Financial Inclusion Commission Call for Evidence – CDFA Response

11th December 2014

About the CDFA

The CDFA is the trade body for community development finance institutions (CDFIs). CDFIs provide loans and technical assistance to individuals and businesses that cannot access finance from commercial banks. The CDFA's mission is to support the development of a thriving and sustainable community development finance sector that provides finance for underserved communities and, as a result, contributes to the economic growth and prosperity of these communities.

Response

Following Ben Hughes', CEO of the CDFA, oral evidence session before the Financial Inclusion Commission on Tuesday 25th November, 2014, the CDFA submits the following evidence for the Commission's review.

The CDFA welcomes the launch of the Financial Inclusion Commission and its core objectives to feature financial inclusion prominently as a public policy priority and identify innovative solutions-based approaches to tackling financial exclusion in the UK.

The scale and extent of financial exclusion is broad, as noted by the Commission[1] and indicates that the demand for affordable finance cannot be met by the existing supply of providers such CDFIs, credit unions, and peer to peer lenders specialising in this market. The following four solutions-based themes, which Ben Hughes raised at the oral evidence session, would catalyse greater scale and geographic reach across all providers, thus enabling individuals across the financial inclusion scale to access finance appropriate to their needs.

1. Government leadership

As has been recognised by the Commission, financial inclusion permeates a community at different levels – individual, household, and firm – and has detrimental effects on all aspects of society. The dissolution of the Financial Inclusion Task Force in 2011 coincided with a period of economic hardship and recession in the UK, and as a result there was not a centralised body in place to monitor the trends in access to affordable finance and strategically support providers of affordable finance.

As a result of this lapse, there is a strong case for government leadership and promotion of financial inclusion. Therefore, we recommend that **a national strategy on financial**

[1] http://www.financialinclusioncommission.org.uk/facts

inclusion is developed and HM Treasury is the leading government body that oversees this strategy. There is also a role for the Bank of England and the Financial Conduct Authority (FCA) where regulation is needed to endorse behaviours that promote financial inclusion.

Since the Financial Inclusion Task Force's dissolution, an important development has been the disclosure of bank lending data by postcode[2]. The quarterly release of this data by the seven largest commercial banks in the UK is a first step in identifying underserved markets, but it is a practice that all credit providers should adopt. CDFIs, credit unions, peer to peer lenders, and high cost short term lenders should all disclose the geographic and demographic patterns of their lending. This level of transparency in the UK's consumer credit market will drive greater efficiency by physically identifying affordable credit deserts, and enable a broader range of individuals to access finance through increased market coverage as a result. The government has a role here in including data disclosure as part of the national strategy and monitoring of financial inclusion.

For more information on this data and how it can potentially be used, please see:

- The CDFA's recent mapping of bank lending, CDFI lending, and Indices of Multiple Deprivation: http://www.cdfa.org.uk/lending-maps/
- The Community Investment Coalition's independent analysis of the bank lending data: http://www.communityinvestment.org.uk/wp-content/uploads/2014/11/FINAL_Full-Report.pdf

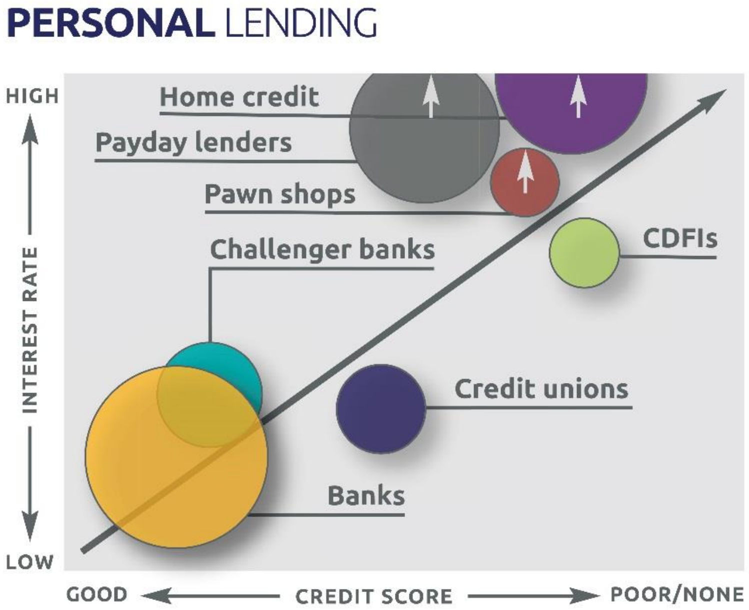
2. Awareness and understanding of alternatives

As was recognised by all community finance providers at the oral evidence session, public awareness of alternative finance providers is low. This is evidenced by the low rate of credit union membership compared to other countries[3]. This lack of awareness and understanding also exists within government and mainstream financial services.

Figure 1 demonstrates the relative size and positioning of credit providers in the consumer credit market. Using credit score as a proxy for risk and interest rate as a proxy for fairness, it is clear that for consumers who cannot access bank finance (which is at least 2 million adults[4]) there are few affordable options.

[2] https://www.bba.org.uk/news/statistics/postcode-lending/
[3] https://www.churchofengland.org/our-views/home-and-community-affairs/home-affairs-policy/work-and-the-economy/creditunions/creditunionsfacts-and-statistics.aspx
[4] http://www.financialinclusioncommission.org.uk/facts

Figure 1: Size and position of consumer credit providers[5].



The alternatives that exist for consumers who cannot access bank finance are local options such as CDFIs, credit unions, and high cost short term lenders, such as payday lenders, home credit, and pawn shops. In reality, the credit union interest rate cap and common bond can prevent them from providing gap-filling finance to the most vulnerable customers due to their higher level of risk. High cost lenders offer a unique product, but often without reference to affordability and the customer's ability to repay, therefore trapping individuals in a cycle of over-indebtedness. CDFIs therefore are often the only providers of affordable finance to vulnerable and low-income populations.

Understanding the market segments is a first step towards promoting and supporting the ethical community finance providers that serve them. Given the Commission's enquiry and evidence collection, we believe that it is uniquely positioned **to champion an awareness raising campaign of providers of affordable finance**.

Greater awareness and promotion by the independent Commission, supported by the government, could encourage the development of local delivery partnerships between providers therefore enabling a broader population of vulnerable consumers to be reached.

3. Capitalisation

In order to fill in the access to finance continuum illustrated in Figure 1 above, providers such as CDFIs, credit unions, and emerging peer to peer lenders must be scaled. For CDFIs, often the only providers positioned to serve vulnerable and financially excluded customers fairly, the ability to scale and reach more customers is constrained by the supply of capital to on-lend.

As non-deposit taking financial institutions, CDFIs must raise their capital to on-lend, in the form of grants, loans, and equity. Given the high levels of exclusion and problem debt facing the UK, the undersupply of capital into CDFIs is a barrier to helping individuals and households stabilise their financial situations and build wealth.

An existing proposal for CDFI capitalisation that the Commission could look into supporting is:

[5] Note: size is illustrative based on loans outstanding

- The Community Finance Fund: a proposal led by Citizens UK and supported by the Church of England, to ring-fence a portion of the fines levied on banks for mistreating customers for a fund for community finance providers, both to on-lend as well as use to build operational sustainability. This would ensure that the proceeds of the misdeeds of banks and payday lenders are used to solve the problem of an uncompetitive and often exploitative financial services sector which is failing to meet the needs of the whole of the UK population.

4. Infrastructure

There are a number of existing providers of affordable finance to vulnerable and excluded customers, such as CDFIs and credit unions, and other satellite service providers who have reach into networks of financially excluded consumers such as Housing Associations, local councils, and the NHS.

There are tremendous opportunities for closer collaboration between CDFIs and other direct community finance and service providers that would help vulnerable consumers move up the credit ladder. The CDFI model enables them to specialise in serving financially vulnerable and excluded consumers. CDFIs build financial capability and confidence in addition to providing finance, and therefore move the consumer to a position where they are able to open a credit union savings account or bank account. **Closer and formalised links between CDFIs, credit unions, and other finance and service providers ensures a continuum in access to finance, and creates a strong alternative ecosystem for consumers who may otherwise fall into borrowing from high cost providers and incurring problem debt.**

Currently there are some partnerships between CDFIs and community support service providers[6], CDFIs and housing associations[7], as well as CDFIs and credit unions[8], but such partnerships, whilst very effective models of local delivery, are not widespread because the infrastructure is not in place to support them. Factors such as project management, marketing, and reporting must all be developed in order for these partnerships to be effective and leverage each partner's core capabilities.

There is an opportunity for the Commission to promote formalised partnerships between existing providers as an effective mechanisms of achieving economies of scale and reaching a wider range of financially excluded consumers, and encourage investment into the infrastructure to develop these models and make them sustainable, thus filling in the continuum of access to affordable finance for the most vulnerable and excluded consumers.

[6] http://www.bristolpost.co.uk/Finance-project-aims-help-businesses-soar/story-21090767-detail/story.html
[7] http://www.insidehousing.co.uk/tenant-start-up-business-fund-to-launch-in-april/7002325.article
[8] https://www.scotcash.net/news/2014/08/scotwest-and-drumchapel-cu/