

FINANCIAL  
INCLUSION  
TASKFORCE

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Credit Union Interest Rate Cap Consultation  
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The Financial Inclusion Taskforce was established following the HM Treasury December 2004 report 'Promoting financial inclusion' which set out the Government's strategy to tackle financial exclusion in three priority areas:

- access to banking;
- access to affordable credit; and
- access to free face-to-face money advice.

The role of the Taskforce is to monitor progress on the objectives the Government has set in these areas and to identify what more needs to be done to tackle financial exclusion.

Specifically, the Government has asked the Taskforce to monitor the provision of affordable credit by third sector institutions such as credit unions and community development finance institutions. The Taskforce therefore has a clear interest in the issue of the capacity of credit unions to provide loans to financially excluded groups and at their meeting on 19<sup>th</sup> April decided to respond to the HM Treasury consultation in the credit union interest rate cap.

The Financial Inclusion Taskforce supports the proposition to raise the maximum interest rate that credit unions can charge to 2% a month. This will enable more credit unions to serve lower income and more excluded groups, and will assist credit unions to provide affordable credit more flexibly to more people. Raising the cap on interest that credit unions can charge may, for example, encourage more credit unions to compete on other factors as well

as from cost, such as quality and convenience, which may mean these credit unions are better able to serve the needs of low-income groups.

The Taskforce recognises that in, raising the cap on interest, credit unions will have increased flexibility to apply a more risk based approach to lending and may be more likely to remove the need for members to save before they can apply for a loan. The Taskforce notes that there is some evidence that capacity-based lending is beginning to happen in the sector with some credit unions using credit reference agencies to obtain more information about their customers. Risk based pricing of loans is one way of achieving capacity-based lending, which may be promoted by a rise in the cap on interest that credit unions can charge. Some credit unions have already expressed an interest in using a method adopted by some community development finance institutions of charging a higher rate for the first loan a customer takes out and then dropping the interest rate subsequently.

The Taskforce notes that, if the ceiling were raised, credit unions would not be obliged to increase their rates and practices if they did not feel equipped to do so. However, the Taskforce has some concerns about the capacity of some credit unions to assess their customers' abilities to repay loans without a savings requirement and to price loans according to risk. Therefore, the Taskforce believes that a rise in the interest rate cap must sit alongside upskilling some credit union staff, particularly in risk assessment practices.

The Taskforce believes that if the cap on interest is raised the Government should also consider whether the regulatory requirements applying to credit unions remains appropriate, particularly having regard to the requirements that would apply to a consumer credit provider charging a similar rate of interest when the Consumer Credit Bill comes into force. The Taskforce suggests that consumers borrowing from credit unions should experience the same protections as those borrowing from all other credit sources and the Government needs to be satisfied that this is the case.

The Taskforce also asks that the Government keep the level of the interest rate cap under review. It is noted that to remove the cap would require primary legislation, and therefore to achieve change a more pragmatic and realistic option is to raise the cap incrementally. However the Government must keep this under review to ensure that the level at which the cap is set remains relevant to the credit market as a whole and to the borrowers accessing loans from third sector lenders.

## **Financial Inclusion Taskforce**

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