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Small loans: credit unions' best-kept secret?

An analysis of the economics and opportunity for credit unions serving the small loans market in Ireland

Lorraine Corcoran
Paul A. Jones
Nick Money
July 2023

afanite.com

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The Centre is rooted in values of co-operation, participation, social and financial inclusion, transparency, integrity, and excellence. Much of its work is done in collaboration with Liverpool John Moores University.

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Afanite has a strong ethos around Corporate Social Responsibility with specific projects operating on a subsidised or pro-bono basis.

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1. Foreword

'Not for profit, not for charity, but for service' – the founding principle of credit unions across the globe – neatly summarises the issues with which this report by Afanite and the Swoboda Research Centre grapples. The interplay between the social and economic objectives of credit unions in the provision of small loans is explored, supported by a preliminary analysis of data, discussion of international credit union practice and interviews with key players.

The emerging 'conundrum' is not new but merely reflects the considerations associated with meeting the combined interests of a diverse and inclusive membership. The tensions arising between the need for economic sustainability and the desire to provide a service that meets the real needs of members that, in itself, may not always cover its own costs, are clearly evidenced in the findings of this report.

In many ways, the report raises more questions than can be answered, providing much food for thought on how credit unions approach lending, what sets them apart from other lenders, and how they can best continue to serve the financial needs of their communities. In essence, this report is the beginning of a conversation on how best to meet the evolving needs of members in an ever-changing financial services landscape.

Dr Olive McCarthy

Director of the Centre for Co-operative Studies and Senior Lecturer,

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1. Executive summary

1.1. Introduction

In this report, Afanite and the Swoboda Research Centre examine the small loans market (loans of less than €2,000) in the Republic of Ireland and the role of credit unions in serving this market. The report offers international comparisons, evaluates commercial viability, assesses the views of credit unions and stakeholders and offers recommendations. The research comprised interviews with credit unions and stakeholders in the Republic of Ireland, USA, Canada and Great Britain, a review of market data and literature, and economic analysis using CUFA Ltd data. However, the report does not refer to Northern Ireland, which was out of scope of the research brief.

1.2. Key findings

1. Importance of the market - Credit unions and High-Cost Credit Providers (HCCP) appear as the dominant providers. In 2022, small loans, albeit declining, were 48% of credit union loans by volume, 10% by value. HCCP loans is a substantial and recovering portfolio.
   Credit unions typically do not actively promote small loans as they are not usually regarded as a strategic priority and outside of existing members they appear a riskier cohort. But, CEOs are committed to continuing to serve their communities' small lending needs.
2. Data and analysis – While there is detailed individual credit union data, there is only limited sector-level data, and insufficient data in the public domain to enable a full understanding of this market, in terms of consumer need or market supply. Data is also not available on Buy Now, Pay Later (BNPL) services, for example volume or purpose, although it is an obvious emerging competitor.
3. Costs and pricing – Internationally credit unions take a commercial approach to small loans, in terms of price and efficiency, so that small loans are self-sustainable.
   For most Irish credit unions, administration costs can be expected to be the same or higher than larger loans unless digitised processes are in place, with arrears and write-offs higher too. Analysis suggests many small loans are cross-subsidised, but CEOs see this as an important part of serving members.
4. Moving with borrower behaviour - Lack of visibility and of a uniform product is a potential barrier to reaching more borrowers. Digitalisation is required to compete with alternatives such as BNPL, while still including members for whom digital is a barrier.
5. Understanding the underserved - It is generally accepted that loans that target the more unserved or underserved borrower carry a higher risk profile and a bigger administrative burden. There is a tension between the economic reality and the desire for equity and avoiding penalising small borrowers. Internationally, there are examples of pricing for risk and in some cases the use of external subsidy for capacity-building.

1.3. Conclusion

Small loans present a conundrum. On the one hand, they are valued and availed of by a significant proportion of members. On the other, they generate minimal income and can be costly to manage, administer and control. Cross-subsidisation of these loans mean that some members cover the costs of other members. How does this balance with the principle in Irish credit unions of solidarity? Small loans are loved, but they are not actively promoted. Credit unions could do more, but is this affordable? If not, who misses out? The issues of price, efficiency and member service are at the heart of this dilemma.

1.4. Recommendations

The report presents recommendations, aimed primarily at credit unions.

1. Importance of the market - There needs to be a movement position on the importance of this market, in the context of credit unions as socially impactful 'community banks' and in order to protect the traditional small loan book that is often referred to as 'bread and butter' lending.
2. Data and analysis – Availability and quality public data is required for a full understanding of this market, in terms of consumer need and market supply. The Consumer Credit Register (CCR) is potentially a rich source of information. Credit unions also have considerable data at an individual level: sector wide tools to measure the nature and economics of these small loans, including cross-subsidy, would be very useful.
3. Costs and pricing - At a movement level, opportunities to collaborate to address costs and increase digitalisation should be tackled. Continued progress in automation and digitalisation, including alternative products, will reduce costs for these (and other) loans and improve member experience.
   Costs must be covered by someone – the borrower, other members through cross subsidy or external support. An evidence-based discussion on this is required, and on how or if different pricing models are consistent with the Irish credit union ethos.
4. Moving with borrower behaviour - Develop a competitive, convenient, digital process to serve existing and new borrowers, especially younger consumers, in a modern manner. Consider products that present an efficient and attractive alternative especially in respect of top-ups. The pending Credit Union (Amendment) Act paves the way for increased credit union service organisations (CUSOs) and Corporate Credit Union activity.
5. Understanding the underserved – To actively own this market segment, by working together and with stakeholders to fill in information gaps about the underserved and yet-to-be served borrowers, so that products and services can - if desired and if lending is the appropriate solution - be effectively designed, priced and delivered.

2. Introduction

2.1. Background

Credit unions in the Republic of Ireland[1] issue considerable volumes of small loans (defined for this paper as to a value of less than €2,000) to their members - 48% of all loans by volume in 2022[2]. However, these products attract less attention in credit union marketing and strategies than larger loans, and there is not yet a full picture of their volume, credit profile or the purposes for which they are needed. These loans can be provided through standard lending practices, local dedicated initiatives, or niche offerings such as the loan offered under the personal micro-credit initiative known as the It Makes Sense (IMS) loan. This report evaluates small loans in general – their economics, perceptions of their role in credit union portfolios, potential developments in light of any future pricing flexibility arising from legislative change and the role of credit unions as the Community Bank in Ireland.

Historically, credit unions served parts of the community that banks did not, and small instalment loans for everyday needs to people on fragile incomes were common. In fact, combating the high rates charged by money-lenders was an inspiration for the movement's founders (Faherty et al, 2017). Over time, a number of factors have resulted in small value loans being potentially less attractive for credit unions to write. This includes: Irish people becoming wealthier, on average; small value loans seen as the need of the under-served (banks typically prefer to lend less than €2,000 to their customers via credit card or overdraft); small credit needs can be met by alternative, fintech-based solutions such as BNPL and salary advance; small loans issued for a term of less than 12 months with repayment on a reducing balance (the credit union model) offers only modest, if any, financial returns.

Unlike the banks who seek to compete with them, Irish credit unions have a legal upper limit on their loan pricing of 1% per month (12.68% APR). Raising the interest rate that a credit union can charge is one of the policy measures in the Credit Union (Amendment) Bill 2022. Under the proposed Bill, the Act will be amended to allow the Minister for Finance to set the maximum interest rate. While a new limit has not yet been prescribed, it has been suggested that the cap would move to 2% per month (26.8% APR). The aim of this policy change is to enable credit unions to offer a wider range of lending products to their members and communities[3].

The authors of this report, from Afanite and Swoboda Research Centre, have researched and analysed small loan products and their promotion, and drawn out

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[1] NB – this research study did not consider the situation in Northern Ireland, which was out of scope of the research brief. In the report, Ireland generally refers to the Republic of Ireland.

[2] Credit union data submitted by credit unions to Registrar for Credit Unions (RCU), provided to the authors by CBI.

[3] Department of Finance press release, 1 December 2022. https://www.gov.ie/en/press-release/a2cac-minister-of-state-fleming-publishes-the-credit-union-amendment-bill-2022/ accessed 1 March 2023

conclusions for consideration by credit unions in order to further benefit their communities and their own commercial and economic needs. The authors are grateful for the sponsorship of the Irish League of Credit Unions for this project.

2.2. Objectives

The objectives of this research project are to:

- Examine the small loans market, the credit union contribution in Ireland and international comparisons
- Evaluate the commercial viability of loans under €2,000
- Assess the views of credit unions and stakeholders
- Offer observations and recommendations for consideration.

3. Method

As summarised in Figure 1 below, the data for this project has been gathered by engaging directly with credit unions in Ireland and overseas, augmented by secondary research and the analysis of anonymised credit union financial data provided by the Central Bank of Ireland and CUFA Ltd[4]. The interviews were not intended to be quantitatively representative, but to provide views from a range of organisational perspectives.

The sample of Irish credit union interviewees was selected to ensure a geographical spread around Ireland, as well as urban and rural perspectives, with some variance in asset size. The international credit unions were accessed through author networks; where possible, credit unions with an interest in small loans were sought.

Relevant stakeholders were presented with initial findings for thoughts and reactions.

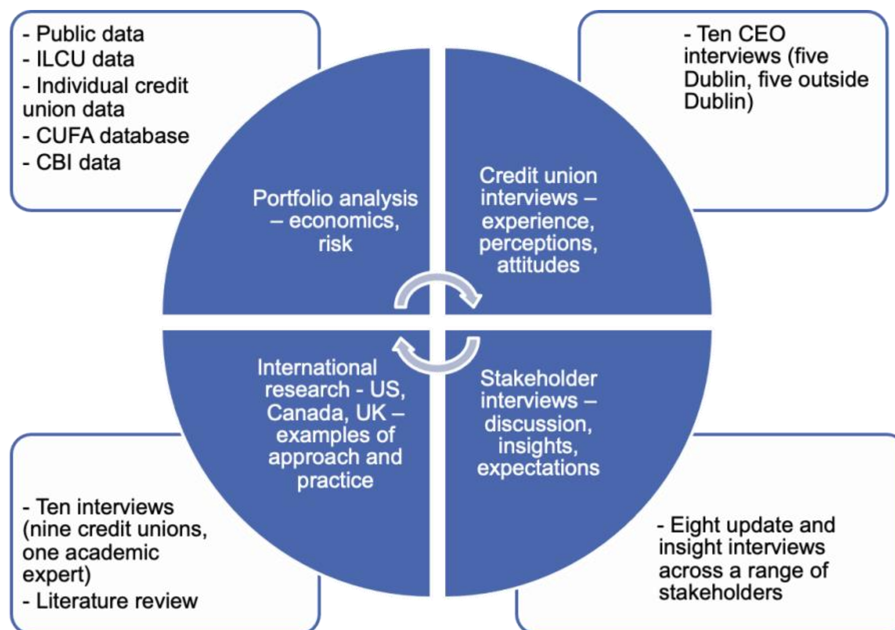

Figure 1: Research Method (project team)

Organisations who participated in the research are listed in Appendix A.

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[4] CUFA Ltd (www.cufa.ie) provides a software solution to 61 credit unions in Ireland that employs statistical techniques to quantify the risks and mathematically determine the expected losses in a consumer loan portfolio. CUFA undertook pro bono analysis in support of this research project.

4. The market for small loans in Ireland

While we do not have a complete picture, we can draw some conclusions from the data available. There is an active personal lending market in Ireland with providers of personal loans ranging from banks to credit unions to HCCP to BNPL. However, it is the credit unions and HCCP that serve the small loan market. The level of activity in the BNPL market is unknown but given the prevalence of this credit option, the sustained marketing activity and comparable data available from the UK, it is likely to be on the rise. Digitalisation[5] and convenience of new offerings is also a feature.

The lack of data relating to the small loans market segment is a barrier to understanding how this market truly operates and who it serves. Combining the number of loans written by credit unions and HCCP indicates that over 450,000 small loans were written in a 12 month period around 2022. For credit unions, the number of small loans written as part of their overall book is substantial. This bears out the ethos of the movement in servicing the needs of their communities.

4.1. Consumer credit

The consumer credit market in Ireland is generally understood as debt taken out by consumers to purchase goods and services, often unsecured. The emergence of digital offerings has led to changes with the availability of rapid online loans and point of sale credit options. In terms of consumer choice, the options include: loans (from banks, credit unions, HCCP); overdrafts; credit cards; personal contract plans (PCP); BNPL; catalogue credit; hire purchase; and in a small number of cases, salary advance.

A number of data sources provide a picture of household debt in Ireland. In March 2023, outstanding consumer credit loans to Irish households stood at €11,796m. There has been a positive growth rate in this market since the end of 2021. The chart below shows the consumer credit trends since 2016. This data is for banks and credit unions and does not include other providers such as HCCP, BNPL or PCP. However, it does cover the majority of this market. Of note is the market share held by credit unions, standing at 43%, as of September 2022.

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[5] This report distinguishes between '*digitisation*', which refers to the conversion of changing analogue to digital such as changing bank statements from mail to app or digital format, and '*digitalisation*', which is how this new digital world will impact people and work by converting business processes to use digital technologies, such as meetings held remotely by video conference.

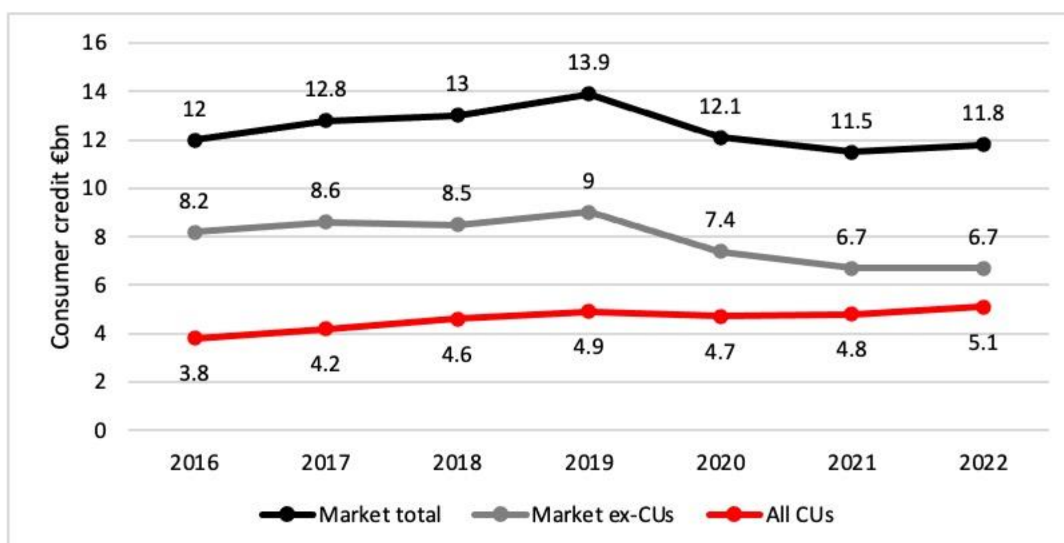

Figure 2: Loans to Irish Households - Consumer Credit €bn (Source: Central Bank of Ireland[6])

Statistics produced by the Banking and Payments Federation of Ireland shows recent strong growth in personal loan activity by banks. For the full year 2022 it was reported that the fastest growing segment remains the 'other loans' category which includes education, holidays and special occasions such as weddings[7]. The Debt and Credit chapter of the Central Statistics Office (CSO) Household Finance and Consumption Survey 2020 (HFCS) notes that the proportion of households in Ireland with non-mortgage loans is 45.5%. Some 26.8% have credit card debt and 6.7% have an overdraft of some kind (CSO, 2022).

In gathering data on the market, the Central Credit Register (CCR) was approached. Section 30 of the Credit Reporting Act provides that the Bank may, but is not obliged to, produce reports, analyses, etc. from Central Credit Register data. It was highlighted that the recently published (March 2023) Services Standards Performance[8] contains increased granularity and it was indicated that it is intention of the CCR to continue with this detailed reporting (CBI, 2023c). It shows that 71% of all credit agreements relate to personal lending. Data collected by the CCR is a valuable source of evidence. This was demonstrated in the CSO HFCS 2020 when it was found that the debt participation rate is approximately 15 percentage points higher when incorporating CCR data (CSO, 2022), suggesting that households under-report their debt. However, in respect of small loans, the CCR only relates to data for loans of €500 or more. It is notable that the Retail Banking Review has recommended reducing the reporting threshold for credit agreements to €200 (DeptFin, 2022).

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[6] RCU data, ibid.; market data from CBI, 2023a

[7] Data relates to AIB, Bank of Ireland, Avant Money, KBC and Permanent TSB (BPFI, 2023)

[8] https://www.centralcreditregister.ie/media/1658/central-credit-register-service-q1-2023-en.pdf

4.2. Financing small amounts

There is no one source for small loan data in Ireland. This point is made with observations and recommendations in the Retail Banking Report 2022. It is generally accepted that access to small loans in Ireland is through credit unions or HCCPs. AIB offers loans of €1,000 online and PTSB €1,500. No data is available from these institutions on the small loan activity that does occur. Bank of Ireland's and Revolut's minimum loans are €2,000, while An Post's is €5,000. It is generally understood that customers of the mainstream banks would use credit cards or overdrafts for smaller amounts.

In addition, there is currently no public information available on the size of the BNPL and the salary advance market in Ireland. In terms of the BNPL in the UK, a study by Bain states that BNPL plays a big role in the UK small loans market with just over 10m people having used it between 2020 and 2021, with a transaction value of £6.4bn or 5% of the e-commerce market (Bain, 2021). This reflects a 60% to 70% annualised growth rate. Analysis undertaken by NestEgg shows that 11% of loan applicants to credit unions in the UK had a BNPL agreement. Applicants with a monthly income under £1,500 owed 14% more and this is expected to rise (Davies, 2023). Bain's paper also demonstrates the popularity of BNPL, with a Net Promoter Score of 30, compared with 6 for credit cards and -15 for overdrafts and noting that the interest-free nature of BNPL serves as the biggest draw for consumers (Bain, 2021).

In May 2022, under new legislation, BNPL providers need to be authorised by the Central Bank of Ireland and are subject to the Consumer Protection Code. This means that they will have to check affordability and if BNPL credit is suitable for the consumer. The law also caps the interest rate BNPL providers can charge consumers at 23% APR[9].

4.3. Credit unions

The personal lending category for credit unions continues to be the significant majority of the credit union loan book. For the year to 30 September 2022, 94% of total new loans advanced were reported as personal loans. The previously identified trend towards increased duration in lending continued during 2022, with close to 32% of loans now outstanding for periods 5+ years compared with 15% at the end of September 2017 (CBI, 2023b). This, along with the move by credit unions into the mortgage market and increased activity in SME lending, reflects the desire for improved loan to asset ratios and greater sustainability.

These figures incorporate the niche IMS loan product that is offered by over 50% of credit unions. Available nationwide since 2016, it assists social welfare recipients that receive a cash payment at a Post Office access credit where they do not meet the

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[9] https://www.ccpc.ie/consumers/money/loans/buy-now-pay-later/

requirements of standard lending policies. The initiative is Government assisted through the use of the An Post-run household budget (HB) scheme (https://www.anpost.com/Money/At-the-Post-Office/Household-Budget) for repayment. Approximately 5,500 individuals use the HB for repayments on a weekly basis. The initiative is structured so that higher risk borrowers can use this specific loan to demonstrate their ability and willingness to repay a loan, and graduate to standard lending products. Beyond this initiative, many credit unions have ring fenced specific loan funds to serve riskier members of their communities - these loans are also included in this data.

Within personal lending, small loan activity is extensive. Figure 3 below shows that, for the year to September 2022, 48% of all new loans written for the year were for €2,000 or below (standalone loans and top-ups below €2,000). This percentage has declined from 58% in 2016 (RCU data, ibid.). Given the value of these loans, the portion they comprise of the overall book is by its nature small: about 10% of loans issued in 2022 (RCU data, ibid., and CBI, 2022).

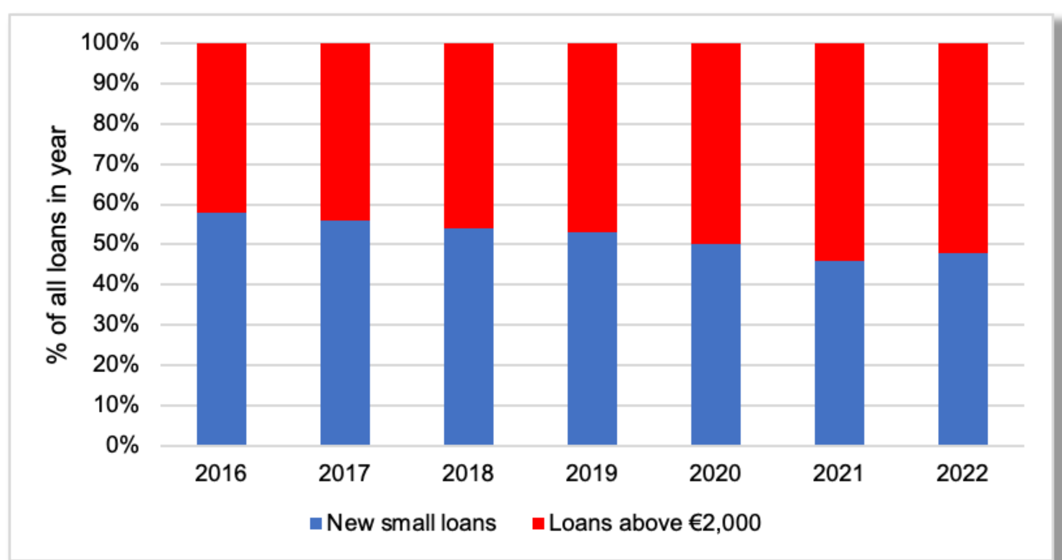

Figure 3: Credit union loans – small loans as proportion of total loans issued, by number (Source: RCU, ibid., CBI, 2022)

An analysis of the activity for loans under €2,000 is shown in Figure 4 below. In 2022, more than 232,000 new loans under €2,000 were written by credit unions, with over 54,000 of these for €500 or less. The average loan size was €1,100, reducing to €392 when loans up to €500 are isolated. This average will include top-up loans, where, for example, members have an outstanding loan balance of €7,000 and return to the credit union to apply for an additional €1,000.

The chart also shows the decline in small lending that was seen during COVID. This was expected as the typical items small loans cover, such as communion expenses, were not needed. There were also substantial state benefits, e.g. COVID payments, that persisted throughout this period. The increase in loan demand is apparent in 2021; however, the data for loans up to €500 remains somewhat flat. There is a view that this could be due to a combination of consumers using savings to cover what small

loans would have previously covered; credit being obtained elsewhere; or the reality of inflation - a €500 loan does not cover what it would have in the past.

Figure 4 shows new loan balances in columns, to be read against the primary axis (left) and loan numbers in lines, to be read against the secondary axis (right).

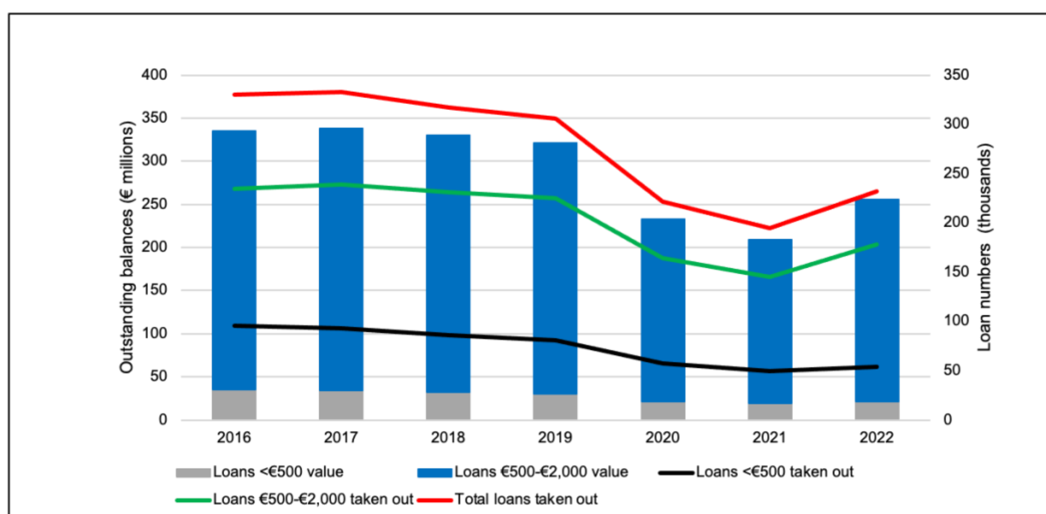

Figure 4: Credit Union Small Loans (Source: RCU, ibid., CBI, 2022)

4.4. High Cost Credit Providers (HCCP)

HCCP are licensed by the Central Bank and provide high cost credit agreements to individuals. The "credit" usually takes the form of a cash loan but may also involve the provision of goods on credit from a retailer or the purchase of goods from a catalogue/website. HCCP were previously known as “moneylenders”. The term HCCP along with other measures, including a restriction on the rates that HCCP can charge, were introduced as part of the Consumer Credit (Amendment) Act 2022. The introduction of an interest rate cap on high cost credit agreements means that 1% per week simple interest can be charged on fixed rate loans, up to a maximum of 48% and 2.83% nominal interest on the outstanding balance per month on running accounts[10]. The cap in fixed rate loans, means that HCCP can earn a maximum €240 in interest on a 12 month €500 loan.

The number of HCCP operating in Ireland is 32, down from 39 in 2016. The most high-profile departure has been Provident Financial in 2021 who were the market leader for home collection credit. The HCCP data includes home collection, catalogue and other providers.

Figure 5 below shows new loan balances in columns, to be read against the primary axis (left), and lines for the number of loans and number of customers, to be read against the secondary axis (right). While the figures are point-in-time and could relate to the previous year (see footnote 11), they provide a valuable insight into activity.

[10] https://www.oireachtas.ie/en/bills/bill/2022/27/

Contraction of the market in 2021 could be accounted for by both the pandemic and the departure of Provident. However, the 2022 increase, both in terms of value and number of loans is significant. The above data also indicates that the number of customers is greater than the number of loans. This could be due to a person availing of the services of a HCCP but not borrowing, e.g. buying an item from a catalogue and paying the amount up front or within the interest-free period.

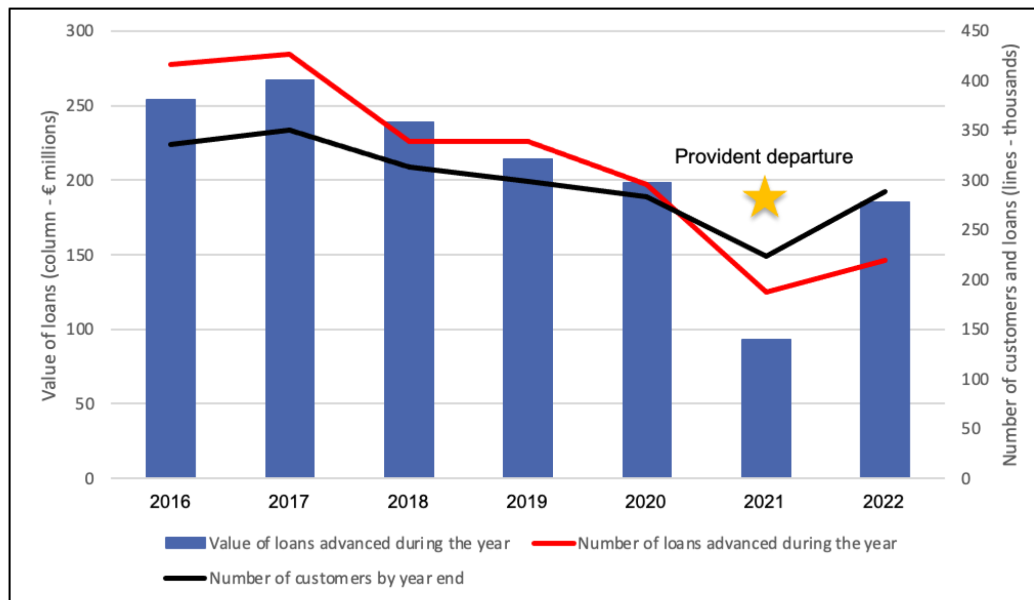

Figure 5: High cost credit provision (Source: CBI direct to project[11])

4.5. Key takeaways

- There is not sufficient data in the public domain to enable a full understanding of this market, in terms of consumer need or market supply
- In 2022, small loans comprised almost half of credit union loans (48%) by volume (10% by value), even after some years of relative decline
- While some banks offer loans below €2,000, credit unions and HCCP appear to be the dominant providers
- BNPL is a competitor to small loans; its significant growth in UK is likely to be paralleled in Ireland
- HCCP loans have also declined, but grew in 2021-2022 and remain a substantial volume of lending.

[11] Note from CBI: the figures are based on information provided by high cost credit providers as part of the annual licence renewal application process (prior to the introduction of five year licences). These figures are based on point-in-time data and dependent on each firm's financial year-end, which in some cases relates to lending for the previous year.

5. The international perspective

In credit unions, small personal loans under €2,000 remain an important part of serving low and moderate-income members. They provide financial support to people facing unexpected expenses and the challenge of managing the ups and downs of the household budget. But the way in which small loans are managed, priced and delivered varies from jurisdiction to jurisdiction. To explore the reality and dynamics of the provision of small loans internationally, the study interviewed nine CEOs in credit unions in the United States, Canada and Great Britain and one international academic expert in the field. As noted in section 3 above, the international credit unions were accessed through author networks, so are effectively a random selection. The aim was to learn from the experience of credit unions in other places serving the small personal loan market.

5.1. The United States

Most credit unions in the United States are full service co-operative financial institutions offering a range of financial products including current accounts, loans, savings, investments, credit cards, mortgages and business finance. There are undoubtedly exceptions to this, but the US credit unions that participated in this study all fell into the full-service category. This has a significant impact on the way small loans are offered, managed and priced in the US.

In general, small loan delivery fell into three main categories. Firstly, standard unsecured, closed end loans usually offered with a minimum borrowing of US $250 or $500. Secondly, small loans are offered through credit cards, overdrafts and lines of credit. In the interviews, the CEOs stressed that the preferred and the most common delivery mechanisms are those in this second category. These are automated and accessed by members themselves without an ongoing requirement to make a loan application. The third category includes products specifically designed to support low-income or financially constrained members and to assist them to avoid high-cost credit providers.

Each of these three categories presents challenges in delivery and vary in both costs and benefits. There was a general perception among interviewees that the delivery of small loans in the low-income market can accrue considerable costs for reduced return. This is not only because of level of interest accrued on small loans, but also because of the administrative costs involved. It is for this reason that small loans in US credit unions are delivered mostly through credit cards and overdraft lines of credit. But these also have operational and technology costs which must be covered. Costs for loans to more financially constrained members can be significant as borrowers may also require support in budgeting and financial education. There may also be costs arising from loan delinquency depending on the market served and the risk appetite of the credit union.

From the interviews, it was clear that the US credit union approach to the small loans market is based on a commitment to serve members but also on the premise that loans in whichever category must be commercially viable. The CEOs argued that small loans

were not internally subsidised - one group of members subsidising another. Some credit unions did receive financial support through the Community Development Financial Institutions Fund (CDFI Fund) to establish and maintain small dollar loan programmes within unbanked and underbanked populations. However, all took the view that credit unions had to approach this market as a business proposition, not as charity, and charge loan interest rates and fees that were economically sustainable (Burger and Zellmer, 1995). Losing money on any loan product was not seen as being in the long-term interest of the credit union or of its members.

Interest rates on loans in the US are mostly priced not on the size of the loan but according to risk as determined by a member's credit score. So, for example, in One Detroit Credit Union, an unsecured, closed-end personal loan, for a period of 12 months, is charged at anywhere between 8.99% APR and 15.99% APR depending on the credit score. Credit card rates which start at 17.5% APR for VISA Classic and line of credit rates which start at 14.5% APR are equally dependent on credit scores and status.

A significant difference between Ireland and the US in generating income from loans is the use of fees, which are not rolled into the quoted APR rates. Non-interest income has become increasingly important in US credit unions and charges are typically made for loan set-up and for late or missed repayments. Fees are part of the mix to ensure that the entire loan book is income generating.

However, US credit unions recognise that there are members whose credit scores militate against accessing standard loans, credit cards and lines of credit. In order that these more financially constrained individuals do not fall through the cracks and are left with little access to credit apart from the ubiquitous high-cost and / or predatory lenders, credit unions locally and nationally have developed a range of small dollar loan products tailored to the low-income market. Access to these loans is not assessed by risk nor by credit score, but rather it depends on the quality of the member's relationship with the credit union and sometimes on the member having an income, either from employment or long-term welfare benefits, preferably paid into a credit union current account. In One Detroit Credit Union, for example, borrowers must have paid $1,000 income for three months before being eligible for a loan. This is waived however if the member has set up at least that amount in direct deposit from his or her employer. The aim is to serve the member within the context that they find themselves and not create unnecessary hurdles. Often these products are linked to financial education and support interventions.

These products are designed for the less well-off, but they are still intended to be income generating to the credit union. This is the case even if a credit union is awarded CDFI Fund support to develop services in marginalised and underserved communities.

One such small dollar loan product is the MyPay Today loan at One Detroit Credit Union. As the title suggests, the product is designed to offer an alternative to the payday lenders who in Detroit often charge 400% APR (or more) on loans that must be repaid in 14 days. The MyPay Today at the credit union offers members access to a form of revolving credit for a $70 annual fee. Members can access as many $500 loans as they wish within the year, but each loan must be repaid within 60 days before

the next loan can be taken out. No top-up loans are allowed so the indebtedness to the credit union never exceeds $500. On average borrowers take out eight loans per annum and a standard rate of 18% APR is charged on all loans. Credit scores are not considered in assessing access to the product. Late payment fees of $29 do apply on MyPay Today accounts, as do $35 Skip-A-Pay fees. Fees are not rolled up into the loan interest APR but are additional.

Reflecting on the level of interest charges and fees on the MyPay Today loan, the CEO of One Detroit was clear that if the credit union was to compete effectively with the high-cost providers, it must do it in a way that is economically sustainable. He argued,

> *"It's a tough discussion (on loan charges). But if I can't be sustainable, I can't be doing this at all. And if you know from a law standpoint, if you want people to be offering this service, you must allow them to charge enough to be sustainable. If we suffer 10% losses and we charge 18%, that means we must cover all the servicing expenses otherwise".*

Nationally, and similar to One Detroit's MyPay Today product, many federal[12] credit unions are involved in the National Credit Unions Administration's (NCUA) Credit Union Small-Dollar Loan Programme, alternatively called the Payday Alternative Loan (PAL) programme. This programme enables credit unions to offer small loans of $200 to $1,000 to borrowers who have been members for at least one month, with a minimum term of one month and a maximum term of six months. They can charge an application fee of up to $20 and an interest rate of 28% APR. There is no need for an assessment by credit scores, but the NCUA insists that proper underwriting standards have been established and are being followed.

The NCUA explains on its website the reason why federal credit unions offering the PAL programme are allowed to charge 28% compared with the standard interest rate ceiling of 18% which applies to all other loans. The NCUA Board believes credit unions would not be able to cost-effectively operate a short-term small loan programme, and manage the higher degree of risk associated with type of lending, at 18% APR.

In 2019, the NCUA introduced PAL II to further promote access to small dollar loans in financially constrained communities. Unlike in PAL I, in PAL II credit unions can make a loan for any amount up to $2,000 with no minimum, PALs II loans have a minimum term of one month with a maximum term of 12 months, rather than six months and credit unions can choose to make a loan immediately upon the borrower's establishing membership rather than waiting a month.

The PEW Charitable Trust reported that NCUA data shows that federal credit unions issued $227m in PAL loans in 2022, an increase of 30% on the $174m, set in 2019. Probably small beer in relation to the $251.4bn, or 20.0%, increase on the entire $1.51

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[12] In the United States credit unions can be federally or state chartered. A federal credit union is regulated and supervised by the National Credit Union Association. State-chartered credit unions are regulated by their respective state's financial services department. In the fourth quarter of 2022, there were 2,980 federal credit unions and 1,780 federally insured, state-chartered credit unions.

trillion federal credit union loan book over the same year (NCUA 2022). However, PEW commenting in the same online report on the rise in PAL loans said:

> *"This increase in affordable, small-dollar credit benefits consumers, because each loan represents hundreds of dollars in potential savings compared with high-cost loans from payday, rent-to-own, or other similar lenders. The growth means that more borrowers with limited or no credit history have been able to borrow funds quickly to cover urgent expenses and avoid more costly alternatives. Expanded automation has helped drive recent increases".*

The note in the above quotation on expanded automation is a reference to the fact that over 90 credit unions are now offering PAL loans through the digital platform Q Cash[13]. This technological solution enables members to access a small dollar loan in under a minute, no matter their credit score, at any time of the day or night. Beneficiaries must receive pre-authorisation to use the platform and eligibility turns on factors such as the member having an account history and on making regular deposits into the credit union current account.

Q Cash is service provided by Alloya Corporate Federal Credit Union, a Corporate Credit Union. There are 1,400 credit union members of Alloya[14] which offers a range of liquidity, investment and transaction services to its credit union members, including Q Cash. Alloya is a credit union for credit unions, employs 160 professionals to maintain its services for credit unions and maintains that the power of co-operation creates enormous value all around.

Tarrant County's Credit Union (TCCU) is a $120m asset, 11,000-member credit union in Texas, a relatively small credit union by US standards. It offers a suite of loan products at variable rates, many of which are used by members to access small dollar loans. Like most US credit unions, the lion's share of the small loan business is via credit cards and lines of credit, but personal loans upwards from $500 are still available. Again, as with most US credit unions, loan eligibility and the interest rate charged are based on the assessment of risk as determined by an individual's credit score. For example, personal loans can be as low as 8.49% up to 17.5% depending on the credit score band. Scores below band D (high risk and imminent high risk) will most likely be refused credit. It is important to note that interest rates are linked to credit scores not to the value of the loan per se.

In discussions, however, TCCU staff explained that, even though they use credit scores to assess eligibility and loan pricing, they are not happy with the system. The algorithms that generate the scores do not always work in favour of low-income individuals as they are unable to capture all relevant information. So, all declined applications are reviewed personally by staff who, as the CEO stressed, "are trained to find a way to say yes".

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[13] https://qcashfinancial.com/

[14] https://www.alloyacorp.org/about-us/

But people still fall through the cracks, and it was in 2008, at the start of the Great Recession, that TCCU realised that it needed to develop a small loan product designed specifically for low-income members who were struggling to make ends meet. These were the people who the banks would not serve, and if the credit union could not serve them either, they were most likely to go to the high-cost payday lenders, more prevalent in Texas, according to the CEO, than McDonalds.

So, in 2008, the credit union developed the Payday Plus Loan, for people ineligible for a standard loan, which replicates the features of the NCUA's PAL loan but which is charged at 18% APR rather than 28% APR as allowed in law by the NCUA. The reduction in interest aims to support low-income and under-served individuals and, with modern technological systems, TCCU finds that the product is profitable even at this reduced rate.

As with the NCUA PAL I product, individuals must: be members for a period (90 days in this case) before they can be granted a loan, have a direct deposit coming into the credit union current account for at least 30 days (this can be wages or a long-term secure welfare payment) and if in work, have been in a job for a least a year. TCCU considers that these criteria are essential if risk, particularly the risk of fraud, is to be mitigated. Loans are not granted on credit scores, but rather on the relationship and engagement the member has with the credit union. A credit check is carried out, in fact, but only to determine that the member is not in bankruptcy, which would make granting a loan impossible according to State Law.

Loans are up to $1,000, repayable within six months, and must be paid down before a member can obtain another loan. Members can only have one Payday Plus Loan at a time. There is no savings requirement linked to the loan.

A set-up fee of $20 is charged and the account also accrues a late payment charge for missed payments (of 5% of the missed payment). These fees augment the income generated through the product.

TCCU staff felt it was important to point out that Payday Plus is a standalone product which is expected to, and does, cover all its own costs and generates income for the credit union. It is not a product that is subsided by other credit union members. As the CEO explained,

> *"With the interest rate and the fees, Payday Plus is a business opportunity. It's a win for the member and it's profitable for the credit union. We've never gotten where the charge-offs have been more than interest earned or the fees generated".*

Currently, TCCU makes Payday Plus loans to a value of $0.5m per annum. There was a peak in 2018 when $0.8m was out in Payday Plus loans but $0.5m is currently standard. And, even at this level, the credit union is generating money from the product.

But the same goes for the standard loans made at the highest interest rate to people with the lowest acceptable D-rated credit score. TCCU is clear that operating in the sub-prime market must be a regarded as a business proposition.

Balancing business profitability and serving members fairly is the constant challenge for TCCU. Staff members interviewed were adamant that they do not "price gouge"

members and there are multiple ways members can improve their credit scores and bring down interest rates. Agreeing to payroll deduction, for example, for loan repayment reduces a loan interest rate by 25 basis points.

However, the fact that the credit union can serve the low-income market profitably means that it can embed the provision of small loans to higher-risk individuals within its overall strategic mission, as agreed and signed off by the board. TCCU is clear that its aim is to penetrate and serve the low-income market to a much greater extent. To this end, more recently, it has introduced a variation of the Payday Plus loan, the Rapid Loan. This is a major digital advance in the provision of small loans to low-income members. It is based on the Q-Cash Platform and offers "cash in a flash" at any time of the day or night for any purpose decided by the member. In just six clicks on a mobile phone, a member can borrow $250 to $1,500 deposited instantaneously in a current account and accessible from any ATM machine.

Like the Payday Plus loan, individuals must be a member of the credit union for 90 days to apply and must not have an outstanding Payday Plus loans. Loans can be for amounts up to $1,500 and must be repaid within 12 months. They are charged at 18% APR and there is an application fee of $20. Late payments fees also apply.

Although most lending in TCCU's $99m loan portfolio is for much higher amounts, staff were adamant that small loans must be part of the credit union offer, particularly if it is to fulfil its mission to serve the entire community fairly. Recently the credit union has received some grant funding from the US Treasury to build its capacity within underserved and marginalised communities. However, the credit union is clear that this cannot undermine the fundamental principle that serving this market must remain a profitable endeavour.

5.2. Canada

In Canada, credit unions for the most part focus on the delivery of large loans for mortgages, business enterprise and agriculture. Affinity Credit Union (ACU) in Saskatchewan, for example, the 10th largest credit union in Canada has 143,102 members (2022) and CAN $9bn in managed assets of which $5.7bn in out on loan. Just $485m (or 8.5%) is in personal loans. The same would be true at Unity Credit Union (UCU), also in Saskatchewan. UCU is a $331m credit union with a loan book of $220m of which personal loans count for just $12m - just 3.6% of the loan business. At Greater Vancouver Community Credit Union, personal small loans are near non-existent.

However small loans are still available but, as in the US, most are accessed through lines of credit (overdraft facilities) on the current account or through a credit union credit card. Members can also obtain a small personal loan. UCU, for example, has two products to this end, the quick loan, which is standalone but with re-advanceable funds up to a pre-approved and authorized limit, and lines of credit which is an authorised overdraft limit that is attached to a current account. All these products are individually priced for risk and interest rates are determined by the credit score irrespective of their size.

In Canada, credit unions follow the overnight lending rate or prime rate as set by the Bank of Canada (currently 6.95%) and generally increase this by 2% or 3% as a minimum rate. The legal maximum interest rate for all financial institutions including credit unions is 60% APR (4% per month), except for payday lenders which can charge much higher rates[15]. There is no specific interest rate cap for credit unions, however in practice credit unions would rarely charge more than 15% APR on standard personal loans (except if a member would go above their authorised credit limit on the current account when a charge of 21% APR would be made)[16]. On revolving credit products, often credit unions charge up to 26% APR. In its 2023 federal budget, the Canadian Government has indicated that it intends to lower the maximum annual interest rate that lenders can charge to 35% APR. This would also apply to credit unions.

However, what makes the difference to the volume of small loans in Canadian credit unions is that they are mostly provided via a credit card. In the case of those interviewed this is not an individual credit union's card, but an off-balance sheet corporate Collabria[17] card run by the Desjardins Financial Group, a credit union co-operative organisation with parallels to a CUSO, based in Quebec. Credit unions such as UCU receive an administration fee and a percentage of the interest charged but the loans are off-balance sheet, do not appear in the credit union figures, and charged by Collabria. Rates on the credit card run from 19% to 26% APR.

There are, however, as in the US some examples of products designed specifically for the high-risk, low-income market. ACU, for example, in 2017 - with a full roll out in 2019, in response to the cost-of-living crisis faced by many lower income members - introduced the Restart Loan. This loan is designed as an alternative to high-cost payday loans and is available to people who have been declined one of the credit union's standard loan products. Members can borrow $200 to $3,000 with repayment terms ranging from 2 up to 24 months. Interest rates are not determined by credit score, as all applicants would have a poor score, and thus all loans are made at the same interest rate of 17.99% APR. This is compared to a standard credit union loan of over $5,000 charged at rates from 9.6% APR. However, there are no fees charged on Restart Loans.

On charging a higher rate, the ACU interviewee explained that the credit union has no issue with charging a higher rate on Restart Loans. They are inherently riskier, and the interest rate is much lower than that of payday lenders which would be the only other option for this group of members.

All applicants are seen in person and loan affordability is assessed in conversation with the member. The interviewee stressed the importance of personal, face-to-face contact with the member as a condition of making the loan. This loan cannot be applied

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[15] Payday loan interest rates on loan usually CAN $100 – $1,500 maximum) typically range from 300% up to 500% APR.

[16] These are the rates quoted by Greater Vancouver Community Credit Union.

[17] https://www.collabriafinancial.ca/about-us/

for online. One condition is that the member must have an income, paid into the credit union's own current account.

ACU does have a policy of offering financial education and budgeting advice to all loan applicants. The interviewee gave the example of all new mortgage borrowers who would have a financial education session with a member of staff. She stressed that it was even more important with Restart Loan applicants given their financial situation. The aim is not to keep members as Restart borrowers but enable them to build their financial health and resilience and repair their credit score so that they can be standard loan borrowers in the future.

The Restart loans are a small proportion of the personal loan portfolio, which is, as noted, only 8.5% of the total portfolio. So, these loans do not feature a strategic growth strategy. They were introduced given an evident need in the community to which the credit union had to respond if it were to remain true to its founding values. The Restart Loan is promoted through community partners and by word of mouth. It is visible on the website and in all marketing materials, but it is not marketed to the same level as other loan products.

Despite their designation as higher risk, there have been minimal losses on the Restart Loan. It has proved to be a commercial success, and, in the interview, it was maintained that this loan has not been cross-subsidised in the credit union.

5.3. Great Britain

Most British community credit unions are predominantly in the small loan market. The two credit unions interviewed for this study, London Mutual Credit Union and Leicester's Clockwise Credit Union reported that 77% and 60% of their loans respectively by volume were under £2,000. Moreover, most of those loans are made to members in low-paid employment or on welfare benefits.

The engagement of credit unions in Britain in the small loans and low-income markets owes much to their origins. In the 1980s and 1990s there was a rapid increase in the registration of credit unions, mostly with the financial and in-kind support of local government. For reasons discussed elsewhere (Jones, 1999), credit unions had come to be regarded as important vehicles in the fight against poverty and financial exclusion in low-income communities. The downside was that credit unions became to be seen by many in the general population as "poor persons banks", an image that undermined growth for decades, and one they have been trying to escape ever since. But more positively, it embedded credit unions in communities marginalised by mainstream financial services, exploited by high-cost lenders and clearly in need of the products and services credit unions could provide.

By the early 2000s, central Government too was convinced of the role credit unions could play in tackling financial exclusion and in offering an ethical and affordable alternative to the rising number of high-cost lenders targeting low-income communities. Payday lenders, money shops, pawnbrokers, buyback stores and cheque cashers were mushrooming, with the detriment of over indebtedness and financial distress that this entailed. From 2006-2011, the UK Government invested £100m in the credit union

sector through the Financial Inclusion Growth Fund. The aim was to enable credit unions to expand lending to people on low-incomes and enable them to avoid the pitfalls of high-cost credit. At the same time, the devolved governments of Wales and Scotland, as well as local authorities, continued to financially support credit unions to a significant degree.

In December 2010, the University of Bristol published an evaluation of the Growth Fund and revealed that 317,798 GF loans had been made in deprived communities from July 2006 up to the end of September 2010, with a total value of over £137m (Collard et al, 2010). Most of these borrowers were new to credit unions and the report related the positive impact of these loans in their lives. But the report also highlighted the cost of delivering these loans to higher risk, financially excluded individuals. The Bristol study's calculations demonstrated that:

> *"Based on 2010 average operating costs, the required APR is estimated to be 39.6 percent to break even at a cost of £60 per loan, and 48.1 per cent to break even at a cost of £75 per loan" (Collard et al, 2010).*

The reality of the costs of lending in this high-risk, low-income credit market had already been recognised by Government in 2005 in its consultation on the credit union interest rate cap of 1% per month. It argued that serving this market is inherently expensive, not only arising from the additional administrative and credit control required to serve the market, but also from the behavioural patterns of low-income credit use. This became crystal clear to Kempson et al (2009) when they explored the possibility of developing a not-for-profit home credit business, based on existing third sector lenders (mostly credit unions). They calculated a no profit, breakeven APR of 129% on a then home credit average 56-week loan of £288. And this was based on zero cost of funds to on-lend, which was unrealistic.

It was for this reason that the UK Government proposed to the British credit union sector to raise the interest rate cap from 1% to 2% per month. External subsidies like the Growth Fund were unsustainable in the long term. Moreover, they tended to generate dependency and inefficiencies if costs were constantly met by a third party. If credit unions were to operate successfully in this low-income, credit marketplace, UK Government believed credit unions would have to develop efficiencies and charge a sustainable rate on loans. It therefore proposed to raise the rate to 2% per month on the grounds that this would enable lending within financially excluded communities and create a more level playing field with other financial institutions.

The proposed change caused much reflection and debate among credit unions. However, in the end, credit unions in Britain realised the economic reality of serving this market with small loans and 77% of credit unions responding to the HM Treasury consultation agreed with the rise in the interest rate (HMT 2006). The Credit Unions (Maximum Interest Rate on Loans) Order 2006 then raised the maximum rate of interest on credit union loans from 1% to 2% per month. HM Treasury further raised the rate to 3% per month in 2014 to "enable credit unions to become more stable over the long term" (HMT 2013). HMT argued that:

> *"A more stable credit union sector will mean that low-income consumers will have greater access to reliable, affordable credit. Even with a 1 per cent increase in the*

monthly rate of interest, credit union loans will still be substantially cheaper than the alternatives for consumers with no mainstream borrowing options" (HMT 2013).

Credit unions in Northern Ireland, through consultation, chose not to adopt the new pricing flexibility, so the cap in Northern Ireland remains at 1% per month.

London Mutual Credit Union (LMCU) is a full-service credit union offering savings, loans, current accounts, mortgages and insurances to its 37,000 members in communities throughout South London and as employees in several professional groups. It has assets of £36m with £24m out on loan. In 2022, 77% of all its loans made by volume were for £2,000 or less, representing 27% of all loans by value. The largest part of those loans would be taken out by people on low incomes, including many on welfare benefits.

Given the social and economic makeup of its common bond, LMCU has taken the strategic decision to serve the low-income market with lower value loans. It has accepted the need to charge a commercial interest rate on loans and to prioritise the digitalisation of services to drive efficiencies and reduce costs. As the CEO of LMCU stressed in interview, the credit union has no choice but to maximise its reach within low-income communities in London. It would be against the ethos and purpose of LMCU, he argued, if the credit union just marketed higher-value loans to higher net worth individuals. He was totally comfortable in charging rates on loans up to 3% per month as otherwise LMCU could not operate in the low-income credit market and many people would be left with little choice but to use high-cost and / or predatory lenders.

To demonstrate his assertion that LMCU markets its products openly within the low-income credit market, he shared a copy of a flyer recently distributed to 80,000 homes in South London. The leaflet is entitled, '*Affordable Loans for Southwark Residents. Here for everyone, including those on benefits, low incomes & unemployed*'. It is offering a loan product of up to £1,200 at a rate of 3% per month (42.6% APR) designed specifically for those on low incomes or unemployed. But to illustrate the often only other options for people, it quotes the rates offered by high-cost lenders operation in the area. Based on £600 repaid monthly over 9 months, Loans2Go's rate is 700% APR and Morses Club is 498.78% APR, both companies used regularly by residents. In comparison, the credit union rate is by far the best option.

LMCU has a range of delivery channels for small loans, not just the one illustrated on the leaflet. It has standard personal loans, which for loans £100 to £2,499, are charged at 19.5% APR, repayable over a period of three months to three years. All applicants are credit checked, but unlike the practice in the US, the credit union does not use the credit check to judge eligibility or assess the interest rate. The credit check is to ensure that the applicant is not bankrupt, which would prevent lending by law, and can comfortably afford the repayment. Loan decisioning is never just by computer but by personal assessment.

The credit union has two products that are designed for people in work and that depend on payroll deduction from one of the 21 NHS Trusts, local authorities and other local organisations, as well as members of the armed forces across the UK, with which LMCU has payroll deduction facilities. These are Salary Flex and the Commodo

Mastercard® and both are made possible through the credit union's own current account.

Salary Flex is like a flexible overdraft. Successful applicants are allocated a pre-approved credit limit up to £2,000 at 19.6% APR, based on making a payroll deducted deposit into the credit union's current account each month. In fact, the credit limit is calculated by the level of the deposit. For example, a deposit of £96.00 from salary into the credit union account each month would result in a £1,500 credit limit. Participating members can borrow from their credit limit at any time of the day or night by using the credit union mobile app or online banking. They can also obtain a quick transfer of £250 per day by SMS. Funds are automatically credited to the member's credit union current account. Interest charges only accrue on drawn down funds.

Commodo is the Salary Flex product enhanced with a debit card. People can use the contactless debit card anytime to make purchases or withdraw cash up to their pre-authorised credit limit also up to £2,000 at 19.6% APR, and as with Salary Flex, interest is paid only on drawn down funds. Interestingly, betting and online gaming sites are blocked by default.

LMCU has two products that are designed to include people who are not in work and are on benefits. The first is the Child Benefit Loan which offers a flexible credit limit of up to £1,200 when the member has their child benefit paid into a credit union account. The first loan can be up to £600, repaid three months to a year. The second and subsequent loans are up to £1,200 with up to two years to repay. Like Salary Flex, these loans are now automated on text messaging and members can draw down up to their pre-authorised credit limit by SMS. Child Benefit loans are open to any member, in work or on welfare benefits. They are charged at 3% per month or 42.6% APR.

LMCU also has a product designed specifically for those who are unemployed or have less-than-perfect credit. These are called Booster Loans which offer members a pre-authorised credit limit of £100 – £1,200 at 42.6% APR, repayable over a period of one to three years. The condition is that members have their welfare benefit paid directly into the credit union current account. As with Child Benefit Loans, members can draw down up to their credit limit by SMS. Interest is only charged on drawn down funds.

Operating in the high-risk, low-income credit market is challenging. But, as LMCU's CEO argues, the mission of the credit union must include serving those underserved and unserved by mainstream financial services. LMCU has recently introduced a mortgage product and does recognise the importance of focusing on the higher-value loan market. But small loans are still part of what the credit union is about.

LMCU's CEO stresses however, that success in the low-income market does depend on pricing loans according to risk and cost and on generating efficiencies through digital technology and having the current account. The current account has been a game-changer in LMCU's ability to deliver small loans to low-income members. It mitigates risk insofar as it allows repayment deductions from members' salary or benefits that are paid directly into a credit union account. It also enables efficiencies that drive down cost and enable rapid loan delivery though SMS or mobile app.

The CEO is confident that small loans are not cross-subsidised in LMCU but, if he could not price appropriately, they would have to be subsidised, or would require external funding to make ends meet.

Like LMCU, Clockwise Credit Union in Leicester serves a predominantly low-income membership. It is a full-service credit union, offering savings accounts, loans and a credit union current account. It has 20,000 members, assets of £12m and currently has 4,800 loans less than £2,000 out in the community amounting to £5.8m. Many of these loans are under £500, and as the CEO maintained in interview, there are still some £50 loans, which is the smallest loan on offer from the credit union.

The credit union actively promotes small loans in the community as it strategically positions itself in the low-income market, but, as the CEO argued, it does this in a way not to encourage unaffordable borrowing. The credit union offers personal loans from £50 to £2,999 charged at the maximum 3% per month or 42.6% APR with a repayment term of 60 days to 60 months, and family loans of up to £500 linked to repayment by Child Benefit also charged at 42.6% APR with the same repayment period as personal loans. Payroll partner loans, again small loans offered at 42.6% up to £1,499 and 26.8% from £1,500 to £2,499, are offered to employees in participating companies. 90% of all loans by number in fact are charged at 42.6% APR which represent 75% of all loans by value.

Loans are subject to rigorous affordability checks. Credit agency checks are carried out on all loans, but the credit union does not only take credit scores into account in loan decisioning. Decisions are made based on affordability assessments and the borrower's relationship with the credit union. 95% of all loan decisions are now automated which drives down cost and offers a much speedier service to the member. Access to open banking is a key feature driving the automated process. As the CEO stresses, an automated decision is now almost instant.

There are moves to introduce individual risk-based pricing of loans based on a template the credit union is constructing. However, this is not yet implemented but is felt will drive down the costs for some members.

90% of all loans at Clockwise are at 42.6% APR. But, as the CEO explains, write-offs on these loans are 75% of all write-offs on the loan book. Currently 7.75% of the loan book is written-off annually. The economic reality is that if Clockwise is to stay embedded in the high-risk, low-income credit market it will have to continue to charge economic rates. There is currently no cross-subsidy in the credit union and no external grant aid subsidy to support lending in this market. The portfolio of small loans covers its own costs and generates income into the credit union.

5.4. Key takeaways from international research

- In the US, Canada and Great Britain, as in Ireland, the delivery of small loans is not only important to credit unions but forms a significant part of their overall loan portfolio, with multiple loan products created to respond directly to the needs and circumstances of low-income or under-served members.

- They are important because they demonstrate a commitment to communities and to the members who need and want small value loans. They assist them to manage the ups and downs of income and expenditure, purchase essential items, respond to immediate needs and avoid other higher-cost options.
- The North American and British credit unions interviewed operate on the principle that small loans should not require cross-subsidy, and they use pricing mechanisms and automation to ensure a net positive economic contribution from this portfolio. Examples, past and present of utilising external support so they can meet the needs of under-served groups is also a small but notable feature.
- There is no one category of member who seeks a small loan. People on moderate to high incomes sometimes require short to moderate term credit to cope with a financial hurdle. And it is well known that credit use is part of the harsh reality of living on a low-income, driven by pressures of income inadequacy and a lack of saving safety nets.
- There is no one delivery mechanism for small loans either. In the US and Canada, small loans are accessed often using credit cards and lines of credit (overdrafts on a current account or revolving credit, as it would be known in Ireland or Britain), but also form part of the standard instalment loan portfolio. In all jurisdictions, they can be new loans or top-up loans, or loans specially designed to target a particular market. However, the importance of having the borrower's current account was prevalent.
- US and Canadian credit unions collaborate to offer consistent propositions, such as PAL or through Alloya Corporate Credit Union, to facilitate economic delivery of their products.

6. The economics of credit union small loans in Ireland

The very nature of a small loan results in a small amount of income being generated. Credit unions in Ireland do not charge fees – as is typical in North America – and given the existing interest rate cap there is a limit on what can be earned.

A €500 loan from a credit union charged at 12.68% APR (the current legal maximum), repaid weekly over 30 weeks, would generate €18.10 in income (or 60 cents a week). Many credit unions charge less than the maximum: 9.4% APR, for example, generates just €13.60 in income for the credit union (or 45 cents a week).

The rate charged on a loan is a decision for each individual credit union. However, given the significant portion of the book that comprises small loans, the economics of this activity is a factor that needs to be considered.

6.1. Breakeven analysis

The individuality of each credit union means that the elements that influence the breakeven rate can vary widely across the sector. To give a sense of breakeven rates that exist, and to be broader than individual case studies, an analysis was undertaken on a sample of 61 credit unions. These credit unions all use CUFA software, which relies on data inputs from the credit unions that CUFA serves. The sample database comprises €3.3bn in loans, or 58%, of all Irish credit union loans as at 30/09/2022 and is skewed towards larger credit unions. The variables included in this evaluation are shown in Appendix B.

Isolating top-ups in a granular fashion from credit union data is problematic, so the CUFA information has been analysed based on looking at 'small loan borrowers' – credit union members who have taken out a standalone small loan or who took out a small loan and subsequently topped it up, in all cases the loans examined were where the opening balance of the new loan was less than or equal to €2,000.

The data showed a breakeven interest rate range of 9.0%-21.0% APR. This implies that there is a cross-subsidy operating for many of these loans. What the monetary amount of this cross-subsidy might be for each credit union or the movement as a whole, and its affordability, is not identifiable. In considering these figures, the following must be borne in mind:

- There will be considerable variability across the movement, and some credit unions may be breaking even on these loans at lower rates. A key factor in this is the loan to asset ratio and the lending income that covers costs.
- There is no allocation of any additional costs of administration often associated with small loans, for example on set-up, servicing or arrears management.
- The analysis assumes no cost of funds from either dividend or capital. Given the current interest rate environment, this is an assumption that is increasingly open to debate.

6.2. Administration Costs

Credit unions vary in their views on the administrative burden of small loans (see section 7.2), but for branch-based lending, labour costs must be high relative to the modest income accruing, especially if direct costs such as CCR, loan protection insurance and the costs of default are added. The acknowledgement of the cost of small loans is also noted in the Retail Banking Review recommendation that CCR charges for low value loans be reduced.

There is a school of thought that the administration is being undertaken by a lending officer that would be present with or without small loans, i.e. the salary cost is fixed. Therefore, while these loans may not cover their own costs, they make a contribution to the 'sunk cost' of the credit union's operating model. This approach does not deny that, in effect, these loans are affordable because other income that is generated supports 'the rest' of the business. It also aligns with the thinking that this is a service that should be provided by the credit union and is part of the ethos of service to members.

The overall cost: income ratio of a credit union is under increased scrutiny. Initiatives to address costs and additional products / services are topical, such as collaboration, possibilities around CUSOs and Corporate Credit Unions[18] (as allowed for under the pending Credit Union (Amendment) Act 2022. Features such as revolving credit, automated decisioning and increased digitalisation are emerging in credit unions and should have an effect in reducing administration costs as well as, potentially, making the member experience faster, more convenient and more attractive. This has the double benefit of protecting the 'bread and butter' small loan business and the prospect of growing lending. Credit unions will need to be mindful of those members for whom digital is a barrier, for example some older members.

6.3. Arrears and Write-offs

As with all data for credit unions, the particularity of each is a key factor for arrears and write-offs. From the CUFA database, there was data available for over 50 credit unions that when analysed demonstrated that small loans have a riskier profile – see Table 1 below.

The sample covered loans issued between 1 October 2021 and 31 March 2023, when the snapshot of performance was taken. Loans included were where the application was for a value of €2,000 or less, whether or not it was a new application or a top-up. Term was not a criterion. This evaluation reveals that small loans are that arrears over 9 weeks for small loans are higher than the overall portfolio. This holds true for the median and the average.

[18] A Corporate Credit Union is a 'credit union for credit unions', effectively a centralised treasury function

Measure	Loans over €2,000	Loans €2,000 or less
Highest *arrears rate in sample*	3.4%	8.2%
Median (*mid-point) rate in sample*	1.1%	2.1%
Average (*the mean) of the rates included in the sample*	1.1%	2.3%

Table 1: Credit union loan arrears (source: CUFA Ltd)

With respect to write-offs - at the riskiest end of the sample (which relates to small loans excluding top-ups) the rate of write-off was four times higher than the main book. This is based on loan numbers and not on value as the amount of loan value written off is minor given the nature of the original small loan.

To crystallise the issue, if just one €500 loan went bad, the credit union would have to make and recover 28 other €500 loans (at 12.68% APR) just to cover the cost of the bad debt, before any additional collections administration costs.

6.4. Key takeaways

- The breakeven analysis suggests that many small loans are individually cross-subsidised, some substantially. The aggregate subsidy for the movement is not known. This assumes all costs are evenly attributed to each loan written.
- Given the very modest interest income arising, the economics of small loans are highly sensitive to cost and risk and the underlying credit union loan book.
- Administration costs can be expected to be the same or higher than higher value loans in many credit unions, unless digitalised processes are in place and pending the widespread adoption of automated lending decisioning. However, some applications will still require more manual intervention where they do not meet standard criteria or where members are not comfortable with digital channels.
- Arrears and write-offs are higher for small loans than the overall credit union loan book.

7. Perspectives from Irish credit unions

Semi-structured interviews were conducted with ten Irish credit union CEOs (listed in Appendix A). This relevant sample of credit unions covered urban and rural common bonds, lower and higher income communities and different asset sizes. The aim was to explore their experience of the delivery of small personal loans up to €2,000 by their respective credit unions. The delineation between top-ups and standalone loans is not drawn consistently through the conversations. This highlights a complexity that some top-ups are built on small loans and some on larger ones.

The credit unions were representative of urban and rural common bonds and of lower and higher income communities. In addition, eight stakeholder discussions took place towards the end of the research. These were semi-structured conversations where indicative findings were shared and the stakeholders were asked where possible for comments or inputs.

A series of themes and considerations emerged out of these conversations and are recorded in this section of the report. They reveal the various, and sometimes differing, concerns and aspirations of the participating CEOs and stakeholders and shed a light on the varying approaches to the delivery of small loans by Irish credit unions.

7.1. Small value loans in Irish credit unions

All ten CEOs reported that small personal loans were still very much part of the business. But how much part of the business varied considerably. For some small loans were very significant, for others they were important but less so. A CEO from an inner-city credit union said that 62% of the loans issued were under €2k, and about 17% of total loan value. This compared with a CEO from a small provincial town who reported that 23% of all loans were for less than €2,000 and 15% less than €1,000. These credit unions would still make loans in the range of €250 - €500, and one said that they would still make a loan of €50, but this seemed to be an exception.

However, in other credit unions, the delivery of small loans was in decline. A CEO in a rural credit union reported that a very low percentage of loans were less than €2,000. He said that in his area there was very little demand for small loans and no demand for loans under €500, a fact he attributed to the growing economy of his small rural town and perhaps a rural reticence to appear in financial need. Another CEO in a large county town also reported that small lending had significantly declined over recent years. This she felt was due to the economic context of a city with high employment, where less people were struggling and where there seemed to be greater disposable income. She also thought it could be a result of more young people staying at home because of the housing market and thus contributing more to the household budget.

Yet another CEO, in a major conurbation, reported that, even though the average loan in the credit union was still only €1,200, there was a marked trend away from low-value loans. She felt that one reason for this was the rise in the cost of living. For many items, what would have cost €500 a few years ago, now cost going on €1,000.

From the discussions with the CEOs, it was also clear that there was no single, homogenous market for small loans. Different markets with distinct characteristics and demographics were being served with small loans, including the relatively stable market of people who have been, or whose families and friends have been, long standing members of the credit union, who use the credit union for small amounts of credit and are regarded as trusted borrowers of good standing. As one CEO said regarding small loans:

> *"The credit union has served several generations; people know that they will be looked after and treated with dignity when they come in."*

CEOs stressed that it is the mission of the credit union to serve such members, mostly on low to moderate incomes and who still rely on the credit union for relatively short-term low-value credit. In the inner-city credit unions, they make up much of the membership and given the fact that they are stable individuals, lending in this market - albeit not particularly profitable - is relatively secure. One CEO made the point that, even though loans under €2,000 may be a small proportion of total loan value, they were a significant part of the credit union offer as they demonstrated the embeddedness of credit unions in local communities. This reality, he felt, attracted other higher borrowers to credit unions as providers of ethical finance.

Another marketplace for small loans is made up of a demographic of people who generally struggle to make ends meet and may be underserved – or even unserved - by the credit market. They probably have impaired credit histories but still have a regular and ongoing need for affordable credit. Their patterns of credit use can be erratic often reflected in missed payments on credit and household bills. The CEOs felt that this demographic is a harder market to serve, in terms of risk and the cost of the often-increased administration involved.

Many people in this demographic would be borrowers served by the IMS Loans, which are available to members over 18 years of age and in receipt of a social welfare payment, collected weekly from An Post in cash. But the demographic of the underserved goes way beyond those on welfare payments paid in cash at An Post.

The study does not focus on IMS loans as by their niche nature, they are relatively small in number nationally and are repaid via the An Post operated Household Budget Scheme into the credit union. But they are small loans, offered by seven of the CEO interviewees, three of whom commented on their experience. One CEO said that his credit union limits IMS loans to €500 given the difficulties that some people in hard financial circumstances have in repaying the loan. He would increase the amount if borrowers could demonstrate self-help and financial responsibility through a good record of payment in the credit union. Another CEO reported IMS loans being both an administrative burden and inherently risky with a higher write off rate than the main book. A third CEO in a city conurbation reported on IMS loans positively, with the scheme running successfully.

An observation made by a stakeholder was that, given where we are currently in the lending cycle, now might not be the time to access credit, and that is possibly reflected in the decline of credit union lending in the small loans market. There is a general focus on budgeting and cutting back on non-essential items (e.g. subscriptions) rather than

borrowing. It was noted by a stakeholder that an insignificant number of calls are being made to the MABS helpline concerning accessing credit – it is not something that is featuring at this moment.

However, several stakeholders argued that there are currently gaps in the market for small loans and some people do fall through the cracks, but it is difficult to tell how big this gap is. Credit unions are acknowledged by stakeholders as the key provider of small loans, but it was suggested that the appetite of the board of a credit union to access this market is the key element in the level of activity. Two stakeholders raised the question of what would happen if credit unions were not there?

The importance of financial education and financial literacy was raised throughout the stakeholder interviews. In particular, the question was asked as to what is meant by financial education and how this differs depending on a multitude of factors including credit needs and accessibility levels. The pros and cons of linking lending to savings was mentioned as was the advantage of savings buffers.

7.1.1. Key takeaways

- Credit unions are active within the small loans market and CEOs are committed to serving their communities with this traditional form of credit union lending
- However, some credit unions perceive small loan activity is decreasing and indeed, at the same time, the size of small loans is increasing. €500 buys much less than it did.
- There is a need for credit for underserved groups – as some people do fall through the cracks. This has led to involvement in such schemes as IMS, but it is generally accepted that loans that target the more financially constrained borrower carry a higher risk profile and a bigger administrative burden.

7.2. The economics of small value loans

There was a general agreement among all CEOs interviewed that small loans contribute little if anything to the financial stability of the credit union. At best they generate a small income or break even, and at worst are a financial cost to the credit union. As one CEO noted, even though small loans were 23% of all loans by number, they generated just 3% of all loan income in the last financial year. Most CEOs would agree with him when he says:

> *"We have consistently made a loss on small loans, we've done an analysis on them for ten years, and we've consistently made a loss."*

However, one CEO did argue that the credit union was "holding its own" on small loans with income just about covering costs. If there is a positive net margin, a high volume, high turnover business model can be attractive, however this CEO noted that this is not where a lot of credit unions want to be. According to the CEOs, minimal income or even losses on the small loan portfolio arises from two main sources – administration costs and loan default.

On administration, one CEO told the research team that:

“Staff report that it is a lot harder [and costlier] to do a €500 than a €50,000 loan … people on very low incomes … need much more handholding and attention”.

With regard to loan default, among the group of CEOs there was a general perception that arrears on small loans were significantly higher than on larger loans. This appears to be maintained, even though CEOs seemed to be ambivalent as to whether these loans were particularly risky. One CEO said that “normal” arrears run at 2.5% compared with first time loans, mostly under €500, at 12.5%, and small loan write offs are “usually somewhere between 10 and 15% per annum”.

However, despite the minimum income generated and the losses, credit unions continue to offer small loans to their members on the basis that the rationale and purpose of a credit union is to serve its members, particularly those facing financial challenges. As one CEO put it:

“It doesn't make sense [lending small amounts] and it's not cost effective. But you're doing it because they're your members and you don't want them to go to moneylenders.”

CEOs and a number of stakeholders recognised that costs must be covered somehow on small loans. Credit unions have their expenses to meet and are not charitable institutions. If small loans are not generating sufficient income to cover their own costs of delivery, they must be cross subsidised within the business or paid for by some external sponsor or donor. There was a general acceptance by CEOs that small loans, in the absence of any external donor, must be cross subsided if credit unions are to remain faithful to their social mission of serving people on lower incomes. But they did admit that cross-subsidy did potentially result in reduced dividends and loan rebates for the wider credit union membership.

There was some discussion in the interviews of the ways in which credit unions could drive down the cost of making small loans. For the most part, small loans are still delivered face-to-face which augments transaction costs. At least two CEOs considered that there should be greater opportunities arising from enhanced technology. One CEO reported the introduction of a semi-automated loan decisioning tool has resulted in a marked decrease in staff time spent on small loans (€100 to €500), particularly through signature digitisation. This CEO estimated that digitisation saves approximately €20 per application which will decrease losses in this field. The CEO noted however, “Whereas full digitalisation of loan processes has reached an average of 47%, there is very considerable resistance to digitalisation among the micro borrowers”.

The issue of automating the small loan market was also discussed with some stakeholders. While this may extend reach and reduce cost, it could result in increased declines (and therefore potential manual intervention) and a lack of alternatives, especially for more risky borrowers. The digitalisation of alternatives to small loans was also raised. The need to reach those who opt for quick credit access but ensuring that affordability features is important. A concern raised by most stakeholders was about BNPL and how prevalent this is in Ireland. The lack of data on this market is an issue. One stakeholder noted that the goals of a retailer offering BNPL are potentially at odds in that the retailer wants to maximise sales, but affordability of credit should be the

priority. A question was raised as to whether this is "the new PCP [personal contract plans, associated with car finance]" as people potentially do not fully understand the terms and conditions.

Given that many CEOs had argued that default on small loans was in general higher than that on larger loans, it might have been expected that they would have also argued that the risk associated with such lending would have also been higher. However, the discussion of risk assessment in relation to small loans was somewhat more nuanced and complex. The perception of most CEOs was that these loans were not significantly higher risk than larger value loans or, at least, perhaps more accurately, the risk was within acceptable tolerances. Borrowers may struggle financially, may even miss repayments but, in the end, CEOs felt that most repay the loan in full. Of course, not all do, and a level of default was accepted as a fact of life. Given the relatively small value of these loans, such defaults could be accommodated within the business. One CEO said:

> *"They are not riskier. People are borrowing to survive, and this is a critical line of credit. It's their last bastion of credit-worthiness so they repay."*

But another articulates well the complexity of the situation:

> *"They're definitely risky; like if I would have come in from a bank and would have looked at these loans. Why in the name of God are we doing this? … But then when you put your credit union hat on … we've given this person 48 loans of this amount already, and they always repaid every week. So long as you can keep them with you and not let them go too high up, then yes, we can lend to them."*

There were varying thoughts on costs from other CEOs and stakeholders, in some cases the thinking is that lending staff and process are a sunk cost so writing small, costly loans is not an issue. Others would be closer to querying the return if full costs were allocated.

In the interviews, CEOs described the pricing models in force in their credit unions. For the most part, credit unions had systematic approaches to pricing particular loan products. As one CEO explained:

> *"The credit union has a straightforward, systematic, and transparent approach to the creation of a new loan product. This involves an analysis of the market including an estimation of demand. Importantly it includes an analysis of the impact of the loan on the member. The credit union looks at the costs of the necessary funding, dividend, and regulatory reserve to facilitate the loan, and at the administration costs [and based on this analysis the interest rate would be set and the expected rate of return calculated].*

It was interesting to note how the approach to pricing confirmed the level of acceptance of cross-subsidy within some credit unions. For even though the credit unions recognised the potential losses on small loans, some still priced them below the permitted regulatory maximum of 12.68% APR. In one credit union, no loans were charged over 9.4% APR, in another it was 8 or 9%, depending on the product and in yet another the maximum was 11.4% APR. The reason for this was aptly explained by one of the CEOs:

"These loans are still a very small part of the loan book; we lose money on these loans, but we do not work out the sums. We can afford to cross-subsidise these loans because they are not of significant volume."

In other credit unions, the price set for small loans was either the maximum of 12.68% or close to it. Even though in one of these credit union, the maximum is only charged on loans less than €1k. One CEO highlighted the general approach to pricing in these terms: "The pressure at board and at management level has always been to try to drive price down, not up."

All CEOs reported that loans were priced on the category of the loan, not on the risk profile of an individual member. In fact, no CEO felt that moving to risk-based pricing as undertaken in other jurisdictions was feasible or desirable in Irish credit unions currently. The discussion on pricing for risk turned on pricing categories of loans by value or by purpose, not by the credit worthiness of the individual. In other jurisdictions, such risk-based pricing is often based on credit scores, which are not available in Ireland. There was a sentiment amongst stakeholders that pricing for risk at an individual level or having access to a personalised credit score is not something that will feature in the Irish market soon.

Some stakeholders expressed the view that charging more for certain small loans may not necessarily be negative. However, it was noted that combining such finance options with wider financial education and supports would be useful. It was mentioned by another that how much more might be charged and how this fits with affordability is key. It's really down to the cost of credit and the burden for those on low income.

7.2.1. Key takeaways

- Small loans are administratively heavy and contribute little financially, but credit unions see this provision as an important part of serving members.
- Varying views and nuances on whether these loans are loss making, but arrears and write offs are typically higher.
- Awareness that costs need to be driven down and that digitisation and digitalisation is playing a role in alternatives. Particular concern was raised about BNPL.
- Most credit unions do not price to the current maximum permitted – they look to absorb the cost as small loans are a small part of the book value.
- Loan pricing is based on category of loan by value or by purpose. There is no apparent appetite to have individual risk-based pricing.

7.3. Promotion of small value loans

The ten CEOs were clear, despite the involvement of credit unions in the delivery of small loans, that they were not promoted vigorously within the common bond. But if credit unions are successfully making small loans, and CEOs regard most of these as not particularly any riskier than larger loans, the question arises as to why credit unions are reluctant to advertise and promote their engagement in the small loan market more

widely. This is particularly pertinent given some stakeholder assertions that some people in Ireland are unable to access affordable credit and that the high-cost moneylender environment is still very active and seems more complex than in previous years. From the discussions, there seems to be three main reasons for this.

First, in the context of having to maximise income to maintain the business, build reserves and potentially pay a dividend on saving to members, small loans are not seen as sufficiently profitable to merit prioritisation within a marketing strategy.

Secondly, if small loans were to be made profitable, it would depend on maximising significantly the volume and turnover of such lending in the low-income market and charging a price that would be required to cover the increased administration costs. This is currently outside the business appetite of most credit unions.

Thirdly, currently small loans seem to be made to members with whom the credit union has a relationship or who, in one way or another, are part of the credit union's social and family networks in the community. Openly promoting small loans would result, CEOs feared, in attracting much larger numbers of applications from financially excluded, credit impaired or otherwise vulnerable individuals, who most CEOs considered that they are not equipped to serve. This demographic is seen as a harder market to serve too risky for limited or no financial return on effort, even with the knowledge that the credit union is reaching out to some of the most underserved and financially vulnerable in society.

One CEO in an inner-city credit union with a large low-income population argued for increased Government support, from subsidies or loan guarantee schemes, to enable credit unions reach out and serve the unserved and underserved. Significantly, the CEO added that, even though his credit union served many low-income members with small loans, he is being forced to prioritise the move to making larger loans to ensure the financial stability of the credit union. A remark from a stakeholder was that it would be great to see a government subsidy of some description so that the poorest don't pay more. Safety nets need to be there in the first place - as a loan is not the best option for everyone – and then credit has a role to play. Access can be difficult.

The result is that, even though credit unions will provide small loans if approached personally, they do not actively promote small loans to any extent if at all. One CEO said, "We don't promote low value loans. We just react to people as they come in."

Yet another CEO in a provincial town, when asked if she felt that there was an opportunity for credit unions to expand into the small loans market, she replied very much in the negative. This was confirmed by another CEO who said credit unions were just not in that part of the small loans market that is higher risk and that has traditionally been served by high-cost, alternative sub-prime lenders.

Of course, among the group of interviewees, there were CEOs from credit unions who do reach out more into the underserved market, even though it may not be promoted openly. They may be known for the support they offer through local social networks and by word of mouth. They may already be doing IMS loans. But they recognise the challenge of operating in this market on an internal cross-subsidy basis alone. Even in

these credit unions, financial realities push the direction of travel upwards to providing higher value loans to more moderate and higher-income borrowers.

From a stakeholder perspective, two raised the lack of marketing around IMS loans as a potential hindrance to greater number of borrowers. They noted that this lack of visibility also applies to small loans and that if there was a commitment to higher profile marketing that it would potentially assist credit unions increasing lending in this area and to prospective borrowers knowing that options exist. However, they noted that it is unclear if this appetite exists amongst credit unions.

Lack of uniform marketing was also raised by stakeholders, in the context of an individual being able to compare different forms of small value credit. Credit union risk appetite and pricing differ. The ideal would be a uniform product but the challenges to this are also understood.

These points on lack of marketing and uniformity echo the issues raised by CEOs in that this is not a homogenous market. A question that arose during several discussions with stakeholders and CEOs was whether it is the responsibility of the credit union to serve risker small borrowers. The significant role that credit unions play in the small loan market is very clear and the importance of it is understood by all stakeholders. But members who are well known, may have shares and borrow small amounts frequently are a very different proposition to new, unknown members with a default history. There was no clear consensus on the role for the credit union in this space. It was raised by a stakeholder that any initiative cannot be a replacement for welfare schemes and reinforced by several stakeholders that sometimes not giving a loan is the right decision.

7.3.1. Key takeaways

- Active promotion of small value loans is not prevalent due to: lack of importance of this segment within overall marketing strategies and pressures; maximising the volume of small value loans to enable profitability is outside the business appetite and; these loans are typically to known members and outside of this is a risky cohort.
- There is activity to help more financially constrained borrowers through dedicated initiatives such as IMS, but it can be challenging.
- Lack of visibility and a uniform product is a potential barrier to reach more borrowers and having a clear message.
- But is it the credit union’s role? Sometimes a loan is not the solution.
- There is an acknowledgement that costs must be covered by someone – the borrower, a cross subsidy or external support.

7.4. Loan pricing

To cover the administrative and loan default costs of serving the low-income market with small loans, commercial credit providers typically charge higher interest rates on loans or, in some cases, augment income through set-up and other fees. The higher

rate can be charged against the size of the loan or against the risk profile of the borrower depending on the business model of the provider.

Most CEOs considered that small loans are not profitable and often resulted in a cost to the credit union. This was particularly the case if direct costs such as CCR and the costs of default were added to those of administration (and some considered write-offs to be higher on these loans). The acknowledgement of the cost of small loans is also noted in the Retail Banking Review recommendation that CCR costs for low value loans is reduced.

One area in which it would allow for greater flexibility in loan pricing would be on the interest rate charged on small loans. If credit unions charged 2% on small loans, they could become economically more attractive and rather than requiring cross-subsidy within the business they could become a net contributor to the financial stability of the credit union. In the interviews, the CEOs expressed a range of opinions on the suggestion of greater flexibility on the pricing of small loans.

Most CEOs had little appetite for raising interest rates on small loans. Some CEOs were sceptical of the idea and others felt that there was no pressing necessity to increase rates. Overall, there was a strong commitment to treating members equally and ensuring as little a pricing gap between members as possible. As noted previously, several credit unions were not charging the current legal maximum on small loans because they did not want to highlight differences within the membership. As one CEO said: "there are already discounts on higher value loans. I don't want a wider gap [between members]."

Interestingly, CEOs did note that there were already differential interest rates between categories of loans, often related to the purpose of the loan (car, home renovation etc) but which also linked to its value. But these differentials were mostly downwards rather than upwards.

Another CEO said that while it might be appropriate to charge more for a risker group, "we have no plans for that." Other CEOs without plans to raise rates also saw the economic case for doing so, for example one said:

> *"If the change enables classic inner-city credit unions to serve the people of their common bond … then that's a good thing to allow them to do that because they are obviously providing an alternative to high-cost lenders [not] profiteering."*

Another CEO was in favour of the rise in interest rates "for people who won't come into the credit union and where we'd go out and serve them in the community." Yet another CEO saw the value of charging higher rates but did not want to be the first credit union to do it, and another thought it was "a useful option to have given volatility on market rates."

By temperament and desire, based on equality and equity, CEOs were sceptical about or even against raising interest rates on small loans. They felt intuitively that that higher rates on small loans penalised the low-income borrower. But on the other hand, on reflection, they appreciated the economic reality of serving this market and were open to the idea of charging higher interest rates if loan volumes were of a sufficient size to

justify it. There could come a point, if the volume of small loans grows, where cross-subsidy of costs becomes unsustainable.

One of the stakeholders noted that it will be interesting to see if the potential increase in interest rates for credit unions, impacts market supply. Others observed that utilising the ability for increased pricing may be seen as a moral dilemma. The more a credit union can understand the cost/ benefit by product the more informed this discussion will be. If certain small loans are being cross subsidised significantly by other members, then a call needs to be made either to increase pricing or obtain support externally or reduce costs. It was pointed out that in assessing supports or initiatives to assist those who are risker borrowers, policy-makers and providers need to be very clear on what problem they are trying to solve and the behaviour they are looking to model. The supports need to be there to empower and encourage people to take ownership and have a better view on their own finances. The success stories from the IMS loan and the importance of using the household budget deduction for repayments were referenced. In addition, the importance of graduating borrowers from IMS to standard lending was noted.

The lack of data on the small loan market was raised by all stakeholders. It is very hard to assess if a market need is being met when the details of what is available and metrics around activity are unknown. It was observed that the CCR would be a good starting point and that the availability of headline, anonymised data would be beneficial. It was noted however that the lowest loan value collected by the CCR is €500. Based on credit union figures alone for loans less than €500, that means that more than 50,000 loans were not recorded in 2022. BNPL firms are also absent from CCR data. As noted above, the Retail Banking Review made several recommendations around the CCR including reducing the reporting threshold, the consultation obligation and the fee for lower value loans.

7.4.1. Key takeaways

- There is a tension between the economic reality and the desire for equity and avoiding penalising small borrowers.
- The principle of varying the price of loans is generally accepted for loan purpose.
- The CEO's current instinct is not to raise rates, but the economic logic of doing so for risker new members is accepted.
- The importance is data was highlighted and the gaps that exist without it, especially when it comes to underserved borrowers.

8. A conundrum, and recommendations

8.1. A conundrum

In conclusion, small loans present a conundrum. On the one hand, they are valued and needed by a significant proportion of the membership. But on the other, they generate minimum income per loan but can be costly to manage, administer and control. Added to this, depending on the market served, there may be additional costs arising from erratic payments and loan delinquency and the personal support required by some members. It is not difficult to appreciate how a Board and CEO would be drawn to put more effort and strategic thinking into maximising higher value loans than building the small loan portfolio. For surely making a €50k loan is going to be of greater long-term benefit to the sustainability of the credit union than making one for €500 within a risker market. Or is it? Would a reticence to engage enthusiastically in the small loans market undermine the very values on which the credit union movement is based? Would it not just make credit unions feel like banks?

But how can credit unions engage in this market and strategically promote small value loans? How realistic is it to do so, given all the other sustainability pressures? How can they cover the costs and indeed generate income from greater involvement in the low-income market?

Credit unions can only cover the costs of small loans either through cross-subsidy within the credit union, through external grants and subsidies or through pricing loans commercially.

Cross-subsidies mean that one group of members cover the costs of another group of members, with potential losses in a return on savings and possibly reduced services. They also mean that effort is put into product and service development with low income generation. Indeed, how equitable is it in a self-help mutual, designed to ensure a good deal for all on financial services, for one group to benefit at the expense of another. How does this balance with the founding principle in Irish credit unions of solidarity?

External grants and subsidies can certainly assist credit unions to build capacity and reach within communities. There have been good examples of this both in the US and in GB. But if the result is to generate unhealthy dependence on external money, bad lending and a reduction of entrepreneurial drive, there are losses all around.

In the US, Canada and GB, credit unions determined that the only way to strategically engage in the small loans market, to any real extent, was to approach this engagement in business and commercial terms. The key issues are price and efficiency. It is in the long-term interests of the credit union that the delivery of small loans does not just break even but is income generating and contributes to the sustainable development of the organisation. So, in the US, Canada and GB loans are priced to cover risk and administration costs and to generate a surplus. The paradox is that by raising interest rates on small loans, more people are served with the loans that they need.

Alongside price is the issue of efficiency. Loan interest rates on small loans can only be kept down if costs are kept to a minimum, and this can only be achieved through

the efficient delivery of services. Achieving this is often dependent on the increasing digitalisation of loan delivery mechanisms.

Can the conundrum of the delivery of small loans be solved? Can they become increasingly a strategic objective of credit unions in Ireland? Could these issues be addressed to enable wider penetration in the small loans market? Maybe, but only if the issues of price and of efficiency are tackled squarely head on.

8.2. Recommendations

These proposals, which need to be driven by credit unions, address the objectives of protecting existing member relationships and seeking to serve new members. It strives to open up the discussion, recognising that this is an area that is not clear cut and has a history as long as the movement itself.

In considering the actions that could be taken, credit unions should view this from three perspectives:

- Protecting the ‘bread and butter’ small loan market share that they hold
- Growing the small loan market for those that meet standard lending criteria
- Assessing the opportunity to address the underserved in their communities with specific products aimed at this riskier borrower profile.

To address the conundrum of small loans the following recommendations are proposed.

1. Importance of the market

1.1 It seems that small loans are loved, but they are costly and are not promoted, and while credit unions could do more, is this affordable? If it’s not, who misses out? These questions need to be teased out in greater detail so that a movement position on the importance of the market – and the various sub strands within – can be articulated.

1.2 This feeds not only into the role of credit unions as community banks and their social impact but would also enable uniform promotion of the products on offer to be developed.

2. Data and analysis

2.1 There is not sufficient data in the public domain to enable a full understanding of this market, including BNPL data, in terms of consumer need or market supply. This needs to be addressed, with the CCR being a rich source of information.

2.2 In considering data, the Retail Banking Report recommendation that the reporting threshold is reduced to €200 would be of benefit.

2.3 Credit unions have considerable data on small loans at an individual level: sector-wide tools to measure the nature and economics of these small loans would be very useful:

- The sensitivity to cost and risk
- The potential volume and performance variations between the different types of small loans that exist e.g. top-ups and standalone loans to riskier borrowers.
- The levels of cross subsidies that exist, if the level of cross subsidisation is aligned to the sustainability pressures facing the sector and if not, whether this needs to change.

3. Costs and pricing

3.1 Continued progress is required in automation and digitalisation, including automated decisioning, to reduce costs for these (and other) loans (and improve member experience, per 4.1 below). At a movement level, there are opportunities to collaborate to address this. The products and efficiencies that could be introduced to assist in servicing this market should be developed. The international examples cited above may provide a useful frame of reference. The pending Credit Union (Amendment) Act paves the way for increased CUSO and Corporate Credit Union activity.

3.2 The Retail Banking Report calls out the anomaly of the flat fee that applies to the CCR. This direct cost should be aligned with loan value.

3.3 Costs must be covered by someone – the borrower, other members through cross subsidy or external support. A discussion on this is needed in the context of the importance of the market. Individually and collectively, agree how or if different pricing models are consistent with the Irish credit union ethos, cognisant that international practices do not necessarily translate directly.

3.4 The current credit union instinct is not to raise rates, but the economic logic of doing so to offer broader products and serve more members is accepted. Other jurisdictions have greater price flexibility which reduces barriers to this opportunity: current legislation prohibits Irish credit unions from offering a broader range of lending products and pricing for risk.

3.5 Explore if raising prices on small loans increases access to credit for riskier borrowers and creates opportunities for growing the lending book in a sustainable way.

4. Moving with borrower behaviour

4.1 Without losing the unique nature of the credit union offering, seek to develop a competitive, convenient, digital process to serve borrowers, especially younger consumers, in a modern manner. Collaboration could play a key role (per 3.1).

4.2 Consider whether revolving credit presents an efficient and attractive alternative especially in respect of top-ups.

4.3 Understand the role of the credit union in financial education for borrowers of small loans.

5. Understanding the underserved

5.1 Work together and with stakeholders to fill in information gaps about the currently and yet-to-be served borrowers, so that products and services can be effectively designed, priced and delivered.

5.2 Determine what providers are expected to contribute and what public bodies are expected to contribute. Seek to collate better information by aggregate and / or segmented data on people who are not well-served by small value credit market Ireland.

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Appendix A: Research participants

Irish credit unions

Affinity Credit Union
Ballyfermot Inchicore Credit Union
Bantry Credit Union
Capital Credit Union
Core Credit Union
Donore Credit Union
Heritage Credit Union
Limerick & District Credit Union
St Canice's Credit Union
St Jarlath's Credit Union

Irish stakeholders

Central Bank of Ireland
Citizens Information Board
Competition and Consumer Protection Commission
Department of Social Protection
Department of Finance
MABS (Money Advice and Budgeting Service)
Saint Vincent de Paul
Social Finance Foundation

International credit unions and support organisations

Canada

- Affinity Credit Union, Saskatchewan
- GVC Credit Union, Vancouver
- Unity Credit Union, Saskatchewan

Great Britain

- Clockwise Credit Union, Leicester
- London Mutual Credit Union, London

USA

- Cornerstones Resources, Texas
- One Detroit Credit Union, Detroit
- Tarrant County's Credit Union, Texas

International academic expert

- University of Bristol, Bristol, GB

Appendix B: Economic analysis based on an example credit union

An analysis based on an example credit union with statistical characteristics taken from the CUFA Ltd loan database, as shown in Table 2 below.

Based on these assumptions, this credit union would need to charge 11.3% APR for small loans to be economically 'self-sufficient' within the portfolio.

Characteristics		Strategic plan assumptions		Implied ratios	
Assets	€300m	Capital ratio	14.0%	Loan margin to achieve capital ratio	2.2%
Capital	€ 40m	Projected loan growth	5.0%	Interest margin to cover expenses	6.2%
Average loans outstanding in year	€ 90m	Dividend target	0.0%	Net margin on book	1.3%
Average savings in year	€300m	Risk premium for small loans	3.0%	Cost of funds as % of loans	8.3%
			Interest rate required to meet targets		**11.3%**

Table 2: Small loan economic model: key inputs and outputs (CUFA Ltd)

Membership of Swoboda Research Centre

* Denotes Founding Member. These organisations supported the inauguration of the Swoboda Research Centre in 2017

Credit Union Platinum Members

Comhar Linn INTU Credit Union*, Ireland
Core CU*, Ireland
Dundalk CU*, Ireland
Health Services Staffs CU*, Ireland

Credit Union Gold Members

Blanchardstown CU, Ireland
Capital CU*, Ireland
Central Liverpool CU*, England
Commsave CU*, England
Dubco CU*, Ireland
Enterprise CU*, England
First Choice CU*, Ireland
First Rate CU, England
Glasgow CU, Scotland
Life CU*, Ireland
NHS CU*, Scotland
No1 CopperPot CU*, England
Savvi CU*, Ireland
TransaveUK CU, England

Credit Union Silver Members

Capital CU, Scotland
Pennine Community CU, England
Plane Saver CU*, England
St Canice's CU, Ireland
TUI (Teachers Union of Ireland) Credit Union, Ireland

Credit Union Bronze Members

1st Alliance CU, Scotland
Altura CU*, Ireland
Black Raven CU, Ireland
Citysave CU, England
Clockwise CU, England
Clonmel CU, Ireland
Community Credit Union, Ireland
Co-operative CU, England
Donore CU, Ireland
Great Western CU, England
Heritage CU, Ireland
HEY CU, England
Hoot CU, England
Just CU, England
London Mutual CU*, England
Manchester CU, England
Member First CU*, Ireland
Metro Moneywise CU, England
Naomh Breandán CU, Ireland
Palmerstown CU, Ireland
Partners CU, England
Penny Post CU, England
St. Jarlath's CU*, Ireland
Salford CU, England
Saveeasy CU, Wales
South Manchester CU, England
Unify CU, England
Youghal CU, Ireland

Corporate Members (reputable suppliers to the sector who wish to support Swoboda's work)

AsOne Digital Business Development, UK
Cantor Fitzgerald*, Ireland
CUFA Ltd.*, Ireland/UK
ECCU Assurance DAC, Ireland
OCWM Law*, Ireland
The Solution Centre*, Ireland

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