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UK Government policy, credit unions and payday loans

Abstract: This article outlines how successive UK governments' policies first created a three tier system of credit unions and then posited credit unions as alternatives to payday lenders. The three tier framework is used for an analysis of loans offered on credit union websites. The findings indicate that while the first two tiers of credit unions now offer loans to people who have not saved with them previously, they do so in ways consistent with credit unions' original character, rather than in ways that replicate commercial payday loans.

Keywords: Credit Unions; Financial Co-operatives; Payday loans; Maximum interest rate; Not-for-profit organizations.

Introduction

Cooperatives as associations of people who seek social and economic benefits through mutuality, shared ownership and democratic control have been recognised as a means through which public administration objectives may be realised (Fenwick and McMillan, 2012, p 374; Pathak and Kumar, 2008). A worldwide form of financial cooperative are credit unions that number 57,000, serving 208 million people in 103 countries across 6 continents and enjoying 8.06% penetration of the financially active population (WOCCU 2014, p 1). Credit unions encourage their members to save regularly, promoting thrift and self-help, to allow those members to borrow money subsequently at lower rates than normally charged by some other financial institutions, recycling funds within a population that shares a common bond and promoting the financial health of that community (Edmonds, 2014; 2015, p 4; Ryder, 2002, p 423; Stango, 2012 p 158; Tischer, Packman, Montgomerie and Warren, 2015, p 6; Wright, 2013, p 5). Their promotion of self-help and thrift makes credit unions compatible with successive UK governments' policies in the current millennium, namely the New Labour governments of 1997-2010 that embodied a co-operative strand in their ideology and the 2010-15 Conservative-led coalition that sought greater reliance on the third sector as a means of managing austerity (Fenwick & McMillan, 2012). Those governments promoted credit unions as an effective way of realising social inclusion by provision of financial services that would break vulnerable people's dependency on exploitative payday lenders whose high interest rates precipitated borrowers falling into ever more serious spirals of debt.

As providers of financial services, credit unions are often presented as located between high street retail banks and commercial payday lenders (Jones, 2008; Mushinski, 1999; Ralston & Wright 2003; Stango, 2012). While retail banks charge low-risk consumers reasonable rates of interest for loans, commercial payday lenders levy exorbitant rates of interest to high-risk consumers excluded by banks. Credit unions that have interest rate levels regulated by government agencies, aim to cater for all members of a community, but promote thrift by requiring their members to save before permitting them to take out a loan (Lewis, 1982; Stango, 2012). In the UK, credit unions exist alongside additional financial institutions such as the Community Development Financial Initiatives (CDFIs). CDFIs are not subject to the same restrictions as credit unions and so can charge higher interest rates. This difference locates their loans between those offered by credit unions and those provided by payday lenders (Tischer *et al*, 2015, pp 25-26).

There is a danger that government policies that encourage credit unions to offer alternative forms of loans that do not require members to save, to compete with payday lenders will compromise the principles of promoting thrift and providing reasonably priced credit to the community (Brown *et al*, 2003; Ralston & Wright, 2003; Tischer *et al*, 2015, pp 11-15) while creating an imbalance in credit unions' membership and loan book that may be detrimental (Edmonds, 2014, pp 30-31). Given that credit unions in places such as the UK are less developed than those in other countries (McAlevey *et al*, 2010, p 425; McKillop & Wilson 2011, p 85; Sibbald *et al* 2002, p 403), such interventions could skew credit unions' development in ways that could erode "the financial health of [many UK] credit unions" (Tishcer *et al*, 2015, p 13).

This article locates successive UK governments' policies around credit unions within a framework that presents credit unions as nascent, in transition or mature (Sibbald *et al*, 2002) and assertions about the existence of a two tier system of credit unions in the UK (Tischer *et al*, 2015) to articulate an emergent three tier system. This framework provides a backdrop for considering: (i) whether credit unions in England have responded to the most recent rise in the ceiling of interest rates for loans by offering payday-type loans in ways that threaten their financial health; and (ii) if the accompanying terms and conditions of such loans are compromising the original objectives of credit unions. A comprehensive study of loans offered on English credit unions' websites has been conducted to address these questions. The remainder of the discussion is organized as follows. First, recent governments' policies affecting both the development and tiers of credit unions and their provision of payday-type loans will be outlined. Second, hitherto literature that discusses the viability of credit unions' payday-type loans will be reviewed to assess the capability of credit unions to provide payday-type loans. The methods of data collection and analysis for the research reported below will then be documented before findings from the study are discussed. Finally, the article concludes that while the top two tiers of credit unions now offer loans to people without a prior savings history which is one of the qualities of a payday loan, the other qualities of the loans offered are more consistent with credit unions' original objectives. However, this legal change appears to have accentuated the emergence of separate tiers of credit unions.

The emergence of credit unions as counters to financial exclusion

Credit unions across the world have been classified as nascent, in transition or mature (McAlevey *et al*, 2010, p 425; McKillop & Wilson, 2011 p 85; Sibbald *et al*, 2002, p 403). Where a country's credit unions appear in this taxonomy depends on: (i) Whether they have developed strong forms of leadership within the credit union movement; (ii) The strength and capability of credit union trade associations to co-ordinate credit unions' interests and activities effectively; (iii) The levels of professionalization in the form of specialist, paid staff employed at individual credit unions; (iv) The amount of legislative support that exists for credit unions to change and innovate around the provision of services; and (v) The degree of technological advancement that has been achieved by credit unions in their provision of services (Sibbald *et al*, 2002, p 404). The ensuing discussion of the development of credit unions in the UK will allow their placement in this taxonomy and permit an assessment of arguments about the emergence of a tiered system (Tischer *et al*, 2015).

Credit unions in the UK have gone through three broad periods of development. The first lasted from 1979 until 1997. Although credit unions have been registered in Britain since 1964 (Ryder, 2002, p 424), they did not have a separate legal identity and existed either as limited companies or as co-operatives. Credit union trade associations lobbied successive governments for a specific legal framework "because if people are going to be asked to lend their money to a financial institution they must have confidence that the institution is based on sound principles" (Lewis, 1982, p 55). The Credit Union Act of 1979 gave credit unions that legal identity within a rigid framework that limited a credit union's: number of members; common bond of eligibility for membership to a specific geographical or employment or associational or occupational interest; membership to individuals, excluding organizations; types of financial transactions; receipt of sums from – and reliance on – any one individual; and interest charges on loans to 1%. While the legislation was intended to protect their members' investment (Ryder, 2002, pp 424-5), it restricted each credit union's growth (Jones, 2008, p 2151; Lewis, 1982, pp 57-8). In the UK, the period between 1979 and 1997 was one of industrial decline and neo-liberal government when changes to benefit entitlements caused poverty for many (Hudson *et al*, 1994). Failure by high street banks to provide financial services to low income households left many people reliant on sub-prime providers who charged exorbitant rates of interest. Community activists, charities concerned with poverty, public sector employees and regional and municipal councils responded by helping to develop credit unions, which grew in number, to counter social and financial exclusion (Homewood, 1989; Hudson *et al*, 1994; Jones, 2008; Thomas & Balluch, 1994, pp 170-2).

The next period in the development of credit unions came during the time of the 1997-2010 Labour governments. As others (e.g., Fenwick & McMillan, 2012, p 369) have reported, these governments sought ways of countering social exclusion. One initiative at the start of this period was the establishment of a Social Exclusion Unit which set up a Policy Action Team to investigate financial exclusion. In its report, *Access to Financial Services*, the Policy Action Team's recommendations included (i) bringing credit unions under the protection of the Financial Services Authority (FSA) while (ii) lifting some legal restrictions so that they could attract a wider range of members and greater assets to (iii) help address problems of financial exclusion. The 2000 Financial Services and Market Act precipitated credit unions being made subject to regulation by the FSA – and its successors – and the Financial Ombudsman, providing credit union members with the same protection as users of other finance providers. The legislation recognised the small size of many UK credit unions and adopted a two tier classification to determine the extent of regulation that would be applicable. "Version 1" type credit unions that were generally smaller scale with fewer assets, were subject to lower requirements for reserves and less onerous requirements for risk management policies, but they also had greater restrictions in terms of the size and length of loans that they could offer. Growth in membership size and assets levels resulted in new restrictions at specified threshold levels for "Version 1" type credit unions. "Version 2" type credit unions were larger, had greater assets and allowed to offer loans over a longer term but were subjected to more stringent capital-asset requirements, risk management regulations and general governance provisions (PRA, 2015).

With a stronger form of regulation in place (Ryder, 2003), secondary legislation in 2001 and a Regulatory Reform Order in 2003 removed other restrictions to promote larger credit unions offering a wider range of services (Edmonds, 2014, pp 10-12). These reduced constraints included: greater flexibility in what constituted the common bond and removal of the ceiling on membership levels; increases in the maximum repayment period allowed for loans; permitting credit unions to borrow money from external sources other than banks and credit unions; greater flexibility on disposal of repossessed collateral; permission for extra services including foreign currency and bill payment services with charges for those services; greater flexibility on dividends including differentiated rates for different types of dividends according to the types of accounts held by members; allowing legitimate credit unions from overseas to operate in the UK; allowing joint accounts to be held without penalty; and alignment of the maximum sum held in a youth account with that which was held in adult accounts. Subsequent changes included: raising the ceiling on the interest charged on loans from 1% to 2% in 2006; further relaxation of the common bond; allowing credit unions to admit corporate bodies; and permitting credit unions to offer interest-bearing accounts and other savings products (HMSO, 2011).

The changes may have “produced a two-tier credit union system, in which a few credit unions (those meeting the condition for version 2 status) are allowed to undertake additional operations that enable them to compete with other providers of financial services more effectively” (Tischer *et al*, 2015, p 15) as well as allowing some other credit unions to grow through merger and consolidation (Baker, 2008, p 309). However, their impact on people on low incomes is questionable. In December 2004, HM Treasury published a report *Promoting Financial Inclusion*. This stated that despite the work of the Policy Action Team, “financial exclusion remains significant in the three areas … banking, affordable credit and money advice” (HM Treasury, 2004, p 7). It (HM Treasury, 2004, p 35) noted that: “Credit unions already operate in some areas of high financial exclusion, but the sector needs a larger capital base in order to grow and become sustainable.” In early 2005, the Government established a Financial Inclusion Taskforce to monitor progress in tackling financial exclusion. The Taskforce had the authority to consider how credit unions might be supported to help low income communities. In October 2005, HM Treasury announced a £120 million Financial Inclusion Fund which included a £36 million Growth Fund for credit unions and the more expensive third sector CDFIs to help expand lending in low income communities and allow borrowers to migrate from sub-prime providers such as payday lenders (Jones, 2008). Consistent with developments elsewhere (Cairns, Harris and Young, 2005) of the government only providing funding to third sector bodies that had strong management systems, the Department of Work and Pensions (DWP) approached only 72 credit unions that could satisfy pre-defined operating standards to help deliver the Growth Fund (Jones, 2008, p 2150). As the number of Version 2 credit unions had only grown to 19 by 2012 (Edmonds, 2015, p 7), the Growth Fund may be seen to have promoted a third tier of larger, more "professionalized" Version 1 credit unions separate from the majority. The Growth Fund was supported with further funding up until 2011 (Jones, 2008). Almost 160,000 loans with a total value of £70 million were made to low-income customers through the Growth Fund (Edmonds, 2014, p 23). When the Financial Inclusion Taskforce (2010, p 9) evaluated the Growth Fund in 2010, it reported that without Government support, "most credit unions would be unable to continue to provide the service at the price level imposed by the 2% per month interest rate cap".

The third period in the development of credit unions came in 2010-2015, during the time of the Conservative Party-led government that held office in coalition with the Liberal Democrat Party. While adopting right-wing policies of austerity management found elsewhere in Europe (Fenwick and McMillan, 2012, p 377), the government embarked on two notable initiatives purported to strengthen credit union's provision of financial services to the financially excluded. Firstly, it funded a credit union Expansion Project which provided £38 million to enable credit unions to expand and modernise. Some of these funds were used to commission a credit union trade body, the Association of British Credit Unions (ABCUL), to provide a common banking platform for credit unions (ABCUL, 2015; Webb, 2013). Secondly, it increased the ceiling on the cap that credit unions could charge as interest on loans from 2% per month (26.8% APR) to 3% per month (42.6% APR). The reasons given in Parliament (Hansard, 2013) for these initiatives were: to increase financial inclusion by extending financial services to a million extra people by March 2019; to allow consumers to save up to £1 billion in loan interest repayments by March 2019 through the provision of affordable credit, bank and savings accounts; to reduce credit unions' costs so they achieve financial sustainability by March 2015; and elimination of the need for the Government to provide further funding of credit unions by the end of the decade. Significantly, in a period, when the public narrative about the role of credit unions has changed to one where their role should be to compete with payday lenders (Tischer *et al*, 2015, p 19), the rise in the ceiling of interest rates was reported as necessary to allow credit unions to earn sufficient returns on low-value, payday-type loans offered over the short-term (Peachey, 2013; Uren, 2013).

The review above suggests that if some credit unions in the UK have succeeded in moving to a transition stage (McKillop & Wilson, 2011, p 85), development is not even across the criteria that define the stages. Although the legislative framework may have long been symbolic of a transition stage (Sibbald *et al*, 2002, p 418), government interventions appear to have had an uneven effect, being beneficial to some credit unions, less beneficial to others and even detrimental to a majority (Tishcer *et al*, 2015, p 14-15). Similarly, while the recent award of government funds to ABCUL to develop a common banking platform suggests credit unions are moving to a degree of technological advancement necessary to provide a range of services and trade associations might be co-ordinating credit unions' interests and activities more effectively, the ambitions of ABCUL endorses the emergent tiered system (Tischer *et al*, 2015, p 15). It is also not clear that the levels of professionalization in the form of specialist, paid staff employed at individual credit unions indicates that all are at a transition stage. The distinction between Version 1 and Version 2 credit unions in the regulatory framework and the limited number of credit unions approached by the DWP to help deliver the Growth Fund each suggest a limited development of professionalization at some credit unions. Thus, this article goes beyond

Tischer *et al*'s (2015, p 15) acceptance of a two tier system of Version 1 and Version 2 to suggest a further divide within Version 1 credit unions between those that have experienced a degree of professionalization and those that have not. Credit unions that fall into this third group could be too small to be viable when offering payday-type loans (Tischer *et al*, 2015, pp 21-22). Instead, the permitted rise in the ceiling on interest rates could lead to a general increase in the cost of loans offered by credit unions, negating their role as low cost finance providers for their members (Tischer *et al*, 2015, p 15). Prior empirical evidence about the viability of any credit unions providing payday loans and the potential of such provisions to change the character of credit unions are now considered.

Credit Unions' capability to provide payday-type loans

The pursuit of government policy goals through third sector agencies, particularly those that have a history and international allegiances that help define their character raises two issues; firstly whether that prevailing character will result in government initiatives being unsuccessful; and secondly whether the initiatives will result in the third sector agencies transforming into something more aligned to the government policy goals than their own original objectives (Cairns *et al*, 2005). Both of these issues are salient when considering government sponsorship of credit unions' provision of payday-type loans. Payday loans are generally low value, short-term advances against future earnings, delivered immediately and secured against a promise to repay within a very short period (Stango, 2012, p 151). They have often been offered by a range of non-traditional providers who charge high interest rates to compensate for the risk of default that they perceive (Ralston & Wright, 2003, p 305). There does not appear to be strong evidence that credit unions could compete meaningfully with commercial payday in the provision of such loans.

For example, in the USA, government-imposed ceilings on interest charges discourages credit unions from offering payday-type loans (Stango, 2012, p 154) even when they are mature, stronger and more commonplace because there is an obligation in the USA for mainstream retail banks to support them in neighbourhoods where those banks are unable to provide services (Tischer *et al*, 2015, p 6).

There is, however, a need for UK credit unions to find new sources of income as their revenues have been affected adversely in recent times by falling returns on the financial instruments in which they invest (Tischer *et al*, 2015, p 10). Whether payday-type loans provide a viable means for credit unions to expand their revenues is not clear from the UK evidence. A study of an experiment with payday-type loans by *London Mutual Credit Union* (*LCMU*) when the interest rate ceiling was 2% per month found that while the scheme was popular, when first applications for payday-type loans alone are considered, the scheme was not viable although provision of subsequent loans to the same borrowers did increase their viability through reductions in some administrative costs (Evans and McAteer 2013). One of the costs incurred when providing payday-type loans to new borrowers is acquisition of independent credit reports which may not be viable for smaller credit unions (McKillop, Ward & Wilson, 2010; Tischer *et al*, 2015, p 24). Although one possible solution to this might be for credit unions to utilize the greater knowledge that they have of people in their community (Mushinski, 1999), this possibility is reduced when the common bond for credit unions has been relaxed. Instead, there is a danger that provision of loans to people who have yet to prove their financial prudency, could increase the risk of default on loans which is already rising (Tischer *et al*, 2015, p 11). More generally, such provision could distort the balance of the loan book to create a greater reliance on small value repayments and lead to patterns of income and expenditure that could affect credit unions' ability to maintain the ratios suggested by regulators. If this happens, the legislation could be seen to have precipitated credit unions changing their character to become more like payday lenders in ways resonant of other third sector bodies affected by Government interventions (Cairns *et al*, 2005).

Whether the legal changes have led credit unions in England to offer payday-type loans and whether provision of such loans is leading credit unions to change character are considered in the empirical study below.

Data collection

The UK is made up of four countries: England; Scotland; Northern Ireland; and Wales. While all four countries are affected by legislation passed in the UK's Westminster Parliament, the last three each have their own devolved administrations (Wiggan 2009, p 1030) that have taken initiatives to support credit unions in their domain. For this reason, the study focused only on credit unions in England. These were identified initially through an extant, dated list, http://www.creditunions.co.uk/. The internet search facility, *Google*, was used to establish whether each credit union endured and had a website. Where a website address was identified, the site was visited for an initial overview of its contents. A template of important issues for a full review of credit unions was constructed from the items identified in the initial review of websites and the literature to prepare an interrogation tool for a fuller investigation of each website's content. The interrogation tool – see appendix 1 - included space for simple recording of whether the website indicated the credit union offered particular services and additional spaces for qualitative comments about the character of those services.

After development of the interrogation tool, second visits were made to each website between June and December 2014 – i.e., after the raising of the interest rate ceiling to 3% per month in April 2014 - when their content was documented. If no website had been found for a credit union at the time of the initial search, a search via *Google* was made again to check whether a website had since been developed. This proved useful as a further five credit union websites were identified. If no website was found at the time of this search, the register of financial institutions held by the Financial Conduct Authority (FCA) – a successor of the Financial Services Authority – was checked to see whether the credit union endured. Finally, a third visit was made to websites between February and March 2015 for the objectives of ensuring consistency between the classifications of the authors and for adding additional notes where necessary. Our endeavours indicated that 236 credit unions existed in England; of these 175 had active websites. There is a possibility that the number of credit unions is understated. Although the FCA's register of financial institutions confirms whether a credit union endures, it does not have a facility to produce a full list of extant credit unions. Enquiries of the Prudential Regulatory Authority confirmed it could not provide a list. Credit Union trade associations such as ABCUL only keep a list of credit unions registered with them. Thus, while our list may not be complete, it is probably the most extensive currently available. Of the 175 credit unions that had websites, there were 10 where the limited information provided meant it was not worthwhile classifying them for the purpose of this study.

A database of the information from all websites was then constructed. Key strengths of websites as a data source are that they are easily accessible for researchers without incursions that would require an invitation. Paradoxically for a non-incursive method, the data collected may be considered naturalistic as the investigator views the available information in a similar format to people who may be looking at the same pages for the purpose of making a financial decision. Moreover, others may check the reliability of findings based on such a public resource. Some may argue that credit union websites are marketing devices that embellish details of their financial services. Such a view denies the limits to which credit unions compete with one another because their different common bonds lead most to cater for their own distinctive constituency. For this reason, credit unions' websites are seen here as a depository for information.

Data analysis

Lee (2012) identifies different ways in which documents – including electronic documents such as webpages – may be analysed. Two such methods are simple content analysis and ethnographic content analysis. With simple content analysis, appearance of a topic in the text is interpreted as symbolic of the existence of a phenomenon. That is to say, advertisement of a loan would be indicative that a loan existed. With ethnographic content analysis, meaning is sought by locating the information within a setting of other symbols that suggest what is intended by the body providing the information. In this context, existence of a loan would be married to other information about the loan and knowledge of the qualities of payday loans to interpret whether the credit unions' loans were comparable to the offerings of commercial payday lenders. Both simple content analysis and ethnographic content analysis are utilised to understand this data.

In the course of this analysis credit unions that offered loans to new members without a savings history were separated from credit unions that were not offering loans to such new members and details were recorded of interest charged on loans, the maximum length of time for repayment of loans, indicative time before decisions on loans and the expression of principles such as affordability. The idea of ethnographic content analysis was then applied in two stages to address the two issues identified above. First, the extent to which the loans for new members without a savings history with the credit union were compared with the conventional idea of payday loans of immediate availability with little attention to affordability charged at a high(er) interest rate with repayment set by the next payday of within a month, to interpret whether the loans for new members complied with the conventional idea of a payday loan. This provided insights into the extent to which changes in regulations led credit unions to offer payday loan-type financial services to people whom they had previously excluded. Second, the provisions for loans for new members without a savings history were compared both with provisions relating to loans for other members and with provisions at credit unions that did not introduce such loans to consider whether any provision of payday-type loans was leading to those credit unions violating their preceding principles. Simple descriptive statistics will be fitted into a narrative below to address each of these issues.

Credit unions' provision of payday-type loans

Of the 165 websites analysed in detail, 76 – or 46% – indicated that the respective credit unions offered loans to new members without a savings history while 89 or 54% of credit unions did not. This figure is considerably greater than the nineteen version 2 credit unions in existence across the UK (Edmonds, 2015, p 7). However, it is only marginally greater than the 72 credit unions involved in the administration of the Growth Fund (Jones, 2008, p 2150). This tends to confirm the earlier suggestion that in addition to the distinction between Version 1 and Version 2 credit unions, there is a divide within Version 1. It appears to be only Version 2 and some Version 1 credit unions that are offering loans to new members who have not saved previously, while for the majority of credit union, the costs of doing so are prohibitive (McKillop *et al*, 2010; Tischer *et al*, 2015).

To assess whether the loans offered to new members were likely to have a negative impact on the financial wellbeing of a credit union, by distorting its loan book (Edwards, 2014), the loans for new members that did not have a savings history with the credit union were compared with the definition of payday loans as of a low value, available immediately, charged at a higher interest rate and to be repaid within a month or at the next payday (Stango, 2012, p 151). The ceiling for most of these loans was less than £1,000, suggesting that a bias towards smaller value loans may have been introduced. A significant variation to this existed at credit unions that shared a common bond of employment, particularly at credit unions associated with the police. For example, *Number 1 Copper Pot Credit Union* offered loans of up to £7,500 for new members who were probationary officers while *Blues and Twos Credit Union* provided loans of up to £5,000 for new members. Table 1 shows the maximum interest rate, the time taken to provide loans

Insert table 1 about here

and the length of time permitted for repayment of loans by new members without a savings history. Notably, while 44 or 57.8% of credit unions took advantage of the opportunity to raise their interest rates to above the previous ceiling of 2%, a considerable minority of 32 or 42.8% did not. When the repayment period is considered, no credit unions' webpages indicated expectation of the loan being paid back on the next payday. A large majority indicated the loan had to be repaid within a year. Some others – particularly those that shared a common bond of employment and offered large value loans to new members – allowed longer periods. For examples, both *Number 1 Copper Pot Credit Union* and *Blues* *and Twos Credit Union* allowed maximum repayment periods of five years for their higher value loans to new members. With the remaining credit unions, 8 or 10.5% provided insufficient detail of repayment periods and 2 or 2.6% stated explicitly that payback periods were flexible, but encouraged the new members to repay the loans quickly to save on total interest payments. On the question of the length of time taken to make a decision and deliver a loan, while there was insufficient detail about 22 – or 28.9% – of the 76 credit unions, no website that provided information suggested that a decision on a loan would be made routinely on the day of application. There was the odd credit union such as *LMCU* that were prepared to process the application on the day at an additional cost to the applicant. Over 35% provided definitive indications of within two weeks while a further 28.9% suggested that the period would be short without providing a definitive period, with statements such as when a credit committee met. In the remaining 5, or 6.6% of, instances, the website indicated that the loan would be made available as soon as the first repayment on the loan had been received either through a payroll, benefit or direct debit deduction.

The greater length of time to make a decision, the diverse value of the loans, the variety of interest rates and the longer time given for repayment of loans suggests that government initiatives have not led to credit unions offering conventional payday loans. However, government policies have led some credit unions to offer low-value, short-term loans and the potential detrimental impact of that needs to be considered. Some loans for new members are not short-term, nor of limited value so these may be unlikely to distort the existing loan book. The fact that it appears to be only the larger credit unions that are offering loans to new members without prior savings would suggest that they already have a larger portfolio of loans to help balance the shorter-term and lower-value quality of some of the loans that are now being offered. Moreover, there are potential positive implications of the liquidity that arises from short-term loans. As noted previously, in recent years, the potential for credit unions to earn returns from some of their previous methods of investment has diminished (Tischer *et al*, 2015, p 10). Provision of short-term loans does not only provide an alternative form of deployment of assets, but the structure of repayments means that those assets will be highly liquid allowing some to be converted into alternative – and potentially higher earning – investments should they become available and the credit union considers it necessary or desirable.

Although the loans do not comply with the conventional idea of traditional payday loans, abandonment of the principle for people to have saved previously with the credit union does move the loans for new members towards conventional payday loans. Given Tischer *et al*'s (2015) concerns of rising levels of default on credit union loans, waiving of the prior requirement to save could have a detrimental impact. The finding in table 1 that the credit unions offering loans to new members tend to take their time to make a decision suggests that they are conducting checks to protect against default. To investigate this issue further, the website database was analysed for issues of affordability. Table 2 provides a summary of the ways in which credit unions checked that new members could

Insert table 2 about here

afford their loan. Significantly, 45 – or 59.2% – of credit unions expected new members seeking loans to complete an extensive form which included itemised detail of their household budget's income and outgoings to ensure that the additional expense associated with the loan was affordable. In a further 5 instances – or 6.6% – of the total, new members had to make an appointment for an interview when extensive detail would be required. In an identical number of instances where no form was available, there was an indication that a significant amount of detail would be required about income and expenditure to apply for a loan. In 8 instances – or 10.5% – of the total of 76 credit unions, the form required only aggregate, rather than itemised, information of income and expenditure. The issue of affordability evident at a majority appeared to be extended to savings. There was no evidence of credit unions providing loans without requiring members to join and a majority also required people to save while repaying their loans. While not denying the potential for default rates to rise at credit unions when they start catering for members without a savings history, the evidence from this study is that the extensive checks on affordability operated by many credit unions may militate against this becoming overly detrimental.

Change as a consequence of taking on new practices

This section investigates whether the legal changes that allow provision of loans to a new constituency has led credit unions to violate their longstanding principles of promotion of thrift and provision of low cost loans to the community (Edmonds, 2014; Tischer *et al*, 2015) in ways that would be consistent with Cairns *et al*'s (2005) suggestion that other third sector bodies' aims have been re-orientated after government initiatives. As noted above, some credit unions that offered loans to new members who had not saved previously, expected those members to save while repaying any loan, which suggests that the principle of thrift was not abandoned. Some even indicated clear criteria for saving. For example, *Cleator Moor and District Credit Union* reported a requirement to save £1 per month for every £100 borrowed. Moreover, 42.8% of those that provided loans to members without prior savings did not increase their interest rates above the prior ceiling of 2% indicating low cost loans were not being abandoned. Two ways of assessing whether there was a drift to a change in principles arising from offering loans to people who had not saved previously are firstly by exploring whether the principles that underlay the interest charged on the new loans are markedly different to the principles that are applied to the existing range of loans and secondly by considering whether the principles for these new loans differed from the principles underlying loans provided by credit unions that did not offer loans to new members without prior savings.

Table 3 provides a summary of the principle for the variation

Insert table 3 about here

in interest evident at those credit unions providing loans to new members who had no savings history and makes a comparison with the principles apparent at credit unions – shown in the shadowed area – that did not offer such loans. 47 or 61.8% of the 76 credit unions that offered loans to new members who did not have a savings history with them, employed a general set of principles to the loans that they offered and the new loans simply fitted in with these general principles. Those principles included variations according to the sum borrowed, the ways of paying back the loan such as through payroll deductions and the extent of security that the credit union enjoyed in terms of proportion of the loan that was covered by the shares held by the member in the credit union. The degree of sophistication of principles in the preceding loan provisions suggests that those credit unions include the emergent third tier that benefited from the Growth Fund and had already realised a degree of professionalism indicative of approaching a transition stage in Sibbald *et al*'s (2002) taxonomy.

The comparison with credit unions that did not offer loans to new members highlights that the largest difference is that those not offering new loans generally had less sophisticated interest distinctions in their range of loans. A majority reported a standard rate for all loans, or that they simply varied the level of interest according to the scale of the loan. The pattern of these credit unions' less sophisticated product range is consistent with the idea that this group constitutes the bottom tier of three and includes the smaller Version 1 credit unions that had not reached the professionalization associated with a transition stage of development. An alternative way of assessing whether the introduction of loans for new members without a savings history was leading those credit unions to abandon their original principles is to compare the terms on such loans with the terms at credit unions that did not offer such loans. Table 4 does this with the

Insert table 4 about here

shadowed area indicating details from the websites of credit unions that had not introduced loans for new members without a savings history. The key differences are that around 15% more websites that had introduced loans for new members had introduced the ceiling of 3% than credit unions that had not introduced loans for new members. By contrast, 15% more credit unions in the latter group had a maximum interest rate of only 1% when compared with those that had introduced loans for new members without a savings history. While it might be tempting to interpret the general higher cost of borrowing as indicative of these changes leading to abandonment of the principles of offering low value loans to the broader community, this argument appears too simplistic, especially as a high proportion - 37.1% – of credit unions that did not offer loans to new members without a savings history, had introduced the 3% ceiling. While this finding highlights the danger identified by Tischer *et al* (2015) of a general rate rise materialising for all credit union member, the generality of the pattern across all different tiers of credit unions suggests its cause could be the costs of greater regulation affecting all credit unions. When the time to make a decision is considered, the percentage of credit unions that gave a definite indicative period of between one day and two weeks were comparable across both those credit unions who offered loans to new members without a savings history and those who did not. Significantly, 5.6% of those who did not offer loans to new members reported a capacity to make a decision about a loan on the same day of the application.

The main variation in indicative lengths of repayment periods between credit unions that offered loans to new members without a savings history and those that did not was that over 30% more of the former group reported that they anticipated repayment of the loan within a year while almost the same total of the latter group indicated that repayment could take more than two years. This pattern tends to suggest that lending smaller sums over a short period was one way in which credit unions built up trust in new members without a savings history before permitting them larger loans over a longer period. Such an explanation would be consistent with the idea that the top tier of Version 2 credit unions and the emergent middle tier – i.e., those Version 1 credit unions who received government monies – that benefited from the Growth Fund developed degrees of sophistication in their techniques of managing loans from people that had previously been financially excluded.

When the comparability of interest rate charges, the longer time to make a decision about a loan by those credit unions providing loans for new members without a savings record and the shorter times permitted for repayment are perceived together with the expectations around saving once a loan had been granted, it appears that rather than diverging from their original principles, the credit unions involved are seeking to extend services and ideas about the value of thrift to a new constituency within the community in a sensible way.

Discussion and conclusion

This article has considered the impact of key changes in the UK government's policy on the capability of credit unions to help counter financial exclusion by offering payday-type loans and – if such loans are offered – whether their provision is having a detrimental effect on credit unions. Central to an understanding of the pattern of evidence found in the study of credit union websites conducted to examine these issues is a classification of credit unions in the UK. Building on McKillop and Wilson's (2011) suggestion that UK credit unions are generally in a state of transition, having experienced advances in the legislative framework, developments in technology and professionalization and Tischer *et al*'s (2015) report that the legislative framework has led to the development of a two tier system, this article has argued the emergence of a third tier. The findings from this research also suggest that in addition to Version 2 credit unions, two tiers exist within the Version 1 class of credit unions. The bottom tier comprises the 61 credit unions that had not advanced sufficiently technologically to have their own website and the remainder of the Version 1 credit unions that the DWP had not selected to benefit from the Growth Fund while the middle tier is made up of the Version 1 beneficiaries of the Growth Fund that had experienced a degree of professionalization and offered a sophisticated range of loan products into which loans for new members without savings could be fitted easily.

This three tiers need to be kept in mind when evaluating arguments about the development of payday-type loans and concomitant dangers of rising levels of default (Tischer *et al*, 2015) and an imbalanced loan book (Edmonds, 2014). The evidence offered tends to suggest that these arguments may be over-generalized. Growth of some credit unions and their development of a range of loans coupled with the initial checks on affordability that they exercise, the methods of repayment that they institute and the ongoing requirement to save, suggests that they can assimilate a new constituency that have not saved with them previously. This indicates that rather than these credit unions changing their character (Brown *et al*, 2003; Edmonds, 2014) as has been suggested for other third sector organizations that receive government support (Cairns *et al*, 2005), they are taking steps to extend their constituency in ways that protect the rest of the community in that constituency. The failure of others to offer loans to new members who have not saved previously appears to be because many have experienced only limited professionalization which leads them to organize their loan provisions according to simple principles and so might not have the wide portfolio of assets that would enable them to do so (Edmonds, 2014) or the mechanisms that would enable them to protect against the risk of default that might accompany such loans (Tischer *et al*, 2015). This pattern suggests that the raising of the cap on the ceiling for interest rates to allow provision of low value loans to a new constituency has accentuated the movement towards a tiered system rather than negating it.

The failure of some credit unions to cater for the constituency of people who have not saved with them previously raises the issue of how those people who are financially excluded by banks and dependent on payday lenders may be catered for by credit unions. As evidence from the USA (Stango, 2012) indicates, some borrowers prefer using payday loan companies because their credit scores are not damaged by late payments which may not be the case with credit unions. However, there may be others who are currently excluded, but who might benefit from credit union provisions. In this regard, Tischer *et al*'s (2015, p 15) observation that mainstream banks have an obligation in the USA to support the provision of credit unions' services in neighbourhoods where banks are themselves unable to do so suggests that if legislation required banks to provide financial support to credit unions and credit unions were to link up with CDFIs, more resources would be available to support those who are currently financially excluded. Moreover, development of the common banking platform through ABCUL could provide data for analysis of default under different conditions which could permit better control of new accounts amongst groups that might be more at risk of defaulting. Development of such a programme of initiatives could provide a model for credit unions in other countries where there is a movement from nascent to credit unions in transition.

A significant finding of this research is that a high proportion of both credit unions that offer loans to new members without a savings history and those that do not, have increased the ceiling of interest rates on some of their loans to the new maximum of 3%. The general nature of the rise across different tiers of credit unions suggests that many may have found it difficult to offer loans of low value to their members who require them while maintaining some of the expectations of regulators around such financial issues as assets and liquidity. If government policies affecting credit unions are to realise their desired social objectives, it is clear that they should be considered in the context of the financial regulations that affect bodies such as credit unions in ways that do not affect subprime providers such as payday lenders. Moreover, more support is required to support what has been identified as a third tier of credit unions who provide a valuable service in their locality, but which appear to have been neglected and disadvantaged by many recent government initiatives.

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Appendix – Website interrogation tool

Credit Union: ~~Bristol Credit Union~~		
	Yes/no	Additional detail
Bond		
Individuals		
Area – residence		
Area – work or residence		
Single employer		
Voluntary organization – church		
Voluntary organization – trade union		
Voluntary organization – other		
Business membership permitted		
Product Range		
Current and Savings Accounts		
Current accounts		
Junior accounts		
Savings accounts		
Seasonal savings accounts		
Individual Savings Accounts (ISAs)		
Loans		
Existing member loans		
Existing member top-up loans		
New member loans		
Large loans (£5,000 +)		
“Green” product loans		
Additional lending products		
Credit Cards		
Insurance		
Income protection insurance		
Death protection loan insurance		
Injury loan insurance		
Terms		

Joining fee		
Dividends		
Repayment frequency		
Minimum repayments		
Flexible repayments		
Rates of interest		
Differentiated rates of interest according to product		
Requirement to save		
<u>Details about administration</u>		
Length of time between application and loan		
Employee payroll facility availability		
<u>Advice</u>		
Advice on application		
Type of information required to make application		
Details of Credit Union using credit reference agency		
Internal calculator		
Other advice		
Details of helpful external agencies		
<u>Marketing</u>		
Price comparisons with payday loans		
Details about evils of loan sharks		
<u>Types of accessibility</u>		
Details of offices		
Details of collection points		
Details of times of openings/ availability		
Website accessibility		

<u>General money management advice</u>		
<u>Extra benefits for members</u>		
<u>Philanthropy</u>		
Credit union hardship fund		
Credit union’s other donations		
Requests to support credit unions debt advice facility		

Table 1

Table 1: Features of loans offered to members without a savings history.							
Maximum interest rates							
Rate p.m.	3%	2.75%	2.5%	1.51-2%	1.01-1.5%	1%	Under 1%
Number	40	3	1	23	5	4	0
% of 76	52.6%	3.9%	1.3%	30.3%	6.6%	5.3%	0%
Time to make a decision							
Length	Same day	1-3 working days	Week	Two weeks	Not clear but short	Linked to first repayment	No detail
Number	0	8	10	9	22	5	22
% of 76	0%	10.5%	13.2%	11.8%	28.9%	6.6%	28.9%
Indicative maximum length of repayment period							
Length	Next payday	One-six months	Six-twelve months	One to two years	Over two years	Flexible	No detail
Number	0	14	39	7	6	2	8
% of 76	0%	18.4%	51.3%	9.2%	7.9%	2.6%	10.5%

Table 2

Table 2: Prominent mechanism to define affordability					
Mechanism	Extensive form	Interview for new member	Less extensive form	No form, but suggestion of detail	No form and no detail available.
Number	45	5	8	5	13
% of 76	59.2%	6.6%	10.5%	6.6%	17.1%

Table 3

Table 3: Principle on which interest charged on loans for new members at credit unions offering loans to new members and comparison with principles at other credit unions							
Principle	Variation simply between new loans and other loans	Variation between first and subsequent loans	Inversion between rate and sum	Product related	Standard	Variable with ratio of savings to loan	Insufficient detail
Number	9	0	11	47	7	0	2
% of 76	11.8%	0%	14.5%	61.8%	9.2%	0%	2.6%
Number	0	2	24	22	32	1	8
% of 89	0%	2.2%	27%	24.7%	36%	1.1%	9%

Table 4

Table 4: Comparison between the terms for loans at credit unions who had and those who had not introduced loans for new members.							
Maximum interest rates							
Rate p.m.	3%	2.75%	2.5%	1.51-2%	1.01-1.5%	1%	Under 1%
Number	40	3	1	23	5	4	0
% of 76	52.6%	3.9%	1.3%	30.3%	6.6%	5.3%	0%
Number	33	0	2	28	7	18	1
% of 89	37.1%	0%	2.2%	31.5%	7.9%	20.2%	1.1%
Time to make a decision							
Length	Same day	1-3 working days	Week	Two weeks	Not clear but short	Linked to first repayment	No detail
Number	0	8	10	9	22	5	22
% of 76	0%	10.5%	13.2%	11.8%	28.9%	6.6%	28.9%
Number	5	9	5	18	9	0	43
% of 89	5.6%	10.1%	5.6%	20.2%	10.1%	0%	48.3%
Indicative maximum length of repayment period							
Length	Next payday	One-six months	Six-twelve months	One to two years	Over two years	Flexible	No detail
Number	0	14	39	7	6	2	8
% of 76	0%	18.4%	51.3%	9.2%	7.9%	2.6%	10.5%
Number	0	6	28	4	32	1	18
% of 89	0%	6.7%	31.5%	4.5%	40%	1.1%	20.2%