO felt it important to stress that to develop a Moneyline-type operation takes time. It is not something that happens overnight. Building trust and confidence in communities in the new organisation will take considerable outreach and marketing, and the active engagement of partner organisations. Any new organisation can expect to make losses for at least the first three years of the business before any Moneyline NI becomes profitable. But of course this will depend on the financial plan and the leadership, dedication and commitment of the people leading the new business. As has been noted above, it has taken Moneyline twelve years to just begin to approach self-sustainable development.

5.3 Key take outs

Key take outs

- Even the most successful social lending operations represent only a very small share of the market. While they offer a valuable service and cheaper credit to their customers, none have achieved the scale to act as a realistic alternative to high cost credit for most high cost credit borrowers.
- Lenders with a social focus see their mission as financial inclusion in the broadest sense and offer a range of services designed to facilitate inclusion, saving and financial resilience.
- The social lenders examined in this chapter have chosen to focus on face-to-face delivery as the best fit with customers' needs and as better facilitating customer engagement with financial inclusion propositions.
- Consumers are however attracted to the loans proposition and achieving growth and scale is more likely if lending is emphasised in consumer facing communications.
- Social lenders of necessity charge high APRs but nonetheless have required significant subsidy. None have yet achieved full sustainability, despite having been established for many years.
- Serving a hard to reach and financially excluded target market with a delivery model that is face-to-face and which requires manual underwriting is inherently very high cost, which impacts both credit pricing and lender sustainability.
- Costs will be considerably increased where lending capital must be sources at high rates from commercial sources.
- Economic performance is also impacted by scale and bad debt levels. A very cautious approach to lending has resulted in levels of bad debt broadly similar to those in the credit union sector and lower than those in the commercial high cost sector more widely. A cautious approach to lending will have constrained reach, growth and scale and suggests that both organisations may be serving a lower risk target market than their private sector equivalents.

5.4 Small scale community schemes

There are no fully-developed comparators for the community-based model which have also been subject to comprehensive evaluation. Bearing that caveat in mind, two schemes have been reviewed to assist in deriving reasonable assumptions regarding lending scale, take-up and loan performance, i.e., the Consumer Council's Financial Capability and Affordability Credit Pilot (FCACP) in Northern Ireland and the Money Advice Budgeting Service (MABS) loan guarantee scheme in the Republic of Ireland.

A pilot project in two locations in Northern Ireland found that most potential borrowers were too disadvantaged to be lent to on responsible lending criteria

The FCACP project was implemented as a pilot project across two locations in Northern Ireland, i.e., deprived areas in Ballymena and Derry. The pilot was taken forward as a partnership involving local community groups, credit unions, voluntary sector organisations and a housing association. It comprised two strands, as follows:

- A financial capability element, including community information events and various training initiatives.
- An affordable credit element, which aimed to make low cost loans available on a more accessible basis to those living in the pilot areas.

In the affordable credit strand, loans were made available in the range £10 to £350. Potential borrowers could be referred from partner organisations to participating credit unions with the intention being that such loans would "help them to cope with changing circumstances, reduce their financial burden or manage spiralling debts", The evidence from the evaluation of the project[20] demonstrates mixed results. In one of the deprived areas in which it operated, the pilot scheme was successful in that it extended credit to those that would not normally qualify for a loan and appeared to enhance the financial capability of borrowers. Lending was, however, very small scale and required significant resource and effort to deliver. 50 people borrowed a total of a llittle less than £15,000, with the average loan being for £187. The scheme reported that almost 80% of the scheme participants in this area went on to have further successful loans with participants also reported to have begun saving, with the scheme extended beyond the original time-scale for the pilot as a result. Significantly, however, achieving lending on even this scale rested on a high degree of local knowledge, partnership working and community support. Bad debt levels, which were relatively modest, were contained by a combination of informed targeting and intensive repayment management, Community workers not only identified suitable participants for the scheme and introduced potential borrowers to it, but also played a role in managing repayment. Community workers encouraged borrowers to make at least some payment even when this was sometimes difficult to do in order to build a repayment mindset to the lender while at the same time seeking to enhance financial resilience by encouraging saving. For example, borrowers were encouraged to repay £5 and save £5 per week, rather than repay £10 to the lender, In some some cases community workers even organised in home repayment collections for those who were unable to travel to the credit union, In it's own terms, however, in which the project sponsors were comfortable with model which rested on the investment of significant resource to support a relatively small number of individuals, the project, in one of the pilot areas at least, could be interpreted as a success,.

The importance of this selective targeting of potential borrowers by intermediaries with local knowledge and the relatively intensive community support and partnership working required to manage repayments is further highlighted by the outcomes of the scheme in the other pilot area, where these elements were absent. In this area no loans were made at all, highlighting the criticality of intensive support and community partnership working in achieving both lending and financial capability building, even where schemes are small scale. This has important implications for thinking through both the target market and lending policy for any community-based lending scheme. The initial intention of the FCACP scheme was that "lending would be subject to the requirement that borrowers had sufficient income to repay the loan amount". The FCACP experience on the ground – and the difference in the outcomes of the schemes in the two pilot areas demonstrates clearly that it is not feasible to lend to borrowers such as those envisaged for such community schemes while also meeting accepted responsible lending criteria. It is important to note that in the area where the pilot scheme did lend successfully that the Consumer Council, the sponsors of the scheme have concluded that if schemes are genuinely going to be readily accessible, "the normal rules of entry to lending need to be waived – no one should be excluded from seeking a loan on grounds of income or credit history. Even in the context of this ethos, however, the Consumer Council emphasises the need for selective targeting.. They also emphasise the criticality of borrower support in minimising bad debt "such schemes would need to be carefully targeted, ensuring that they build on existing and trusted community infrastructures, which are able to provide sustained

[20] Consumer Council, 2016 *Financial Capability and Affordable Credit Pilot – Final Report.*

support to borrowers. Also, the borrowers themselves need to be targeted, both to create role models and minimise bad debts" . Indeed another point of interest from the FCACP project was that a lot of preparatory work was required for the financial capability element, including the creation of effective referral networks and the design of the affordable loan applications process

A scheme targeting the deeply financially excluded in Ireland is very small scale and has been able to lend only a little over a third of available funds

On a larger scale and over a much longer period, the operation of the Money Advice Budgeting Service (MABS) is instructive. In Ireland, MABS exists to help people on a low income to cope with debts and manage and control their finances[21]. As part of that help, money advisers have the facility to provide their clients with access to credit through the guaranteeing of loans in the local credit union, "where the member does not qualify on his/her own savings record". The facility has existed since 1989, when the Irish Government established a revolving Loan Guarantee Fund (LGF), as part of an action plan to address problems due to money-lending, with the intention of providing access to credit in times of need or crisis. As noted in their 2012 Pre-Budget Submission, the effectiveness of the LGF has not been fully researched. However, at that time, there were 181 clients availing of the LGF, with 63 credit unions. The amount guaranteed was €175,000. Interestingly, the amount guaranteed as of 2012 represented just 35% of the total available under the scheme (€494,700).

5.5 Key take outs

Key take outs

- Community schemes are likely to be extremely small scale.
- Small scale schemes targeting deeply disadvantaged or already indebted individuals are not consistent with observing responsible lending criteria.
- Where schemes seek to observe responsible lending standards or achieve a degree of sustainability, funds available have largely not been lent as a result.
- Genuinely fully inclusive and accessible community lending schemes would need therefore to agree to waive responsible lending criteria.
- Small scale community based schemes are unlikely to be financially sustainable and will always require both significant subsidy and underwriting by scheme sponsors, and the deployment of significant – and some may feel disproportionate – resource.
- Containing bad debt to manageable levels requires both informed targeting and intensive repayment management which in turn f needs to rest on effective leverage of local knowledge and partnerships between the community and the lender.
- Those setting up community lending schemes need to be clear and realistic both about the the nature of the target market and business model and the balance between the affordable credit and financial inclusion and capability benefits in the scheme objectives.
- Encouraging a savings habit alongside a repayment culture requires both significant customer support and an acceptance that enhanced savings and improved financial resilience will come at the cost of a reduced repayment income stream for the lender if repayments are to be affordable and saving practicable for the consumer.

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[21] See MABS Pre Budget Submission 2012, pg.10 https://www.mabs.ie/fileadmin/user_upload/documents/Reports___Submissions/Submissions/Pre_Budget_Submission_2012.pdf

6.0 Model outputs – affordable credit models for Northern Ireland

The research team presented the Advisory Group with six alternative affordable credit models, with the original intention being that the Group would select one model to be taken forward for detailed development. The six options were:

- A consumer-facing, national online affordable credit service which would be based on automated credit scoring.
- A national online lending service on a referral-only model, with referrals generated by credit unions, the social housing sector and debt advice services.
- A "Growth Fund" style model for credit unions in Northern Ireland to enable them to extend the reach of credit unions into more deprived communities and the financially excluded.
- An online payday product on the lines of the London Mutual payday product.
- A branch-based lending service on the Moneyline / Scotcash models.
- A third-sector led and community-based affordable credit service, co-located with debt advice services and with a wider financial inclusion remit.

On the basis of the evidence presented to them at the various reporting sessions and the divergent nature of stakeholders' views on both the nature of the need for affordable credit in Northern and appropriate delivery models , the advisory group asked the research team to develop directional models providing indicative funding needs and scale benefits for the group to consider further. The three models chosen were:

- A third-sector-led and community-based lending model focused on the hardest to reach borrowers and co-located with advice services
- A branch-based operation on the Moneyline / Scotcash model.
- An online national lending service on a referral-only model, to be run in partnership with credit unions, the social housing sector and debt advice.

This chapter describes the outputs of the modelling process for each of these concepts and discusses the pros and cons of each, together with the implications for developing an affordable credit model for Northern Ireland. It is worth noting that in all three cases, the proportion of low income borrowers that could be covered is small. Nonetheless, for those that could be reached, the various models do offer real benefits.

The three models developed initially were created on the original assumption that each model must be sustainable and that credit pricing would need to accommodate this requirement. After the outputs of the three models have been presented to the board and faced with the reality of what the cost of credit would need to be in each case to support a sustainable operation, the advisory board then sought the development of a number of models that would offer affordable loans within a 100% APR price cap, deemed to be the maximum politically acceptable. This chapter also discusses the outputs of this second round of modelling.

6.1 The community model: the impact of varying the APR on cost savings to consumers and funding requirements

As with the other models reducing the APR from that necessary to achieve break-even would act to dramatically increase consumer savings. The cost of credit would reduce to £27 per £100 at 100% APR,

£16 per £100 at 48% APR and £13 per £100 at 36% APR. This would result in consumer savings relative to high cost credit for every £100 borrowed of £28, £37 and £40 respectively and savings per average loan of £95, £125 and £134 respectively. By contrast this type of lending is so expensive to deliver that if it were delivered without subsidy, the APR would need to be 620%, being £54 per loan more expensive than the highest cost commercial provider.

Aggregate consumer savings over six years would rise to £83,000 at 100%APR, £109,000 at 48% APR and £117,000 at 36% APR.

Table 3. The community model: the impact of varying the APR on cost savings to consumers

	Breakeven in year 6				Zero operating subsidy	Provident
APR	300%	100%	48%	36%	620%	372%
Cost of Credit (£ per £100 lent)	£55	£27	£16	£13	£82	£66
Average loan value	£336	£336	£336	£336	£336	£336
Average term (weeks, weighted by loan values)	35	35	35	35	35	35
Weekly payments	£14.50	£11.80	£10.70	£10.40	£17.10	£16.00
Lending fee	5%	5%	5%	5%	5%	0%
Average consumer savings per:						
£100 lent	£5	£28	£37	£40	-£16	£0
Per loan	£18	£95	£125	£134	-£54	£0
Average per week, £350 loan (with 5% fee weeklyised)						
32 weeks	£0.97	£3.79	£4.91	£5.21	-£1.71	
Aggregate consumer savings						
Total	£16,000	£83,000	£109,000	£117,000	-£47,000	£0

Unsurprisingly, as with all the other models, if APRs are set at lower levels, funding and subsidy requirements also rise. Total funding requirement would rise to £148,000 at 100% APR and to £175,000 and £184,000 at 48% and 36% APR respectively. Subsidy per £100 lent would rise to £50.51 at 100% APR and to £59.73 at 48% APR and £62.80 at 36% APR.

Table 4. The community model. The impact of varying the APR on funding and subsidy requirements

APR	300%	100%	48%	36%	620%
Funding required					
Year 1	£41,000	£42,000	£43,000	£43,000	£38,830
Cumulative years 1-6	£83,000	£148,000	£175,000	£184,000	£19,069
Subsidy per £100 lent					
Funding and operating costs	£28.33	£50.51	£59.73	£62.80	£6.51
Net operating costs					
0% cost of capital	£21.66	£44.37	£53.58	£56.31	£0.00
8% cost of capital	£24.40	£47.44	£56.31	£58.70	£2.74

6.1.1 The community model: key take-outs

Key take outs

- This model is clearly cost and resource intensive and will be difficult to scale.
- The strength of the community based model is that it could reach and serve a small number of highly disadvantaged individuals who might otherwise find it difficult to access credit and who may be exposed to illegal lenders
- The likelihood is however that volumes would be very low and that the impact would be correspondingly disappointing, particularly in relation to the effort expended.
- The profile of potential borrowers is unlikely to support effective and responsible lending on any kind of viable financial basis.
- Costs to the consumer, even with a degree of subsidy, will be very high if the model is to be sustainable.
- Savings to the consumer relative to commercial high cost credit providers will be relatively modest.
- Delivery will require significant commitment and engagement from the voluntary sector and community workers.
- Grant finance and debt counselling may be more appropriate responses to the needs of these most vulnerable borrowers.

6.2 The branch-based model

6.2.1 Key assumptions

The key reference points in developing this model and on which the central assumptions were based were, on the one hand, the experience of Moneyline and Scot Cash (see chapter 5) and, on the other, the total market for home credit in Northern Ireland. The Moneyline and Scot Cash experience provided reference points around financial performance, reach, scale and achievements of other affordable credit operations. The scale and nature of the home credit market in Northern Ireland acted as a proxy for demand for small sum high cost credit, with the published financials of the major providers in the market providing some reference points for default rates and credit performance.

The key assumption is of branch-based lending and case by case personal under-writing. The accept : decline ratios are assumed to be broadly in line with market experience.

The assumption in the base case is of a single branch in year one, expanding to three branches after three years. Alternative scenarios were developed in which five branches were established by year 6.

The set up and ongoing costs were derived from the Moneyline and Scotcash experience. Assumptions on the scale of lending per branch, lending values and bad debt and collections performance drew on both the Moneyline and Scotcash experience and that of Provident Financial. The default rate was assumed to be 12% for the base case scenario, broadly in line with the average write-off rate in the CDFI sector[22] and reflecting also the Moneyline experience (10% write-off). An allowance was made, however, (-10%), for reduced performance relative to established affordable credit initiatives on the grounds that a small scale operation serving a potentially higher risk market would be significantly less efficient than the commercial high cost credit suppliers.[23]

[22]According to the CDFA's June 2012 report on CDFIs, the write-off rate on consumer loan portfolios averaged 12%. The CDFA's June 2014 report showed an average write-off-rate of 11.2% for lending to individuals.
[23]The efficiency factor was assessed by comparing lending volumes from a Scotcash-type branch with the expected or modelled value from a single 'branch' of a market-leading provider.

On the basis that the Advisory Group felt strongly that the operation should be self-sustaining, the pricing on the loans was set at a rate that would enable the operation to break even on operating costs by year 6. On this basis, on an average £500 loan, on an average term of 45 weeks, the APR was set at 173 % with a total cost of credit of £49 per £100 lent. By year 6, the model indicated that the operation would be making a total of 5,400 loans p.a. and achieving a market share of a little less than 7%, having made a cumulative total of a little over 27,000 loans since inception.

6.2.2 Key metrics and achievements

The key achievements on cost savings to consumers were that by year 6 consumers were saving £21 for each £100 borrowed and £104 on the cost of the average loan, relative to the leading high cost provider. This amounted to a total consumer savings of a little over £2.5m over the six year period.

Table 5. Base case branch model. Key achievement metrics

Three branches: APR set to break even in year 6			
APR (average term = 44 weeks)	173%		
Cost of Credit (£ per £100 lent)	£49		
	Year 1	Year 6	Cumulative years 1-6
Loans made	1,376	5,400	27,052
Amount lent	£688,000	£2,699,000	£13,523,000
Share of market	1.70%	6.80%	
Average consumer savings per:			
£100 lent	£7	£21	£19
Per loan	£33	£104	£93
Aggregate consumer savings			
Total	£45,000	£560,000	£2,518,000

6.2.3 Funding requirements

These results were achieved through subsidy to cash flow (to cover operating costs and loan capital) over the period of £1.7m and the equivalent of £12.35 per £100 lent and £62 per loan. In net terms, and assuming the capital invested was provided at 0%, the subsidy over the 6 year period was £0.54m, and a little short of £4 per £100 lent and just short of £20 per loan. However, if the lender were required to pay for capital on commercial terms, at 8%, as is the case with Moneyline, the cumulative net subsidy required would rise to a little over £1m and circa £7.50 per £100 borrowed and a little over £37 per loan.

Table 6. Funding requirements for branch model with break-even in year 6

	Cumulative subsidy required:	Per £100 of lending	per average £500 loan
Funding requirement to support lending capital and cash flow needs from start up to break-even Year 6	£1.7m	£12.53	£62
Cumulative net subsidy required after 6 years if capital provided at 0%	£0.54m	£3.98	£19.96
Cumulative net subsidy required after 6 years if capital provided at 8%	£1.01m	£7.47	£37.30

with offering low-income borrowers loans at high APRs, albeit that the cost of credit to the consumer would still be lower than market rates. The research team also therefore considered the likely funding requirements if loans were to be made available at a range of APRs. Table 7 following shows the cost of credit per £100 borrowed at various APRs and compares this with the cost of credit if the operation were to be established with no operating subsidy and with the market leading home credit loan. It is assumed throughout that the loan values and loan term are the same at £500 and 45 weeks respectively whatever the APR charged.

Table 7. The impact of varying the APR on cost to consumer and cost savings relative to leading commercial product

	Breakeven in year 6				Zero operating subsidy	Provident
APR	173%	100%	48%	36%	199%	313%
Cost of Credit (£ per £100 lent)	£49.00	£33.00	£18.00	£14.00	£54.00	£76.00
Weekly payments	£16.20	£14.40	£12.70	£12.30	£16.70	£19.80
Lending fee	5%	5%	5%	5%	5%	0%
Average consumer savings per:						
£100 lent	£19	£31	£43	£46	£15	£0
Per loan	£93	£157	£214	£231	£73	£0
Average per week, £500 loan (with 5% fee weeklyised)						
45 weeks	£3.05	£4.87	£6.49	£6.94	£2.49	£0
52 weeks	£2.45	£4.27	£5.89	£6.35	£1.89	£0
Aggregate consumer savings						
Total	£2.5m	£4.3m	£5.8m	£6.2m	£2.0m	£0

** Levied upfront as per Scotcash model*

For borrowers, their key concern is less the overall cost than how much their weekly payment is. A loan from the market leading home credit company would cost a little short of £20 p.w., while that on the break-even APR for an affordable credit operation would cost a little over £16 per week, Reducing the APR clearly also reduces the weekly cost to the borrower, £14.40 at 100% APR, £12.70 at 48% APR and £12.30 at 36% APR. This amounts to significant savings over the duration of the loan, being £157 at 100% APR, £214 at 48% APR and £231 at 36% APR.

These savings could only be achieved by significantly increasing the funding requirement. At 100% APR the cumulative funding requirement for the lenders' cash flow would rise to £3.4m over the period, and to £4.9m at 48% APR and £5.4m at 36% APR. The equivalent subsidy for each £100 lent would be £25.18, £36.60 and £39.84.

On a net basis, this would reduce somewhat, particularly if capital were provided free of interest, but the subsidy would remain substantial as can be seen in Table 8 following. For some existing affordable credit models, such as Moneyline, the cost of capital is some 8%.

Table 8. Impact of varying the APR on level of subsidy and total funding requirements

APR	173%	100%	48%	36%	199%
Funding required					
Year 1	£675,000	£717,000	£753,000	£764,000	£662,000
Cumulative years 1-6	£1,670,000	£3,405,000	£4,950,000	£5,387,000	£1,130,000
Subsidy per £100 lent					
Funding and operating costs	£12.35	£25.18	£36.60	£39.84	£8.36
Net operating costs per £100 lent					
0% cost of capital	£3.98	£16.82	£28.25	£31.47	£0.00
8% cost of capital	£7.47	£20.30	£31.74	£34.96	£3.48

6.2.4 Business case risk

There is considerable business case risk associated with some of the underlying assumptions in the base case, one of the most important being the default rate. The base case pricing assumes a default rate of 12%. If the default rate were in the event to be higher than was assumed in setting pricing and developing the business case, this would also have a significant impact on funding requirements. If the operation was launched with a break even pricing of 173% APR on an assumed 12% default rate but the default rate transpired in reality to be 15%, the funding requirement over the six year period would rise from £1.7m to £2.1m. At 100%, 48% and 36% APR the funding requirement would rise to £3.8m, £5.3m and £5.7m respectively. The subsidy per £100 lent would rise to £7.15 for the intended break even rate of 173% APR, to £19.66 for the 100% APR, £30.79 for the 48% APR and to £33.94 per £100 lent for the 36% APR.

Should the default rate be higher still, at 17.5%, funding and subsidy requirements would also rise. In this case the 173% APR pricing would require funding of £2.7m, the 100% APR pricing, funding of £4.3m, the 48% APR funding of £5.8m and 36% APR funding of £6.2m. Subsidy per £100 lent would rise to £11.76, £23.74, £34.41 and £37.41 respectively for APRs of 173%, 100%, 48% and 36%.

Table 9. The business case risk. The impact of increasing the default rate

Position after 6 years of operations:
Base case – default rate assumption = 12%; 3 branches making a total of 5,400 loans per annum by year 3; Value of loans – year 6=£2.7m; cumulative years 1-6=£13.5m; Market share=6.8%.

	Breakeven in year 6				Zero subsidy APR
APR	173%	100%	48%	36%	199%
Cost of Credit (£ per £100 lent)	£49	£33	£18	£14	£54
Scenario 1. Base case: pricing assumes default 12%					
Subsidy £m	0.54	2.27	3.82	4.26	0
Funding £m	1.67	3.41	4.95	5.39	1.13
Scenario 2. Pricing assumes default 12%, actual default =15%					
Subsidy £m	0.97	2.66	4.16	4.59	0.44
Funding £m	2.1	3.79	5.29	5.72	1.57
Scenario 3. Pricing assumes default 12%, actual default =17.5%					
Subsidy £m	1.59	3.21	4.65	5.06	1.09
Funding £m	2.72	4.34	5.78	6.19	2.22

The team also examined how funding requirements would be impacted if fewer loans were achieved than assumed in the base case. The base case assumed that by year 6 the operation would be making 5,400 loans a year. Achieving lower volumes, 4,500 loans p.a., on the intended break-even pricing scenario of 173% APR would increase total cash flow funding requirements from £1.7m in the base case scenario to £2.1m. At 100% APR, funding requirements would rise from £2.7m to £3.6m, while in the 48% APR and 36% APR scenarios funding requirements would rise to £4.8m and £5.2m respectively.

Table 10. The business case risk. The impact of lower lending volumes

Position after 6 years of operations:
Base case – default rate assumption = 12%; 3 branches making a total of 5,400 loans per annum by year 3; Value of loans – year 6=£2.7m; cumulative years 1-6=£13.5m; Market share=6.8%.

	Breakeven in year 6				Zero subsidy APR
APR	173%	100%	48%	36%	199%
Cost of Credit (£ per £100 lent)	£49	£33	£18	£14	£54
Scenario 1. Base case: Pricing assumes 5,400 loans per annum, by year 3					
Subsidy £m	0.54	2.27	3.82	4.26	0
Funding £m	1.67	3.41	4.95	5.39	1.13
Scenario 2. Pricing assumes 5,400 loans per annum, actual = 4,500 (-17%)					
Subsidy £m	1.169	2.617	3.905	4.268	0.722
Funding £m	2.112	3.559	4.848	5.21	1.663

6.2.5 The impact of scaling up the branch based model

The analysis also addressed the scenario of developing a branch based model with 5 rather than 3 branches after 6 years of operation. This scenario resulted in some 9,000 loans p.a. being made from year 5. There were correspondingly larger aggregate savings to consumers as a result, ranging from £3.3m at the intended breakeven 173% APR scenario to £8.1m at 36% APR.

Funding requirements also rose, to £2.7m at the 173% APR scenario to £7.5m at the 36% APR scenario.

Table 11. Branch based model: The impact of scaling up the model

Position after 6 years of operations:
Loans per annum = 9,000 (year 5 onward), Value of loans – year 6=£4.5m; cumulative years 1-6=£18.1m; Market share=11.3%; Default rate=12%; Average loan value=£500.

	Breakeven in year 6				Zero subsidy APR
APR Cost of Credit (£ per £100 lent)	173% £49	100% £33	48% £18	36% £14	202% £55
Consumer savings					
Total	£3,258,000	£5,516,000	£7,527,000	£8,094,000	£2,474,000
Per £100 lent	£18	£31	£42	£45	£14
Subsidy					
Total	£783,000	£3,042,000	£5,052,000	£5,620,000	£0
Per £100 lent	£4.34	£16.86	£28.01	£31.15	£0.00
Funding					
Total	£2,667,000	£4,925,000	£6,937,000	£7,504,000	£1,885,000
Per £100 lent	£14.78	£27.30	£38.46	£41.60	£10.45

Further detailed tables showing how different scenarios would impact the base case for the branch model can be found in the appendix.

6.2.6 Key takes outs on the branch based model.

- It is clear that if a Northern Ireland version of Scotcash or Moneyline were to be established, the APR would need to be high if the operation were to be sustainable.
- There are potential costs savings to consumers, which will vary with the APR, albeit that on a fully sustainable basis, these may not be sufficient to tempt consumers to move away from established relationships with existing high cost credit suppliers, particularly where these are long-standing.
- High APRs may also pose political and reputational risks for potential political supporters but also for delivery partners such as social landlords.
- An APR that would be more politically acceptable and which would generate larger savings for consumers would require significant subsidy, which may not be achievable in the current climate.
- Given that the intended target market is inherently higher risk that that served by either Scotcash or Moneyline, there is considerable risk that performance may be worse than the indicative model outputs suggest.
- There is also the risk of adverse selection in which those least able to access credit from existing market suppliers are the first to present to a new social lender
- As the business case risk analysis suggests, either scenario could result in a requirement for both upfront and ongoing funding which is significantly higher than the base case scenario suggests.
- For locations outside Belfast, reach would be limited to catchment areas determined by potential customers' willingness to travel. Also, in a Northern Ireland context, location would need careful consideration to ensure both main communities are served.
- Accelerating growth and scaling up the number of branches to extend to more locations would allow lending to reach a wider audience and to take a larger market share. It may be wiser however, given the various uncertainties and the business case risk, to minimise risks and costs by piloting and learning from a branch model in a single location before seeking to expand.

6.3 The online model

6.3.1 Key Assumptions

The key assumption in relation to the online affordable credit model was that the service would be online-only, offering a national affordable credit service, with central underwriting, servicing and back office facilities, supported by partnership working with banking partners to provide the necessary infrastructure and technical support.

It is important to note that a further key assumption is that this online model would not be consumer-facing, i.e. there would be no direct access from the public. Applications would rather be driven by referrals from credit unions, social landlords and other intermediaries. The online model is also assumed to be co-located with a host organisation, potentially a social landlord, local authority or debt advice service, to minimise both set up and ongoing costs.

Credit unions are assumed to be making referrals of suitable candidates for loans, with borrowers assumed not to be appropriate candidates for credit union lending. Credit unions were also assumed to have undertaken a degree of screening and pre-qualifying of loan candidates against agreed lending criteria for the affordable credit online operation.

A referral-based model is assumed to generate much lower levels of applications than in a consumer-facing model (in which a large majority of applications would be declined) but that the quality of applications would be superior to those that might be generated by a consumer facing model. Clearly, the key driver of the scale of demand and the pace of growth will be the effectiveness of both outreach and engagement with potential intermediaries and of the pre-qualification process.

For the purposes of the model, the team assumed that a little over one in five credit unions (i.e. 34 out of 158 Credit Unions in Northern Ireland) will engage and pre-qualify referrals to the service at a rate of one per week each, with an acceptance rate of 57%. It was further assumed that one in four housing associations and advice services will engage with the service[24]. These were assumed to be less likely to encounter potential candidates for the affordable credit service and, in the base case, were assumed to generate 21 referrals per annum each. For these referrals the acceptance rate was assumed to be 40%.

The foregoing referral rates were assumed to build up gradually over a period of three years, requiring proactive outreach and engagement with potential partner organisations to embed a referral network.

The assumed referral rates are clearly subject to considerably uncertainty and scenarios for changes to referral volumes are considered below, following the presentation of the base case results. Underwriting was assumed to be credit scored but not fully automated, as would be the case with a consumer-facing site. Overall, the ratio of accept to declines were assumed to be higher than market levels but underwriting costs and bad debt were assumed to be lower than the market level, reflecting the pre-qualified referrals.

Staffing costs were linked to the build-up of numbers of applications.

The required investment in technology, for both set-up and ongoing costs, was based on the experience of London Mutual in the establishment of their not for profit payday loan product.

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[24] *Encompassing 24 housing associations, 21 CABx offices and 61 Advice NI members i.e. a total of 106 potential sources of referrals.*

6.3.2 The online model. Key metrics and achievements.

Reflecting the need for outreach and engagement to build a referral network, the online service was assumed to make a little over 200 loans in the first year of operation rising to circa 1,240 by year four, making some 5,690 loans over the course of the six year period assumed for the operation to break even. A total of £105,000 was lent in the first year, rising to £620,000 p.a. by year four with a cumulative £2.8m lent over the six year period to break even.

Relative to the cost of credit from the market leading high cost credit provider, borrowers would save an average of £21 per £100 borrowed across the six year period amounting to £104 per loan on the average loan of £500. Aggregate consumer savings over the six year period on the basis of the loan volumes estimated would be £0.58 million.

As with the branch model, the APR in the core scenario was set to achieve break even in year 6, in line with the advisory group's concern that the model be self-sustaining. This means an APR of 153% would need to be charged, implying a total cost of credit of £45 per £100 borrowed.

Table 12. Online model: Base case scenario key achievement metrics

Online option: APR set to break even in year 6			
APR	153%		
Cost of Credit (£ per £100 lent)	£45		
	Year 1	Year 6	Cumulative years 1-6
Loans made per annum	211	1,239	5,589
Amount lent	£105,000	£620,000	£2,794,000
Share of market	0.30%	1.50%	
Average consumer savings per:			
£100 lent	£8	£23	£21
Per loan	£38	£117	£104
Aggregate consumer savings			
Total	£8,000	£145,000	£581,000

6.3.3 Funding requirements for the base case

The model assumes that these results were achieved through subsidy to cash flow (to cover operating costs and loan capital) of a little under £0.5m, being a subsidy of £17.54 per £100 lent and £88 for the average loan.

In net terms, provided capital was provided at 0% interest, subsidy required would be £0.23m, £8.25 per £100 lent and £41 for the average loan. If capital had to be paid for at commercial rates similar to those which other affordable credit models such as Moneyline have to pay, the net subsidy required would rise to £0.33m over the period, being the equivalent of £11.75 per £100 lent and £59 per average loan, assuming an 8% cost of capital.

Table 13. Online model: Funding requirements for the base case

	Cumulative subsidy required:	Per £100 of lending	per average loan (£500)
unding requirement to support lending capital and cash flow needs from start up to break-even Year 6	£0.490m	£17.54	£88.00
Cumulative net subsidy required after 6 years if lending capital provided at 0%	£0.230m	£8.25	£41.00
Cumulative net subsidy required after 6 years if lending capital provided at 8%	£0.329m	£11.75	£59.00

6.3.4 The online model: the impact of varying the APR

As with the branch model, the team explored the funding implications of varying the APR for the online model, using the same range of potential APRs as was used for the branch model.

An APR of 100% reduced the cost of credit to the consumer to £33 per £100 borrowed, with 48% APR reducing the cost to £18 per £100 borrowed and 36% APR reducing the cost to £14 per £100 borrowed. This compares to £56 per £100 borrowed were the model required to operate without subsidy and £83 per £100 borrowed from the leading commercial high cost provider. In terms of weekly payments, a 100% APR, 48% APR and 36% APR reduced weekly outlays on repayments on the average loan of £500 to £14.40, £12.70 and £12.30 respectively. A subsidy free APR (of 209%) would require weekly payments of £16.90. Payments on an equivalent loan from the leading commercial high cost provider would be £20.50 (360% APR).

Average consumer savings increased as the APR reduced, being £30 per £100 lent at 100% APR, £41 per £100 lent at 48% APR, £44 per £100 lent at 36% APR. Aggregate consumer savings over the total six year period increased to £0.84m at 100% APR, £1.15m at 48% APR and £1.24m at 36% APR.

Table 14. Online model: The impact of varying the APR on cost savings to consumers

	Breakeven in year 6				Zero operating subsidy	Provident
APR	153%	100%	48%	36%	209%	360%
Cost of Credit (£ per £100 lent)	£45	£33	£18	£14	£56	£83
Average loan value	£500	£500	£500	£500	£500	£500
Average term (weeks, weighted by loan values)	45	45	45	45	45	45
Weekly payments	£15.70	£14.40	£12.70	£12.30	£16.90	£20.50
Lending fee	5%	5%	5%	5%	5%	0%
Average consumer savings per:						
£100 lent	£21	£30	£41	£44	£13	£0
Per loan	£104	£150	£205	£221	£63	£0
Average per week, £500 loan (with 5% fee weeklyised)						
52 weeks	£2.90	£4.26	£5.89	£6.35	£1.69	£0.00
Aggregate consumer savings						
Total	£581,000	£838,000	£1,148,000	£1,235,000	£350,000	£0

Funding and subsidy requirements correspondingly increased as the APR reduced. Funding of £0.75m would be required at 100% APR, £1.06m at 48% APR and £1.11m at 36% APR. The equivalent subsidy per £100 lent rose to a little over £26 at 100% APR and circa £38 at 48% and £41 at 36% APR.

Table 15. Online model: The impact of varying the APR on funding and subsidy requirements

APR	153%	100%	48%	36%	205%
Funding required					
Year 1	£204,000	£209,000	£215,000	£216,000	£200,000
Cumulative years 1-6	£490,000	£747,000	£1,058,000	£1,114,000	£258,000
Subsidy per £100 lent					
Funding and operating costs	£17.54	£26.74	£37.87	£40.94	£9.23
Net operating costs					
0% cost of capital	£8.25	£17.50	£28.53	£31.68	£0.00
8% cost of capital	£11.75	£20.97	£32.03	£35.18	£3.51

6.3.5 Online model: The business case risk

The base case assumed a default rate of 15% to generate the metrics presented in previous paragraphs and summarised in Table 16 following:

Table 16. Online model: The base case default rate of 15% assumed in break-even pricing

Position after 6 years of operations:					
Base case – default rate assumption = 15%; Loans = 1,239 per annum by year 4					
	Breakeven rate with default =15%				Zero subsidy rate with default =15%
APR	153%	100%	48%	36%	209%
Cost of Credit (£ per £100 lent)	£45	£33	£18	£14	£56
Consumer savings					
Total	£581,000	£838,000	£1,148,000	£1,235,000	£350,000
Per £100 lent	£21	£30	£41	£44	£13
Subsidy					
Total	£230,000	£489,000	£797,000	£885,000	£0
Per £100 lent	£8.25	£17.50	£28.53	£31.68	£0.00
Funding					
Total	£490,000	£747,000	£1,058,000	£1,144,000	£258,000
Per £100 lent	£17.54	£26.74	£37.87	£40.94	£9.23

Table 17. Online model: The impact of actual default rate of 17.5% instead of 15% assumed in break-even pricing

Position after 6 years of operations:					
Variation – default rate =17.5%, holding all else constant, including base case APRs					
	Breakeven rate with default =15%				Zero subsidy APR with default =15%
APR	153%	100%	48%	36%	209%
Cost of Credit (£ per £100 lent)	£45	£33	£18	£14	£56
Consumer savings					
Total	£551,000	£798,000	£1,094,000	£1,177,000	£330,000
Per £100 lent	£20	£29	£39	£42	£12
Subsidy					
Total	£356,000	£605,000	£901,000	£984,000	£136,557
Per £100 lent	£12.79	£21.65	£32.25	£35.22	£4.89
Funding					
Total	£616,000	£863,000	£1,160,000	£1,242,000	£397,000
Per £100 lent	£22.05	£30.89	£41.52	£44.45	£14.21

The team also looked at the impact of both lower than expected referrals and higher than anticipated loan volumes. Assuming that referrals would be half that in the base case scenario reduces lending to 620 loans p.a. at full operations and consumer savings on high cost credit to £290,000. Funding requirements, while lower than the base case, would nonetheless be £380,000 in the scenario with lower referrals.

Table 18. The online model: impact of lower sales than assumed in base case scenario

Position after 6 years of operations:					
Variation – 620 loans per annum at full operation versus 1,239 per annum in base case. Holding all else constant, including base case APRs					
	Breakeven APR with base case demand				Zero subsidy APR with base case loans
APR	153%	100%	48%	36%	209%
Cost of Credit (£ per £100 lent)	£45	£33	£18	£14	£56
Consumer savings					
Total	£290,000	£419,000	£574,000	£617,000	£175,000
Per £100 lent	£21	£30	£41	£44	£13
Subsidy					
Total	£251,000	£379,000	£532,000	£577,000	£134,975
Per £100 lent	£17.92	£27.13	£38.08	£41.30	£9.66
Funding					
Total	£380,000	£508,000	£663,000	£706,000	£264,000
Per £100 lent	£27.20	£36.36	£47.46	£50.54	£18.90

If, on the other hand, the referral rate was to be 45% higher than in the base case, the operation would be generating 1,800 loans p.a. and generating consumer savings of £843,000. Funding requirements would be circa £590,000 in this scenario.

Table 19. The online model: The impact of higher sales than assumed in base case scenario

Position after 6 years of operations:					
Variation – 1,800 loans per annum at full operation versus 1,239 per annum in base case. Holding all else constant, including base case APRs					
	Breakeven APR with base case demand				Zero subsidy APR with base case loans
APR	153%	100%	48%	36%	209%
Cost of Credit (£ per £100 lent)	£45	£33	£18	£14	£56
Consumer savings					
Total	£843,000	£1,218,000	£1,667,000	£1,793,000	£508,000
Per £100 lent	£21	£30	£41	£44	£13
Subsidy					
Total	£212,000	£587,000	£1,037,000	£1,162,000	-£122,127
Per £100 lent	£5.24	£14.47	£25.55	£28.63	-£3.01
Funding					
Total	£589,000	£964,000	£1,414,000	£1,540,000	£255,000
Per £100 lent	£14.51	£23.76	£34.84	£37.95	£6.28

6.3.6 Further iterations of the online model to accommodate additional scenarios on scale and variations in degree of participation by the social housing and credit union sectors

Following presentation of the various model outputs to the advisory board, the board collectively took the view that a 100% APR would be the maximum that would be politically acceptable.

Some board members expressed interest in seeing a version of the online model which assumed greater involvement and more pro-active engagement from Housing Associations, with a view to understanding the potential for the social housing sector to drive greater scale in an affordable credit operation than the original modelling had suggested.

The board also wanted to understand what would happen in terms of funding requirements and scale both with no credit union engagement and with a higher degree of credit union engagement.

The board also took the view that referrals from advice agencies in Northern Ireland to an online model not offering additional financial inclusion services would be unlikely, given these agencies opposition to high cost borrowing and the financial difficulties that debt advice clients would be facing. It was thought that the existing indebtedness of debt advice clients would tend to preclude an ethical affordable credit provider from making further credit available to them without breaching responsible lending guidelines.

Accordingly the research team developed further iterations of the model to understand the outcomes of these various scenarios for scale of operations, funding requirements and consumer savings.
It was important in arriving at the new iterations of the model, however, that the research and modelling team were realistic in framing assumptions. The team were careful therefore to root assumptions in the experience of other organisations who have operated in the affordable credit space, both elsewhere and in Northern Ireland.

The first new iteration of the online model (online model scenario A) assumed no referrals from the advice sector and that within the social housing sector, only the 23 registered Housing Associations in Northern Ireland would be involved in the scheme (and not area offices of the National Ireland Housing Executive).

The assumption was that half of the Housing Associations would engage and that each would make an average of four referrals per month on the basis of need, but without pre-screening or pre-qualifying the applications, Some 40% of applications sourced in this way were assumed to be accepted, a little higher than in commercial operations where lenders are seeking borrowers with a lower risk profile.

Overall these assumptions resulted in this scenario generating a total of circa 530 loan applications per year and some 212 approved loans from the housing association sector.

A little over one in five of the 158 credit unions in Northern Ireland were assumed to make referrals, with these being pre-screened by the credit unions, with the credit unions generating some 1,810 referrals of which some 57% would be approved, making a total of 1030 approved loans from credit union sources. Total annual lending therefore for this scenario would be circa 1,240 loans per annum.

Table 20. Online Scenario A Half of housing Associations and one in five credit union generate referrals to the online model

Organisations	Engagement rate (%)	Referring organisations	Referrals			Approvals	
				Per annum	Total	% of referrals	Loans
NIHE	44	0%	0	0	0	40%	0
HAs	23	52%	12	45	529	40%	212
Credit Unions	174	20%	35	52	1,810	57%	1,028
Totals	241	19%	47	50	2,338	53%	1,239
Composition							

Notes: The NI Direct site lists 23 local registered housing associations http://www.nidirect.gov.uk/housing-associations-contact
The NI Federation of Housing Associations (NIFHA) lists 21 members http://www.nifha.org/membership/hamembers/

The research team then moved on to explore how this outcome might differ were the 44 area offices of the Northern Ireland Housing Executive also to participate in the Affordable Credit scheme alongside the registered Housing Associations (online scenario B).

In this case a little less than a quarter of NIHE area offices were assumed to participate in the scheme, each referring a little over 50 potential borrowers a year, none of whom would be pre-qualified, again with an acceptance rate of 40%.

The model suggested this scenario would generate a total of a further 212 loans per year from NIHE tenants.

Assumptions about the quantum of referrals and loans from the Housing Association and the Credit Unions remained the same as for Scenario A. Taken together, this iteration of the model would generate a little under 1,500 affordable loans per annum for Scenario B.

Table 21. Online Scenario B Northern Ireland Housing Executive participate alongside social housing associations and credit unions

Organisations	Engagement rate (%)	Referring organisations	Referrals			Approvals	
				Per annum	Total	% of referrals	Loans
NIHE	44	23%	10	52	520	40%	208
HAs	23	52%	12	45	529	40%	212
Credit Unions	174	20%	35	52	1,810	57%	1,028
Totals	241	24%	57	50	2,858	51%	1,447
Composition							100%

The next iteration of the model (Online Scenario C) set out to understand what the outcomes of the model would look like on the assumption of higher levels of engagement from both the Housing Executive and Housing Association sector.

The Housing Executive is responsible for circa twice as many social housing tenants as the Housing Association sector. This version of the model assumed that 75% of NIHE area offices participated, each making two referrals a week (i.e. twice the level assumed for the Housing Associations). Participation by Housing Associations was also assumed to be 75% of all associations.

The assumptions in relation to the credit union sector were kept the same as for the two previous new iterations, with assumptions on approval rates remaining the same also.

Taken together, the assumptions underpinning Scenario C generated some 2,760 affordable loans p.a.

Table 22. Online Scenario C Higher levels of engagement from both NIHE and social housing associations

Increase NIHE and HA participation

Organisations	Engagement rate (%)	Referring organisations	Referrals			Approvals	
				Per annum	Total	% of referrals	Loans
NIHE	44	75%	33	104	3,432	40%	1,373
HAs	23	75%	17	52	897	40%	359
Credit Unions	174	20%	35	52	1,810	57%	1,028
Totals	241	35%	85	72	6,139	45%	2,759
Composition							100%

The next two iterations of the model then examined the consequences of both no credit union participation in the scheme and enhanced credit union participation in the scheme. In the first of these scenarios (Online Scenario D) credit unions were assumed not to participate and all other assumptions relating to the social housing sectors were kept the same. Together this reduced the annual volume of approved affordable loans to 1,730 for Scenario D.

Table 23. Scenario D Credit unions do not participate in scheme, Referrals from social housing sector only

No credit union participation

NIHE and HAs per Scenario 3

Organisations	Engagement rate (%)	Referring organisations	Referrals			Approvals	
				Per annum	Total	% of referrals	Loans
NIHE	44	75%	33	104	3,432	40%	1,373
HAs	23	75%	17	52	897	40%	359
Credit Unions	174	0%	0	52	0	57%	0
Totals	241	21%	50	86	4,329	40%	1,732
Composition							100%

The second of these two scenarios (Online Scenario E) envisaged credit union participation increasing to 30%, resulting in a total of 3, 270 affordable loans a year.

Table 24. Scenario E Enhanced credit union participation alongside high levels of engagement from social housing sector

Increase credit union participation

NIHE and HAs per Scenario 3

Organisations	Engagement rate (%)	Referring organisations	Referrals			Approvals	
				Per annum	Total	% of referrals	Loans
NIHE	44	75%	33	104	3,432	40%	1,373
HAs	23	75%	17	52	897	40%	359
Credit Unions	174	30%	52	52	2,714	57%	1,542
Totals	241	43%	102	69	7,043	46%	3,273
Composition							100%

The following tables pull together the results for each of the iterations of the model in a series of comparative tables showing annual loans after a three year build, and how this would translate into consumer savings, subsidy requirements per loan and overall funding requirements. In each case the APR (at100%) and the cost of credit per £100 borrowed (at £33 per £100 lent) remain the same.

As can be seen from Table 25 following, loan volumes range from 1,240 p.a. to 3,270 p.a.

Table 25. The impact on loan volumes of varying social housing and credit union participation

Loan volumes p.a. for the various online model scenarios
APR = 100%

Assume 15% default rate					
	A. Housing associations and credit union referrals only	B. NIHE participation alongside housing associations	C. Increase social housing participation	D. No credit union participation	E. Increase credit union participation
APR	100%	100%	100%	100%	100%
Annual applications / referrals following three-year build up	2,338	2,858	6,139	4,329	7,043
Annual loan approvals following three-year build up	1,239	1,447	2,759	1,732	3,273

Each iteration of the model produces significant savings for consumers compared to private sector home credit loans, being £30 per £100 lent, with cumulative savings in aggregate ranging from circa £840,000 over six years to in excess of £2.2 million over the same period, depending on the scale of the operation.

Table 26. Consumer savings per £100 borrowed and cumulative consumer savings over 6 year period for the various online model scenarios

The impact of varying social housing and credit union participation
APR = 100%

Assume 15% default rate					
	1. Housing associations and credit union referrals only	2. NIHE participation alongside housing associations	3. Increase social housing participation	4. No credit union participation	5. Increase credit union participation
Cost of Credit (£ per £100 lent)	£33	£33	£33	£33	£33
Consumer savings					
Total	£838,000	£979,000	£1,867,000	£1,171,000	£2,214,000
Per £100 lent	£30	£30	£30	£30	£30

The other side of these savings to consumers is the subsidy required per £100 lent. This is highest in the scenario where there is no credit union participation, because of the lower cost of screening where credit unions are able to pre-qualify and lowest where credit union participation is highest. Subsidies per £100 lent range from a little over £14 per £100 to circa £21 per £100. We would caution however that for the UK Growth Fund scheme, which involved circa 100 credit unions subsidy per £100 lent was circa £17 per £100 lent, while for the CDFI sector, in 2013/14 average subsidy per £100 lent was £23 per £100, so this may be optimistic. In neither case are any of the operations sustainable, previous modelling earlier described having indicated that a much higher APR (of 173%) would be required for an affordable credit model to be sustainable even after a six year period.

Table 27. Subsidy required per £100 lent and cumulative funding required over a six year period for the various online model scenarios

The impact of varying social housing and credit union participation
APR = 100%

Assume 15% default rate					
	A. Housing associations and credit union referrals only	B. NIHE participation alongside housing associations	C. Increase social housing participation	D. No credit union participation	E. Increase credit union participation
Subsidy					
Total	£489,000	£555,000	£965,000	£813,000	£1,041,000
Per £100 lent	£17.50	£17.01	£15.51	£20.83	£14.11

Funding requirements similarly varied considerably, reflecting the scale of the operation, from circa £0.75m to £1.7m. It should be borne in mind that in the case of the iteration of the model where volumes rest on credit union participation, in the interviews undertaken to inform this project with the credit union representatives from both communities in Northern Ireland, the credit unions were clear that they would only participate in an affordable credit scheme on a fully funded or fully guaranteed basis, being unwilling to take on any risks to their own members' assets. The cost of funding does not include an allowance for the cost of fully guaranteed loans because it is assumed that the loans are made by the entity constituting the national online lender (assumed to be a CDFI). It should be borne in mind however that the credit union representatives interviewed for the project had mixed feelings about working with a CDFI in such a capacity, which could be seen as a competitor in some contexts.

Table 28. Funding requirements for the various online model scenarios

The impact of varying social housing and credit union participation
APR = 100%

Assume 15% default rate					
	A. Housing associations and credit union referrals only	B. NIHE participation alongside housing associations	C. Increase social housing participation	D. No credit union participation	E. Increase credit union participation
Funding					
Total	£747,000	£857,000	£1,543,000	£1,175,000	£1,725,000
Per £100 lent	£26.74	£26.26	£24.81	£30.11	£23.38

Taken together however, in all cases that for each pound expended on subsidy and funding, consumer savings were greater than subsidy or funding expended. This was however very finely balanced and/or marginal for several of the models.

Table 29. Consumer savings to subsidy and funding ratios for the various online model scenarios

The impact of varying social housing and credit union participation
APR = 100%

Assume 15% default rate					
	A. Housing associations and credit union referrals only	B. NIHE participation alongside housing associations	C. Increase social housing participation	D. No credit union participation	E. Increase credit union participation
Consumer savings per:					
£ of subsidy	£1.71	£1.76	£1.93	£1.44	£2.13
£ of funding	£1.12	£1.14	£1.21	£1.00	£1.28

Some members of the board expressed concerns that the model outputs and assumptions around the scale of the referrals was insufficiently ambitious, and that affordable lending on the scale the model outputs suggested would have less impact as an alternative to private sector high cost credit than they would have wanted. Table 28 following shows the penetration of social tenants in Northern Ireland achieved by the various models. How this compares to the experience of other affordable credit models elsewhere is discussed in the following section 6.5.

The proportion of individuals in the social housing population in Northern Ireland aged 18+ reached by the affordable credit lending envisaged ranges for the different scenarios envisaged from 0.8% of the social tenant population to 2.0% of the population, while the proportion of the more disadvantaged 18+ population of social tenants falling into the bottom 50% of household incomes ranges from 0.9% to 2.5%.

Table 30. Affordable credit lending volumes and penetration of social housing tenants for the various online model scenarios

The impact of varying social housing and credit union participation
APR = 100%

Assume 15% default rate					
	A. Housing associations and credit union referrals only	B. NIHE participation alongside housing associations	C. Increase social housing participation	D. No credit union participation	E. Increase credit union participation
APR	100%	100%	100%	100%	100%
Annual applications / referrals following three-year build up	2,338	2,858	6,139	4,329	7,043
Annual loan approvals following three-year build up	1,239	1,447	2,759	1,732	3,273
Referrals as % of social housing sector population:					
All aged 18+	1.4%	1.7%	3.7%	2.6%	4.3%
Bottom 50% aged 18+	1.8%	2.1%	4.6%	3.2%	5.3%
Approvals as % of social housing sector population:					
All aged 18+	0.8%	0.9%	1.7%	1.1%	2.0%
Bottom 50% aged 18+	0.9%	1.1%	2.1%	1.3%	2.5%

The estimated share of affordable credit loans as a proportion of all home credit loans being advanced to social tenants in Northern Ireland ranges from 5% to 13%.

Table 31. Affordable credit applications and loan volumes as a share of home credit users within the social tenant population

The impact of varying social housing and credit union participation
APR = 100%

Assume 15% default rate					
	A. Housing associations and credit union referrals only	B. NIHE participation alongside housing associations	C. Increase social housing participation	D. No credit union participation	E. Increase credit union participation
APR	100%	100%	100%	100%	100%
Annual applications / referrals following three-year build up	2,338	2,858	6,139	4,329	7,043
Annual loan approvals following three-year build up	1,239	1,447	2,759	1,732	3,273
Referrals as % of social housing sector population:					
HC users	9.5%	11.6%	24.9%	17.6%	28.6%
Approvals as % of social housing sector population:					
HC users	5.0%	5.9%	11.2%	7.0%	13.3%

6.3.7 Key take outs on the online model

- The key advantage of the online model is that it would facilitate a national affordable credit service.
- As with other high cost models, however, a high APR would be required if the model is to be sustainable without long term subsidy.
- Although remote service will act to increase losses relative to the branch based model, the cost savings to consumers are potentially greater than would be the case for some other models.
- A 100% APR pricing will not allow for sustainability but will be considerably less onerous in terms of funding requirements than face to face delivery.
- It needs to be borne in mind however, that semi-automated underwriting and remote service will require that borrowers will need be lower risk than either would be the case with a branch based model, and indeed, commercial high cost credit models.
- An online referral-based model is unlikely to serve the most vulnerable and excluded consumers as a result.
- The main limiting factors in the success of the model are the effectiveness of the outreach and engagement with partner organisations and the quality of referrals.
- Growth potential and reach will be constrained if referrals are lower than envisioned or if the quality of the leads is inappropriate to the business model and associated lending criteria.
- The biggest challenge in implementing this model will be to engage intermediaries and communicate the appropriate borrower profile to potential referrers, in order to ensure that only relatively credit worthy borrowers are put forward.
- Experience in other contexts suggest that the biggest risk for this model is that referrals are biased to potential borrowers who are more vulnerable and who do not fit an acceptable risk profile
- The scale of a referral based model will be critically determined by the commitment of the credit unions and social housing sector to the affordable credit proposition and the online service.

6.4 Comparison of the various affordable credit models at 100% APR

6.4.1 Key achievements and funding requirements

This section provides a comparison of the key dimensions of the various models at 100% APR. The various stakeholders brought a wide range of considerations and aspirations to thinking around the development of an affordable credit model for Northern Ireland. Some thought in terms of a broad financial inclusion service targeting the most disadvantaged while others thought simply in terms of provision of an alternative to high cost credit for credit-worthy borrowers with restricted access to the credit mainstream. Yet others were particularly focused on the needs of social tenants or though in terms of widening the reach of credit unions. Table 32 which follows summarises how these various considerations fit with the three broad model types considered, i.e. the community model, the branch-based model and the national online referral-driven service as a partnership between social housing and credit unions and a new dedicated social lender. In this case the assumption is that each model would offer credit at the 100% APR pricing which the advisory board viewed as the maximum likely to be politically acceptable.

Table 32. Overview of the strengths and weaknesses of the three model types in relation to an affordable credit model for Northern Ireland

Key considerations in development of an affordable credit model for NI	Community-based model	Branch-based, face to face model	Referral based national online service
Target market			
Vulnerable financially excluded borrowers	*****	***	*
Current users of high cost credit	*	***	***
Those struggling with mainstream models	*	**	***
Potential users of illegal lending	*****	**	*
Added value social benefits			
Financial inclusion / capability / resilience	*****	****	*
Cost savings / enhanced residual income	***	***	***
Limitations			
Reach	*	**	*****
Serve both communities	***	***	*****
Serve urban and rural areas	*	*	*****
Cost of credit			
High APR	***	***	***
Scale			
Potentially scaleable	**	***	****
Sustainability	*	*	**
Funding requirement	*	*****	***
Business risk	*	***	***

Key: the numbers of stars denotes degree of fit with each factor being rated, with 1 star being a poor fit and 5 stars being a strong fit.

For the remainder of this section, we assume the community based model not to be a viable alternative for an affordable credit model of any scale but best viewed as essentially a financial inclusion and financial capability outreach service with some capacity to offer small scale emergency funding to those in dire need and otherwise unlikely to be eligible to borrow elsewhere.

Comparisons of models for the rest of this section are for the various iterations of the branch based and national online referral service at 100% APR.

Table 33 following summarises the key achievement metric s (in terms of loan volumes and cost savings to consumers) for the various branch and online models. For convenience the various scenarios have been given numbers 1–7, numbers 3–7 being the online scenarios previously described as online scenarios A–E.

The various scenarios produce loan volumes ranging from some 1240 p.a. to 9,000 p.a., generating cumulative savings to consumers of between a little less than £1m to £5.5m over the first six years of operation.

Table 33. Loan volumes and consumer savings relative to private sector home credit pricing Key dimensions of branch-based and online lending scenarios at 100% APR

	Financial inclusion led		**Lending led**				
	Branch-based		National online referral based				
After 6 years of operation	Scenario 1. Base case: 3 branches	Scenario 2. Scaled up lending volumes	Scenario 3. Base case, credit union and housing association referrals (ABCDE)	Scenario 4. NIHE referrals additionally alongside HAs and CUs (ABCDE)	Scenario 5. Increased social landlords engagement alongside CUs (ABCDE)	Scenario 6. No credit union referrals (ABCDE)	Scenario 7. Increased credit union engagement (ABCDE)
% of CUs, HAs and NIHE area office engaging							
Credit union participation rate			20%	20%	20%		30%
Housing Association participation rate			52%	52%	75%	75%	75%
NIHE participation rate				23%	75%	75%	75%
APR	100%	100%	100%	100%	100%	100%	100%
Default rate	12%	12%	15%	15%	15%	15%	15%
Scale							
Loan volumes p.a.	5400	9000	1239	1447	2759	1732	3273
Cost of credit							
Per £100 lent	£33	£33	£33	£33	£33	£33	£33
Total repaid on £500 loan	£665	£665	£665	£665	£665	£665	£665
Average consumer savings per:							
£100 lent	£31	£31	£30	£30	£30	£30	£30
Cumulative consumer savings £m	£4.3	£5.5	£0.84	£0.98	£1.87	£1.17	£2.21

None of these models would be sustainable at 100% APR, with funding requirements ranging from £0.75m over the first six years for the social housing association-led online service to some £4.9m for the most ambitious and rapid growth version of the branch based model. See Table 34 following.

Table 34. Funding requirements of branch-based and online lending scenarios at 100% APR

	Financial inclusion led Branch-based			**Lending led** National online referral based			
After 6 years of operation	Scenario 1. Base case: 3 branches	Scenario 2. Scaled up lending volumes	Scenario 3. Base case, credit union and housing association referrals (ABCDE)	Scenario 4. NIHE referrals additionally alongside HAs and CUs (ABCDE)	Scenario 5. Increased social landlords engagement alongside CUs (ABCDE)	Scenario 6. No credit union referrals (ABCDE)	Scenario 7. Increased credit union engagement (ABCDE)
Funding requirement							
Subsidy per £100 lent based funding and operating costs	£25.18	£27.30	£26.74	£26.26	£24.81	£30.11	£23.38
Cumulative funding required £m	£3.4	£4.9	£0.75	£0.85	£1.54	£1.75	£1.73

If it were decided to combine these models in some configuration to create a two channel model, funding requirements would vary depending on how the approaches were combined but would appear to lie in the range of £4.2m to £6.6m.

Table 35 Funding requirements for multi-channel affordable credit operation at 100% APR

		Loan volumes p.a.	Cumulative consumer savings	Ratio of £1 funding to £ consumer savings
Base case: Scenario 1 and 3 3 branches plus 20% credit union and 52% housing association referrals to online service	£4.2	6639	£5.14	1.2
Scenario 1 and 4 3 branches and 20% credit union, 52% housing association and 23% NIHE area offices make referrals to online service	£4.3	6847	£5.28	1.2
Scenario 2 and 5 Scaled up branch lending volumes and 75% social housing sector, 20% credit unions make referrals to online service	£6.4	11759	£7.37	1.1
Scenario 1 and 6 3 branch model plus 75% of social housing sector making referrals to online service, no credit union referrals	£5.2	7132	£5.15	1.0
Scenario 2 and 7 Scaled up branch lending volumes plus 75% social housing sector and 30% credit unions make referrals to online service	£6.6	12273	£6.63	1.0

6.4.2 Key take outs. Comparison of model outputs at 100% APR

Key take outs

- At 100% APR neither branch nor online models can be sustainable without ongoing funding.
- The branch-based model offers the potential to support broader financial inclusion objectives and will serve more disadvantaged borrowers:
- Projected lending volumes after five years range from 5,400 p.a. for a three branch model to 9,000 for a more rapid growth, multi branch operation.
- Cumulative cost savings to consumers relative to high cost credit lie within a range of a little less than £4.3m to £5.5m for the most ambitious scenario.
- Funding requirements lie in the range £3.4m to £4.9m over five years.
- The online model will not serve the most disadvantaged borrowers but with commitment from credit unions and social landlords could act to expand the reach of credit unions to more financially excluded groups they are not in a position to serve directly and could act as an alternative to high cost credit for that sub-set of social tenants which are credit worthy and able to cope with an online, bank-collected service:
- Projected loan volumes range from 1240–3274 loans p.a. with the latter depending on a high degree of engagement by both social landlords and the credit union sector. Lack of credit union engagement would significantly impact potential lending volumes and the underwriting cost base.
- Corresponding consumer savings lie in the range of circa £1m–£2.2.m after five years of operation.
- Funding requirement range from £0.75m for a housing association only sector in partnership with credit unions to circa £1.75m for a more ambitious operation with NIHE involvement.
- Funding requirements for a multi-channel operation would appear to lie in the range £4.2m to £6.6m, generating between 6,600 and 12,2675 loans p.a. after five years, with cumulative consumer savings over the period lying in the range £5.1 m to £7.4m, depending on the scale of the operation and the approach taken.

6.5 Setting realistic expectations of the scale of an affordable credit operation for Northern Ireland

6.5.1 The model outputs compared to the experience of existing affordable credit initiatives

Some stakeholders expressed reservations about the scale of the proposed social lending operation suggested by the model outputs relative to that of the private sector high cost credit sector, the concern being that an affordable credit operation of the scale proposed would be insufficient to make a significant impact as an affordable alternative to commercial high cost credit.

In considering whether the scale of the lending arising for the different models and from the different scenarios and iterations of the various model is achievable and whether it is realistic to plan for larger volumes and greater impact than those suggested by the first iterations of the model, it is instructive to compare the model outputs with the actual experience of other affordable credit initiatives in Northern Ireland and elsewhere.

For the face to face model the experience of ScotCash in Glasgow provides a useful benchmark. ScotCash, as discussed in earlier chapters encompasses a partnership between the lender and housing associations and Citizens Advice, with referrals generated by outreach. After twelve years of operation, in the year 2013/14 Scotcash received some 3286 applications and made 1792 loans in that year, 73% of which were to social tenants. On this basis, some 2418 applications were received by ScotCash from social tenants, converting to 1318 ScotCash loans to social tenants. This would represent applications coming from 2.2% and loans being made to 1.2% of the 110,000 households in the social rented sector in Glasgow City. Bearing in mind that the number of individuals will likely be significantly lower than the number of loans made (home credit loans averaging 2.1 loans per year), the actual proportion of social tenants in Glasgow reached by ScotCash will be lower still.

The experience of South West Pound, set up by Places for People to provide community banking and affordable credit to social tenants in Devon provides another useful indicator. This was a partnership initiative between seven housing associations and five credit unions. The service was reported to be offering between 60 and 70 affordable loans a month, or between 720–840 loans per annum by 2013. In the 2014/15 annual report, some 879 loans were provided to Places for People tenants, equating to 2.1% of the 42,000 social rented units or 0.6% of the association's total homes owned or managed. This scheme also offered up to three hours of information and advice, with housing association staff trained to offer money and debt advice, with a claimed knock on effect of reducing social housing rent arrears.
On the basis of the comparables and the experience of these affordable credit initiatives elsewhere, the research team would take the view that a realistic upper limit of scale for an affordable credit operation in Northern Ireland would be loan volumes equivalent to lending to circa 2% of social housing tenants and that the most likely outcome of either a branch based or online model would be significantly lower volumes.

It is clear that for a referral based model loan volumes will rest on the degree of engagement by partners, whether social housing landlords, credit unions or community organisations, and the quality and scale of the referral streams that arise from that engagement. A sense check for assumptions on participation rates by credit unions could benefit from consideration of the experience of the Irish Loan Guarantee Fund in Ireland. The Irish Loan Guarantee Fund operates a guaranteed loan scheme which is based on referrals from the Money Advice Budgeting Service (MABS) to credit unions. The latest available data on take up is for 2012. In this year there were 181 clients who had Loan Guarantee Scheme funded loans from 63 credit unions. In other words for each participating credit union, there is an average of 3 MABs clients per participating credit union. Just 15% of Irish credit unions in the Irish League of Credit Unions (excluding the 95 in Northern Ireland) are participating in the MABs referral scheme, despite the presence of the guaranteed loan fund. Put another way, of the 26 MABS loan offices located in each of the counties of Ireland, this would suggest an average of just 7 loans per annum for each MABs office in Ireland in this year. Of the nearly 500,000 euros available under the scheme, just 175,000 was being utilised in that year, just 35% of the fund.

On this basis, it could be argued that some of the more ambitious iterations of the referral model may be unrealistic without significant leadership commitment from social landlords or the credit unions, combined with high profile and pro-active outreach to grow awareness and stimulate a strong referral streams. In the case of the credit unions in the MABS, it would seem that even guaranteed loan funding providing 100% protection against the risk of bad loans would seem insufficient of a motivator to have generated significant loan volumes. Research from the Joseph Rowntree Foundation[25] has found that take up of affordable credit schemes among social housing tenants has often been lower and slower than anticipated and that it proved difficult to attract tenants using high cost credit away from these sources, even where these were significantly more expensive. This was particularly the case where affordable credit schemes did not offer rapid loan delivery or easily accessible processes.

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[25] *Housing Association Innovation in Delivering Affordable Credit, July 2016*

In the Northern Ireland context, it may moreover be challenging to achieve leadership commitment to an affordable credit proposition with an interest rate of 100% APR. Social landlords, the Housing Executive and credit unions may take the view that espousing such a concept could expose them to significant political and reputational risk, no matter what the cost savings to consumers.

The modelled outputs for the local community based model suggest that a community based model would best be regarded less as a potentially viable alternative lending proposition of any scale and more as a financial inclusion and financial education initiative, with some capacity for offering emergency finance for those in dire need.

Evidence to support this approach comes from the experience of the Credible Credit initiative in two areas of Northern Ireland, Derry and Ballymena, which aimed to make low cost loans more accessible to those in poverty otherwise dependent on high cost credit. In Derry, the partnership encompassed a local credit union and two organisations which acted as referrers to the credit unions, i.e., Greater Shantallow Area Partnership (GSAP) and Apex Housing. GSAP is an umbrella group which provides "core community support services to community, voluntary and private sector organisations" in the Derry area. Apex is a housing association based in Derry, but with units across Northern Ireland. The 2014-15 Annual Report states that Apex has 3,619 general needs units, of which 2,178 are in Derry City and county. Over the pilot period, however, a total of 52 people took out loans under the scheme in Derry. No loans were approved in Ballymena. The initiative was successful in running a number of financial education and capability building events and in making referrals to debt advice. No loans were approved in Ballymena. The initiative was more successful in running a number of financial education and capability building events and in making referrals to debt advice.

6.5.2 Key take outs on potential scale of an affordable credit model for Northern Ireland

Key take outs

- A realistic cap for an ambitious affordable credit model targeting social tenants in Northern Ireland is likely to be in the region of 2% – 2.5% penetration of social tenants.
- The most likely outcomes, on the basis of experience of affordable credit initiatives elsewhere, is for lower penetration than this however, whether branch based or online.
- Individuals community-based models with some facility for offering emergency loans are likely to see very low take up

7.0 Conclusions and recommendations for an affordable credit model for Northern Ireland

7.1 Conclusions

- There are no easy answers in arriving at an affordable credit model for Northern Ireland. It is important however to be realistic about what can be achieved.
- It is clear that an affordable credit model would need to charge much higher APRs than would be politically acceptable if it were be sustainable in even the medium term. Any model that operates a pricing policy that would be politically acceptable (deemed by the advisory board to be a maximum of 100% APR) will require significant funding and on an ongoing basis and would have little realistic prospect of achieving sustainability, even where supported by patient and low or no cost capital.
- It is also important to recognise that no affordable credit models elsewhere have achieved the scale to be viable as an alternative to high cost credit for most borrowers using high cost models, even where they have been the subject of very significant investment and capacity building by Government.
- Nonetheless, affordable credit models have offered worthwhile cost savings in comparison to high cost credit and have also acted as a lever for financial inclusion for significant numbers of borrowers, albeit that numbers have been small relative to the private sector. The lack of scale relative to the private sector is not necessarily an argument for doing nothing. Rather it is important to be realistic about the limits of what an affordable credit model could achieve in acting as an alternative to high cost lending.
- It would seem likely that any affordable credit model targeting existing home credit users would need to recognise that it would probably attract higher risk borrowers than those using private sector lenders overall. This will have implications for bad debt and collections management, in turn impacting on cash flow and funding requirements and the potential for sustainability.
- Clearly the more expensive a model is to deliver the greater will be the funding requirements, both at start up and ongoing. A full service face to face branch based service with a wide focus on financial inclusion and financial capability building and targeting more disadvantaged individuals will be cost and resource intensive and thus will require concomitantly greater funding. Moreover relatively few of the deeply financially excluded and most vulnerable would-be borrowers, envisaged by some stakeholders as the target market for an affordable credit service in Northern Ireland, will be viable as borrowers on a "responsible lending" basis. For this type of individuals the benefits of the model may be greater financial inclusion and increased resilience rather than cheaper credit. Branch based models will of course also not necessarily have national reach and, in a Northern Ireland context, may require a degree of duplication in that branches may need to be sited to serve specific communities.
- An online service will be lower cost and have greater potential for national reach. It will however depend on automated underwriting and credit scoring and electronic collections and will need to serve a less disadvantage target market as a result. In so doing however it will have the potential to offer cheaper credit to those currently using high cost private sector providers. If a partnership can be forged between a new social lender operating online and relying for applications on a referral stream from social landlords and credit unions this may prove a route to lower cost credit particularly for social

tenants who are currently under-served by the credit unions. Such a model will be cheaper to deliver and thus require funding on a smaller scale than a face to face model. The advisory board rejected the idea of a consumer-facing online service, as being expensive to develop initially and complex to deliver, in favour of a referral-based service, which was felt better placed to target social tenants and those in need of affordable credit. This model will however be critically dependent on the commitment to the scheme of the social housing sector and credit unions, the effectiveness of partnership working and the quality of referrals.

- The advisory board originally took the view that an Affordable Credit model for Northern Ireland would need to be sustainable and that there was, at the time of the project inception, no appetite within Government for substantial funding of such an initiative. It may be that the policy context has since evolved and that the challenges originally envisaged in raising funding may now be more tractable.
- The various affordable credit options that have now been developed for consideration by the board require funding at differing levels and will deliver differing levels of financial inclusion and affordable credit benefits. In deciding how to take forward an Affordable Credit model for Northern Ireland, the advisory board has had to balance funding considerations, a range of financial inclusion considerations and sometimes competing agendas within the stakeholder community. The recommendations made by the advisory board represent their view of the optimal way forward for an Affordable Credit model for Northern Ireland, given the complexities and challenges inherent in development and the constraints of the reality of funding and sustainability issues.

7.2 Recommendations for an affordable credit model for Northern Ireland

Against this background, the advisory board took the view that an appropriate Affordable Credit model for Northern Ireland would need to offer credit at an APR of 100%, recognising that while this represented a high APR that would be difficult for some to countenance in a not for profit model, that this would nonetheless represent significant savings for the target market of existing high cost credit users who would otherwise pay a much higher cost for their much-needed credit.

The board also felt that, in a Northern Ireland context, an Affordable Credit model would need to incorporate elements of both the face to face branch model and the online service. It was felt that a significant element of the target market would require face to face delivery, particularly if borrowers – and unsuccessful applicants for loans – were to benefit from the financial inclusion and financial capability-building element of the proposition. It was felt however that the more realistic option would be to take an evolutionary, incremental stance and aim for the three branch model along the lines of MoneyLine or Scotcash in the first instance.

The limitations of the branch-based model were also recognised by the advisory board, and in particular the inability of a branch-based model to deliver national reach. For this reason, the board felt that the branch based model should be complemented by a national online service, able to reach both urban and rural borrowers and both communities.

It was agreed that an online service would need to be referral-based. It was felt however that it was not feasible to look to Credit Unions as principal agents for a referral scheme, on the basis that the credit union representatives on the board felt that there were a number of key barriers to credit union participation. These included a likely reluctance on the part of credit unions to make referrals to a loan service at 100% APR, a lack of shared infrastructure and a relatively low level of declines for loan applications which would therefore form an insufficiently substantial referral stream for the new service. It was felt that referrals would need rather to rely on the social housing sector, both housing associations and the Housing Executive, among whose tenants there is relatively little credit union penetration and a high incidence of high cost credit use compared to the wider population. The board recognised that the population served by an online model would be less disadvantaged than that served by the branch-based model.

The advisory board acknowledged that there are clearly some disadvantaged individuals who may seek credit or need funding to address cash flow crises or spread the cost of essential major purchases whom it would not be possible for an ethical affordable credit model to serve on a "responsible lending" basis. It was felt, however, that some provision needed to be made for such would-be borrowers, albeit that this should be on a grant or guaranteed loan basis. It was that such provision could be regarded as a potential optional add-on to the model, with some form of small-scale, community and outreach based provision potentially sponsored and delivered within deprived communities, , along the lines of the community model earlier discussed.

Taken together therefore the key dimensions of the recommended affordable credit model for Northern Ireland are as laid out in Table G following:

Table G. Summary key dimensions of the recommended affordable credit model for NI - cost of credit, loan volumes and consumer savings

Cost of credit	
APR	100%
Per £100 lent	£33
Total repaid on £500 loan	£665
Default rate	
Branch based	12%
National online service	15%
Loan volumes p.a.	
Branch	5400
Online	1732
Total branch and online	7132
Consumer savings	
Average per £100 lent	£31
Per average £500 loan	£155
Cumulative consumer savings £m over 6 years branch based and national online service	£5.47

Overall it is anticipated that the new Affordable Credit Model for Northern Ireland would, once established, make 7130 loans per year, This represents savings to consumers of an average of £31 per hundred and an average of £155 per loan. Cumulative savings to consumers over the six year period would be £5.47m.

The funding requirement for the model would be £5.15m representing a subsidy per £100 lent of a little over £25 for the branch model and a little over £30 for the online service, The outreach and community based grant funding scheme for those in need of emergency funds but without the means to repay a loan would require additional funding of £0.36m over the period.

Table H. Summary funding and subsidy requirements for the recommended affordable credit model for NI

Subsidy per £100 lent based funding and operating costs	
Branch based	£25.18
National online service	£30.11
Cumulative funding required branch based and national online service £m	£5.15
Additional funding for grant-based community service £m	£0.36

NICVA will now take the recommended model forward and engage with stakeholders, policy makers and potential funders to make a new Affordable Credit model a reality for Northern Ireland.