FINANCIAL INCLUSION TASKFORCE

Towards a step-change in 3rd sector lending coverage and capacity

Report of the third sector credit Working Group of the Financial Inclusion Taskforce

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A successful partnership

- Government and the banks are working well together to promote inclusion in banking
  - 60% of the way towards the shared goal
  - 800,000 people brought into banking, double that if you measure transactional accounts
  - more than half of 600 new ATMs for key low-income areas now installed and dispensing cash
- Affordable credit is the strategic next step

An opportunity: to extend the partnership and realise mutual benefit by widening access to affordable financial services.

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Why affordable credit?

- People on low incomes typically require small-value loans repayable over short periods (avg. £400 or less)
- These can be hard to find and expensive, or (worse) offered by illegal loansharks
- **3rd sector lenders (credit unions & CDFIs)** offer:
  - an affordable, legal option and a first step in escaping a cycle of debt and poverty
  - a pathway to engagement with financial services

For Govt: a key solution to a policy problem.
For banks: a possible opportunity to develop a new route to market – more than just a CSR win

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Why banks?

- Treasury Select Committee, 2006: bank CEOs defined their role in the market for affordable credit as supporting 3rd sector growth *
- Bank partnerships with 3rd sector lenders can work for the benefit of all: e.g. PEARLS / CUCA / Scotcash
- Govt now defining its new inclusion strategy: chance to move from ad-hoc initiatives to a strategic partnership
- Working Group's role is to define this partnership

Banks are well placed to help develop a sustainable 3rd sector now, and this may lead to wider commercial opportunities in the future

* See annex B for quotations from TSC record

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What is Government doing?

- Govt has invested over £40 million in third sector lenders through its “Growth Fund”
- Since July 2006, Growth Fund has supported 46,500 loans totalling £20.4 million (reaching 90% of target)
- Growth Fund is well-focused: over 80% of loans to low income customers in areas of high financial exclusion
- Growth Fund is effective: over two-thirds of lenders are hitting targets for on-lending and managing delinquency

But Growth Fund only goes so far – its target is c.75,000 loans p.a. (on track to achieve this)

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Where are the gaps?

- Mapping conducted by the Working Group shows there are many underserved local authority (LA) areas with high demand and no supply of 3rd sector credit:
  - 25 "red alert" and 56 "amber" LA areas *
- Working Group has conservatively estimated nationwide demand for affordable credit from financially excluded clients at £1.2 billion p.a. (3,000,000 loans) **
  - vs current Growth Fund capacity target of £30m lending p.a. (75,000 loans)

There are massive gaps, relative to demand, in both coverage and capacity of 3rd sector lenders

* See annex C for definitions and annex F for map ** see annex D for detail of demand estimate

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What is the vision?

- WG has an aspirational **long-term sustainable vision**
- A sustainable 3rd sector, able to serve the market for affordable credit, including financially excluded clients, through commercially-secured deposits and investments
  - Sustainable coverage in at least all c.200 LA areas with above-average demand for affordable credit
    - To be sustainable, lenders require loan book of at least £2 million (5,000 loans p.a.)
  - Therefore, minimum capacity required is £400 million lent to 1,000,000 customers p.a.

This aspiration may take 10 years or more to achieve – needs a strategic routemap

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How can the vision be reached?

- Realistic, achievable goals for the medium term
- WG has defined the next steps needed for **accelerated momentum in 2008-11:**
  - Extending coverage to 25 "red alert" LA areas
  - Increasing capacity to double Growth Fund levels
  - £60 million p.a. lent to 150,000 financially excluded clients p.a. by 2011
  - Widening opportunities for commercial financing, to support lending to the financially excluded by the most successful credit unions and CDFIs

Laying the foundation for the long-term vision

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This is not just about money…

- Many of the inputs required for accelerated momentum are non-financial. For example:
  - Govt can ensure regulation is enabling, and build demand for 3rd sector products;
  - Banks can strengthen governance and boards, or help develop products and services;
  - 3rd sector lenders can commit to sector benchmarks, long-term business plans, identifying training needs, supporting professional development;
  - Local authorities and social landlords can support new provision in specific areas

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… and there are many ways in which banks can take action

- Action to develop provision in new areas could include:
  - secondment or placement of staff with relevant experience and skills;
  - investment in IT systems and equipment;
  - back-office premises;
  - increasing lending and risk-assessment capabilities;
  - provision of access to banking platforms; or
  - direct financial support to meet revenue costs

WG estimates the average funding requirement of a new lender during first 3 years at c.£700k *
Plus £300-400k in lending capital

* See annex E for breakdown

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A commitment to action is needed

- WG expects Government to commit (£30m plus) to:
  - Supporting and strengthening the Growth Fund
  - Capitalising the sector while commercial financing to support lending to the excluded remains uneconomic
- WG urges banks to partner with Government in committing to:
  - Support the expansion of lending to 25 new areas through financial and in-kind support, focusing action in priority areas

Crucially: Govt, banks and 3rd sector must commit to a shared vision of growth and progress

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The shared commitment

- A 3rd sector widening its commercial financing potential to cover its lending to the financially excluded
- New provision in 25 areas, lending up to £10 million each year to 25,000 people who, today, have no access to affordable credit
- An expanded Growth Fund, providing up to £50 million of affordable credit to a further125,000 people p.a.
- A total of £60 million of affordable third-sector credit provided to 150,000 people p.a. by 2011

Govt, the banks, the 3rd sector, local authorities, and social landlords working in partnership

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What happens next?

- Commitment to action from Govt and banks announced in financial inclusion action plan (Dec 07)
- Work on the ground – led by Govt – to assess local conditions, engage key partners, and identify targets in “red alert” and “amber” areas (Jan 08 onwards)
- Govt provides lending capital through the Growth Fund (March 08 onwards);
- Banks deliver support mechanisms to establish new provision in priority areas (March 08 onwards);
- Taskforce monitors and report on progress (ongoing)

But no single blueprint – a “mixed economy” approach, tailored to opportunities in each area

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Annex: supporting material

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A: Working Group members

- Claire Whyley (National Consumer Council, Chair of the Working Group)
- Benny Higgins (Former CEO Retail, HBOS)
- Gary Hoffman (Group Vice-Chairman, Barclays)
- Elaine Kempson (University of Bristol)
- Mark Lyonette (CEO, ABCUL)
- Bernie Morgan (CEO, CDFA)
- Brian Pomeroy (Chair, Financial Inclusion Taskforce)
- Allan Watt (Head of Group Brand Communications, RBS)

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B: TSC record

- "*It is not commercially viable for us to offer high volumes of very low value loans to customers… we think credit unions are well placed to do that and we are helping to support them"*

  (Gary Hoffman, Group Vice-Chairman, Barclays)
- *"provision of the short-term, very low value micro-credit typically required by these customers is simply not deliverable [by banks] in a cost effective manner… [credit unions and CDFIs] have the potential to make a significant impact in the market for small sum credit"*

  (HSBC, written memorandum)
- *"Our involvement now is reasonably fragmented across the industry… were an opportunity to present itself to resolve that I would be happy to do it"*

  (Sir Fred Goodwin, CEO, RBS)

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C: Definitions of priority areas

- Of c.450 Local Authority areas in England, Wales and Scotland, the Working Group has identified 25 "red alert" areas in the highest need of new affordable credit provision, and 56 "amber" areas, which are next in the priority order.
- <u>"Red Alert"</u> areas are defined as those with 40% or more of wards in the local authority in the most mismatched 1000 wards nationwide – these LAs have substantial gaps between demand for third sector credit and current supply, and represent the areas in most immediate need of new provision.
- <u>"Amber"</u> areas are defined as those with between 20% and 40% of wards in the local authority in the most mismatched 1000 wards – significant parts of these LA areas lack coverage of third sector credit where it is most needed. New provision is likely to be required in many of these areas.

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D: Demand for affordable credit

Competition Commission inquiry showed that:

- Home-collected credit sector served 2.3 million customers in 2004, lending £1.5 billion
- Over 600,000 customers borrow from pawnbrokers each year
- Many thousands more use rental purchase shops (e.g. “Brighthouse”) and sale-and-buyback services

Academic research shows that:

- More than 20% of low-income households borrow through agency mail order (*Affordable credit: the way forward,* Sharon Collard, Elaine Kempson, 2005)
- 165,000 people a year borrow from illegal loansharks (*Illegal lending in the UK*, DTI, 2006)

Working Group conservatively estimates the market for affordable credit as £1.2 billion lent to 3,000,000 customers

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E: Funding requirements for a new lender – worked example

Item	Total (£k), yrs 1-3
Start up (fit out, equipment, recruitment, legal, consutants etc)	200
Staff	450
Premises	75
Insurance (including for loan and saving protection)	30
Marketing materials, printing, supplies etc	25
Telephone and postage	15
Training	15
Regulatory and trade fees	8
Computer software	7
Professional services	5
Bad debt (provisions and write off)	75
Dividends and reserve transfers	50
Total expenses	**955**
Interest received on loans and investments	250
Member fees	15
Total income	**265**
Net funding requirement (total expenses - total income)	**690**

Funding requirement for new lender in Yrs 1-3 = c.£700k *

* Model projects funding requirement in yrs 4-6 = £250k; zero funding requirement thereafter

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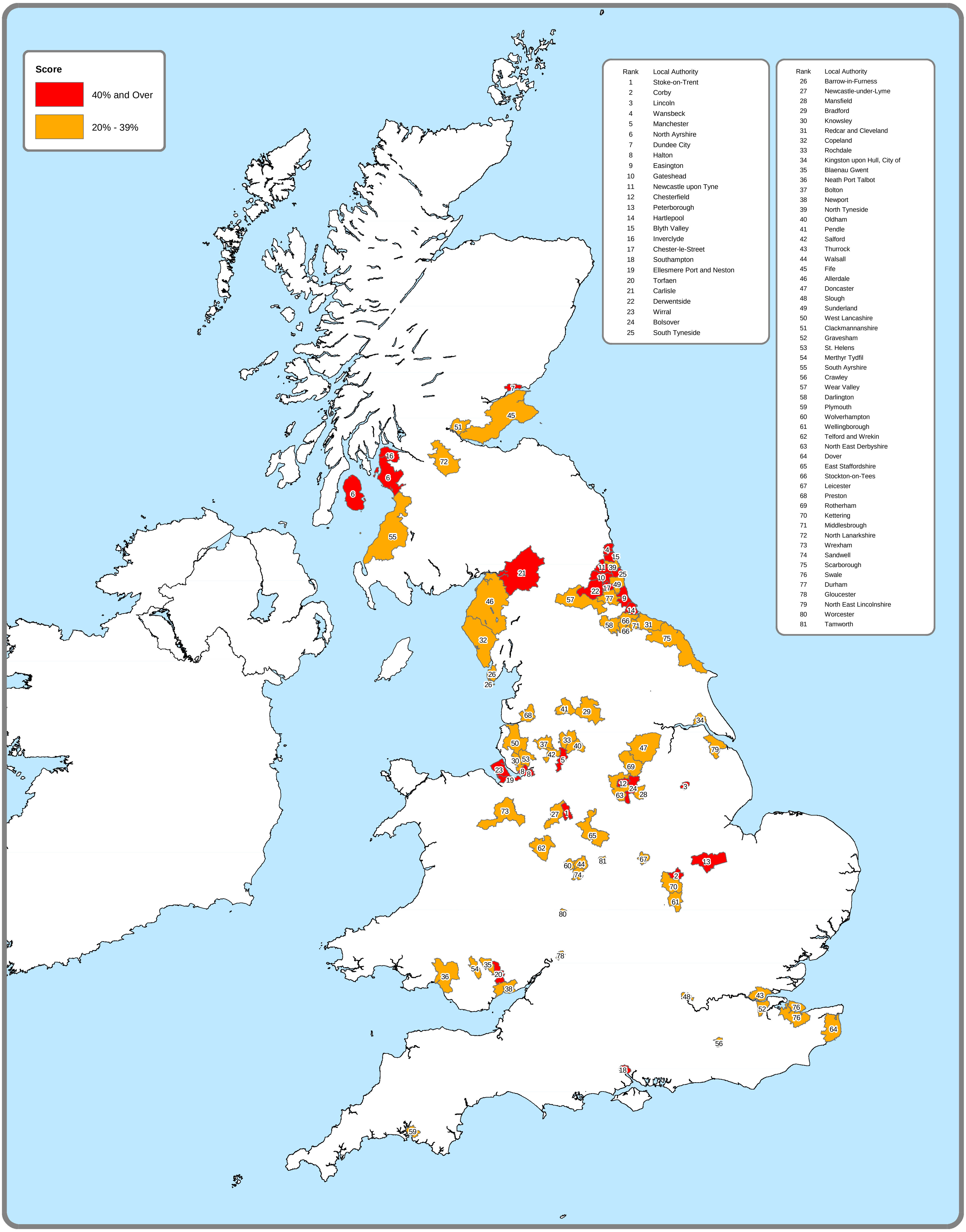
Annex F: map of high priority Local Authority areas

- See over page for map of "red alert" and "amber" areas

Third Sector Affordable Credit

Red Alert Mismatch Map - Percentage of Wards Within The Top 1000 for Mismatch



Rank	Local Authority
1	Stoke-on-Trent
2	Corby
3	Lincoln
4	Wansbeck
5	Manchester
6	North Ayrshire
7	Dundee City
8	Halton
9	Easington
10	Gateshead
11	Newcastle upon Tyne
12	Chesterfield
13	Peterborough
14	Hartlepool
15	Blyth Valley
16	Inverclyde
17	Chester-le-Street
18	Southampton
19	Ellesmere Port and Neston
20	Torfaen
21	Carlisle
22	Derwentside
23	Wirral
24	Bolsover
25	South Tyneside

Rank	Local Authority
26	Barrow-in-Furness
27	Newcastle-under-Lyme
28	Mansfield
29	Bradford
30	Knowsley
31	Redcar and Cleveland
32	Copeland
33	Rochdale
34	Kingston upon Hull, City of
35	Blaenau Gwent
36	Neath Port Talbot
37	Bolton
38	Newport
39	North Tyneside
40	Oldham
41	Pendle
42	Salford
43	Thurrock
44	Walsall
45	Fife
46	Allerdale
47	Doncaster
48	Slough
49	Sunderland
50	West Lancashire
51	Clackmannanshire
52	Gravesham
53	St. Helens
54	Merthyr Tydfil
55	South Ayrshire
56	Crawley
57	Wear Valley
58	Darlington
59	Plymouth
60	Wolverhampton
61	Wellingborough
62	Telford and Wrekin
63	North East Derbyshire
64	Dover
65	East Staffordshire
66	Stockton-on-Tees
67	Leicester
68	Preston
69	Rotherham
70	Kettering
71	Middlesbrough
72	North Lanarkshire
73	Wrexham
74	Sandwell
75	Scarborough
76	Swale
77	Durham
78	Gloucester
79	North East Lincolnshire
80	Worcester
81	Tamworth