

FINANCIAL
INCLUSION
TASKFORCE

*Review of the GB cooperative and credit union legislation:
consultation response of the Financial Inclusion Taskforce*

General principles

The Financial Inclusion Taskforce welcomes the opportunity to respond to the Government's review of cooperative and credit union legislation. Earlier this year, and following the publication of the Government's financial inclusion strategy, *the Way Forward*, the Taskforce established a Working Group with senior representatives from the banking sector to consider how to achieve a nation-wide increase in the coverage and capacity of third sector lenders – credit unions and community development finance institutions (CDFIs).

The Taskforce is therefore particularly interested in reforms to the legislation that could help facilitate an expansion in coverage and capacity of the credit union sector. As such, we have focussed on the questions that are concerned with these aspects of credit union legislation.

In general terms, the Taskforce is concerned that the current legislation for credit unions may restrict their ability to play a greater role in promoting financial inclusion – the Taskforce would welcome the necessary changes to ensure that the credit union sector has a modern up-to-date legislative framework that is fully compatible with the Government's commitment to promoting financial inclusion.

The Taskforce is keen that key changes necessary for expanding the coverage and capacity of the credit union sector, for example changes to the common bond restrictions, should be introduced as soon as it is feasible to do so.

General comments on Industrial and Provident societies legislation

In respect of the cooperatives sector, the Taskforce is aware that many CDFIs offering a personal lending service to the financially excluded are currently incorporated under the Industrial & Provident Societies Act. The Taskforce would therefore like to see this legislation brought up to date in a way that facilitates further growth of this sector. In particular:

- The Taskforce understands that the title 'Industrial and Provident Society' is perceived by many in the sector as outdated, and should therefore be subject to review; and
- The Taskforce understands that there are significant concerns in the I&PS sector that the maximum limit of £20,000 that an individual member of

an I&PS can invest may restrict growth, and considers that this ceiling should therefore be reviewed.

Responses to specific questions

1. What are your views on whether the cooperative sector should have a wider role in financial services (including banking) and what evidence is there for a need for such provision.

The Taskforce would welcome a wider role for the cooperative sector in the provision of financial services. In particular, the Taskforce is impressed by the early examples of credit unions developing current account banking services, and would be keen to see more credit unions develop this service. There is evidence that, for many, mistrust of mainstream financial institutions is a significant factor in their non-use of banks, and the ability of credit unions to offer transactional banking is already providing a solution for at least some of the unbanked.

Future direction of the credit union sector

17. Should credit unions aim to extend their membership to embrace the more affluent sections of the community? If yes, how can this be achieved?

The Taskforce recognises that some credit unions do already serve a wide cross-section of the population, whilst others have focussed on serving lower income consumers exclusively. The Taskforce would welcome an extension of credit union membership to embrace more affluent sections of the community, as this could enable credit unions to attract much larger deposits that can then be mobilised for on-lending to the financially excluded. Credit unions whose membership is predominantly people on low incomes may therefore have more difficulty in achieving sustainability. The Taskforce is aware that internationally, where strong credit unions have developed, they have been successful in attracting membership from across the community, not only from the poor. The Taskforce appreciates that this could be difficult to achieve, but would be keen to see more marketing activity from credit unions, and more skills training in this area.

19. What are your views on a suggested name change from credit unions to community banks?

The Taskforce recognises that this is a sensitive issue within the credit union movement. However, the fact that this is being debated shows how far credit unions have come in recent years is expanding their product offering beyond loans and savings accounts to the development of full-service transaction banking accounts. The Taskforce is concerned that name recognition of credit unions is low amongst many parts of the population (more than 50% of low-income respondents to a Taskforce survey in areas where there was an active credit union that had just received support from the Growth Fund had not

heard of a credit union, although there were significant regional variations¹), and considers that raising levels of awareness of the products and services offered by credit unions is a key priority whether or not there is a change in the branding.

Membership

20. What are your views on the following issues relating to membership of credit unions?

- **Common bond;**
- **Non-qualifying member rules;**
- **Minimum age;**
- **Restriction on number of members; and**
- **Prohibition of corporate membership.**

Common bond

In general terms, the Taskforce is in favour of changes to the legislation that will facilitate growth in the credit union sector. In particular, the Taskforce is concerned that the current common bond restrictions may prevent growth by some very successful credit unions, which are unable to move into geographical areas where there is no current coverage, or to partner with national organisations such as RSLs. Research for the Taskforce shows that, despite the injection of capital from the Government's Growth Fund, there are still many areas of the country unserved by a provider of affordable, third sector credit, including some where there is likely high demand for such credit. In the interests of facilitating greater geographical coverage, the Taskforce considers that the common bond restrictions should be relaxed to allow successful credit unions to establish outlets in these areas where they wish to do so. The Taskforce would also be keen to see more partnerships develop between credit unions, housing associations and other potential partners, in particular to achieve better penetration in less dense urban and rural areas and is aware that the current legislation around common bonds makes this problematic.

Non-qualifying member rules

The Taskforce believes that the current 10% limit for non-qualifying members is too restrictive and could result in members who are receiving their social security payments through the credit union or running a credit union current account having to close their account and leave the credit union as a result of changing address. The Taskforce is aware that the majority of credit unions favour amending this restriction.

¹ *Access to affordable credit: baseline survey of Growth Fund catchment areas*, GfK/ Financial Inclusion Taskforce, July 2007, available at www.financialinclusion-taskforce.org.uk/research.htm

Minimum age

The Taskforce is in favour of removing the 16 years or over age limit on credit union membership. The Taskforce understands that many credit unions are already accept deposits from children and young people, and have active collection points in school. Allowing children to be members could enhance the work of credit unions in promoting financial capability in schools.

Prohibition of corporate membership

The Taskforce is in favour of credit unions being able to receive deposits from corporate members in some circumstances. The Taskforce is keen to encourage greater investment of funds from both the private and charitable sectors into credit unions, and considers that allowing credit unions to receive such deposits could add significantly to their capital base for on-lending. At the same time, the Taskforce recognises that safeguards are necessary to prevent corporate members exerting disproportionate influence over the credit unions.

Savings

21. What are the advantages and disadvantages of allowing credit unions to pay interest on members' savings?

The Taskforce is in favour of credit unions being able to pay interest on members' savings as the concept of interest payments is likely to be more readily understood amongst potential savers than dividends, and may also be more transparent in that savers can better understand the return they will receive on their funds. The Taskforce recognises the role that credit unions have in providing savings products as well as credit for their members, and considers that the ability to offer a competitive and attractive range of savings products will also be important for a credit union to attract a more diverse membership and increase the available deposits for on-lending.

However, the Taskforce also recognises that paying interest on savings may not be feasible for smaller credit unions due to increased capital requirements and the need to change systems. The option of paying dividends should therefore remain available to these credit unions. The Taskforce also understands that offering dividends rather than interest payments may allow credit unions to better serve those within Muslim communities who prefer to use financial products that are compliant with shari'a law.

Provision of auxiliary services

22. What are the costs and benefits of credit unions providing auxiliary services to their members, including for example complementary financial services, hire purchase and holding of land?

The Taskforce is in favour of credit unions diversifying the range of products to meet as wide as possible the financial needs of their members, provided they develop the competencies necessary to deliver them effectively and that provision of auxiliary services does not distract from the core activities of credit unions. The Taskforce understands that current legislative restrictions on pricing may prohibit some services, for example bill payment or home insurance, from being offered, and is aware that internationally there are examples of microfinance organisations offering goods on hire-purchase. The Taskforce would like to see this explored further, as it could potentially result in credit being offered more cheaply than loans.

Governance, accountability and reporting

23. What are your views on electronic communications between credit unions and their members?

The Taskforce would welcome credit unions being able to make greater use of electronic communication with their members, provided that other channels of communication, for example telephone or face-to-face, remain available for those without internet access.

25. Should there be restrictions on transactions with directors and connected persons and if so what should they be? Please give reasons.

The Taskforce recognises the importance of strong governance arrangements and transparency to further improve the credibility of the sector. Other parties, such as the FSA and the credit union trade bodies, will be better placed to consider the detail of how this can be best achieved.

26. Should the application of Company Directors Disqualification Act be extended to credit unions?

As with the above answer, the Taskforce would welcome any measures that can contribute towards strengthening governance arrangements for credit unions without creating undue regulatory burdens.

27. Should there be a power in the new legislation to assimilate the law for building societies and companies to the law for credit unions?

The Taskforce understands that this is a sensitive issue within the credit union, and does not wish to comment on this area of the legislation.

28. How should charges for a copy of a credit union's rules be determined?

The Taskforce has no particular views on this question.

29. Should all credit unions be required to produce annual accounts audited by a registered auditor or should there be exceptions for smaller credit unions?

The Taskforce is keen for credit unions to develop high governance standards and enhance their credibility with the wider public, and recognises the importance of the annual audit in contributing to this. The Taskforce is therefore not in favour of exemptions for smaller credit unions.

30. What are your views on auditors being required to report to the Registrar any issues of concern about a credit union's financial practices and procedures.

Again, the Taskforce would welcome this as a further strengthening of governance arrangements and protection for consumers.

31. Please list in order of priority the policy changes which would have most impact on improving the ability of credit unions to compete with proprietary firms?

As outlined above, the Taskforce has a particular focus on the measures needed to achieve a scaling-up of third sector lenders so that financially excluded people across Great Britain may be able to access affordable loans and other financial products from credit unions and CDFIs. In order to contribute towards achieving this vision, the priorities for change therefore appear to be:

- A relaxation of the **common bond** requirement to facilitate the growth and expanded geographical coverage of strongly performing credit unions;
- Enabling **organisations to deposit** with credit unions could potentially make available significant new capital for credit unions to lend on; and
- The Taskforce would also like to see credit unions being able to offer a **wider range of financial services** where they have developed the competencies needed to deliver them effectively. It appears that the current legislation may restrict product innovation in a number of areas.