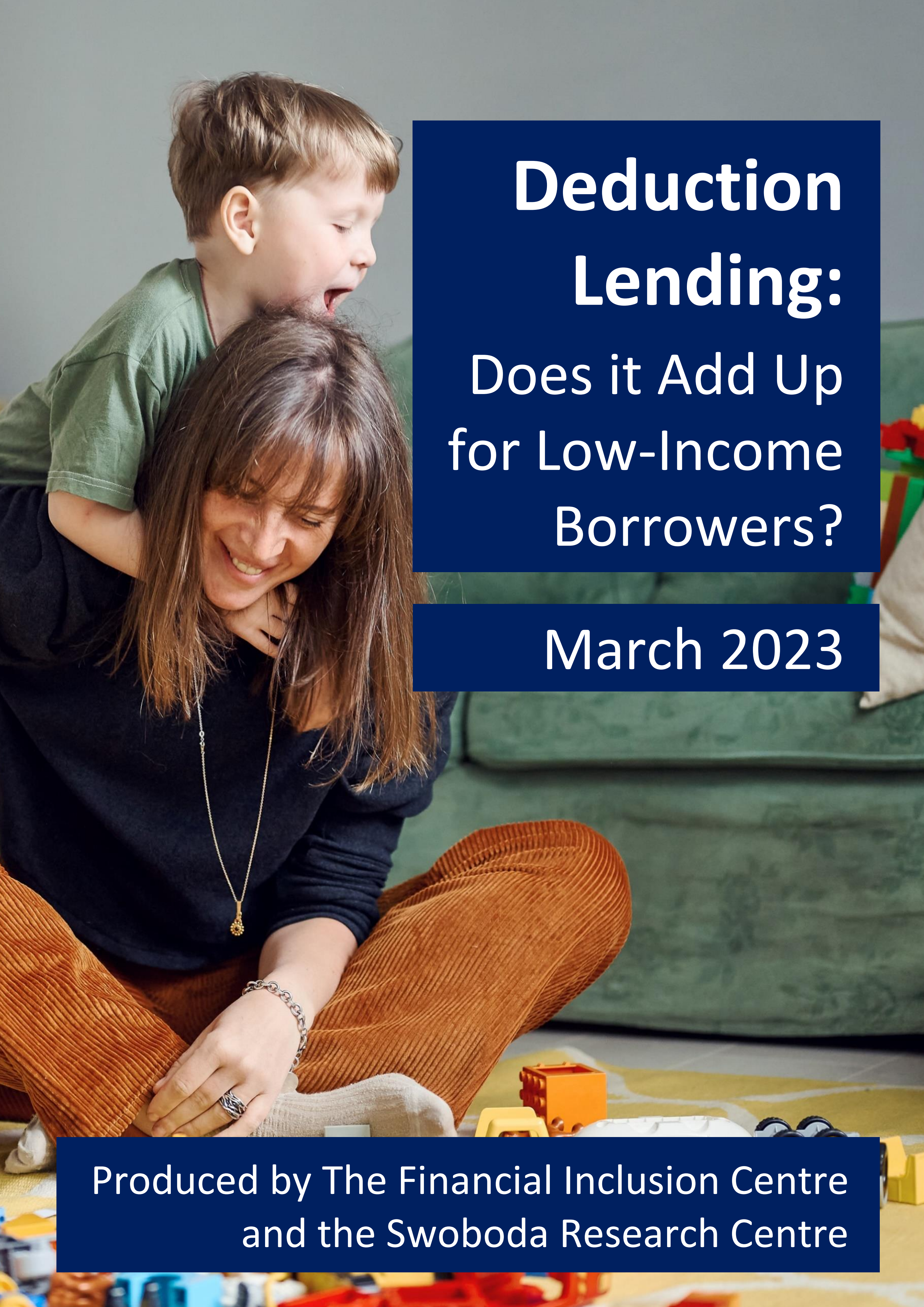

# Deduction Lending:

## Does it Add Up for Low-Income Borrowers?

March 2023

Produced by The Financial Inclusion Centre and the Swoboda Research Centre

**Commissioned by:**

Fair4All Finance is a not-for-profit organisation founded in early 2019 to improve the financial wellbeing of people in vulnerable circumstances by increasing access to fair, affordable and appropriate financial products and services.

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# Executive summary

This research project was conceived by Fair4All Finance to test the potential for deduction lending, repaid at income source, either through salaries (payroll lending) or through Child Benefit (benefit lending), to be advantageous for borrowers due to the automatic repayment mechanism, and for lenders, due in part to better repayment performance than other loans. Specifically, the project looked at low value lending (less than £1,500), as people borrowing at this level tend to have lower incomes and be less well-served by the credit market. It aims to enable a better understanding of how these services work and where, or if, they could be enhanced to benefit more customers and, potentially attract more provision.

From a provider perspective, while deduction lending is unsecured, by facilitating the payment before the borrower starts to utilise the income for other purposes, this model helps mitigate against default and result in better loan performance. This means that the price of the loans can reflect lower risk and potentially the underwriting can be more inclusive, providing greater access to affordable borrowing for more financially vulnerable households who might otherwise have few options beyond high cost and more disadvantageous subprime credit.

## About payroll lending

For many years, payroll partnerships between employers and credit union have allowed staff to automatically transfer funds each payday directly from their salary to make loans repayments cover and/or regular savings contributions.

**Loan application** – applicant completes application. form.

↓

**Assessment / decision** – relevant checks (affordability/credit check) undertaken.

↓

**Loan agreement / payroll deduction mandate signed** (if approved) – signed electronically or in person.

↓

**Payroll deduction set-up by HR/Payroll department** – instructions sent to employer and set-up on system.

↓

**Loan fund disbursement** – funds sent to borrower.

↓

**Regular loan repayment (and savings)** – each pay run, the employer sends across remittance payment and deductions file which CU uploads - loan repayments / savings are allocated to members' accounts.

Looking at the borrower, providers report that customers like the simplicity and convenience of the model and find that the automatic repayments make the loans more manageable. Furthermore, providers believe that deduction lending still provides suitable control to the customer should their outgoings need to be prioritised and some loan repayments cancelled. Savings contributions are often deducted alongside loan repayments and there is a developing evidence base that highlights the effectiveness of salary deductions in fostering regular saving habits, especially pronounced amongst low-income workers who are unlikely to have saved regularly in the past.

Yet with the wider adoption of deduction lending, concerns have been raised by some within the debt advice sector, especially relating to benefit lending linked to Child Benefit repayments. Their concerns relate to the apparent rigidity of deduction payments that might prevent struggling borrowers from more easily missing payments and that the model encourages lenders to forgo proper loan assessments. More specifically there would appear to be a general discomfort with Child Benefit deducted loans where there is a judgement that essential income should only be used to support the family and not be used to service credit repayments. Similarly, there is an unease that payroll deducted loans may make borrowers feel unable to leave their employer until the loan is repaid or negatively impact the relationship between the employer and the worker.

Therefore, this research asks how well deduction lending works for lenders and most importantly for borrowers on low incomes, and where there may be opportunities to improve the offer. It also considers how savings can be integrated into this process and how deduction lending can impact savings behaviour.

### About benefit lending

Lending that utilises welfare benefits, in the form of non-means tested Child Benefit, as the mechanism for repayment has become increasingly popular amongst credit unions and their members. A growing number, especially community-based credit unions are now delivering small value loan products, often known as Family Loans, that direct the borrower's Child Benefit payment to into their credit union account as the loan repayment method.

**Loan application** – applicant completes application form.

↓

**Assessment / decision** – relevant checks (affordability/credit check) undertaken.

↓

**Loan agreement signed** (if approved) – signed electronically or in person.

↓

**Redirect Child Benefit payment to CU** – borrower contacts HMRC by phone/online or CU sends signed notification by

↓

**Loan fund disbursement** – funds either transferred immediately or after first CB payment received.

↓

**Regular loan repayment (and saving contribution)** – each time the CB payment is received – loan and savings are automatically allocated. Any remaining funds transferred into bank account or added to savings.

### Methodology overview

The research team adopts a broad evaluation framework that combines quantitative and qualitative approaches:

I. Literature review - to provide context from existing research on this topic.

II. Qualitative stakeholder interviews - the research team interviewed 26 key stakeholders to gain their views of deduction lending.

III. Quantitative borrower survey - an extensive survey was conducted with 7,559 borrowers from seven participating credit unions[1] that had taken any type of loan of £1,500 or less over the last three years.

IV. Qualitative borrower interviews - conducted interviews with 20 borrowers to gauge the reasons behind either more positive or more negative views.

V. Quantitative lending data – analysis of available credit union lending data obtained across the three types of loan.

**Borrower cohort:** The focus of the research is borrowing amongst low-income borrowers using the proxy of any member taking a low-value loan equal to £1,500 or less (either as new borrowing or topping up of an existing loan) from the participating credit unions over the previous three-year period covering January 2019 and December 2021.

**Loan comparison with subprime lenders - borrowing £500 over 12 months (52 weeks)**

With severely restricted borrowing options available to many low-income families, benefit lending can save these households hundreds of pounds in interest compared to borrowing from subprime lenders.

| | Family Loan with Clockwise Credit Union | Home-collected credit with a leading provider | High-cost short-term credit with a leading provider |
|---|---|---|---|
| Representative APR | **42.60%** | 342.94% | 1261.00% |
| Monthly payment | **£50.23** | £81.25[2] | £83.33 |
| Amount of interest | **£102.76** | £475.00 | £500.00 |
| Total Repayable | **£602.76** | £975.00 | £1000.00 |
| Difference in total cost | - | £372.24 | £397.24 |

Source: Price quotes taken from leading company websites on 25/01/23

[1] Advance CU, Clockwise CU, Cooperative CU, Enterprise CU, Manchester CU, Leeds CU and London Mutual CU – providing a range of geographical coverage, business models, customer demographics and cross-section of lending approaches.

[2] Please note the monthly repayment figure is for illustration purposes and is based on weekly repayment of £18.75 from leading lenders website.

## Key findings – borrower experience

### Benefit loans supporting distinctive borrower profile with greater challenges

Users of both payroll lending and standard lending are broadly demographically similar. Yet, the profile of borrowers using benefit lending is distinct – tending to be almost exclusively younger mothers that are much more likely to be single and supporting a higher number of children, living in rented accommodation with noticeably lower incomes and less likely to be in work.

| | Benefit Loans | Payroll Loans | Standard Loan |
|---|---|---|---|
| Female | **97%** | 66% | 68% |
| 18–34 Age | **52%** | 22% | 22% |
| Renters | **90%** | 54% | 67% |
| Annual income <£15K | **51%** | 21% | 31% |
| Working (PT/FT) | 42% | **94%** | 64% |
| Single | **70%** | 35% | 45% |
| 2 or more children | **65%** | 22% | 25% |

### Limited access to other forms of credit for those using benefit lending

Benefit loan users seem to have **fewer traditional borrowing options available to them**, with much lower usage of authorised overdrafts (4%), loans from banks/building societies (1%) and credit card /store card (8%) compared to both payroll loan and standard loan borrowers. And compared to these two types of borrowers, more of those using benefits loans have taken a Universal Credit advance (19%) and have higher usage of friends and family borrowing (15%), loans from the Department of Work and Pensions (13%) and home collected credit (4%).

*"I was paying double if not more, what I was lending. Absolutely ridiculous on a doorstep lender… So, then every month I was robbing Peter to pay Paul type thing. And they just don't care. They didn't care at all and one of them type of people that just hound you. "*

**Case study 6 – Family Loan borrower at Manchester Credit Union**

### Benefit loans spent on family expenditure

One of the criticisms of benefit lending, especially using Child Benefit as the repayment, is that it diverts essential funds away from the household that should be used solely for spending on their children.

Yet, **the results show that the most popular use of benefit loans were for expenditure relating to their families.** In comparison, payroll loan borrowers were most likely to use their loan for more discretionary spending.

| | Payroll Loans | Benefit Loans | Standard Loans |
|---|---|---|---|
| 1st | Birthday / Christmas (23%) | Birthday / Christmas (29%) | Birthday / Christmas (23%) |
| 2nd | Holidays (18%) | Household item / change (21%) | Household item / change (21%) |
| 3rd | Household item /change (15%)<br>Car repairs (15%) | Clothing / school uniform (18%) | Holidays (17%) |

*"I don't have to remember to make the payments it just gets done automatically."*

**Case study 2 – Family Loan borrower at Leeds Credit Union**

### Automated repayments are the key reasons for choosing deduction lending

Overall, it is the basic feature of the loan with the credit union – the convenience of automatic payments – and affordability of the loan repayments which are the main attractions to deduction lending amongst those that use it. **Having funds automatically transferred directly to the credit union is seen as a positive rather than a negative feature** and was the most popular reason given for choosing a payroll loan (25%) and benefit loan (18%).

### Positive experience of the application process

Both payroll and benefit loan borrowers reported very favourable experiences with the application process, with **96 percent and 97 percent respectively strongly agreeing or agreeing that the application process to obtain the loan was straightforward and easy to follow**. Just under two percent disagreed in relation to both loans.

Almost all respondents for both loans strongly agreed or agreed (95% for payroll loan users and 98% for benefit loan users) that they felt that the credit union sufficiently assessed their ability to afford the loan. Yet, more than half of payroll borrowers (54%) and half of benefit loan borrowers (57%) said they **did not know if the credit union had carried out a credit check as part of the application process**.

### Lending via credit unions is universally seen as affordable

The results suggest very clearly that both payroll and benefit loan borrowers found their loans affordable, **with 97 percent of borrowers across all three types of lending either strongly agreeing or agreeing that their loan was affordable.** The results were uniformly positive across all the participating credit unions.

### No difference in borrowers experiencing financial difficulties

Only seven percent of payroll loan borrowers and nine percent of benefit loan borrowers either strongly agreed or agreed that they had struggled to keep up with household finances since part of their wage or their Child Benefit had been transferred directly to the credit union to cover their loan repayments. Notably, the result from those using both forms of deduction lending were broadly in line with those reported by users of standard loans.

There appears to be no difference between the proportion of payroll loan borrowers (10%) and benefit loan borrowers (11%) that had made a loan repayment that they would have preferably missed, compared to those using a standard loan (11%). However, this is still not an insignificant proportion, and therefore would appear that around one in ten borrowers are experiencing some degree of financial pressure during the lifetime of their loan.

At just two percent, there was **no difference between the proportion of payroll loan borrowers and benefit loan borrowers saying that they had actually missed a loan payment**. However, this was markedly lower compared to 15 percent of borrowers that stated they had missed a payment with a standard loan. This would indicate that those repaying via deduction repayments are less likely to miss at least one payment compared to those using repayment methods such as standing order, direct debit and payments made at branch.

*"I think it's fantastic. It's definitely a thumbs up from me. It's just it's manageable, obviously because you're not missing that money. It's easier because you never miss a payment because it's just coming out your wages."*

**Case study 4 – Payroll Loan borrower at Enterprise Credit Union**

Given that there were no real differences between the three types of loan users, there is a question about the cause of this marked difference. Some credit unions point out that some of this is often due to the very first payment being missed when a new borrower does not set up their bank payment, which is far less likely to happen with deduction lending.

Yet, the survey results also indicate that **there is a much lower appreciation, particularly amongst payroll loan users on how they would go about cancelling their loan payments.** More than two thirds of payroll loan borrowers (69%) and more than half (53%) of benefit loan borrowers were not aware they could stop their payments by contacting their employer or benefit provider, dependent on their loan type. This is higher than those with standard loans who were not aware they could stop their payments by contacting their bank (28%).

### Few concerns about transferring Child Benefit to the credit union

One of the issues raised about expanding access to benefit loans was that people would be concerned about transferring their Child Benefit to the credit union and losing control over their money. The survey responses would not appear to support those concerns. A large majority of respondents (91%) were very comfortable or comfortable about transferring their Child Benefit to their credit union. Just one percent said they were uncomfortable. The results suggest that the downsides of benefit loans are not an issue for most respondents.

### Positive impact on savings behaviour amongst deduction lending users

Prior to borrowing with the credit union, overall levels of saving appear low across all loan users but especially amongst benefit loan users. Almost three quarters (72%) said they rarely or never saved, compared to 54 percent of payroll loan users and 56 percent amongst standard loan users. These results are perhaps not surprising given the significantly lower incomes of those using benefit loans compared to the other loan types.

However, despite the relatively low saving levels prior to taking their loan consultation, it appears that the automated mechanism of **deduction lending is fostering higher levels of regular saving**. Seventy three percent of those repaying by Child Benefit and 72 percent by payroll deduction agree that the loan had helped them save more regularly. This compares to 66 percent amongst standard loan users.

*"I didn't actually have much in the way of saving. But I have now."*

**Case study 1 – Payroll Loan Borrower at Clockwise Credit Union**

### Relationship with employer not negatively impacted by payroll lending

One of the concerns raised about expanding access to payroll loans was that employees would be afraid to make use of schemes as it might affect their relationship with their employer, or they would not want employers to know about their finances. **The survey responses would not appear to support those concerns.**

On the specific point about borrowers being concerned that their employer would know too much about their finances, only 14 percent (or one in seven) strongly agreed or agreed. Forty five percent were neutral on the question, while 41 percent strongly disagreed or disagreed. Equally, having a payroll loan does not appear to be broadly perceived as a barrier to employees' ability to change jobs. Eighteen percent strongly agreed or agreed that since taking out their loan they felt unable to change employers until it is repaid. Nearly 40 percent (39%) were neutral and 43 percent strongly disagreed or disagreed.

### Deduction lending realising positive financial impacts and wellbeing improvement

Encouragingly, 70 percent of payroll loan borrowers and 72 percent of benefit loan borrowers either strongly agreed or agreed that they felt more confidence about managing money. Under three percent disagreed in relation to both loans. In addition, more than two thirds of respondents said they were more satisfied with their overall financial circumstances since taking out their payroll, benefit or standard loan. Again, only a very small minority under four percent disagreed.

Low levels of financial resilience can have an impact on both mental and physical health. The research shows that **borrowing with the credit union seems to make respondents feel less stressed, anxious, or depressed** after taking out their loan with 60 percent of payroll loan users, 61 percent of benefit loan users and 63 percent of standard loan users either strongly agreeing or agreeing that it had helped.

### Overwhelming satisfaction and benefits from deduction lending

**Ninety seven percent of benefit loan borrowers felt that their loan had helped them a lot**. This impressive figure was notably higher than amongst users of both payroll loans (87%) and standard loans (86%). Given the criticisms of benefit lending, it is important to highlight that this form of lending appears to be having a positive effect on the vast majority of those accessing this type of loans appears and markedly higher than either payroll or standard lending.

Similarly, satisfaction levels appear to be extremely high across all three types of lending with 97 percent of benefit loan users, 95 percent of payroll loan users and 95 percent of standard loans users saying that they were very satisfied or satisfied with their loan.

## Key findings – credit union experience

### Fewer loan applications rejected with deduction lending

Analysis of one credit union's lending data suggests that applications for deduction lending tend to have much higher approval rates compared to those for Standard Loans using direct debit, standing orders or cash payments. This is especially marked for its Family Loans which also tend to be for significantly smaller loan values. Over the last three years, 55 percent of all applications for Standard Loans were shown to be rejected. This compares to 40 percent of Payroll Loans and just seven percent of all applications for the Family Loans. The credit union relates both these factors to the significant proportion of borrowers who top up at certain points within the year when they have repaid a certain proportion of their loans.

### Deduction lending appears to perform better

Importantly, **benefit lending and especially payroll lending are shown to have markedly better performance than their standard lending with much lower levels of arrears** (both for arrears of 3-12 months and more than 12 months) and write offs. The total number of Family Loans written off over the three year period as a proportion of the number of Family Loans outstanding at the end of the period analysed was nine percent. This compares to 17 percent for Payroll Loans and 36 percent for Standard Loans. The number of Family Loans in arrears of 3-12 months is four percent of the total number of loans outstanding compared to 10 percent for Standard Loans. Loans repaid using payroll deduction fare even better with just 2% of loans in arrears of 3-12 months.

## Conclusions

Overall, the research proves that the deduction lending model, delivered either via payroll deduction or benefit deduction, is extremely popular, advantageous and overwhelmingly positive in terms of the beneficial impact it delivers for low-income households accessing affordable lending with credit unions. It helps foster financial improvements and wider health and wellbeing benefits as well as encouraging positive saving behaviours – especially amongst those that previously found it difficult to put aside money.

As well as evidencing the benefits for borrowers, the research also points to deduction lending being positive for credit unions, enabling them to deliver low-cost lending to more financially vulnerable households who might otherwise have few options beyond high cost and more disadvantageous subprime credit.

Criticism raised about deduction lending has not been substantiated through the research. Of course, credit provision to lower income customers, who are often in more financially vulnerable circumstance, has inherent risks. Automatic deduction may also pose potential risks that have to be mitigated, but this research has demonstrated that if delivered appropriately, the model can provide huge benefits to customers. This makes the learning identified in this research around what is working well amongst the participating credit unions even more important.

Deduction lending is a credible and effective way of extending access to affordable credit for lower income households. It offers a tangible and scalable solution that could help divert households away from subprime credit and illegal forms of lending and into fair, responsible and affordable borrowing with not-for-profit credit unions that can realise positive benefits for these households.

Therefore, the report provides a series of recommendations that attempt to bring together the good practice that should be adopted by the credit union sector in order to extend and enhance this form of lending. More broadly it also considers what can be done by stakeholders to scale both payroll and benefit lending in order to extend credit to those within society that currently have very few suitable options.

## Recommendations and good practice

**Recommendations for stakeholders**

**Payroll loans:**

1) More employers should partner with credit unions to deliver payroll deduction schemes to their employees.
2) Payroll deduction should become a policy priority for business organisations, trade bodies, funders, central and local government, and civil society.

**Benefit loans:**

3) Stakeholders working with financially excluded people, such as local authorities, social housing providers and the DWP, should work with credit unions to promote access to benefit lending.
4) Debt advice and credit union trade bodies should find out more about each other's work and agree productive ways to work together.

5) HMRC should work with credit union trade bodies to formalise and streamline the notification process to reduce waiting times for Child Benefit loans.

**Payroll and benefit loans:**

6) Credit unions and trade bodies should make use of the good practice highlighted by this research in delivering deduction loans.

**Good practice in delivering deduction lending**

**Loan application and assessment:**

1) Always conduct thorough affordability assessments for both new and repeat loans

2) Use credit checks to complement affordability assessments where a more complete picture of applicant's existing borrowing commitments is needed.

**Repeat lending and topping up:**

3) Ensure that there are robust criteria and processes in place for repeat borrowing and topping up existing lending.

**Financial difficulties and support:**

4) Put in place additional monitoring and positive communications to make sure that borrowers who are experiencing difficulties feel supported and able to contact the credit union if they are struggling.

5) When setting up a Child Benefit loan, inform all borrowers at the point of approval of the details of the credit union destination bank account.

6) Offer a package of financial tools, support and guidance for both existing members and declined applicants.

**Marketing and promotion:**

7) Use the positive experience and impact evidenced among deduction lending as the basis for proactive promotional campaigns for these products.

8) Marketing should avoid referring to the lack of credit checks.

9) Regularly report to employer partners and other stakeholders (such as local authorities) to demonstrate the beneficial impact of their relationship.

10) Reassure payroll lending customers that their finances will remain private from their employer and make clear the process that happens if a borrower leaves their current employer.

**Additional product improvements:**

11) Offer automated transfers of residual balances of Child Benefit payments back to borrower's bank account after both loan repayment and any savings have been allocated.

# Definitions

This section provides the definitions used for several key terms used throughout the report.

| | |
|---|---|
| Benefit lending | Refers to loans linked to non-means-tested Child Benefit, where the benefit payment is transferred directly from source by HMRC to the lender and used to make loan repayment and any saving contributions. |
| CDFIs | Community Development Finance Institutions are social enterprises that lend to businesses and individuals on low incomes who are struggling to access mainstream credit. Many offer financial education, as well as budget and debt advice. |
| CSR | Corporate Social Responsibility is defined as the responsibility of an organisation for the impacts of its decisions on society and the environment above and beyond its legal obligations, through transparent and ethical behaviour. |
| Community-based credit union | Not-for-profit financial cooperatives serving people who live or work within a defined geographical area. |
| Community finance | Umbrella term capturing all the organisations providing access to fair and responsible finance, including credit unions and CDFIs. |
| DWP | Department of Work and Pensions (DWP) is the government department responsible for welfare, pensions and child maintenance policy. |
| Deduction lending | Collectively used to refer to both payroll loans and benefit loans where funds are automatically transferred from source to the credit union or other lender and used to repay loan repayment as well as contribute to any saving contributions. |
| Employee-based credit union | Not-for-profit financial cooperatives serving the employees of specifically defined employers, or those working in specific industries and business sectors. |
| Family loan | A common term for Child Benefit loans used by credit unions |
| Financial wellbeing | The Money and Pensions Service (MaPS) highlight that financial wellbeing is about feeling secure and in control. It is about making the most of your money from day to day, dealing with |

| | |
|---|---|
| | the unexpected, and being on track for a healthy financial future. In short: financially resilient, confident and empowered. |
| HMRC | HM Revenue and Customs is a government department responsible for the collection of taxes, the administration of other regulatory regimes and payment of some forms of state support (including Child Benefit). |
| High-cost loan | The FCA defines a high-cost loan, or credit, to include products such as high-cost short-term credit (including payday loans), home-collected credit, rent-to-own (RTO), buy now pay later offers, overdrafts, guarantor and logbook loans. |
| NEST | National Employment Savings Trust is a defined contribution workplace pension scheme in the United Kingdom set up to facilitate automatic enrolment. |
| Open Banking | The process of banks and other financial institutions opening up data for regulated providers to access, use and share. |
| Payroll deduction scheme | Refers to arrangement for the regular transfer of an agreed amount directly from an employee's wages via their payroll. |
| Payroll lending | Refers to loans linked to payroll, where a small part of the borrower’s salary is transferred directly from source by the employer to the lender and used to make loan repayment and any saving contributions. |
| Salary advance | A salary advance is when an employer agrees to let a worker have a portion of their wages before the usual pay date. These schemes are unregulated and administered through a third party (not the employer) and usually include a fee. |
| Standard lending | Refers to loans, where repayments come from the borrower’s account after they themselves have received it via salary or benefit income. These including methods such as standing orders, direct debits or cash paid into the branch. |
| Topping up | When an existing borrower has repaid a proportion of their original loan and applies for additional borrowing. |

# 1. Introduction

This research project was conceived by Fair4All Finance to test the potential for deduction lending, repaid at income source of either through salaries (payroll lending) and through Child Benefit (benefit lending), to be advantageous for borrowers due to the automatic repayment mechanism, and for lenders, due in part to better repayment performance than other loans. Specifically, the project looked at low value lending (less than £1,500), as people borrowing at this level tend to have lower incomes and be less well-served by the credit market.

The research was undertaken by the Financial Inclusion Centre and the Swoboda Research Centre between January and September 2022, just as a cost-of-living crisis was growing, affecting in particular those with low financial resilience. The aim was to enable a better understanding of how these services work and where, or if, they could be enhanced to benefit more customers and, potentially attract more provision.

For many years, credit unions with links to local authorities, the police, the NHS or other employers have linked lending (and saving) to payrolls, allowing lenders to take repayments directly at source from workers' salaries. More recently a range of new profit with purpose lenders have taken up this model and greatly expanded the payroll deduction lending market.

In a separate, more recent development, a growing number of community-based credit unions have also arranged loans tied to direct payment of Child Benefit into the credit union, often marketed as Family Loans. Benefits deposited with the credit union can be used to repay a small loan (usually less than £500), where the inbound benefit payment enables the required repayment instalment on the loan and a modest payment to the borrower's savings. Any residual balance is returned to the borrower or credited to their savings account.

From a provider perspective, while deduction lending is unsecured, by facilitating the payment before the borrower starts to utilise the income for other purposes, this model helps mitigate against default and result in better loan performance. This means that the price of the loans can reflect lower risk and potentially the underwriting can be more inclusive, providing greater access to affordable borrowing for more financially vulnerable households who might otherwise have few options beyond high cost and more disadvantageous subprime credit.

Looking at the borrower, providers report that customers like the simplicity and convenience of the model and find that the automatic repayments make the loans more manageable. Furthermore, providers believe that deduction lending still provides suitable control to the customer should their outgoings need to be prioritised and some loan repayments cancelled.

Yet with the wider adoption of deduction lending, concerns have been raised by some within the debt advice sector, especially relating to benefit lending linked to Child Benefit repayments. Their concerns relate to the apparent rigidity of deduction payments that might prevent struggling borrowers from more easily missing payments and that the model encourages lenders to forgo proper loan assessments. More specifically there would appear to be a general discomfort with Child Benefit deducted loans where there is a judgement that essential income should only be used to support the family and not be used to service credit repayments. Similarly, there is a concern that payroll deducted loans may make borrowers may feel unable to leave their employer until the loan is repaid or negatively impact the relationship between the employer and the worker.

These are the expectations and perspectives that this report will test, so that there is better visibility and understanding of the arrangement and its distinctiveness from more standard lending.

In summary, this report asks how well deduction lending works for lenders and most importantly for borrowers on low incomes, and where there may be opportunities to improve the offer.

The main focus is on lending repaid by benefit and payroll deduction, but it is important to consider the impact of this model on savings. Savings contributions can be deducted in the same way alongside loan repayments, and indeed generally are in the case of credit unions. There is a developing evidence base that highlights the effectiveness of salary deductions in fostering regular saving habits that can support improvements to financial wellbeing and greater resilience within the workforce. This is especially pronounced amongst low-income workers who are unlikely to have saved regularly in the past. This research therefore considers how savings can be integrated into this process and how deduction lending can impact savings behaviour.

This report examines the existing research as well working with seven credit unions to analyse available lending data and undertake extensive consultation with borrowers as well as lenders and key other stakeholders, documents and evidences the impact of both payroll and benefit lending on consumers and the impact and potential opportunities for lenders. It also explores the potential risks and concerns associated with this lending model and sets out good practice in the use of these lending models that might maximise benefits and mitigate detriments.

The report concludes with a clear set of considerations and recommendations for the community finance sector, relevant trade bodies, policymakers and other key stakeholders, such as money/debt advice organisations, aimed at driving improvements, consistency and the use of best practice to maximise the positive opportunities of this lending for both community finance providers and borrowers.

## 1.1 Methodology overview

The research team has adopted a broad evaluation framework that combines quantitative and qualitative approaches conducted to address research questions and overall perspectives.

**Participating credit unions:**

At the outset of the project, the research team worked with Fair4All Finance to select seven credit unions to participate in this research project – that offered a range of geographical coverage, business models, customer demographics and cross-section of lending approaches:

| | |
|---|---|
| Advance Credit Union | Community-based credit union<br>Coverage: Birmingham and Solihull.<br>www.advancecu.org.uk |
| Clockwise Credit Union<br>safe savings & affordable loans | Community-based credit union<br>Coverage: Leicester, Leicestershire, Rutland, Northamptonshire, Coventry and Warwickshire<br>www.clockwise.coop |
| The coop Credit Union | Employee-based credit union<br>Coverage: Employees of Co-operative and other selected co-operative and mutual businesses.<br>www.co-operativecreditunion.coop |
| ECU Enterprise Credit Union | Community-based credit union<br>Coverage: Knowsley, Liverpool, Sefton, St. Helens, Wirral, Halton and Warrington Boroughs of Merseyside.<br>www.enterprisecreditunion.org |
| Manchester Credit Union | Community-based credit union<br>Coverage: Manchester, Bury, Rochdale, Stockport, Tameside, Trafford and High Peaks.<br>www.manchestercreditunion.co.uk |
| Leeds Credit Union | Community-based credit union<br>Coverage: Leeds, Wakefield, Harrogate, Craven or Barking and Dagenham.<br>www.leedscreditunion.co.uk |
| London Mutual Credit Union | Community-based credit union<br>Coverage: Southwark, Lambeth, Camden and Westminster.<br>www.creditunion.co.uk |

All participating credit unions deliver a variety of loan products that provide the ability for repayments to be collected through a combination of:

- payroll lending – collected through regular deductions made from the borrower's wages and automatically transferred directly into their credit union account.
- benefit lending - collected through the borrower's Child Benefit payments directed into their credit union account, and
- standard lending – using direct debit, standing order or cash payments.

**Borrower cohort:**

The focus of the research is deduction lending amongst lower income borrowers. However, as outlined in the limitations section, the research has used the proxy of any member taking a low-value loan equal to £1,500 or less (either as new borrowing or topping up of an existing loan) from the participating credit unions over the previous three-year period covering January 2019 and December 2021.

### Literature review

**Insight objective 1:**
Identify and highlight relevant learning and best practice from a review of UK-based and international research, to provide evidenced context for the study's research aims and to inform the practical design of the evaluation framework (including survey/interview and data collection requirements).

To set some context for the research, a desktop review of relevant literature relating to the use and impacts of both payroll lending and benefit lending models delivered via this lending approach. A full list of the research and sources of information has been provided in the References section.

### Qualitative stakeholder interviews

**Insight objective 2:**
Provide more in-depth understanding regarding the views of both the benefits that deduction lending can realise for credit union members, as well as any detriment and risks that might be associated. Utilise this learning to inform the relevance and efficacy of the identified research aims and the practical design of the evaluation framework. Establish good practice in the use of these lending models to evidence and inform any practical recommendations in response to the study's research.

The research team worked with Fair4All Finance to agree a list of key stakeholders and representatives to consult about their views on payroll lending and/or benefit lending under several key stakeholder categories:

- participating credit unions;
- other lenders;
- debt advice sector;
- other trade bodies and policy/regulatory stakeholders; and
- employers.

The interviews were conducted to learn more about the benefits that deduction lending can realise for customers (or members), as well as any detriment and risks that might be associated. Alongside understanding their impacts, the research also focused on establishing good practice in the use of these models to maximise their benefits and mitigate any detriments.

In total, 26 telephone or video interviews were conducted. The full list of organisations and their representatives can be found in the acknowledgment section. Interviews were recorded where agreeable and transcripts produced.

### Quantitative borrower survey

**Insight objective 3:**
Enable self-reported responses on customers' attitudes, behaviours and impacts/outcomes relating to the use of the credit union and their lending. Enable comparison between different loan products, including payroll deduction and child benefit loans and standard loans, to evidence and inform conclusions and practical recommendations relative to the study's research aims.

An extensive borrower survey was conducted with borrowers from the each of the seven credit unions who had taken a loan of £1,500 or less over the last three years. The survey questions were designed to allow self-reported responses on customer attitudes, behaviours, and impacts/outcomes relating to the use of credit union loans.

The surveys were hosted electronically on SurveyMonkey and were distributed via email to over 38,000 borrowers identified by each participating credit union as meeting the agreed borrowing criteria. A further two email reminders were sent to maximise completion by as many borrowers as possible. In total, 7,559 people responded to the survey.

*Table 2: Breakdown of completed borrower survey by credit union*

| Credit Union | Total eligible borrower | Total borrower surveys completed | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | Benefit Loan | | Payroll Loan | | Standard Loan | | All Loans | |
| | No | No | % | No | % | No | % | **No** | % |
| Advance | 4,154 | 819 | 86% | 9 | 1% | 120 | 13% | **948** | 23% |
| Clockwise | 6,165 | 698 | 57% | 66 | 5% | 464 | 38% | **1,228** | 20% |
| Coop | 2,884 | 72 | 11% | 495 | 74% | 103 | 15% | **670** | 23% |
| Enterprise | 9,104 | 2,507 | 95% | 9 | 0% | 120 | 5% | **2,636** | 29% |
| Leeds | 2,565 | 59 | 20% | 30 | 10% | 200 | 69% | **289** | 11% |
| London Mutual | 5,358 | 137 | 27% | 145 | 29% | 226 | 44% | **508** | 9% |
| Manchester | 7,987 | 988 | 77% | 49 | 4% | 243 | 19% | **1,280** | 16% |
| **TOTAL** | **38,217** | **5,280** | **70%** | **803** | **11%** | **1,403** | **20%** | **7,559** | **20%** |

To help attract attention and encourage completion, two prize draw incentives of £50 cash payments were offered within each credit union. The winners were selected at random by the research team from those respondents that wished to be entered and who had provided their contact details specifically for this purpose.

Following the completion deadlines, the responses were then analysed on Excel. Whenever conclusions are drawn from the survey data, this is only done when results are significant at $p < .05$ (chisq). Results are excluded from the main report where the sample size is under 50. Due to rounding, totals may not always add up to 100%.

### Qualitative borrower interviews

> **Insight objective 4:**
> Provide more in-depth understanding of the reasons behind both positive and negative views expressed during the survey, regarding credit union members experiences of using either payroll deduction or child benefit loans. Provide real-life testimony and lived experience to evidence and inform conclusions and practical recommendations relative to the study's research aims.

As part of the borrower survey conducted across all seven participating credit unions, all respondents were asked whether they would be willing to take part in a follow-up telephone interview with a £10 payment offered as an incentive to take part. Of the approximately 7,759 borrowers who completed the surveys, 3,294 were willing to be contacted for interview.

From amongst the respondents prepared to be contacted, the research team identified 20 borrowers from across the credit unions to be interviewed. The interviews were used to gauge in more depth the reason behind positive or negative views expressed during the survey about their experience of using either the payroll deduction loans or child benefit loans. The research team conducted an equal number of interviews across four different cohorts. There were:

**Cohort 1: Payroll Deduction Borrowers – exhibiting a positive experience.**

Insight objective 4a: Better understand the motivation and experience of borrowing with the credit union and repaying using payroll deduction – especially the reasons for the beneficial impact and/or overall satisfaction identified during the survey.

**Cohort 2: Payroll Deduction Borrowers – exhibiting a negative experience**

Insight objective 4b: Better understand the motivation and experience of borrowing with the credit union and repaying using payroll deduction – especially the reasons for their more downbeat experience that may include overall dissatisfaction. This cohort also included borrowers who expressed overall satisfaction but raised specific issues such as a desire to have missed payments and/or to have cancelled their payroll deduction or perceived concerns about the relationship with their employer.

**Cohort 3: Child Benefit Borrowers – who exhibited a positive experience**

Insight objective 4c: Better understand the motivation and experience of borrowing with the credit union and repaying using child benefit payments directed into the credit union – especially the potential reasons for the beneficial impact and/or overall satisfaction.

**Cohort 4: Child Benefit Borrowers – who exhibited a negative experience**

Insight objective 4d: Better understand the motivation and experience of borrowing with the credit union and repaying using child benefit payments directed into the credit union – especially the reasons for their less positive experience. This may include overall dissatisfaction levels and/or where they stated during the survey that they experienced financial problems and a desire to have missed payments or to have cancelled their payment with HMRC.

It is important to highlight that many of those identified as having some element of negative experiences with either of the payroll deduction or child benefit loan products still expressed an overall satisfaction.  For example, a number interviewees were selected because they had stated that they had struggled financially and had wanted to miss repayments but were still very much satisfied or very satisfied with the loan and would still recommend it.

In fact, the research team experienced some difficulties in identifying sufficient borrowers who presented an overall negative experience, had indicated that they were willing to be interviewed and then could be contacted and actually able to participate in the interviews.

The research team conducted telephone interviews, following set discussion guides that were specific to each of the four different cohorts. Each interview was written up with the names changed and quotes from the interviews and a set of case studies have been used throughout the report.

### Quantitative lending data

**Insight objective 5:**
Enable comparison between different loan products, including payroll deduction and child benefit loans and standard loans, in relation to issues such as borrower demographics; number of loan approvals/declines; loan arrears and missed payments. Evidence and inform conclusions and practical recommendations relative to the study's

The research team agreed a detailed list of financial and lending data to be requested from each participating credit union covering all borrowing of £1,500 or less over the three-year period between January 2019 and December 2021 – split across the three types of loan repayment mechanisms covering:

- Total new loan applications – number and value of approved and declined.
- Total outstanding loans (approved) – number and value of loans; interest generated; arrears, missed payments and bad debt provisioning/written off.
- Individual borrower data – anonymised information for each borrower including: demographic data; (age, gender, postcode, tenure, dependents, employment status and household income); and lending data for each loan (loan date, type, amount, term, interest rate, purpose, repayment method, repayment value and missed payments and arrears value).

### Research limitations

***Table 3: Research limitation and impact on research***

| Limitation | Description | Impact on research |
|---|---|---|
| Borrower cohort | The participating credit unions do not universally collect or record income data against their members. Therefore, it presented difficulties in being able to accurately establish the borrower cohort with specific income levels. | Instead, the research team agreed that it would use any member that had borrowed £1,500 or less. Whilst this provides a reasonably good proxy, it is by no means exact and does mean that some borrowers will be included |

| | | |
|---|---|---|
| | | that have higher household incomes. |
| Sample profile | There are challenges in obtaining a representative sample with some borrowers being more difficult to reach and therefore less likely to have taken part in the survey. | As this survey was conducted electronically, those members that are less digitally engaged would therefore be less likely to take part and will therefore be underrepresented. The research also relied on the participating credit unions to provide the list of eligible borrowers. |
| Research topic | Money and especially borrowing is a highly sensitive matter that many do not feel comfortable discussing or if they do, might not always provide an accurate picture. Despite reassurances that the research was being conducted independently and about strict confidentiality and anonymity, it is likely that some borrowers may still perceive that their answers would be seen by the credit union. | As a result, this presents several limitations. Firstly, those struggling with their finances might be less likely to participate in the study in the first place, and secondly, some respondents may not provide accurate answers or downplay the extent of their views or behaviours. |
| Borrower interviews | London Mutual conducted the borrower survey themselves adopting the same questions but using their own surveying facility. Therefore, those stating that they were willing to be interviewed were not able to be identified as the credit union did not pass individual personal data across to the research team. | This means that no borrowers from London Mutual were not able to be included in qualitative interviews. |
| Data collection / analysis | The research team experienced significant problems obtaining the borrower data from individual credit unions. Firstly, one of the credit unions was simply unable to provide any data within the timeframes due to staff capacity issues within their finance team. Secondly, there was a much more common issue in that the four different IT accounting software packages used by the different credit unions were unable able to easily or accurately determine the repayment mechanism used to make the | This means that only one credit union were able to provide the full extent of the required borrower data split by the three types of repayment method in the requested format. The borrower data for this credit union has been analysed and presented in the research as a case study. |

| | | |
|---|---|---|
| | loan repayments. Most could analyse across different loan products but unless there were specific loan products for particular repayment mechanisms, it was impossible to accurately attribute. | |

# 2. Deduction lending

This section explains in more detail how the payroll lending and benefit lending models work and are practically delivered by lenders.

## 2.1 About payroll lending

Payroll partnerships between employers and lenders are not a new method of enabling workforces to access saving and loan services. For decades, employee-credit unions (sometimes referred to as industrial credit unions) have been born directly out of either:

- specific industries such as the postal services (for example; CommSave, Penny Post or 1st Class) or the police service (for example Police Credit Union, now part of Serve and Protect) or;
- individual groups of employees such as British Airways (PlaneSavers) or BAE Systems (First Rate Credit Union)

In fact, many of the community-based credit unions that operate in more local geographical areas were originally established to just serve local authorities or NHS hospitals staff before being expanded into the community - for example London Mutual (Southwark Council) and Leeds Credit Union (Leeds City Council).


*www.manchestercreditunion.co.uk*


*www.enterprisecreditunion.org/cu-at-work*

Payroll deductions simply allows staff to automatically transfer funds each payday directly from their salary to cover savings on a regular basis and/or make loans repayments.

More recently, a range of new lenders have taken up this model and greatly expanded the payroll lending (such as Salary Finance and Salad Money) and even more recently there has been significant growth of the salary advance market (such as WageStream, Level and Hastee).

### How does the payroll loan model work?

As part of the process of joining the credit union or completing the loan application process, the employee of one of a credit union's employer partners can opt to make deposits via payroll deduction. This is normally completed as a section on the application form or a separate payroll deduction mandate. The individual will simply select the amount they would like to deduct from their salary and provide additional information such as their payroll number.

Once the membership account is opened or loan application approved, the credit union will forward these payroll deduction instructions to the designated payroll department to be added to their payroll system.

At the next pay date, the agreed payment amount will be automatically deducted directly from the staff member's salary in the same way as other salary deductions (such as pensions, union subscriptions). This deduction will appear on the employee's payslip and they will receive their salary into their usual bank or building society account.

From the employer side, immediately after the pay run, the payroll department will forward the deduction schedule file that details all deductions that have been made in the required format. At the same time, they will send across the remittance of the funds that have been deducted. It is important to note that the employer send just one amount per employee to the credit union. The employer does not know if this is to repay a loan or credit savings or both.

The credit union can normally upload the file directly into their IT accounting system that will automatically allocate each member's payments into their credit union account. In most cases it can automatically apportion this payment based on the instructions of the individual member assigning the deposit to cover any loan repayments and to credit a member's saving account.

If the member needs to increase, decrease or cease the amount being deducted by their employer, ordinarily they should contact the credit union who can update their account and notify the payroll department. Nevertheless, if the staff member were to go directly to their employer this would also be actioned.

Should a staff member change employer, they can still retain their membership but would need to establish an alternative payment arrangement such as direct debit or standing order to continue saving and/or repaying their loan.

***Diagram 1: Summary of payroll loan process***

**Loan application** – applicant completes a short application form.

↓

**Assessment / decision** – credit union undertakes relevant checks (affordability/credit check) and assessment (varies based on individual credit union).

↓

**Loan agreement and payroll deduction mandate signed** (if approved) – signed electronically or in person.

↓

**Payroll deduction set-up by HR/Payroll department** – credit union sends instructions to employer and deductions arrangement created on payroll system.

↓

**Loan fund disbursement** – funds normally transferred immediately.

↓

**Regular loan repayment (and savings)** – each pay run, the employer sends across the remittance payment and deductions schedule file. The credit union then automatically uploads this into their system and any loan repayments and savings are automatically allocated to members' accounts.

***Case study 1 – Tracey*, Clockwise Credit Union:***

*“I didn't actually have much in the way of saving. But I have now.”*

Tracey joined the credit union over three years ago to try to start saving more regularly after seeing it on the intranet of the local authority that she works in order to try to start saving:

*“I didn't start saving very much at the beginning, it was just.... let's just see how this works. And then then I had a loan.”*

She then needed to take a loan with Clockwise when *“My car had a sad moment so had to get a new car.”*

*“I just felt that I know I'm know how much I’m going to get and I know that the loan is taken out. It was just so convenient. That's all I can say really, it’s just so convenient. That it's just taken out and it's not some I've got to remember to pay the rent to pay that. I don't have to remember to pay that it's already done.”*

She like the fact that it is through her work and doesn’t see any issues of her employer knowing her financial business:

*“On my payslip it just says Clockwise. That could be savings or the loan and it doesn't say nowt on there because it just says Clockwise.”*

Or have any feeling of being locked in:

*“Because I know that if I wasn't with that employer, I'd just contact Clockwise, and try and do it any other way.”*

Another feature that Tracey likes about her loan from the credit union is that she can over pay and save money on the interest:

*“I love the fact that then I can see that my interest is less. And I can also see when it's ending, and it's quite an incentive to me when I’ve knocked another month off.”*

Tracey also attributes her new saving habit to being able to make payments through salary deduction:

*I tried to save but no, now I do save. I'm so much better with my money all of a sudden, I don't know why I mean, I should have been before but I think because it's a regular thing. It's just building up and I'm like OK I’ve actually got some money now.*

** Name changed to retain anonymity.*

## 2.2 About benefit lending

Lending that utilises non-means-test Child Benefit as the mechanism for repayment has become increasingly popular amongst credit unions and their members. A growing number, especially community-based credit unions are now delivering small value loan products that require the borrower's Child Benefit payments to be redirected into their credit union account as the loan repayment method.

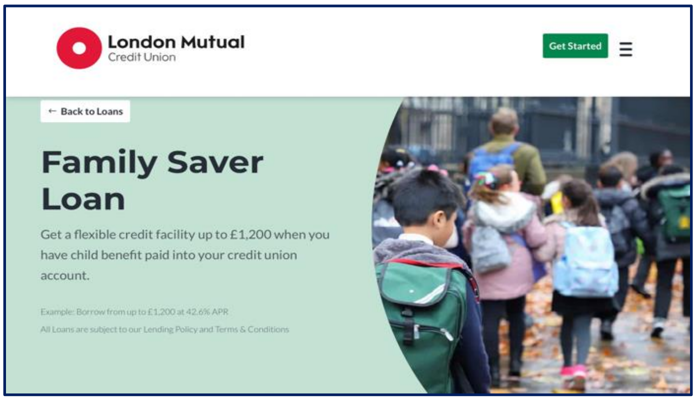
Like payroll lending, this approach offers an effective mechanism to attract new users who anecdotally say they appreciate the simplicity and automated payments. For credit unions, it is seen to mitigate credit risk, enabling them to increase their service provision within more deprived communities and provide a responsible and affordable borrowing option for more families, regardless of their employment situation or credit history.

In essence, the benefit loan model using Child Benefit (often branded by credit unions as a 'Family Loan') is seen by its advocates as allowing credit unions to positively respond to the financial realities of households struggling on lower-incomes. By still ensuring borrowing is affordable for each user, it can help more families than would otherwise to budget and to smooth out the cost of events such as Christmas, birthdays and back to school, as well as dealing with financial emergencies and large expenditure items.

Credit unions are therefore able to reach the same households that would otherwise have few options other than much more expensive subprime borrowing such as home collected credit, high-cost short-term credit or even illegal lending sources. This has the potential to achieve significant financial savings for these low-income households in relation to loan interest and fees (as shown below in Table 4).

Providers would also point to its potential to realise improvements to financial behaviours and resilience, especially in fostering regular savings habits amongst families that rarely or have never saved before.


*Source: www.co-operativecreditunion.coop*




*Source: www.creditunion.co.uk*

Yet, certain elements of the benefit lending model have been highlighted by some parts of the debt advice sector, questioning whether the repayment mechanism for payroll lending and especially benefit lending is encouraging poor practices. One of the challenges presented is that insufficient assessments are being undertaken thus, encouraging lending to people that should not be given credit due to a lack of affordability or already being overindebted.

In addition, where a household is facing financial difficulties there is a perception that deduction lending creates a barrier to either cancelling the Child Benefit payment (or salary deduction). Equally, as payments cannot be readily missed, there is a belief that that people may be committed to payments to the credit union over more pressing outgoings such as rent and other priority payments.

More broadly, there seems an unease amongst some about Child Benefit income being used to service credit repayments, judging that it should be helping with the costs of bringing up their children and assuming that the loan is not doing that.

### How does the benefit loan model work?

Whilst the application and operational process for benefit loans may differ slightly between individual credit unions, diagram 2 provides an overview of the general Child Benefit loan process, outlining the different stages from loan application, through to the deduction of loan repayments and regular saving contributions from Child Benefit.

***Diagram 2: Summary of benefit loan process***

**Loan application** – applicant completes a short application form.

**Assessment / decision** – credit union undertakes relevant checks (affordability/credit check) and assessment – which vary based on the individual credit union.

**Loan agreement signed** (if approved) – signed electronically or in person.

**Redirect Child Benefit payment to credit union** – either approved borrower contacts HMRC by phone/online or credit union forwards signed notification letter by post.

**Loan fund disbursement** – funds either transferred immediately or following receipt of the first Child Benefit payment.

**Regular loan repayment (and saving contribution)** – each time the Child Benefit payment is received – loan and savings are automatically allocated. Any remaining funds can either be withdrawn/transferred into bank account or added to savings.

**Loan application process**

To apply for a Child Benefit Loan, an individual must meet the key eligibility criteria of being over 18 years old, be in receipt of Child Benefit and becoming a member of the credit union (which is now often be done at the same time as the loan application).

Applicants also have to agree that their Child Benefit is paid directly from HMRC to the credit union for the duration of their loan repayments. In some cases, the credit union may also require a minimum amount to be saved each week, or month, that often cannot be withdrawn until the loan has been fully repaid.

The applicant would then complete a detailed loan application form. Where the applicant is not already a member, increasingly credit unions delivering Child Benefit loans enable prospective borrowers to become a member simultaneously.

The amount that an applicant can apply for usually depends on the specific loan product of each credit union – most have lower borrowing limits for a prospective member's first loan which can increase for subsequent loans subject to their financial circumstance. The amount may also be restricted by the amount of Child Benefit being received by the household.

**How much does a benefit loan cost:**

With severely restricted borrowing options available to many low-income families, benefit lending can save these households hundreds of pounds in interest compared to borrowing from subprime lenders.

The amount that each credit union charges for these benefit loans differs but the maximum interest rate that a credit union can charge is capped at 42.6% APR, which many credit unions choose to charge for these types of loan. Amongst our seven participating credit unions, four have set their loan interest at 42.6% APR with three credit union, Enterprise (27.85% APR), Coop (29.8% APR) and Advance (34.5% APR) having lower rates.

As the example in Table 4 below shows, for a family with two children receiving Child Benefit of £145 paid every four weeks (equivalent to £36.25 per week) who wished to take a £500 Family Loan repaid back over 12 months (52 weeks) at the maximum rate of 42.6% APR, the total cost of this loan would be £602.76. As the Child Benefit is paid four weekly (equalling 13 payments over the year), it can therefore be covered by 13 payments of £46.37.

Using the Family Loan will help achieve significant cost savings for this household of between £372 and £397 in interest costs compared to borrowing either by home collected credit or high-cost short term credit.

*Table 4 - Loan comparison with subprime lenders - borrowing £500 over 12 months (52 weeks)*

| | Family Loan with Clockwise Credit Union | Home-collected credit with a leading provider | High-cost Short-term credit with a leading provider |
|---|---|---|---|
| Representative APR | **42.60%** | 342.94% | 1261.00% |
| Monthly payment | **£50.23** | £81.25[3] | £83.33 |
| Amount of interest | **£102.76** | £475.00 | £500.00 |
| Total Repayable | **£602.76** | £975.00 | £1000.00 |
| Difference in total cost | **-** | £372.24 | £397.24 |
| Difference in total cost (%) | **-** | 62% | 66% |

Source: Price quotes taken from leading company websites on 25/01/23.

**Loan assessment and decisioning**

As with all loans, the credit union must ensure that sufficient assessment is undertaken when determining whether to approve or decline each loan application. It must adhere to the requirements for checking and assessing affordability and creditworthiness. Across the credit unions delivering Child Benefit loans there are a range of assessment practices – with some credit unions requiring self-declared income and expenditure statement while others undertake full credit checks and/or income and expenditure assessments via bank statements or increasingly using Open Banking.

**Loan disbursement and repayment**

Credit unions delivering a Child Benefit loan can choose to either disburse the loan funds as soon as the loan is approved or wait until the first payment is received from HMRC. This process for notifying HMRC can be completed by the successful applicant requiring them to contact HMRC by phone or online. Alternatively, the credit union can take greater control by producing and asking successful applicants to electronically sign an authorisation letter and automatically printing and sending it directly to HMRC.

Once the credit union receives the Child Benefit payment from HMRC (which might be weekly or 4-weekly), the loan repayments and any regular saving contributions are automatically taken each time, with any remaining funds made available to the member either via their credit union account or automatically transferred into their bank account.

In the example in Table 4 (above), every four weeks the whole of the Child Benefit payment (£140.60) would be paid directly by HMRC into the member's credit union account. From

[3] Please note the monthly repayment figure is for illustration purposes based on weekly repayment of £23.70 from lenders website.

this, £46.37 and £10.00 would then be automatically deducted for the loan repayment and regular saving contribution respectively, leaving remaining funds of £88.63 to be used by the individual. This can either be left in the member's credit union account and withdrawn at their discretion or automatically transferred back to the member's bank account. **Over the course of the year, the loan would be fully repaid and the individual would have built up a savings pot worth £130.**

### *Case study 2 – Lucy*, Leeds Credit Union:*

*"It's just convenient. It's like setting your direct debits to come out your bank the same day your wages go in."*

Lucy, a single parent of two children has been a member of the credit union for at least three years after hearing about it through the Council's newsletter and her friend:

*"I actually joined so I could get one of the Family Loans from them. About three to four years ago. I got I got offered a house so I needed some money for moving. I got told about Leeds Credit Union and the Family Loan and so I joined them and got one."*

Unable to work due to her long-term ill-health she had few borrowing options and would normally use high-cost lenders such as: *"Morses, Provident and usual rip-off places."* Lucy now takes a loan once a year to help cover costs at Christmas and really likes the simplicity of her Child Benefit being paid directly into the credit union so she can forget about it:

*"I don't have to remember to make the payments it just gets done automatically and that's how I like my payments to be done, automatically. I have some health problems and it affects my memory, it coming straight out my child benefit when my child benefit goes in. It works really well for me."*

She now completes all her loan applications and feels the process is simple and quick but the credit union still checks that the loan is affordable:

*"They asked me my income and outgoings. And when first couple of times when I went in to apply, I took a bank statement but that was more for ID, I think. The conditions are simple. I know they do affordability checks to see income and outgoings, you know, its self-explanatory you get your child benefit paid into your account there and then and they just take it straight from that."*

Because Lucy manages her credit union account online, she is able to transfer the remaining funds across to her bank:

*"I didn't really notice it because I was still able to access what was left over from my child benefit and transfer that to my main account when I needed it."*

But highlights that for some people that are not digitally engaged they could find difficulties applying online and transferring the remaining funds.

** Name changed to retain anonymity.*

# 3. Literature Review

This section sets out summary findings from a review of UK and international research relating to payroll and benefit lending, in line with insight objective 1.

The full literature review, including references, is included in Appendix 1.

**Insight objective 1:**
Identify and highlight relevant learning and best practice from a review of UK-based and international research, to provide evidenced context for the study's research aims and to inform the practical design of the evaluation framework (including survey/interview and data collection requirements).

## 3.1 Payroll lending

**Employers:**

- Reducing employee financial stress and improving their financial wellbeing is seen as a key issue for employers, and many employers see clear benefit from investing in this area.
- An important point to note in terms of confidentiality for employees, is that employers do not know the details of an employee's deduction, for example, whether it is for savings, borrowing or both.
- Employer motivations from engaging with payroll deduction schemes include the objective of supporting the community, or CSR, but are primarily about improving financial wellbeing of the employee through savings.
- Employers particularly like the potential for payroll deduction to enable employees to develop a savings habit. One company in Great Britain is testing a scheme where employees must 'opt-out' rather than 'opt-in' to a membership of a credit union and a consequent savings arrangement.

**Borrowing:**

- There is a very clear benefit to low-income employees from payroll borrowing, which enables them to manage shocks or interruptions to cashflow.
- The credit alternatives to payroll lending can be exploitative and at higher interest rates.
- The connection of the loan repayments to payroll reduces impairment, which leads to lower interest rates for borrowers than for equivalent risk where there is no link to payroll.

- Brazilian legislation limits payroll borrowing to 30 percent of income (loan principal and interest). A commercial provider in the US caps lending at 8 percent of an employee borrower's regular salary.

**<u>Savings:</u>**

- There a very considerable benefits to low-income workers from building financial resilience through savings-based assets, even if relatively modest savings.
- Most employees who have payroll deductions to credit unions are generally savers rather than borrowers.
- Payroll borrowing can be a platform for encouraging positive and sustained savings behaviours – a critical objective for credit unions and national policy makers.

## 3.2 Benefit lending

- Literature relating directly to benefit lending in the UK appears to be limited.
- Historically, the most well-known form of loan related to repayment by welfare benefit deduction was the Social Fund Budgeting Loan. Research evidences that the facility of having the repayment deducted at source was highly valued by beneficiaries of the budgeting loan.
- More than 100 credit unions in the Republic of Ireland offer 'It Makes Sense' loans aimed primarily at those in receipt of welfare benefits. Weekly repayments are made via deduction from welfare benefits through the Household Budget Scheme, run by An Post (the Post Office). However, no systematic evaluation of the 'It Makes Sense' scheme has been undertaken to date.

## 3.3 Salary advance

Whilst salary advance was outside of the scope of this research report, the literature review did evidence some potentially useful findings and relevant learning regarding the provision of this service, that have been highlighted in Appendix 2, for information. These findings also help to set some of the wider context surrounding the use of payroll deduction and the issues and needs that are currently being presented by employers in this arena.

# 4. Stakeholder consultation

This section summarises the results of consultation undertaken with the participating lenders and a selection of other relevant stakeholders with an interest in payroll and benefit lending. In line with insight objective 2, a broad range of stakeholders were engaged to ensure that all views were fully recognised and understood as part of this research,

Full details of the organisations and individuals consulted are provided in the Acknowledgements.

> **Insight objective 2:**
> Provide more in-depth understanding regarding the views of both the benefits that deduction lending can realise for credit union members, as well as any detriment and risks that might be associated. Utilise this learning to inform the relevance and efficacy of the identified research aims and the practical design of the evaluation framework. Establish good practice in the use of these lending models to evidence and inform any practical recommendations in response to the study's research,

## 4.1 Participating credit unions

Structured interviews were completed with all the credit unions participating in the research project. Key findings have been summarised into themes below.

***The benefits of deduction lending***
Across all the participating credit unions there was common consensus about the benefits provided by both payroll and benefit lending, both for members and the credit union itself, and essentially this relates to certainty and reassurance.

- For members, this method provides a quick, easy and convenient method of repayment, that helps to mitigate the risk of forgetting to pay or being late with payments and the adverse impact this could have on their credit rating. It was also highlighted that this is likely to also help with personal budgeting and money management.

- For the credit unions, repayments deducted from salary or benefit reduce the level of lending risk, providing the credit union with a greater degree of certainty regarding repayment and thus more opportunity to offer credit in circumstances where it may otherwise be too uncertain for them to do so, which in turn provides a further benefit to their members.

***Affordability assessments***
Whilst affordability assessments were embedded within the application processes of all the participating credit unions, slightly different approaches towards this assessment were identified during the interviews. This principally related to the scale and depth of the assessment undertaken and whether credit checks were completed alongside the affordability assessments. For example, some credit unions highlighted that they did not undertake credit checks with a credit referencing agency as a matter of course and relied on their affordability assessment to provide an effective and accurate understanding of an applicant's financial circumstances and thus inform responsible decisions. This was particularly the case for those credit unions using open banking technology to verify income and expenditure, as well as to validate the wage payments from a particular employer or the receipt of certain benefits. Other credit unions highlighted that they **did undertake credit checks alongside their affordability assessments for all their applications**, as a standard part of their processes.

Examples were also given of credit unions using the affordability process to look for indicators of vulnerability and people with more than 60% of their income going on everyday food and bills, which might therefore present a credit risk or potential for detriment. Finally, evidence was also provided of **credit unions giving applicants a clear reason for any decline**, for example, problems with gambling.

***Redirecting Child Benefit to the credit union***
Different approaches were highlighted regarding the process to get an applicant's Child Benefit payments redirected to the credit union, which is a critical element of the benefit deduction loan. Some of the credit unions noted that they send the necessary information to the applicant, and thus rely on the applicant themselves contacting HMRC to request the redirection. Of course, it was also noted that this could increase the risk of delays to the disbursement of the loan if the applicant does not take immediate action, perhaps because they are unsure of what to do, or get side tracked by other priorities. An example of a different approach was also shared, where the credit union facilitated a three-way call with the borrower and the child benefit team, **ensuring the borrower fully understands the process and all requirements and therefore the loan disbursement can be expedited**.

***Communications and promotions***
Differences in communications and promotions across the credit unions appeared to reflect the slight differences in how the individual payroll or benefit deducted loans were administered. Some comments were raised about the negative publicity that the promotion of child benefit (or family) loans can attract, due to how some people view and perceive child benefit and what it should be used for. This resulted in one credit union not undertaking external promotion of their Family Loan. It is noted though that these negative comments are in a minority.

***Support in times of financial difficulty***
All of the credit unions highlighted that they are supportive of their members when they are experiencing financial difficulties. Examples included, ongoing communication and messages to members and the offer of options such as payment holidays, alternative repayment

mechanisms and access to financial support and guidance. In relation to this last point, some credit unions did note that their approach towards supporting members to access local or national support services, such as money/debt advice or welfare grants, could be made more effective, for example through the greater use of direct referrals to identified money/debt advice contacts rather than general signposting.

## 4.2 Credit union trade bodies

Structured telephone interviews were completed with ABCUL and the Scottish League of Credit Unions. Key findings from these interviews have been summarised below.

***Concerns about deduction lending***
There was recognition of some of the concerns regarding benefit lending that had been raised by some in the money/debt advice sector, although it was considered that **this only related to a very small minority of specific cases within individual credit unions** and was not indicative of benefit lending per se or the product's use and management across the sector as a whole.

***The benefits of deduction lending***
One of the key benefits of benefit lending was highlighted as being its promotion of a savings culture through the requirement of a level of savings to be made alongside loan repayments. It was considered particularly **effective at developing saving habits amongst people who had previously never, or infrequently, saved**.

***Key requirements***
An important requirement in the delivery and administration of deduction lending was highlighted as being the ability and flexibility of borrowers to manage their repayments in times of financial difficulty, for example, by lowering the amount they repay. Effective engagement from the credit union to work directly with the member in support of their overall financial wellbeing is a critical element of this.

An important requirement in the successful delivery of deduction lending is making sure that borrowers have the ability and flexibility to manage repayments in times of financial difficulty, for example, by reducing the amount of their repayment. This necessitates effective engagement with the member by the credit union and working with them in support of their overall financial wellbeing.

***Branding and marketing***
Some comments were raised questioning whether branding the loans as Child Benefit loans or associating the loan directly with Child Benefit as the driving message within marketing material presented the right image of the credit union, particularly as credit unions are trying to move away from the tag of a 'poor man's bank'. Would less direct naming and branding provide a more useful and relevant image and portrayal of the credit union in support of their growth and development?

***Developing a balanced loan book***
Finally, it was suggested that it was important for the longer term, sustainable growth and development of credit unions, that they consider the mix of risk profiles amongst their members when looking at deduction lending options. For example, a good balance of both payroll and benefit lending is likely to provide the credit union with greater stability and security and the opportunity for growth, than if the credit union is perhaps solely community focused and only provides benefit deducted lending.

## 4.3 The debt advice sector

Structured telephone interviews were completed with several organisations and individuals from the debt advice sector, including the Institute of Money Advisers (IMA), StepChange, one of the UK's leading debt charities, Debt Camel as well as frontline debt advisers. Discussions primarily focused on understanding concerns and issues from within the sector regarding the practical provision of child benefit deducted lending and potential areas of improvement that could mitigate any of these concerns.

***The need for benefit deducted lending***
An initial point of consideration relates to how Child Benefit itself is viewed or perceived. For example, some stakeholders noted their view of Child Benefit as being primarily for the benefit of a child, or children, and, as an initial position, would therefore prefer recipients of this benefit to use the regular income directly for this purpose, rather than to service repayments for a loan taken out from a credit union.

However, whilst there may be a general preference from within the advice sector that people avoid getting into, or further into, debt, the need for borrowing in certain circumstances was acknowledged. It was recognised that borrowing can often be driven by an emergency or specific flashpoint and sometimes urgent expenditure is needed specifically in relation to children, for example, to cover the costs of new school uniform, a laptop for school work or Christmas presents.

***Assessing affordability***
Across all the interviews, stakeholders raised significant concern about whether thorough and detailed affordability assessments were routinely and consistently undertaken by credit unions across the sector, in relation to both new and repeat Child Benefit loans - several examples were cited of Child Benefit loans that were advertised by credit unions as requiring no credit check, which it was maintained could create significant doubt as to the level of assessment that is actually being undertaken.

There was also some suggestion that the extra security of the deduction model, in terms of securing repayments, is perhaps viewed as an alternative option to undertaking proper affordability and credit checks, rather than as a complement.

Stakeholders were clear that the issue of affordability should be a critical and fundamental part of the loan process across the whole sector, to ensure that more credit is not added to existing unmanageable debt. This is also critically important for top ups too, to ensure that loans are still affordable for the applicant's current circumstances.

Additionally, it was suggested that an appropriate referral system should be built into the loan application and affordability assessment processes that underpin any child benefit loan type product, to support access to free, independent debt advice services in those circumstances where a loan is identified as not being a suitable option.

***Unfair relationships and loss of control***
Another common issue raised across the interviews was whether the deduction lending products were encouraging borrowers to relinquish too much control over their income to third parties and creates a negative 'power dynamic' between borrowers and their credit union, employer or both.

Child Benefit Lending

- Potential concerns were raised that Child Benefit loans could leave a significant hole in the borrower's regular income. This appeared to particularly reflect the view that if an individual wanted to retrieve their remaining funds from the credit union, after a child benefit payment had been made and loan repayments and additional saving amount deducted, this could potentially be inconvenient and costly given the perceived lack of fintech infrastructure across much of the credit union sector. Additionally, it was suggested that this could be compounded by poor communication and limited information provision from some credit unions, leaving borrowers unaware or unsure about what they were able to do and how.

- Linked to the issue of control, it was also suggested that the deduction lending products could reduce the flexibility that borrowers would have if they wanted to take some action in relation to their repayments due to financial difficulty, compared, for example, to the ease of cancelling a direct debit payment with the bank. Again, lack of awareness about the options available to borrowers, due to poor communication, was considered a potential issue in this regard, particularly, for example, in relation to the ease of obtaining the relevant information for the borrower to get their child benefit payments redirected from the credit union or repayments stopped by contacting their employer.

Payroll Lending

- The impact payroll lending could have on the relationship between the borrower (e.g. the employee) and their employer were also raised by debt advice stakeholders. There was a specific concern that employees may worry about how much their employer knows about their loan and financial situation and the impacts they may face at work in the event of any financial difficulties, repayment problems or complaints to the credit union. Lack of awareness and understanding about the employer – credit union relationship and options available to the borrower, due to poor communication and information, is, again, considered a potential issue in this regard by the advisers interviewed.

***Dealing with problems***
Another significant area of concern raised across all stakeholder interviews was whether there were consistent robust processes, or safeguards, in place across the sector to support borrowers who might be struggling with their finances or to make their loan repayments, and how well these were communicated to borrowers. This included for example whether borrowers were aware that they could approach the credit union for support when something goes wrong, the options that might be available to them to make their repayments more manageable and wider support services that might be available.

***Holistic package of support***
A common suggestion from the debt advice stakeholders was that it was important that credit unions offer a holistic package of support and guidance to those members approved for a loan, but also for declined applicants. This could include, for example, direct referrals to local or national sources of debt advice for those identified as being over-indebted, budgeting support, income maximisation and the provision of information on welfare grants available from local authorities.

***Infrastructure***
Stakeholders also identified the importance of credit unions fully harnessing digital technology, such as online and mobile banking, to provide borrowers with easy, quick and frictionless access to their loans and in relation to child benefit loans, access to the remaining amount of child benefit left in their credit union account after loan repayments have been taken.

***Better partnership working***
Comments and feedback throughout the interviews highlight some tensions locally between credit unions and debt advice organisations and point towards the need for closer working between the two sectors to prevent and tackle financial harm. It was suggested that the trade bodies for both sectors could take some positive steps towards engaging and actively exploring how financial support and advice could be effectively embedded within the delivery of loans.

***Best practice code***
Recognising that there is likely to be a scale of quality across lenders providing deduction loans, stakeholders suggested that a set of key lending principles, or a best practice code, relating to deduction lending could be developed and adopted by lenders. This could include recommended actions focused on driving improvements, consistency and best practice regarding the delivery of payroll and benefit deduction.

## 4.4 Employers

Structured telephone interviews were completed with a number of employers. Discussions primarily focused on understanding more about the payroll deduction schemes that these employers had in place with their local credit unions and identifying what worked well and what didn't, areas for potential improvement and examples of good practice.

***Context for supporting payroll deducted lending***

All of the interviewed organisations provided a clear rationale and reasoning for the provision of payroll deduction schemes, all of which were centred around supporting the financial and mental wellbeing of their employees.

Providing access to affordable credit was also recognised as an important part of supporting employee financial wellbeing, with Suez, for example, noting that providing safe employer facilitated lending is essential to help employees avoid high-interest loans. Similarly, USDAW felt that a lot of their members were getting pushed into high-cost credit at times of need and therefore wanted to provide access to more affordable and responsible credit.

*"For us, financial wellbeing is about doing what we can to help our colleagues live less stressful lives, have more control and do a little better"*

A major retailer

*"For me, it's all about financial resilience – I can't mention enough that financial wellbeing as a whole is what matters"*

Leeds City Council

However, the importance of embedding this credit provision within a wider package of advice and support, and not promoting access to loans in isolation, was also clearly highlighted. Leeds City Council (LCC) for example noted that their focus is not on the provision of credit itself, even though this affordable credit is seen as an important part of the package, but on building financial resilience through financial education, advice and the promotion of savings.

The credit union facility is viewed by LCC as being very much about supporting the financial health, wellbeing and resilience of the workforce, particularly those on lower incomes.

***Scale of borrowing***

A common issue raised across the interviews was the lack of detailed knowledge held by employers regarding the scale of borrowing via payroll schemes across the workforce. Where data was available, this tended to be related to the level of credit union membership or number of savers and total volume of savings. This perhaps reflects the focus of the employers on the promotion of a holistic package of support and not just lending, as highlighted above.

However, Suez did note that credit union membership across their workforce has increased from 6% to 11% in six months (see Suez case study for further details) and that data from their credit union partner suggests that broadly 60% of members are borrowers and savers and 40% are just savers. This level of borrowing perhaps provides further rationale as to why affordable credit is an important part of the package of support that is made available to employees and why further performance management of this activity could be useful.

An additional important point to note here however, is that where it is available, this type of performance detail is anonymous. A number of the interviewed employers explicitly stated that they do not have sight of any individual's activity with the credit union, including any borrowing, as there is just one salary deduction made to the credit union which doesn't reference any specific details, such as loan amounts.

***Main benefits to employees***

A consistent view was provided across the employers in terms of the main benefits that they consider are provided for their employees by the offer of a holistic package of advice and support, including the availability of payroll lending. Comments particularly referenced reduced stress, improved mental health, greater wellbeing and higher levels of happiness and confidence. It should be noted however, that it is difficult to identify to what degree these benefits are directly attributable to payroll lending, rather than other elements within the package, or indeed the package as a whole. Additionally, these benefits and impacts are often anecdotally identified by employers and therefore more thorough survey work with employees to robustly evidence the impacts could be beneficial.

***Main benefits to organisation***

As per the benefits to employees, there was also a strong degree of consistency across the employers regarding the benefits that are provided to the organisation. Common comments included positive impacts on sickness, absence and productivity as a result of reduced stress levels, but also the potential for the support on offer to improve employee retention, recruitment and loyalty, essentially helping the organisation to become an 'employer of choice'. However, in a similar vein to the employee benefits, it appears that many of the highlighted organisational benefits are anecdotally evidenced and would also therefore benefit from more robust, quantifiable analysis.

*"This type of benefit can show employees that we care about their financial wellbeing and help us to become an employer of choice"*

Suez Group

***Awareness***

The interviews highlighted a variance in the scale of promotional and marketing activity undertaken by the employers to raise awareness of the payroll lending scheme, as part of a wider holistic package of support, with their employees. This ranged from doing very little, if indeed anything, to promote and raise awareness through to the delivery of a comprehensive programme of activity, including embedding the scheme within the organisation's formal benefits package, the promotion of the scheme as part of every employee's job induction, the distribution of regular marketing material, staff webinars and the use of champions / ambassadors to spread the word face-to-face – see the Suez case study, for further details.

***Issues or concerns***

Aside from minor operational issues that occasionally occur and require resolution, there were limited strategic issues or concerns raised by the employers regarding the payroll lending schemes that they have in place. However, one or two broader issues were raised by some of the employers, particularly relating to the promotion of credit and some element of tension between the drive of their local credit union to promote specific lending products versus the desire of the employer to promote a more holistic offer that is not purely focused on credit or is credit led. On the other side of this, some employers felt that the issue was more of a management challenge within their organisation, where a lack of awareness about the role that credit plays in people's lives, or particular perceptions of debt and credit use, impacted buy-in to, and thus effective promotion, of the payroll lending scheme.

***Roles of the employer and credit union***

The consensus across the employer stakeholders was that the roles and responsibilities of the employer and credit union within payroll deduction schemes tended to be clearly defined and well understood. Contracts and agreements are generally drawn up and agreed before schemes start, setting out practical responsibilities.

***Improvements***

In relation to payroll lending, improvements suggested by employers tended to relate to one of two themes: technology or promotion and maximising service take-up. In terms of technology, employers highlighted the importance of harnessing this as effectively as possible to maximise online service provision, particularly to ensure that loans could be disbursed to borrowers quickly and efficiently. Regarding promotion, employers recognised that it was important that they continue to work with their local credit unions to maximise the effectiveness of marketing material and employee communications, as well as identifying new promotional opportunities and approaches, that help to raise awareness of the offers in place, particularly with those harder-to-reach employee across the workforce.

***Scaling up***

Stakeholders generally agreed that there was some opportunity to scale up deduction lending within employers, principally through the better use of technology, particularly in relation to the links with payroll systems, and the potential use of innovative solutions such as opt-out. In this regard, for example, Suez highlighted potential interest from within their workforce to extend their auto-savings pilot (see case study box below) to every employee. Whilst this is focused on saving and wider financial resilience, it would also provide the additional benefit of increasing the potential for future affordable lending. Other stakeholders also highlighted their interest in exploring the potential for similar opt-out schemes.

### *Employer case study – Suez Recycling and Recovery UK:*

***Opt-out scheme:***
In November 2021, Suez introduced a credit union opt-out scheme for all new employees, with their credit union partner Transave. Through the scheme all new employees are now automatically enrolled as credit union members upon joining Suez, with the option of opting-out. To date, 40 percent of all new employees have not opted-out and have stayed in the scheme, which has increased credit union membership in the workforce from 6% to 11% in only 6 months.

The opt out scheme is regarded as an "automatic payroll savings trial" and is currently being assessed by Nest Insight and Harvard University in the US in this context (See Payroll Deduction Literature Review).

However, initial findings and feedback have been positive and it is likely that the scheme will be continued and potentially even expanded. The scheme is badged as a payroll savings trial, with a focus on savings and wider financial wellbeing, rather than specifically loans. This reflects the common perspective among employers about promoting a holistic package of support, as detailed in the employer stakeholder comments above, which has the additional benefit of increasing the potential for future affordable lending.

***A co-ordinated promotional campaign:***
Suez deliver a co-ordinated programme of promotional activity to raise awareness of the support that is available across their workforce, including:
- publicising information as part of the onboarding process (job induction) for new employees:
- Embedding details within the formal employee benefits package;
- Regular promotion within the Suez Life magazine that goes to every employee and which is used to promote key benefits;
- Promotion at the weekly 'Wellness for All' webinars delivered by the HR Director; and
- The use of staff champions / ambassadors across the workforce to promote the offer to colleagues by word of mouth.

## 4.5 Other stakeholders

Structured telephone interviews were completed with several other stakeholders with an interest in deduction lending and employee financial wellbeing, including the national Illegal Money Lending Team (IMLT) and companies such as Flexiwage and Salary Finance.

***Scope and scale of illegal money lending***
A lack of access to mainstream and responsible sources of credit is recognised as a key contributory factor that underpins borrowing from illegal money lenders, borrowing which is often needed just to be able to buy necessitates and cover essential costs of day-to-day

family life. IMLT referenced the recent research report, Swimming With Sharks[4], which estimated that 1.08 million people are borrowing from illegal lenders in England. IMLT also highlighted that an estimated 20% of this illegal lending happens in the workplace, which it considers provides further justification for the continued, and increased, provision of more affordable (and legal) lending options via payroll.

***Benefits***
In terms of organisational benefits, stakeholders highlighted that employers expect to see a reduction in employee stress, leading to improved retention and productivity, which fits in well with the wellbeing strategies that many now have in place. It was also suggested that the use of deductions is likely to make it easier for people to access affordable lending, particularly given its simplicity and frictionless nature.

***Assessing affordability***
Stakeholders referenced the importance of assessing affordability as regards any employer supported lending, noting that a thorough investigation into whether the person can afford the loan should be a routine undertaking.

***Issues and concerns***
However, it was also recognised that the deduction model could remove flexibility for customers when things go wrong. In this regard, stakeholders noted that there is a scale of operational quality across the credit union sector, with some credit unions providing a better service than others, and therefore suggested that **a code of practice specifically relating to deduction lending may be useful to help drive up improvements** and standards across the whole of the sector.

Communicating effectively with employees can often be a challenge, as lenders are reliant on employer communications to reach the workforce. Messages can therefore often be diluted due to the volume of information on different issues and services that is regularly communicated to employees by their employers.

***Improvements***
It was commonly recognised across all stakeholder interviews that whilst there are differences in quality between individual credit unions, as a sector, credit unions need to be more responsive to customer needs for immediate access to affordable cash, and this should be underpinned by increasingly digital and agile service provision. This provision should also be part of a more integrated, triage-based service offer, that brings together a range of services including debt/money advice, welfare benefits and credit union services, ensuring that people can get the right support to meet their needs, which isn't always necessarily a loan.

***Roles of employer and loan provider***
Stakeholders noted the importance of ensuring that clear roles and responsibilities are in place between lenders and their employer partners and that these are clearly

[4] https://www.centreforsocialjustice.org.uk/library/swimming-with-sharks

communicated to employees. In particular, it is important to be clear that employers are explicitly not involved in lending decisions and that there is no sharing of employee financial details between the lender and the employer, although sometimes aggregated, anonymous performance management data is provided.

***Financial wellbeing***

Stakeholders noted the importance of providing access to affordable loans via payroll, as part of a wider, holistic package of support. Messaging to employees cannot just be about loans – there is a much wider context of building financial resilience and well-being that needs to be covered and loans alone cannot be the answer. Alongside an element of financial education and signposting to money and debt advice agencies, saving should be a key element in the promotion of financial well-being and must feature in the messaging to employers and employees.

# 5. Deduction borrower consultation

This section examines the borrower experience, presenting the findings of the extensive survey undertaken with over 7,500 borrowers from the approximately 38,000 (20% return rate) who had taken at least one small value loan over the previous three years with the participating credit unions. The results are split by the three different users of payroll loans, benefit loan (Child Benefit loans) and standard loans.[5] They cover; demographic profiles, credit usage, loan affordability and difficulties, impact on wellbeing, changes to saving habits, impact on relationship with employer and overall satisfaction.

It also contains the findings from the in-depth discussions with individual payroll and benefit loan users to explore their positive and negative experiences that have been included in the form of case studies in this section and throughout the report.

**Insight objective 3:**
Enable self-reported responses on customers' attitudes, behaviours and impacts/outcomes relating to the use of the credit union and their lending. Enable comparison between different loan products, including payroll deduction and child benefit loans and standard loans, to evidence and inform conclusions and practical recommendations relative to the study's research aims.

**Insight objective 4:**
Provide more in-depth understanding of the reasons behind both positive and negative views expressed during the survey, regarding credit union members experiences of using either payroll deduction or child benefit loans. Provide real-life testimony and lived experience to evidence and inform conclusions and practical recommendations relative to the study's research aims.

## 5.1 Profile of the deduction borrowers

The demographic profile of borrowers using the three different loan types offered by the credit unions differ considerably.

### Gender

Credit union borrowers are predominantly female. Users of benefit loans are almost exclusively female with 97 percent of borrowers. This compares to 66 percent of payroll loan borrowers and 68 percent of standard loan borrowers.

[5] The survey results show that amongst what has been categorised as standard loan users, 49 percent repay using standing order, 45 percent by direct debit and 5 percent by other (which is primarily payments at branch offices).

*Table 5: Borrower gender*

| | Payroll Loans | Benefit Loans | Standard Loans | All Loans |
|---|---|---|---|---|
| Female | 66% | 97% | 68% | 86% |
| Male | 34% | 3% | 32% | 14% |
| Other (please specify) | <1% | <1% | <1% | <1% |

### Age

Benefit loans are being used by a significantly younger profile of borrower than both payroll loans and standard loans with more than half (52%) aged between 18-34 years old, compared to 22 percent for both payroll and standard loans.

*Table 6: Borrower age*

| | Payroll Loans | Benefit Loans | Standard Loans | All Loans |
|---|---|---|---|---|
| 18 to 24 | 2% | 8% | 5% | 7% |
| 25 to 34 | 19% | 43% | 17% | 34% |
| 35 to 44 | 29% | 36% | 24% | 32% |
| 45 to 54 | 29% | 11% | 27% | 17% |
| 55 to 64 | 18% | 1% | 20% | 8% |
| 65 or older | 2% | <1% | 7% | 2% |

### Housing status

Overwhelmingly, benefit loan borrowers are renters (90 percent) with 63 percent in council or housing association properties and 27 percent renting privately. This compares to 67 percent standard loan borrowers and 54 percent of payroll loan borrowers who are renters. Nearly one in four (24%) payroll loan borrowers are home owners compared to 22 percent of the standard loan borrower and only 4 percent of benefit loan borrowers.

*Table 7: Borrower housing status*

| | Payroll Loans | Benefit Loans | Standard Loans | All Loans |
|---|---|---|---|---|
| Home owner - with mortgage | 19% | 3% | 16% | 8% |
| Home owner - without mortgage | 5% | 1% | 6% | 1% |
| Tenant - housing association / council | 38% | 63% | 46% | 56% |
| Tenant - private landlord | 26% | 27% | 21% | 26% |
| Living with family / friends | 10% | 5% | 9% | 7% |
| Shared home arrangement / renting a room | <1% | <1% | <1% | 1% |
| Prefer not to say | 1% | 1% | 2% | 1% |

### Employment status

Each of the three different types of loan products are used by borrowers with very different employment profiles.

Unsurprisingly, payroll loans are almost exclusively used by those in employment with 94 percent of users working either full-time (68%) or part-time (26%). In comparison, 64 percent of standard loan users are working either full-time (50%) or part-time (14%) and just 42% of benefit loan borrowers working either full-time (17%) or part-time (25%).

Twenty percent of benefit loan borrowers classify themselves as unemployed, compared to 4 percent of standard loan users and 1% of payroll users.

***Table 8: Borrower employment status***

| | Payroll Loans | Benefit Loans | Standard Loans | All Loans |
|---|---|---|---|---|
| Working full-time | 68% | 17% | 50% | 30% |
| Working part-time | 26% | 25% | 14% | 22% |
| Self-employment | 0% | 2% | 4% | 2% |
| Zero hours / casual contract | 0% | 1% | 1% | 1% |
| Maternity leave | 1% | 2% | 1% | 2% |
| Unemployed - seeking work | 1% | 11% | 2% | 8% |
| Unemployed - not seeking work | 0% | 9% | 2% | 6% |
| Unable to work due to long-term sickness /disability | 1% | 18% | 16% | 15% |
| Retired | 1% | <1% | 5% | 2% |
| Looking after family | 0% | 13% | 4% | 9% |
| In education (full / part-time) | 0% | 2% | 1% | 1% |
| Prefer not to say | 1% | 1% | 1% | 1% |

### Annual household income

Overall, the survey results show that credit unions are providing access to small value loans to households with relatively low incomes, with 70 percent having an annual household income below £25,000. Linked to the trends in employment status identified above, those taking out payroll loans and standard loans tend to have higher levels of income, compared to those taking benefit loans. Nearly half (49%) of payroll loan borrowers have an income of £25,000 or more compared to 34 percent using standard loans and 14 percent of benefit loan borrowers.

Importantly, the results show that benefit loans in particular are giving those with extremely low incomes access to credit. More than half (51%) of benefit loan users have an annual household income below £15,000, compared to 21 percent of payroll borrowers and 31 percent of standard borrowers.

*Table 9: Borrower annual household income*

| | Payroll Loans | Benefit Loans | Standard Loans | All Loans |
|---|---|---|---|---|
| 0 - £4,999 | 4% | 13% | 5% | 11% |
| £5,000 - £9,999 | 5% | 14% | 9% | 12% |
| £10,000 - £14,999 | 12% | 24% | 17% | 20% |
| £15,000 - £19,999 | 13% | 17% | 14% | 16% |
| £20,000 - £24,999 | 13% | 11% | 14% | 11% |
| £25,000 - £29,999 | 10% | 6% | 10% | 7% |
| £30,000 - £34,999 | 9% | 3% | 7% | 4% |
| £35,000 - £39,999 | 9% | 2% | 6% | 3% |
| £40,000 - £49,999 | 10% | 2% | 6% | 4% |
| £50,000 - £74,999 | 11% | 1% | 5% | 3% |
| Prefer not to say | 5% | 7% | 7% | 7% |

### Marital status

In relation to marital status, benefit loan borrowers are much more likely to be single, with 70 percent of users classifying themselves as single, compared to 35 percent of payroll loan borrowers and 45 percent of standard loan borrowers. In comparison, 37 percent of payroll loan borrowers are married or in a civil partnership compared to 28 percent of standard loan borrowers and 12% of benefit loan borrowers.

### Number of children within the household

Benefit loan users have significantly more children to support, with nearly two thirds (65%) having two or more children compared to 22 percent of payroll loan borrowers and 25 percent of standard loan borrowers. More than half of payroll loan borrowers (56%) and standard loan borrowers (57%) have no children compared to 2 percent amongst benefit loan borrowers.

***Case study 3 – Natalie*, Clockwise Credit Union:***

*"So, I had a door step loan before I used Clockwise. And if I'd heard about Clockwise before, I'd have just come straight to Clockwise there and then."*

Natalie and her three children were living in temporary accommodation and quickly needed money to help move into their new tenancy. Her friend recommended getting a Family Loan with Clockwise Credit Union. Before joining, Natalie used home collected credit companies that *"charge mega interest"* to borrow money:

*"With a doorstep lender, it's a lot of pressure. They like they will come out to you. They know who you are. They know the kind of know your circumstances. I know Clockwise know your circumstances because you have to fill out applications but obviously if you think about it, it's anonymous. They don't know who you are. And I find with doorstep lenders they can become quite.... when it comes to money, they can become very, I wouldn't say aggressive but I'd say pushy."*

Natalie sees the automated monthly deduction of her Child Benefit into the credit union to repay her loan as a key benefit:

*"It's just helpful because you know, like I say, we don't have to stress about paying it back. It automatically gets paid and then what Child Benefit we have left gets put into either our bank account or into my Clockwise account. And just the fact that it's, you know, every four months, if I am running low on money, then I can top off if I need to. So that's a really good benefit for us."*

In the two years since becoming a member, Natalie has turned to the credit union when she has been struggling financially:

*"It's just, you know, obviously like when unexpected bills and stuff like that it's just been helpful. I'd say a couple of months ago, I had a TV licence bill. And I was being told that I didn't pay for a full TV licence then I'd have to go to court and whatnot and didn't want that stress. So I did go to Clockwise and I did ask if they could top up or get another loan to pay that. Obviously, I had to prove that that's what I was paying. At first, they told me that they would have to pay that debt. But they didn't do that. They just put the money into my account. And then I just paid my TV licence from them. So it's good for like unexpected bills or... and they are understanding because you know, there's been times when I've had to have it a lot earlier than I have been allowed. They are understanding. They do sympathize."*

** Name changed to retain anonymity.*

## 5.2 Use of credit

### Access to other forms of credit

A significant proportion of credit union borrowers also continued to access other types of credit during the previous three years. In terms of access to borrowing, benefit loan users would appear to have very different available credit sources compared to those using both payroll and standard loans.

Importantly, benefit loan users would seem to have fewer more traditional borrowing options available to them, demonstrating much lower usage of authorised overdrafts (4%), loans from banks/building societies (1%) and credit card /store card (8%) compared to both payroll loan and standard loan borrowers. Equally, compared to these two types of borrowers, those using benefits loans tend to have taken a Universal Credit advance (19%) and have higher usage of friends and family borrowing (15%), loans from the Department of Work and Pensions (13%) and home collected credit (4%).

Amongst payroll loan borrowers, the most common other form of credit was credit /store card (20%), authorised overdraft (11%) percent used their overdraft (authorised and unauthorised), compared to eight percent of the total sample and 6% of benefit loan borrowers.

Another notable finding was the high use of buy now, pay later products across all three credit union loan users, which has been used by approximately 15% across each of the borrower categories.

***Table 10: Use of other types of credit***

| | Payroll Loans | Benefit Loans | Standard Loans | All Loans |
|---|---|---|---|---|
| Authorised overdraft (from bank / building society) | 11% | 4% | 9% | 6% |
| Unauthorised overdraft (from bank / building society) | 2% | 2% | 1% | 2% |
| Loan (from bank / building society) | 7% | 1% | 5% | 3% |
| Credit card / store card | 20% | 8% | 18% | 12% |
| Online payday loan / short-term loan / instalment loan | 4% | 2% | 3% | 3% |
| Home collected loan (e.g. Provident, Morse Club) | 2% | 4% | 3% | 4% |
| Rent to own (e.g. BrightHouse, Perfect Home) | 1% | 1% | 1% | 1% |
| Buy now pay later (e.g. Klarna, ClearPay) | 15% | 15% | 14% | 14% |
| Catalogues (e.g. Very, Freemans) | 9% | 7% | 10% | 7% |
| Pawnbroker | 1% | <1% | 1% | 1% |
| DWP (budgeting loan or social fund) | 2% | 13% | 6% | 10% |

| | | | | |
|---|---|---|---|---|
| Universal Credit (advances or budgeting advances) | 4% | 19% | 7% | 14% |
| Friends and family | 9% | 15% | 9% | 13% |
| Unregulated lender | 1% | <1% | 1% | 1% |
| I have not borrowed from anywhere else. | 9% | 7% | 9% | 8% |
| Prefer not to say | 4% | 3% | 3% | 3% |

### Loan purpose

There are also some important findings relating to what the loans were reportedly used for. One of the criticisms of benefit lending using Child Benefit as the repayment, is that it diverts essential funds away from the household that should be used solely for spending on their children. Yet, **the results show that the most popular use of benefit loans were for expenditure relating to their families** including; birthdays/Christmas or special occasion (29%), clothing/school uniforms (18%), living expenses (13%), and to purchase household items such as white goods (10%) or furniture/home improvements (9%).

Payroll loan borrowers were also most likely to use their loan for discretionary spending on birthdays/Christmas or special occasions (23%) but also holidays (18%), car repairs (15%) and repaying arrears and other debts (14%).

***Table 11: Loan purpose***

| | Payroll Loans | Benefit Loans | Standard Loans | All Loans |
|---|---|---|---|---|
| Birthday/Christmas or special occasion | 23% | 29% | 24% | 27% |
| Furniture/home decor/home improvements | 2% | 9% | 9% | 8% |
| Clothing such as school uniforms | 3% | 18% | 5% | 14% |
| Car repairs | 15% | 4% | 12% | 6% |
| White goods such as a washing machine | 9% | 10% | 8% | 9% |
| Rent/mortgage | 3% | 1% | 1% | 1% |
| House deposit | 2% | 1% | 2% | 1% |
| Electrical items such as a laptop/tablet or TV | 4% | 2% | 4% | 3% |
| Holiday or spending money | 18% | 8% | 17% | 11% |
| Living expenses (e.g. food or shopping) | 7% | 13% | 8% | 12% |
| Pay off rent/mortgage arrears or bills | 6% | 3% | 4% | 3% |
| To pay off credit commitments (debt consolidation) | 8% | 2% | 6% | 3% |
| Other | <1% | <1% | <1% | 0% |

***Case study 4 – Denise*, Enterprise Credit Union:***

*"I was going through some financial difficulty a couple years ago, due to personal reasons and I did contact the credit union and they just lowered the payroll amount and just said ring up when you want to up it back up. So that was really good. That was really helpful. I like the payroll."*

Denise lives with her partner in a private rented property and works for the local Council. She joined the credit union in 2013 after seeing it on the staff intranet at her employer:

*"With it going straight out my wages, I thought I could start saving, obviously, finding out that it does loans was a bonus as well."*

She first got a loan from Enterprise to cover the cost of Christmas but used to resort to payday loans:

*"I needed the money, obviously first go to family and if that weren't accessible, then it was payday loans, which are ridiculous when you're paying them back to the mean so that's why I really do speak highly of the credit union, because obviously, like the interest rates on the payday loans - they're just rubbish."*

Having the money go straight from her wages and into the credit union is a major benefit:

*"It's easy to just not have that money there but it's still going into the credit union. I mean, it's just that it's like because I'm not missing the money. If I had it like and me doing the repayments like I think you're more tempted to like if you're desperate, you're more tempted to use it for other things but with this, obviously it's manageable for me."*

When Denise was having financial difficulties, she naturally turned to the credit union for help who were really supportive and reduced her loan repayments:

*"I was probably a lot more at ease contacting them than say saying to my work that I'm having financial difficulties. It was easy to speak to the credit union."*

The other major advantage of using payroll deduction is it has encouraged her to regularly save alongside her loan repayments:

*"I like that even if it's a little amount that's going into the savings account, I just prefer it that way. Just that when I've got a loan that I saving at the same time, if you get me."*

*"I think it's fantastic. It's definitely a thumbs up from me. It's just it's manageable, obviously because you're not missing that money. It's easier because you never miss a payment because it's just coming out your wages. You just you don't have to worry about like repaying the loan because it's just coming back out of your wages…….. I just think it's all around easier, accessible and it's really good and I've got nothing bad to say about it.*

### Reasons for choosing the loan type

The survey highlights that the ease offered by automated repayments is the key reason why borrowers choose deduction lending.

Having their funds transferred directly to the credit union is seen as a positive rather than a negative feature by payroll loan users and was the most popular reason given for choosing a payroll loan was that borrowers could make repayments via their salary (25%) – the convenience point. The next most popular reason was that repayments were affordable (14%). The price of the loan – the APR – was mentioned by just eight percent. Additionally, the non-profit status of credit unions was also not highlighted as a key reason.

As with employer loans, the most popular reason (18%) given for choosing a benefit loan was that borrowers could make repayments automatically this time via benefits. The next most popular reason was that repayments were affordable (17%). Recommendation by family and friends was also a popular reason (12%) as was the reputation of the credit union (12%) and preference for borrowing from credit unions (11%). The price of the loan – the APR – was mentioned by just five percent.

Another finding relates to the importance given to the lack of a credit check for choosing the loan. Critics of deduction lending particularly benefit lending point to promotion by credit unions that focus on this aspect. Amongst payroll loan borrowers it was highlighted by one in ten users (10%) as one of the main reasons for choosing the loan but only three percent amongst users of benefit loans.

Overall, it is the basic feature of the loan with the credit union – the convenience of automatic payments – and affordability of the loan repayments which are the main attractions to deduction lending amongst those that use it.

***Table 12: Reasons for choosing the loan***

| | **Payroll Loans** | **Benefit Loans** | **Standard Loans** | **All Loans** |
|---|---|---|---|---|
| Interest rates (the price, APR) | 8% | 5% | 10% | 6% |
| Because I can make repayments via my wage/salary or child benefit | 25% | 18% | n/a | 14% |
| Affordable repayments (the cost per week, fortnight or month) | 14% | 17% | 18% | 17% |
| Recommended by family/friend/colleague | 6% | 12% | 12% | 12% |
| I was already a credit union member | 8% | 3% | 10% | 5% |
| Advertising | 8% | 1% | <1% | 2% |
| Because the credit union is not-for-profit | 10% | 6% | 10% | 7% |
| Because the credit union is more personal and approachable | 8% | 9% | 11% | 10% |
| Good reputation | 2% | 12% | 14% | 11% |
| Because there was no credit check | 10% | 3% | 2% | 4% |

| | | | | |
|---|---|---|---|---|
| Prefer borrowing from a credit union than other lenders | 1% | 11% | 12% | 10% |
| Turned down by another lender | 2% | 1% | 1% | 1% |
| Other | <1% | 2% | <1% | 2% |

In terms of how users found out about the credit union loan, by far the most popular way amongst benefit loan borrowers was through word of mouth via family, friends or colleagues. More than two-thirds (68%) found out through this method, compared to 56 percent for standard loan users and only 17 percent for payroll loan users.

***Table 13: How did you find out about the loan scheme?***

| | Payroll Loans | Benefit Loans | Standard Loans |
|---|---|---|---|
| From my employer | 44% | n/a | n/a |
| Recommended by family/friend/colleague | 17% | 68% | 56% |
| Heard about it through a local community organisation | 1% | 8% | 6% |
| In branch | 6% | 5% | 9% |
| Promotion by the credit union | 16% | 1% | 9% |
| Leaflet, poster or printed material | 11% | 2% | 3% |
| Search engine (such as Google) | 2% | 6% | 6% |
| Social media | 1% | 7% | 6% |
| Other (please specify) | 1% | 4% | 5% |

### Experience of the application process

Both payroll and benefit loan borrowers reported very favourable experiences with the application process, with 72 percent and 74 percent respectively **strongly agreeing that the application process to obtain the loan was straightforward and easy to follow**, with a further 24 and 23 percent agreeing. Just under two percent disagreed in relation to both loans.

It is worth noting that for both payroll and benefit loans there was quite a large range between the individual credit unions participating in the research.  In terms of payroll loans, one credit union had 83 percent strongly agreeing, while at the other end of the range one credit union had 50 percent strongly agreeing, whilst the same range for benefit loans ran from 79 percent to 52 percent. Each of the credit unions received commendable scores but it suggests that some credit unions could focus on further improving their application process.

***Table 14: Experience of the application process (those agreeing/disagreeing process was straightforward and easy to follow)***

| | Payroll Loans | Benefit Loans | Standard Loans | All Loans |
|---|---|---|---|---|
| Strongly agree | 72% | 74% | 71% | 73% |
| Agree | 24% | 23% | 25% | 24% |
| Neither agree nor disagree | 2% | 2% | 3% | 2% |
| Disagree | 1% | 1% | 1% | 1% |
| Strongly disagree | <1% | <1% | 1% | 0% |

Similarly, for both payroll and benefit loans a large majority of respondents strongly agreed (70% and 74% respectively) or agreed (26% and 23% respectively) that they had been provided with the appropriate information about the loan before applying. Again, there was a range of results for both loans, with the best in relation to payroll loans achieving a 'strongly agree' score of 80 percent compared to 46 percent achieved by the credit union at the other end of the range, and the same range for benefit loans running from 80 to 55 percent.

Almost all respondents for both loans strongly agreed (69% for payroll loan users and 74% for benefit loan users) or agreed (26% for payroll loan users and 24% for benefit loan users) that they felt that the credit union sufficiently assessed their ability to afford the loan. For individual credit unions, the proportion saying they strongly agreed ranged from 78 percent to 52 percent for payroll loans and 79 to 62 percent for benefit loans.

More than half of payroll borrowers (54%) and half of benefit loan borrowers (57%) said they **did not know if the credit union had carried out a credit check as part of the application process**. In terms of benefit loans, the 'don't knows' ranged from 73 to 38 percent. This suggests that some credit unions could do more to clearly communicate to borrowers what the application process involves or might reflect wider lack of understanding or appreciation about credit referencing amongst borrowers.

Sixty eight percent of respondents with a payroll loan said that the credit union had asked for proof of their income and expenditure, compared to 78 percent of benefit loan borrowers. In terms of payroll loans, 32 percent either said no it hadn't (18%) or didn't know whether it had asked for proof (14%), whilst 23 percent of benefit loan borrowers either said no it hadn't (7%) or didn't know (16%)

Again, for both loans, there was a range of results, with 91 percent of payroll loan borrowers of one credit union saying they were asked for proof of income and expenditure, yet only half of borrowers from another credit union said they had been asked for proof. In terms of benefit loans this ranged from 88 to 58 percent.

## 5.3 Loan affordability and difficulties

### Loan affordability

The next set of questions looked at whether borrowers considered their loans to be affordable. The results below suggest very clearly that both payroll and benefit loan borrowers found their loans affordable. Ninety seven percent of borrowers across all three types of lending either **strongly agreed or agreed that their loan was affordable. The results were uniformly positive across all the participating credit unions**. Even in the 'worst' performing case, just four percent of payroll loan respondents, and two percent of benefit loan respondents, said they either disagreed or strongly disagreed that the loans were affordable.

***Table 15: The loan repayments are/were affordable (those agreeing/ disagreeing)***

| | Payroll Loans | Benefit Loans | Standard Loans | All Loans |
|---|---|---|---|---|
| Strongly agree | 70% | 71% | 67% | 70% |
| Agree | 27% | 26% | 30% | 27% |
| Neither agree nor disagree | 3% | 2% | 3% | 2% |
| Disagree | <1% | <1% | <1% | 0% |
| Strongly disagree | <1% | <1% | <1% | 0% |

### Financial difficulties

The positive responses relating to the affordability of the credit union loans were reinforced by the results from the next set of questions relating to financial difficulties experienced by borrowers.

Only seven percent of payroll loan borrowers and nine percent of benefit loan borrowers either strongly agreed or agreed that they had struggled to keep up with household finances since part of their wage or their child benefit had been transferred directly to the credit union to cover their loan repayments. Eighty two percent of payroll loan borrowers and 77 percent of benefit loan borrowers strongly disagreed or disagreed with the statement. Notably, the result from those using both forms of deduction lending were broadly in line with those reported by users of standard loans.

***Table 16: Struggled to keep up with household finances since loan repayment was transferred to the credit union (those agreeing/ disagreeing)***

| | Payroll Loans | Benefit Loans | Standard Loans | All Loans |
|---|---|---|---|---|
| Strongly agree | 3% | 5% | 4% | 4% |
| Agree | 4% | 4% | 4% | 4% |
| Neither agree nor disagree | 11% | 13% | 12% | 13% |
| Disagree | 39% | 33% | 36% | 35% |
| Strongly disagree | 43% | 44% | 44% | 44% |

### Concerns about transferring Child Benefit to the credit union

One of the issues raised about expanding access to benefit loans was that people would be concerned about transferring their Child Benefit to the credit union and losing control over their money. The survey responses would not appear to support those concerns. The big majority of respondents (91%) were very comfortable or comfortable about transferring their Child Benefit to their credit union. Just one percent said they were uncomfortable. The results suggest that the potential downsides of benefit loans are not an issue for most respondents.

### Missed loan payments

Another way to gauge affordability and those experiencing problems is to establish whether borrowers would have preferred to miss some payments on their loans. This seeks to answer a key question of the research, over whether this repayment mechanism could lead struggling users to still make payments that they would others preferred to have missed.

There appears to be no difference between the proportion of payroll loan borrowers (10%) and benefit loan borrowers (11%) that had made a loan repayment that they would have preferably missed, compared to those using a standard loan (11%). However, this is still not an insignificant proportion of borrowers across all credit union loans, and therefore would appear that around one in ten borrowers are experiencing some degree of financial pressure during the lifetime of their loan.

***Table 17: Made payments preferred to have missed (those agreeing/ disagreeing)***

| | Payroll Loans | Benefit Loans | Standard Loans | All Loans |
|---|---|---|---|---|
| Strongly agree | 3% | 5% | 4% | 4% |
| Agree | 7% | 6% | 7% | 6% |
| Neither agree nor disagree | 17% | 17% | 17% | 17% |
| Disagree | 37% | 34% | 34% | 34% |
| Strongly disagree | 36% | 39% | 37% | 38% |

Another important finding from the survey results is that they confirm that both payroll and benefit deduction do have an impact on reducing the number of missed payments. At just 2%, there was **no difference between the proportion of payroll loan borrowers and benefit loan borrowers saying that they had missed a loan payment**. However, this was markedly lower compared to 15 percent of borrowers that stated they had missed a payment with a standard loan. This would indicate that those repaying via deduction repayments are less likely to miss at least one payment compared to those using repayment methods such as standing order, direct debit and payments made at branch.

***Table 18: Borrowers saying they missed payments on their loan***

| | Payroll Loans | Benefit Loans | Standard Loans | All Loans |
|---|---|---|---|---|
| Yes | 2% | 2% | 15% | 6% |
| No | 98% | 97% | 82% | 93% |
| Prefer not to say | <1% | 1% | 3% | 1% |

Given that there were no real differences between the three types of loan users in terms of making payments that they would have preferred to have missed, there is a question about the cause of this marked difference.

Some credit unions point out that some of this is often due to the very first payment being missed when a new borrower does not set up the payment with their bank. This is far less likely to happen with payroll loans because the credit union sends the completed mandate to the employer to set up the deduction or with benefit loans because many credit unions often do not transfer the loan funds until the first payment is received from HMRC.

Yet, the survey results also indicate that **there is a much lower appreciation, particularly amongst payroll loan users on how they would go about cancelling their loan payments.** More than two thirds of payroll loan borrowers (69%) and more than half (53%) of benefit loan borrowers weren't aware they could stop their payments by contacting their employer or benefit provider, dependent on their loan type. This is higher than those with standard loans who weren't aware they could stop their payments by contacting their bank (28%).

***Table 19: Awareness of ability to stop payments by contacting relevant organisation***

| | Payroll Loans | Benefit Loans | Standard Loans | All Loans |
|---|---|---|---|---|
| Yes | 23% | 40% | 64% | 44% |
| No | 69% | 53% | 28% | 48% |
| Don't know | 8% | 7% | 8% | 7% |

One area which could be improved is providing borrowers with better information on their options if they do experience financial difficulty including who to contact within the credit union and how to cease their deduction repayments if necessary.

But it is worth noting that survey showed that 17 percent of benefit loan customers did have their loan repayment period extended by the credit union, a much higher proportion than the one percent with payroll loan product and six percent with standard loans. Consultation with participating credit unions point to some of this difference being down to those using Child Benefit repayments turning to the credit union if they are struggling but primarily resulting from the high number of benefit loans that are 'topped-up' when a proportion of their loan has been repaid.

Therefore, it is important that credit unions are attempting to actively identifying cases when borrowers are under financial pressure and continually encourage struggling borrower to contact them as the first point of support and ensure specific help and support measures are in place and offered.

***Case study 5– Lisa*, Manchester Credit Union:***

*“I did it quite a few times because I paid it back and then obviously, I got into a bit of a situation and I stopped paying it.”*

Lisa, a single parent, had previously been borrowing from a door step lender before she became a member after hearing about it through a friend who recommended getting a loan with the credit union:

*“I joined to get a loan I needed some money for Christmas to get Christmas presents.”*

She applied in one of the credit union branches and completed the paper work for the Family Loans:

*“I think that was the only one they had or it was the easiest for me because it went straight out my child benefit.”*

At first, she didn’t miss the child benefit payment going directly into the credit union and liked the fact that her loan repayments were taken care of:

*“I've gotten used to having a certain amount paid into my account…… It's just cos obviously my brains like a sieve and I knew it was gonna get paid because it was going straight to them. I don't have to worry about figuring out what day it was.”*

Lisa had also started to save for the first time as a result of the Family Loan:

*“It would go into like a saving pot and off. Some of it would be in a savings pot and the other would be paying off that loan and then obviously once I paid that loan off I had the choice to renew or keep saving.”*

But after a couple of years with the credit union and having taken a number of loans, she experiences some financial problems that meant that she was struggling and decided to contact HMRC to redirect the Child Benefit payments back to her bank account:

*“I just cancelled it.”*

When asked why Lisa had not approached the credit union for help first:

*“I didn’t think they could help…… I don’t know really, I just got a bit worried about it.”*

She now borrows from family if she needs to:

*“It doesn’t feel like not rushed but I don’t know a bit more.... a bit more relaxed…… I’ve just got to be careful near Christmas and birthdays.”*

## 5.4 Impact on savings behaviour

As well as providing access to affordable, manageable loans, an important aspect championed by supporters of deduction loans is that the set up makes it much easier for people to get into the savings habit, especially those on low income that have previously struggled to save before. And the survey findings do seem to bear out the view that this form of financial relationship does encourage positive savings behaviours. Prior to borrowing with the credit union, users of benefit loans were less likely to both have a savings account and be saving regularly, compared to both payroll loan borrowers and standard loan borrower.

In terms of having a savings account before taking out their loan, only about a third of both payroll loan borrowers (37%) and standard loan borrowers (36%) but this was even lower amongst benefit loan borrowers (16%).

***Table 20: Having a savings account before taking out a loan***

| | Payroll Loans | Benefit Loans | Standard Loans | All Loans |
|---|---|---|---|---|
| Yes | 37% | 16% | 36% | 23% |
| No | 63% | 84% | 64% | 77% |

Prior to borrowing with the credit union, overall levels of saving appear low across all loan users but especially amongst benefit loan users. Almost three quarters (72%) said they rarely or never saved, compared to 54 percent of payroll loan users and 56 percent amongst standard loan users. This means that only seven percent of benefit loan users were previously saving regularly, either most weeks or months (4%) or every week or month (3%). These results are perhaps not surprising given the significantly lower annual incomes of those using benefit loans compared to the other loan types – as shown in Table 9, above.

***Table 21: How often borrowers saved before taking out loan***

| | Payroll Loans | Benefit Loans | Standard Loans | All Loans |
|---|---|---|---|---|
| Rarely/never | 54% | 72% | 56% | 66% |
| Some weeks or months, but not others | 21% | 20% | 21% | 21% |
| Most weeks or months | 7% | 4% | 6% | 5% |
| Every week or month | 18% | 3% | 16% | 8% |

However, despite the relatively low saving levels prior to taking their loan what is really encouraging is how the next set of results demonstrate that borrowing with the credit union helps foster greater and more persistent saving habits amongst all users.

It would appear that the automated mechanism of deduction lending **is fostering higher levels of regular saving**. Seventy three percent of those repaying by child benefit said they either strongly agreed (40%) or agreed (33%) that the loan had helped them save more regularly. Similarly, 72 percent of payroll loan users said they either strongly agreed (37%) or agreed (35%) that the loan had helped them save more regularly. This compares to 66 percent amongst standard loan users that either strongly agreed (35%) or agreed (31%).

***Table 22: Borrowers agreeing the loan helped them save more regularly***

| | Payroll Loans | Benefit Loans | Standard Loans | All Loans |
|---|---|---|---|---|
| Strongly agree | 37% | 40% | 35% | 39% |
| Agree | 35% | 33% | 31% | 33% |
| Neither agree nor disagree | 22% | 22% | 27% | 23% |
| Disagree | 5% | 4% | 5% | 4% |
| Strongly disagree | 1% | 1% | 2% | 1% |

Likewise, most benefit loan borrowers (61%) and payroll loan borrowers (57%) stated that the amount of money they saved had increased since they took out the loan, which was slightly higher than the 55% amongst standard loan users.

***Table 23: Borrowers agreeing the amount of money they saved has increased***

| | Payroll Loans | Benefit Loans | Standard Loans | All Loans |
|---|---|---|---|---|
| Strongly agree | 29% | 32% | 27% | 30% |
| Agree | 28% | 29% | 28% | 29% |
| Neither agree nor disagree | 32% | 30% | 33% | 31% |
| Disagree | 9% | 7% | 10% | 8% |
| Strongly disagree | 2% | 2% | 3% | 2% |

Moreover, 81 percent of payroll loan borrowers and 78 percent of benefit loan borrowers strongly agreed or agreed that they planned to continue to save after repaying their loan, which is in line with standard loan borrowers (77%). Just four percent of payroll loan borrowers and three percent of benefit loan borrowers strongly disagreed or disagreed. Of course, these are statements of intent and we cannot guarantee that people will continue to save. Nevertheless, the responses are supported by the positive comments made during the structured interviews on how the automatic component of the arrangement helped people get into the savings habit without having to think about it too much.

*Table 24: Borrowers planning to continue to save after repaying loan*

| | Payroll Loans | Benefit Loans | Standard Loans | All Loans |
|---|---|---|---|---|
| Strongly agree | 41% | 41% | 42% | 42% |
| Agree | 40% | 37% | 35% | 37% |
| Neither agree nor disagree | 15% | 18% | 18% | 18% |
| Disagree | 3% | 2% | 3% | 3% |
| Strongly disagree | 1% | 1% | 1% | 1% |

## 5.5 Impact on relationship with employers

One of the concerns raised about expanding access to payroll loans was that employees would be afraid to make use of schemes as it might affect their relationship with their employer, or they would not want employers to know about their finances.

**The survey responses would not appear to support those concerns.** Most respondents (67%) were neutral on the question of whether the relationship with their employer had improved. Nearly one quarter (23%) of respondents agreed that their relationship with their employer had improved. Fewer than one in ten (9%) disagreed.

Similarly, 42 percent strongly agreed (15%) or agreed (27%) that they would be comfortable talking to their employer about their loan if needed. One third were neutral. One in four strongly disagreed (18%) or disagreed (7%).

On the specific point about borrowers being concerned that their employer would know too much about their finances, only 14 percent (or one in seven) strongly agreed (5%) or agreed (9%). Forty five percent were neutral on the question, while 41 percent strongly disagreed (13%) or disagreed (28%).

*Table 25: Payroll borrowers agreeing that they are concerned their employer knows too much about their finances*

| | Payroll Loans |
|---|---|
| Strongly agree | 5% |
| Agree | 9% |
| Neither agree nor disagree | 45% |
| Disagree | 28% |
| Strongly disagree | 13% |

Having a payroll loan does not appear to be broadly perceived as a barrier to employees' ability to change jobs. Eighteen percent strongly agreed (6%) or agreed (12%) that since taking out their loan they felt unable to change employers until it is repaid. Nearly 40 percent (39%) were neutral and 43 percent strongly disagreed (12%) or disagreed (31%).

Overall, the above findings suggest that there are no widespread concerns for most borrowers relating to the potential negative impact on the relationship with their employer. However, a minority still expressed some perceived issue, which should provide the impetus for credit unions to improve communications to reassure about privacy and explain more about what happens should a borrower leave their current employer.

## 5.6 Impact on wellbeing

The final set of questions looked at the impact having access to a payroll or benefit loan had on respondents' financial circumstances, their confidence about managing money and overall satisfaction with the loans.

### Credit scores

As well as providing access to affordable credit, an additional benefit of deduction loans is that these should act as a bridge to financial inclusion by helping people rebuild credit scores. Indeed, given that the survey found that very few borrowers had missed payments on their loans, this might be expected to be reflected in an improvement in their credit score. **More than one third of payroll loan borrowers (37%) and benefit loan borrowers (36%) said that their credit score had indeed seen a positive improvement.** This is encouraging. But it is perhaps more notable that more than half (53% payroll and 54% benefit) said they didn't know. There is an opportunity here to inform people about checking credit scores as part of a wider financial education package.

***Table 26: Has your credit score seen a positive improvement since taking out a loan?***

| | Payroll Loans | Benefit Loans | Standard Loans | All Loans |
|---|---|---|---|---|
| Yes | 37% | 36% | 47% | 39% |
| No | 10% | 11% | 8% | 10% |
| Don't know | 53% | 54% | 45% | 51% |

When respondents were asked whether they felt more confident about managing their money since they took out their loan, encouragingly, the overall responses were certainly positive. Seventy percent of payroll loan borrowers and seventy two percent of benefit loan borrowers either strongly agreed or agreed that they felt more confidence about managing money. Under three percent disagreed in relation to both loans.

*Table 27: Borrowers feeling more confident about managing money*

| | Payroll Loans | Benefit Loans | Standard Loans | All Loans |
|---|---|---|---|---|
| Strongly agree | 30% | 32% | 31% | 32% |
| Agree | 40% | 40% | 40% | 40% |
| Neither agree nor disagree | 28% | 26% | 25% | 26% |
| Disagree | 2% | 2% | 3% | 2% |
| Strongly disagree | <1% | 0% | 1% | 1% |

As well as feeling more confident about managing their money, more than two thirds of respondents said they were more satisfied with their overall financial circumstances since taking out their payroll, benefit or standard loan. Again, only a very small minority under 4 percent disagreed.

*Table 28: Borrowers saying they are more satisfied with overall financial circumstances*

| | Payroll Loans | Benefit Loans | Standard Loans | All Loans |
|---|---|---|---|---|
| Strongly agree | 28% | 30% | 28% | 29% |
| Agree | 40% | 37% | 42% | 39% |
| Neither agree nor disagree | 28% | 30% | 25% | 28% |
| Disagree | 3% | 3% | 3% | 3% |
| Strongly disagree | 1% | 1% | 1% | 1% |

Of course, it is not just the impact on financial circumstances that matters. Low levels of financial resilience can have an impact on both mental and physical health. The research asked questions to gauge whether access to loans had any positive effects on health.

*Table 29: Borrowers saying they feel less stressed, anxious, or depressed*

| | Payroll Loans | Benefit Loans | Standard Loans | All Loans |
|---|---|---|---|---|
| Strongly agree | 27% | 29% | 28% | 29% |
| Agree | 33% | 32% | 35% | 33% |
| Neither agree nor disagree | 30% | 29% | 25% | 28% |
| Disagree | 6% | 6% | 8% | 7% |
| Strongly disagree | 4% | 4% | 4% | 4% |

**Borrowing with the credit union seems to make respondents feel less stressed, anxious, or depressed** after taking out their loan with 60% of payroll loan users, 61% of benefit loan users and 63% of standard loan users either strongly agreeing or agreeing that it had helped. Just 10 percent disagreed.

Interestingly, more than one-third (37%) of payroll loan borrowers and benefit loan borrowers (34%) said that since taking out their loan, their general health had improved. Half (54%) neither agreed or disagreed. So, it seems that access to the loans have had additional benefits for a significant minority of borrowers. Moreover, a significant minority - a third of payroll loan borrowers and a quarter of benefit loan borrowers said that personal relationships with family and friends had improved since taking out their loan.

Ninety seven percent of benefit loan borrowers felt that their loan had helped them a lot – either strongly agreeing (55%) or agreeing (42%). This impressive figure was higher than amongst users of both payroll loans (87%) and standard loans (86%). The findings would indicate that lending delivered by the participating credit unions is having an overall beneficial impact on their borrowers with just one percent of all borrowers disagreeing. Yet, given the particular criticisms of benefit lending, it is important to highlight that this form of lending appears to be having a positive effect on the vast majority of those accessing this type of loans appears and markedly higher than either payroll or standard lending.

***Table 30: Borrowers who feel the loan has helped them a lot***

| | Payroll Loans | Benefit Loans | Standard Loans | All Loans |
|---|---|---|---|---|
| Strongly agree | 45% | 55% | 46% | 52% |
| Agree | 42% | 42% | 40% | 41% |
| Neither agree nor disagree | 12% | 2% | 12% | 6% |
| Disagree | 1% | 1% | 1% | 1% |
| Strongly disagree | 0% | 0% | 1% | 0% |

Similarly, satisfaction levels appear to be extremely high across all three types of lending with 97 percent of benefit loan users, 95 percent of payroll loan users and 95 percent of standard loans users saying that they were very satisfied or satisfied with their loan.

***Table 31: Borrowers who are satisfied with their loan***

| | Payroll Loans | Benefit Loans | Standard Loans | All Loans |
|---|---|---|---|---|
| Very satisfied | 67% | 75% | 72% | 73% |
| Satisfied | 28% | 22% | 23% | 23% |
| Neither satisfied nor dissatisfied | 4% | 2% | 4% | 3% |
| Dissatisfied | 1% | 0% | <1% | <1% |
| Very dissatisfied | 1% | 0% | <1% | <1% |

It is clear from the survey responses that borrowing with credit unions is extremely well regarded by the vast majority of borrowers. Not only are satisfaction levels overwhelmingly positive, but it is clear that the lending is also generating positive impacts on financial circumstances, attitudes and behaviours as well as wider health and wellbeing. While these benefits are being realised across all types of lending, it would appear that the improvements tend to be more marked with deduction lending and in particular benefit lending, which is especially encouraging given the greater financial challenges faced by these users evidenced as part of the survey.

### *Case study 6 – Rachel*, Manchester Credit Union:*

*"I feel safer using you guys than I did using the doorstep lenders only because of the fact that obviously I'm saving at the same time."*

Following the breakdown of her relationship, with a large family Rachel struggled for years with her finances and then the transition to Universal Credit:

*"My fridge freezer broke. Not long after I started getting back on my feet. And with having four children at the time, and being on my own, it was quite difficult and it was only a neighbour that recommended yourselves to me."*

Before getting her Family Loans three years ago with Manchester Credit Union, she resorted to various subprime lenders including door step lenders and *BrightHouse*:

*"I was paying double if not more, what I was lending. Absolutely ridiculous on a doorstep lender… So, then every month I was robbing Peter to pay Paul type thing. And they just don't care. They didn't care at all and one of them type of people that just hound you. "*

Rachel now borrows with the credit union at key time throughout the year:

*"I normally try and top up around that time to help cover the cost of Christmas and the children's birthdays. The only other time I have topped up is when it's come to school uniforms. Other than that, I try not to unless it's absolutely necessary."*

She recommends the Family Loan to friends because of the peace of mind that having her Child Benefit payments covering her loans provides:

*"I know that doing it with my child benefit and you's getting that and then sending me what's left after I'd paid you, that put my mind at ease because I knew you's were getting paid if that makes sense."*

This has helped Rachel improve her financial behaviours and start saving for the first time:

*It's not a lot what I put away, but it's better than nothing. If you know what I mean? I think now, I think there's about maybe two, three hundred pounds in there of savings.*

And she attributes this down to the ease of saving alongside her loan repayments and not being able to access those savings:

*"So obviously while I've got a loan with you, I'm also putting money into my savings. So when I do pay that, that loan off, I've also got a lump sum to fall back on."*

*"See it's savings that I can't touch which is good because if I had a savings account, I can always dip into it. Whereas with yourself I know I can't touch that until I paid off what I owe, and then at least to know that that one is there if I need it."*

** Name changed to retain anonymity.*

# 6. Lending Data: Manchester Credit Union Case Study

This section provides a snapshot of the lending data provided by Manchester Credit Union over the last three years broken down by different repayment methods for all its loans up to £1,500. This will help illustrate the experience of providing loans to lower income families that are repaid via both benefit and payroll deduction and highlight any benefits to the lender from deduction lending model.

**Insight objective 5:**
Enable comparison between different loan products, including payroll loans, benefit loans and standard loans, in relation to issues such as borrower demographics; number of loan approvals/declines; loan arrears and missed payments. Evidence and inform conclusions and practical recommendations relative to the study's research aims.

Operating for over 30 years, Manchester Credit Union serves almost 25,000 people who either live or work in the Manchester, Bury, Rochdale, Stockport, Tameside, Trafford or the High Peak. Its membership is extremely diverse attracting people with a broad range of financial circumstances.

It has over 40 payroll partnerships with local councils, housing associations, NHS trusts and several private sector companies such as Timpsons and Manchester Airport – enabling staff of these employers to save and borrow directly through their wages.

The credit union delivers lending across all three types of loan product. But its more recent growth has been through the expansion of its Family Loan (benefit loans) product that is successfully attracting large numbers of new borrowers who can initially apply for up to £500 repaid using their Child Benefit over 3 – 12 months at an interest rate of 42.6% APR. This escalation has occurred solely through word of mouth with Manchester Credit Union confirming during the stakeholder interviews that it has purposefully avoided all external marketing and promotion of its Family Loan.

For loans with a value of £1,500 or less, there were 91,792 applications over the last three years for its Family Loan – representing three quarters (74%) of all new applications. This was followed by 30,745 applications (25%) for its Standard Loan and just 1,492 applications (1%) for its loans repaid via payroll deduction (Payroll Loan). Of course, this distribution is skewed from the overall number of loan applications because it does not include applications for larger loans over £1,500 which would be applied for under Payroll Loans and Standard Loans – but very much reflects the direction of travel.

One of the notable insights from the lending data is the much higher approval rates for deduction loans and in particular the Family Loan repaid using Child Benefit. Over the last three years, 55 percent of all applications for Standard Loans were shown to be rejected. This compares to 40 percent of Payroll Loans and just seven percent of all applications for MCU's Family Loans. This indicates that someone applying to Manchester Credit Union for either a new loan or additional borrowing (sometimes referred to as topping up - which with MCU can be done when at least one third of the original loan has been repaid) that will be repay via payroll deduction or Child Benefit deductions is far more likely to be approved than someone repaying using standing order, direct debit or cash payments.

The average approved loan size of the Family Loan is significantly smaller at £234, which is significantly less than half the average size of approved Standard Loans (£533) and Payroll Loans (£663).

With the Family Loan, this much smaller loan size taken together with the high number of applications and low rejection rates[6] is indicative of a sizable proportion of borrowers that are topping up loans at least once or more a year. This is also reflected in both the borrower survey and interviews where respondents identified regular points in the year where they needed extra funds, in particular before Christmas and to a lesser extent during the summer for school uniforms.

For these borrowers, the user consultation shows that knowledge that they can draw upon additional funds at certain pinch points throughout the year is shown to provide peace of mind and is part of their financial coping mechanism. Equally, the lending data indicates that the Family Loan product is performing very well for the credit union in question. The higher acceptance rates from this loan products reduce the administration costs associated with loan assessment and checks for new applications that are rejected.

***Table 32 – MCU lending data - new loans over last three years (£1,500 or less):***

| | **Overall, 3 years borrowing data** | | | |
|---|---|---|---|---|
| **All loan applications:** | **Payroll Loans** | **Family Loans** | **Standard Loans** | **All Loans** |
| **Total number** | **1,492** | **91,792** | **30,745** | **124,029** |
| Proportion | 1% | 74% | 25% | 100% |
| **Total value** | **£1,832,704** | **£21,948,127** | **£29,541,654** | **£53,322,485** |
| Proportion | 3% | 41% | 55% | 100% |
| **Rejected loans:** | | | | |
| Total number | 595 | 6,623 | 16,842 | 24,060 |
| Total value | £1,237,826 | £2,018,656 | £22,128,998 | £25,385,480 |

[6] The percentage of loans approved for Family Loans, Payroll Loans and Standard loans was 93 percent, 60 percent and 45 percent respectively

| Approved loans: | | | | |
|---|---|---|---|---|
| **Total number** | **897** | **85,169** | **13,903** | **99,969** |
| Proportion | 1% | 85% | 14% | 100% |
| **Total value** | **£594,878** | **£19,929,471** | **£7,412,656** | **£27,937,005** |
| Proportion | 2% | 71% | 27% | 100% |
| Av approved loan size | £663 | £234 | £533 | £279 |
| | | | | |
| **Approval rate (number)** | **60%** | **93%** | **45%** | **81%** |

Looking at loans written off and levels of arrears, both the Family Loans and Payroll Loans perform much better on these measures than the Standard Loan. The total number of Family Loans written off over the three year period as a proportion of the number of Family Loans outstanding at the end of the period analysed was nine percent. This compares to 17 percent for Payroll Loans and 36 percent for Standard Loans[7].

The number of Family Loans in arrears of 3-12 months is four percent of the total number of loans outstanding compared to 10 percent for Standard Loans. Loans repaid using payroll deduction fare even better with just 2% of loans in arrears of 3-12 months.

Similarly, both the number of Family Loans and Payroll Loans in arrears of 12 months plus is three percent and four percent compared to 10 percent for Standard Loans.

***Table 33 – MCU lending data – total loans made over 3 years (approved loans of £1,500 or less):***

| | **Payroll Loans** | **Family Loans** | **Standard Loans** | **All Loans** |
|---|---|---|---|---|
| **All Loans (Approved Loans of £1,500 or less)** | | | | |
| Approvals – number | 897 | 85,169 | 13,903 | 99,969 |
| Approvals - total value £ | £594,878 | £19,929,471 | £7,412,656 | £27,937,005 |
| **Outstanding Loans (Approved Loans of £1,500 or less)** | | | | |
| Total loans – number | 445 | 12,868 | 4,030 | 17,343 |
| Proportion | 3% | 74% | 23% | 100% |
| Total - value | £949,078 | £5,097,335 | £5,668,578 | £11,714,991 |
| Proportion | 8% | 44% | 48% | 100% |

[7] We stress that this does not mean that 9% of Family Loans, 17% of Payroll Loans, and 36% of Standard Loans made have been written off. The figure represents the cumulative number of loans written off over the three year period as a proportion of the total number of outstanding loans at the end of that three year period. Ideally, we would have data showing what proportion of loans made in any previous year were then written off in subsequent years. But, this data was not available. The number of loans written off as a proportion of loans approved was 1%, 9%, and 10% respectively. This is because the cumulative number of loans approved over the three year period is higher than the total amount outstanding at the end of the period. Nevertheless, the key point is that whichever denominator is used, the proportion of Family Loans written off is lower.

| | Payroll Loans | Family Loans | Standard Loans | All Loans |
|---|---|---|---|---|
| Total loan repayments | £2,213,056 | £21,389,557 | £13,969,752 | £37,572,365 |
| | | | | |
| Total loan income (Interest) | £353,751 | £4,151,905 | £2,458,729 | £6,964,385 |
| | | | | |
| Arrears 3-12 months – no | 7 | 511 | 400 | 918 |
| Arrears 3-12 months - value | £6,432 | £179,882 | £347,185 | £533,499 |
| Arrears over 12 months – no | 17 | 398 | 400 | 815 |
| Arrears over 12 months – value | £25,607 | £164,315 | £413,572 | £603,494 |
| Arrears No/ Loans (Outstanding 3-12 months) | 2% | 4% | 10% | 5% |
| Arrears No/ Loans (Outstanding 12+ months) | 4% | 3% | 10% | 5% |
| Loans written off – number | 77 (17%) | 1,195 (9%) | 1,451 (36%) | 2,723 |
| Provisions for doubtful debts – value | | | | £1,385,057 |
| Bad debt provisions and write offs – value | £101,367 | £461,463 | £1,166,877 | £1,729,707 |

Using Bank of England data for credit unions in England [8] we can examine how Manchester Credit Union's arrears performance compared to the wider credit union sector.

Family Loan compare only slightly better than the arrears experienced across the credit union market. Over the three years, the number of Family Loans in arrears of 3-12 months represented four percent of total Family Loans outstanding. This compared to 4.9 percent for the total credit union sector in England. The comparison is even better when arrears over 12 months are considered – 3.1 percent compared to nearly 9.6 percent.

Yet, Payroll Loans fare significantly better. Over the three years, the number of Payroll Loans in arrears of 3-12 months represented just 1.6 percent of total Payroll Loans outstanding, compared to nearly five percent (4.9%) for the total credit union sector in England. Looking at arrears of 12 months or more, the figure for Manchester was 3.8 percent compared to 9.6 percent.

Looking at income generated, the interest received on Family Loans and Payroll Loans as a proportion of loans outstanding within Manchester Credit Union was higher than the equivalent for the credit union sector – particularly on Family Loans.

[8] As this is more relevant and data for Northern Ireland skews the figures.

*Table 34: Bank of England Data on English Credit Union's arrears and income*

| Credit Unions in England – Total Loans | 2019 | 2020 | 2021 | 3 years average |
|---|---|---|---|---|
| **Arrears** | | | | |
| 3-12month/ loans outstanding (Value) % | 2.9 | 4.4 | 2.9 | 3.4 |
| 12months+ / loans outstanding (Value) % | 4.1 | 4.7 | 5.8 | 4.9 |
| | | | | |
| 3-12month/ loans outstanding (Number) % | 5.0 | 5.5 | 4.1 | 4.9 |
| 12months+/ loans outstanding (Number) % | 9.5 | 9.7 | 9.5 | 9.6 |
| | | | | |
| **Income** | | | | |
| Interest received / loans outstanding % | 12.0 | 13.0 | 12.0 | 12.3 |

*Table 35: MCU's arrears and income by loan product*

| Family Loan | 2019 | 2020 | 2021 | 3 years average |
|---|---|---|---|---|
| 3-12month/ loans outstanding (Value) % | 4.1 | 3.9 | 3.5 | 3.5 |
| 12months+ / loans outstanding (Value) % | 3.0 | 4.5 | 3.2 | 3.2 |
| | | | | |
| 3-12month/ loans outstanding (Number) % | 4.2 | 4.1 | 4.0 | 4.0 |
| 12months+/ loans outstanding (Number) % | 2.9 | 4.3 | 3.1 | 3.1 |
| | | | | |
| Interest/ value of loans outstanding % | 26.0 | 29.8 | 30.6 | 28.8 |
| **Payroll Loan** | | | | |
| 3-12month/ loans outstanding (Value) % | 3.0 | 3.3 | 0.7 | 0.7 |
| 12months+ / loans outstanding (Value) % | 3.1 | 4.2 | 2.7 | 2.7 |
| | | | | |
| 3-12mth/ loans outstanding (Number) % | 4.0 | 7.3 | 1.6 | 1.6 |
| 12mths+/ loans outstanding (Number) % | 6.6 | 5.5 | 3.8 | 3.8 |
| | | | | |
| Interest/ value of loans outstanding | 13.3 | 14.0 | 11.3 | 12.9 |
| **Standard Loan** | | | | |
| 3-12mth/ loans outstanding (Value) % | 10.1 | 6.8 | 6.1 | 6.1 |
| 12mths+ / loans outstanding (Value) % | 9.4 | 12.2 | 7.3 | 7.3 |
| | | | | |
| 3-12mth/ loans outstanding (Number) % | 11.0 | 8.6 | 9.9 | 9.9 |
| 12mths+/ loans outstanding (Number) % | 11.1 | 14.3 | 9.9 | 9.9 |
| | | | | |
| Interest/ value of loans outstanding | 18.2 | 18.0 | 13.3 | 16.5 |

| All Loans | | | | |
|---|---|---|---|---|
| 3-12mth/ loans outstanding (Value) % | 6.9 | 5.1 | 4.6 | 4.6 |
| 12mths+ / loans outstanding (Value) % | 6.1 | 7.9 | 5.2 | 5.2 |
| | | | | |
| 3-12mth/ loans outstanding (Number) % | 6.2 | 5.4 | 5.3 | 5.3 |
| 12mths+/ loans outstanding (Number) % | 5.5 | 7.0 | 4.7 | 4.7 |
| | | | | |
| Interest/ value of loans outstanding | 21.1 | 23.3 | 20.6 | 21.7 |

The lending data from Manchester Credit Union provides valuable insights on their experience of delivering small value loans across all three forms of lending and the comparative effectiveness of these different repayment models.

Applications for deduction lending tend to have much higher approval rates compared to those for Standard loans. This is especially marked for its Family Loans which also tend to be for significantly smaller loan values. The credit union relates both these factors to the significant proportion of borrowers who top up at certain points within the year when they have repaid a certain proportion of their loans.

Importantly, **Family Loans and especially Payroll Loans are shown to have markedly better performance than their Standard Loans with much lower levels of arrears** (both for arrears of 3-12 months and more than 12 months) and write offs.

# 7. Conclusion and recommendations

There needs to be a much more open and pragmatic conversation about credit provision for low-income households. Credit, provided at the right time, in the right circumstances, and on the right terms can be both a safety net in difficult times and a bridge to financial inclusion and resilience. Yet, across the UK millions do not have access to fair and affordable sources of credit and resort to subprime or illegal money lenders that can have a huge impact on their household finances and their physical and mental wellbeing.

With this in mind, this study provides a timely examination of deduction lending, where repayments are taken directly at source from either the borrower's salary or their benefits, to better understand this model of borrowing and determine whether it has the potential to serve and benefit those on low incomes that need to borrow small amounts of money.

The research shows that deduction lending is hugely under-appreciated apart from amongst the users themselves. Payroll and benefit lending are both extremely popular amongst users with over 95 percent of payroll lending and benefit lending customers stating that they were extremely satisfied or satisfied. In fact, the automated repayment mechanism was found to be the key advantage amongst both benefit and payroll lending users – recognised as the most common reason for choosing their specific loan – followed by the affordability of the loan payments.

In addition to the high levels of satisfaction found among deduction loans users, the report evidences that the borrower's experience is overwhelmingly positive in terms of the beneficial impact that the loans have realised. Loans were said to be financially affordable by almost all borrowers using benefit lending and payroll lending. As a result, the research also showed that the majority of users were felt more confident about managing their money and more satisfied with their overall financial circumstances after taking out their loan. As well as realising financial improvements, the results also point to wider health and wellbeing benefits for deduction loan users with the majority tending to feeling less stressed, anxious, or depressed as well as a significant minority stating that, since taking out the loans, personal relationships with family and friends had improved. Overall, the vast majority of borrowers said that taking out the loan had 'helped them a lot' with 87 percent in the case of those with payroll loans and 97 percent in the case of benefit loans.

Finally, an extremely important aspect of deduction lending identified during the research is the clear effect the repayment mechanism has on positive saving habits – especially amongst those that previously found it difficult to save. As well as encouraging borrowers to start to putting aside savings, the findings also show high levels of intent to continue to save after repaying their loan – and therefore potential to build future resilience amongst lower income households.

As well as being positive overall for borrowers, the research also points to deduction lending offering advantages for the credit unions. Feedback from the participating credit unions indicate that deduction loans are generally easier to administer so reducing unit costs. Equally, looking at the available lending data supplied by the credit unions, it would also appear that deduction loans have higher approval rate and perform better in terms of arrears compared to standard loans. These three factors enable credit unions to deliver affordable low value lending to more financially vulnerable households who might otherwise have few options beyond high cost and more disadvantageous subprime credit.

Of course, the research has also considered the criticism raised about deduction lending. Many of the concerns identified during the research have been focused towards benefit lending and in particular the use of Child Benefit deduction for loan repayments. Yet, it should be noted that the issues raised could be equally directed toward payroll lending as well.

One concern raised by some in the debt advice sector is that the deduction at source model could encourage lenders to forgo proper loan assessments. The research found no evidence of poor lending practices amongst the participating credit unions. It is worth noting that not all credit unions undertake formal credit checks for small value loans, instead favouring affordability assessments using tools such as Open Banking to verify income and expenditure for applicants who can often have thin or historically poor credit files but can still afford the loan. Overall, the insights from both benefit and payroll lending customers show very favourable experiences with the application process and that applicants had been provided with the appropriate information about the loan before applying, and that the credit union had sufficiently assessed their ability to afford the loan.

The other main criticism is that the deduction mechanism itself that might prevent struggling borrowers from more easily cancelling payments that they would have chosen to have missed. The results show that only a very small minority reported having any financial difficulties during the period of their loan due to the nature of the repayments. In addition, around one in ten borrowers across the three different lending types stated that they made payments during the lifetime of their loan that they would have preferred to have missed. Importantly, there were no difference between the proportion of deduction lending borrowers that had made a loan repayment that they would have preferably missed, compared to those using a standard lending. This was backed up by the finding specifically related to benefit lending that a small minority of respondents said they struggled to keep up with household finances since their Child Benefit payment had been directed to the credit union. But in practice, borrowers appear to find keeping up with repayments more manageable, with only two percent of both benefit and payroll borrowers saying they had missed a loan payment, compared to 15 percent of borrowers with a standard loan.

Much of the aversion towards benefit lending seems to be around a more general discomfort with Child Benefit being used to service loan repayments where there is a judgement that essential income should only be used to support the family and not be used to service credit repayments. Yet, the results show that the most popular use of benefit loans were for expenditure relating to their families – such as birthdays, Christmas, household items or clothing such as school uniforms.

This also needs to be considered in relation to the evidence around the financial benefits realised, especially for benefit loan users which the research shows are much more likely to face financial challenges. These borrowers were shown to be almost exclusively younger mothers that are much more likely to be single and supporting a higher number of children with noticeably lower household incomes and less likely to be in work. As a result, users were shown to have fewer traditional borrowing options available.

Similarly, the results from the borrower survey seem to counter the concerns that payroll deducted loans may make borrowers feel unable to leave their employer until the loan is repaid or negatively impact the relationship between the employer and the worker. However, a minority still expressed some perceived issue, which should provide the impetus for credit unions to improve communications to reassure about privacy and explain more about what happens should a borrower leave their current employer.

Overall, the research proves that, when delivered appropriately, the model of deduction lending via both payroll deduction or benefit deduction, is a win-win for the vast majority of borrowers and the credit unions offering the lending.

Deduction lending must therefore be seen as a credible and effective way of extending access to affordable credit for lower income households. It offers a tangible and scalable solution to help divert millions of households away from subprime credit and illegal forms of lending and into fair, responsible and affordable borrowing with not-for-profit credit unions that can realise significant savings to household finances and build financial resilience.

Credit provision to lower income customers, who are often in more financially vulnerable circumstance, has inherent risks. Automatic deduction may also pose potential risks that have to be mitigated, but this research has demonstrated that if delivered appropriately, the model can provide huge benefits to customers. This makes learning identified in this research from what is working well amongst the participating credit unions even more important.

The recommendations that follow set out what needs to be done by policymakers and other stakeholders to scale both payroll and benefit lending in order to extend credit to those within society that currently have very few suitable options. We also attempt to bring together the good practice that should be adopted by the credit union sector to enhance their offer and address specific concerns, and ensure that this form of lending is scaled appropriately.

## Recommendations and good practice:

### Recommendations for stakeholders

If the full potential of deduction lending through both payroll deduction and benefit deduction is to be harnessed, in addition to much greater promotion, government and other policymakers must create the right framework to foster the growth of these two forms of lending.

Below, we make several recommendations for policymakers, funders, and other stakeholders. We make specific recommendations to support the development of benefit lending and payroll lending.

**Payroll loans**

1) **More employers should partner with credit unions to deliver payroll deduction schemes to their employees.** This research has demonstrated the huge benefits that payroll lending by non profit community finance organisations can deliver for employees, including improved wellbeing, improved satisfaction with finances and increased savings levels.

2) **Payroll deduction should become a policy priority for business organisations, trade bodies, funders, central and local government, and civil society.** To address the lack of access to affordable credit as well as encouraging savings amongst squeezed and struggling households, key stakeholder should deliver an ambitious and collaborative national strategy scale up payroll savings and borrowing, including:
   - Payroll deduction schemes should be included in good practice charters and kitemarks for employers;
   - Trade bodies and business organisations should promote the benefits of payroll lending and saving among their members; and
   - Central and local government should provide credit union payroll deduction schemes to their staff.

**Benefit loans**

3) **Stakeholders working with financially excluded people, such as local authorities, social housing providers and the DWP, should work with credit unions to promote access to benefit lending**. This type of lending is hugely underutilised as an effective way of giving low-income households access to responsible and affordable credit that provides a real alternative to high-cost borrowing or going without. Key stakeholders with an established primary financial relationship with financially vulnerable households and can play a big role in promoting benefit lending.

4) **Debt advice and credit union trade bodies should find out more about each other's work and agree productive ways to work together.** The research has identified a lack of understanding and in some cases tensions locally between credit unions and debt advice organisations, especially in relation to the Child Benefit loans. Stronger links between credit unions and debt advice organisations would improve awareness and appreciation of each other's important role and activities in both preventing and supporting financial harm. Credit unions and debt advisors should work constructively together in the best interests of their members and clients.

5) **HMRC should work with credit union trade bodies to formalise and streamline the notification process to reduce waiting times for Child Benefit loans.** The initial process of transferring funds from HMRC to credit unions can take between 4-6 weeks and identifying beneficiaries can be a complicated manual process for credit unions.

**Payroll and benefit loans**

6) **Credit unions and trade bodies should make use of the good practice highlighted by this research in delivering deduction loans.** This research has demonstrated the huge benefits this form of lending can provide to customers if delivered appropriately. We have set out good practice used by credit unions participating in this research below, for others to draw on. Trade bodies are well placed to share best practice, offer training, and ensure that their members follow high standards when delivering deduction loans.

## Good practice in delivering deduction lending

Based on the conversations with the participating credit unions themselves and other consulted stakeholders, and analysis of the differences in borrower survey results between different credit unions, we have set out a series of good practice behaviours for the delivery of payroll and benefit deducted lending by credit unions. These highlight best practice that could be further encouraged as well as areas to be addressed to improve the loan products, their delivery and help scale affordable credit provision for low-medium income households.

This list is meant to be complementary to existing regulatory standards and good practice guidance. Some of the behaviours overlap with these standards where we have wanted to highlight their relevance to deduction lending.

**Loan application and assessment:**

1) **Always conduct thorough affordability assessments for both new and repeat loans.** Positive survey results around affordability and low rates of financial difficulty indicate that participating credit unions were demonstrating best practice in affordability assessment. It is essential that the good performance of deduction loans does not mean affordability assessments are treated differently by lenders.

Wider adoption of Open Banking would support quicker and more accurate assessment of affordability. Most of the participating credit unions were already utilising Open Banking technology to help satisfy themselves that the applicant can afford the loan repayments by verifying income and expenditure (as well as validating the wage payments from a particular employer or the receipt of certain benefits). Some in the sector still verify affordability by requesting bank statements and manually reviewing.

2) **Use credit checks to complement affordability assessments where a more complete picture of applicant's existing borrowing commitments is needed.** For many lenders, affordability assessments especially where Open Banking is adopted provide a more effective and accurate method of understanding an applicant's financial circumstances and making responsible decisions than using credit searches. This is especially true for applicants that have historic financial issues or thin credit files but can afford the loan repayments. Given the high repayment rates of deduction lending, credit unions should also consider credit reporting as means to improve the credit scores of borrowers. Where credit searches are conducted, applicants should be clearly informed, as the survey results show that a proportion of borrowers were sometimes unclear if one has been carried out.

**Repeat lending and topping up:**

3) **Ensure that there are robust criteria and processes in place for repeat borrowing and topping up existing lending.** Processes around repeat borrowing and topping up should prevent borrowers from being overextended and ensure that repayments are still affordable for their financial circumstances at that time.

**Financial difficulties and support:**

4) **Put in place additional monitoring and positive communications to make sure that borrowers who are experiencing difficulties feel supported and able to contact the credit union if they are struggling.** Proactive communications, monitoring for financial difficulty, and providing flexible forbearance can encourage the customer to contact the credit union for support. This will help address a small but important proportion of consulted borrowers who experienced difficulties during the lifetime of their loan. This also ensures that the automatic deduction mechanism doesn't lead to customers making repayments that they can no longer afford. The research found no differences between the proportion of customers experiencing financial difficulty across the different loan types, suggesting that the participating credit unions were demonstrating good practice and the automatic mechanism was not causing difficulties for borrowers.

5) **When setting up a Child Benefit loan, inform all borrowers at the point of approval of the details of the credit union destination bank account.** Credit union bank account information should always be communicated to each new borrower. As above, borrowers should be encouraged to reach out for support from the credit union if they need support or are struggling with repayments. But sharing this information upfront,

and never withholding it if requested will ensure that borrowers always have control over their Child Benefit payments.

6) **Offer a package of financial tools, support and guidance for both existing members and declined applicants.** This might include, embedding automated benefit entitlement checks into loan applications to maximise incomes, direct referrals to local or national debt advice support to those identified as overindebted, budgeting tools and services, provision of information on welfare grants offered by their local authorities, energy providers and benevolent charities; and promotion of social tariffs and other appropriate financial support.

**Marketing and promotion:**

7) **Use the positive experience and impact evidenced among deduction lending as the basis for proactive promotional campaigns for these products.** The perceived sensitive nature of Child Benefit lending has seen many credit unions not advertising these types of loans for fear of negative publicity. Equally, some employers have expressed reservations about explicitly promoting lending to their workforces. The key advantages should be emphasised in messaging around: levels of overall satisfaction; the positive financial and wellbeing impacts experienced by borrowers; levels of savings realised by households; and the ease of loan repayments from payroll or benefit deductions.

8) **Marketing should avoid referring to the lack of credit checks.** Some credit unions have advertised Child Benefit loans with the phrase 'no credit checks', meaning specifically that searches at credit referencing agencies won't be used, as this can put off customers with impaired credit history from applying. The FCA has stated that this is misleading as it could cause customers to think that no creditworthiness assessments or affordability checks will be conducted[9]. Instead, credit unions could promote that anyone can be considered for deduction lending, including those with poor credit history.

9) **Regularly report to employer partners and other stakeholders (such as local authorities) to demonstrate the beneficial impact of their relationship.** None of the employer interviewees had awareness of the scale of lending to their workforces and in some cases even how many staff were members.

10) **Reassure payroll lending customers that their finances will remain private from their employer and make clear the process that happens if a borrower leaves their current employer.** This research has shown that the majority of payroll lending customers do not perceive any negative impacts on their relationship with their employer. However, credit unions should take steps to reassure the minority who still have concerns.

[9] https://www.fca.org.uk/news/press-releases/fca-warns-businesses-stop-misleading-credit-adverts-protect-consumers

**Additional product improvements:**

11) **Offer automated transfers of residual balances of Child Benefit payments back to borrower's bank account after both loan repayment and any savings have been allocated.** Some credit unions already enable this facility, which can support members with financial budgeting especially if released weekly. Yet the majority rely on members to withdraw funds themselves, which is shown to work well for those able to access their credit union account online or via an app but will prove more difficult and costly for those more digitally excluded.

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A major retailer

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# Appendices

## Appendix 1 – Literature review

### Payroll lending literature review

A financially stable workforce, free from debt and money worries, is clearly in the interest of all employers. For it is well known that financial problems adversely affect mental health, cause stress, depression, and anxiety, all of which impact on work performance. This has been confirmed in many studies exploring the relation between money worries and employee wellbeing. A study commissioned by Sodexo[10], for example, involving 740 UK employees aged from 18 to 64 across all social classes (A to D) showed that financial stress was impacting negatively on productivity for nearly a quarter of all employees. This rose to 36% for employees aged between 18 and 34. More recently, Collington[11] in a study of 2,001 UK employees revealed that three-fifths (60%) had financial concerns that caused them anxiety, stress, and depression.

Collington stresses that, "Employers have a hugely significant role to play in supporting people's mental and financial health, and in doing so, they are much more likely to cultivate a healthy and happy workforce". Indeed, some years before, Dame Carol Black[12] had already demonstrated in her DWP review of the health of Britain's working-age population, the benefits of employers investing in employee wellbeing, including financial well-being. These benefits included increased productivity; reduced sickness absences; reduced staff turnover, increased skills retention, and improved staff morale. Recognising the importance of attending to the financial well-being of the workforce is nothing new to employers. Like Black, many have long since recognised that a financial stable workforce is not only good for employees but is good for business too. Informal subbing of cash-strapped workers, with small advances on pay, was part of many companies' practices for a long time.

But such subbing, albeit a lifeline to a worker in need, can only have a limited reach and often not open to all. As companies have become increasingly aware of the importance of attending to employee financial wellbeing, they have also looked for more consistent ways of regularly supporting their employees.

It is in this context that they have turned to social and commercial firms, including credit unions, to offer their employees financial services based on payroll deduction. In this chapter, we look at what the literature tells us about such payroll arrangements for saving, borrowing and salary advance. Often these arrangements also include a form of financial budgeting support.

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[10] Sodexo (2014), Financial stress is impacting productivity for nearly a quarter of UK employees. London, UK
[11] Collington D. (2021), Money worries causing mental health problems for more than half of UK employees.
[12] Black C (2008), Working for a healthier tomorrow, Review of the health of Britain's working age population, TSO (The Stationery Office), London.

### Employer motivations for payroll deduction

The Personal Finance Research Centre (PFRC) and Ecorys in their 2015 report[13] "Action research with UK employers and credit unions" identified two main motivations for employer involvement in payroll deduction schemes with credit unions. First, they found that there was sometimes the thought of supporting the local community, maybe linked to a Corporate Social Responsibility (CSR). This was based on the idea that expanding the reach of credit unions into the workforce enabled them to strengthen as viable organisations so that they could serve financially excluded communities more effectively. But the second motivation was the most immediately relevant to the employer. This was an awareness that some staff were *"facing financial difficulties and access to CU services might help to address this through encouraging staff to save and manage money better: CUs were thus seen as one route to this, potentially helping staff to avoid getting into financial difficulties and, by extension, making them less likely to be distracted by such concerns*".

The employer focus here is on the financial health, well-being, and stability of the workforce but significantly primarily through the promotion of saving and good money management rather than by borrowing. This is a theme that reoccurs regularly in the literature[14]. It is one of the reasons why employers often value partnership arrangements with credit unions, rather than loan companies, as credit unions are deposit takers and offer a product that links borrowing to prior and ongoing saving. It is notable that the commercial provider Salary Finance entered the market as a loan provider, but subsequently partnered with Yorkshire Building Society to offer savings. For credit unions, though, as PRFC points out, the focus can be somewhat different. The focus can be more on maximising higher-value lending than saving. In fact. PRFC found that *"developing employer partnerships is not primarily intended by credit unions to help low-income households, as our research has found; rather, credit unions tend to see employer partnerships as a potential means of serving more profitable customers who take larger and longer-term loans".*

That said, PRFC recognises in its study that employer partnerships with credit unions have the potential to help low-waged workers both with in saving and in accessing affordable loans if they can develop ways of engaging effectively with them. Several barriers to effective engagement are discussed in the report, but so too are ways to overcome them.

[13] PFRC and Ecorys (2015). Action research with UK employers and credit unions. Personal Finance Research Centre, University of Bristol.
[14] Thomson K. (2015) Policy research paper – saving through payroll, The Chartered Institute of Payroll Professionals, London, UK
Nest Insight (2022) Talking about payroll autosave with employees. National Employment Savings Trust Corporation. UK.
Evans G., McAteer M., and Earnshaw M. (2021). Getting Workforces Saving: Payroll Schemes with Credit Unions. The Financial Inclusion Centre

### Employee benefits from payroll deduction schemes

Baker and Kumar[15], however, have a different perspective and stress the primary importance of access to short-term loans or salary advances for low-wage working people through automatic salary deduction repayment. Although writing within the American context, the situation they describe of low-wage working people struggling to make ends meet is similarly replicated in the UK. They argue that the most pressing issue for low-paid workers is managing cash flow – people may have the resources for day to day living but they cannot manage financial shocks or unexpected expenses given their lack of a savings net. The result is, as Baker and Kumar put it, *"a damaging cycle of repeated reliance on payday loans, auto title loans, bank overdrafts and other costly financial products for liquidity and credit support."*

They see the solution to the problem in employer-sponsored fintech that takes advantage of payroll deduction to provide employee access to short-term loans and salary advances, third-party savings accounts, and financial management apps. In their paper, they evaluate a short-term instalment loan provided by Salary Finance and a payroll advance product provided by PayActiv to judge whether they offer efficient, positive outcomes for employees and employers. Baker and Kumar concluded that both financial products were more efficient than market alternatives and provided clear and compelling benefits to employees. They were cheaper and offered greater inclusivity, given that they could be accessed by many financially vulnerable employees who would be excluded from products in the mainstream market. They state that:

> *"The principal reason we found to explain both the lower cost and the greater inclusiveness of these products is the power of the so-called "salary link"—the ability of the FinTech provider to access an employee's salary directly to ensure repayment of advances or loans. The factors associated with the salary link lead to markedly superior loan/advance performance (with defaults currently at <20% of the rate predicted by credit scoring) which is passed through in the form of lower costs to a larger portion of the employee population than is possible with market alternatives.*

### Payroll deduction for saving

The focus of this report is primarily repayment of loans by payroll deduction. However, it is unrealistic to consider this issue apart from the equally important payroll deduction for saving. In fact, in partnerships between employers and credit unions, the single, often monthly amount deducted from salary and sent to the credit union is not identified by the employer as a savings deposit, a loan repayment or both. It is only when funds reach the credit unions that they are they divided between savings and loan repayments according to the wishes of the employee.

[15] Baker T. and Kumar S (2018). The Power of the Salary Link: Assessing the Benefits of Employer-Sponsored FinTech Liquidity and Credit Solutions for Low-Wage Working Americans and their Employers, M-RCBG Associate Working Paper Series. No. 88. Harvard Kennedy School, USA.

In 2015, The Chartered Institute of Payroll Professional published a policy research paper[16], in which it described how it had been collaborating with several partners, particularly credit unions, to encourage saving through payroll to ensure employees do not have to resort to pay day lenders. Interestingly the focus is on saving even though it is recognised that the payroll deduction schemes are designed both for saving and the repayment of loans. As detailed in the paper, CIPP's vision was to see "more people saving for that 'rainy day' but, at the same time having the opportunity to obtain a competitive loan when needed."

It is clear in this paper that building financial health and resilience in the workforce is understood primarily in terms of the promotion of saving. This approach chimes well with such authors as Sherraden who considered in his influential book "Assets for the Poor,"[17] that it is the maximisation of savings or assets that has the greatest, long-term social, economic, and psychological benefits for individuals. Indeed, it is the *"promotion of thrift among the members of the society by the accumulation of their savings,"* that is the number one credit union objective in the Credit Unions Act 1979.

In the CIPP paper, it notes that of those employers offering a savings scheme via the payroll at the time, 70% did so via a credit union, others used an external partner for example a bank scheme or had an in-house solution for example a pay day advance scheme. Salary Finance has emerged as a large provider since the CIPP report. At the end of 2020 it had 527 employer partners[18].

The paper explores some of the challenges of setting up payroll deduction schemes with credit unions but also itemises many of the benefits as identified by employers themselves. Among those benefits were, *"employees can only borrow so much against what they have saved so encourages saving, 'you can't have one without the other'"; "encourages good saving practices in many young employees to plan for the future, it also helps with employee retention*," and "*helping employees avoid pay day loans*."

In 2021, Evans, McAteer and Earnshaw published a report[19] based on a two-year research project evaluating the impact of a payroll deduction scheme at Leeds Credit Union on employee household savings and financial resilience. They found that participation in a savings scheme made a significant contribution to personal financial resilience particularly among lower-paid workers in the Money and Pensions Service's 'squeezed' and 'struggling' population segments[20]. Interestingly, they found that just 20% of the payroll savings scheme members had borrowed from the credit union in the last 12 months. This was higher than the credit union's overall average of borrowers among the entire membership[21]. But it did indicate that payroll deduction both from an employer and employee perspective is mainly about saving. That said the authors were able to conclude that "*Building up a savings*

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[16] Thomson K. (2015) Policy research paper – saving through payroll, The Chartered Institute of Payroll Professionals, London, UK

[17] Sherraden, M. (1992) Assets and the Poor: A New American Welfare Policy, Armonk, NY: M. E. Sharpe.

[18] Financial Statements, Salary Finance Limited, 31 December 2020

[19] Evans G., McAteer M., and Earnshaw M. (2021). Getting Workforces Saving: Payroll Schemes with Credit Unions. The Financial Inclusion Centre

[20] Cf Money and Pension Service, UK Strategy for Financial Wellbeing.

[21] It should be noted that many credit unions have much higher rates of borrowing among their membership

*cushion, and being able to access affordable loans when needed, is an important feature of financial resilience*."

In 2022, Nest Insight[22] released the report, *"Talking about payroll autosave with employees".* This report is based on the premiss that most people, including people on lower incomes, want to save as they recognise that saving improves their financial stability and security and thus contributes to their wider sense of social and psychological well-being. However, many people struggle to save because a range of behavioural and cultural factors get in the way. This is the case even when an employer offers the opportunity to save through payroll deduction.

The report analyses the range of behavioural and cultural factors that prevent people saving regularly and based on an understanding of behavioural economics, recommends a practical way forward to overcome these and more effectively promote saving within the workforce. This is an opt-out approach in which, with agreement at the job-sign up stage, employees automatically start saving through payroll if they do not opt out. Given that most people go with the flow and adopt the default position in any situation, employees starting work in a company just accept saving as the given norm.

Of course, employees can opt out at any time, and withdraw their savings too, but in general the theory goes that they do not, that they stay in the savings scheme and only draw out savings when they really need to do so. The authors of the report are convinced that a change from an opt-in to an opt-out, autosave approach could overcome many of barriers preventing those who want and need to save from getting started. They stress that there is no hint of coercion in an autosave model, as people can opt out easily at any time. The thinking behind autosave led, as noted in the Nest Insight report, to development of a pilot autosave project involving SUEZ recycling and recovery UK and TransaveUK Credit Union. The idea was to evaluate the effectiveness of an opt-out approach to workplace saving. New workers when taken on by SUEZ are automatically signed up to payroll saving with TransaveUK, if they do not opt out on job signup. As noted in the report, employees can amend the amount they save whenever they want and quickly withdraw their money if they need it. They can stop saving at any time. This project is new only having started in November 2021. Results of the trial should be available by the end of 2022.

### Payroll deduction for loan repayment

Even though, based on the literature, there appears to be a propensity among employers to favour payroll deduction primarily for employee saving, it is now widely accepted that access to affordable credit is a fundamental element of financial inclusion and entrenched in the reality of life on a low income. For many it is the only way of managing cash flow and funding major purchases. The Policis report[23] offers a classic exposition of the dynamics and patterns of low-income credit use and how it is driven by a lack of savings safety nets and competing pressures on budgets.

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[22] Nest = National Employment Savings Trust Corporation.UK.

[23] Ellison A., Whyley C, Forster R., and Jones P.A. (2011) Credit and low-income consumers. A demand-side perspective on the issues for consumer protection. Friends Provident Foundation and Policis.

The Policis report stresses, however, that the benefits and risks of credit use are finely balanced. Credit use, not effectively managed, can add to the stress on household budgets, reduce disposable income and increase the risk of financial distress and breakdown. However, at the same time, without access to affordable credit, out of necessity, people can find themselves having to borrow in the high-cost and often exploitative sub-prime credit market.

In many of the reports already cited above, the importance of payroll deduction partnerships between employers and credit unions and other providers to enable employees to access affordable credit is well documented, albeit often within the wider context of promoting saving. In the literature, there are more international examples of payroll deduction loan including the Employer-Sponsored Small-Dollar Loan (ESSDL) programme in the United States.

An evaluation report of ESSDL was written by Filene, the US credit union research institute, in 2017. It explains that ESSDL was a programme designed by credit unions, in partnership with employers, to enable low- and moderate-income employees avoid the prohibitive cost of alternative high-cost borrowing, establish, or repair a credit score, and begin to save. The report[24] describes how loans of up to $2,000 were available to employees of partner companies based on the borrower's ability to repay, as evidenced by length of employment in good standing and not by credit scores. Twelve credit unions and one B Corp community bank[25] participated in the Filene evaluation. The system was a standard payroll deduction system, with a straightforward application process, and funds being ready within 24-48 hours. Loans are repaid by payroll deduction and, importantly, repayment is reported monthly to credit bureaux, thus enabling an improvement in the borrower's credit score. After the loan is repaid, a deduction equivalent to the loan repayment amount is made on an opt-out basis and deposited in the participant's savings account. During the 18-month evaluation period, over 1,000 loans were made to a total value of $1.2 million. The report notes that many employees continued to save after loan repayment, to a total value of $42,000, a figure that indicates the difficulty of many of the participants to save a significant amount.

The Filene report discovered a high level of satisfaction with ESSDL both among employers and borrowers. Selected key findings

- *"The ESSDL meets important needs for both employees and employers. The ESSDL program exceeded employer expectations as a low-cost, highly valued employee benefit."*
- *"The ESSDL outperformed financial projections—with reported loss rates ranging from 2 to 3% during the first two phases of product testing. Participating credit unions also reported that the program is recognized as a valuable community service."*

[24] Filene (2017a). The Employer-Sponsored Small-Dollar Loan, Filene Research Institute, Wisconsin, USA
[25] B Corp Certification is a designation that a business is meeting high standards of verified performance, accountability, and transparency on factors from employee benefits and charitable giving to supply chain practices and input materials. https://www.bcorporation.net/en-us/certification, accessed 04/08/2022

- *"ESSDL programs benefit from collaboration with non-profit partners. While employers may offer the ESSDL as a stand-alone benefit, partnerships with non-profit community partners enhance program uptake and implementation."* (Filene 2017a)

Alongside the report, Filene also published an implementation guide[26], which assists employers, credit unions and other social lenders to establish ESSDL partnerships.

The Filene report focused on partnerships with credit unions and a socially-oriented community bank. Yet, there is also a number of commercial companies now entering the low- to moderate-income payroll deduction loan market, offering intermediary management services to employers. Lipkin[27] argues how small loans in the low-moderate income market are becoming profitable for profit-maximising, commercial companies once employers are on board. Payroll deduction lowers risk and a credit report, or a specific loan officer is not necessary since the loan amount is based on the individual's salary. The paper looks at the case of TrueConnect[28], the trading name of Employee Loan Solutions (ELS), a San Diego-based commercial company that manages the payroll deduction loan process for a range of companies. It markets itself as a socially responsible lender endeavouring to "*provide safe, affordable financial support and hope to employees in need of a helping hand that is an alternative to predatory lending products*"[29].

ELS does not provide the finance itself but through a partner commercial bank. Typically, loans are between $1,000 and $3,000 repaid over a year. Free financial counselling sessions are offered to all borrowers, and all loan repayments are reported to credit bureaux to assist them improve their credit scores. TrueConnect is free for employers, besides the work required to connect its payroll system to ELS. It generates its income from the loan interest payments, which are shared with the partner bank. At the time of writing of the Lipkin paper, loan interest was fixed at 24.9% APR, which is higher than conventional bank loans but much lower than the charged by payday lenders, the prior go-to providers for many of the borrowers. The paper also notes that the loans are capped so that employees do not spend more than 8 percent of their regular salary on the loan.

An interesting paper on payroll lending is Coelho et al[30] which offers an analysis of the legalisation of payroll lending in Brazil. In 2003, the Brazilian Congress passed a law that allowed banks to offer loans with repayment though automatic payroll deduction both from salary and from social security benefits.

This resulted, according to the authors, in future income (salary or benefits) now being considered as collateral. This had a major impact on the banks' ability to underwrite, and thus improve borrowers' access to credit. There was also a reduction in interest rates and a

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[26] Filene (2017b). The Employer-Sponsored Small-Dollar Loan, Implementation Guide, Filene Research Institute, Wisconsin, USA
[27] Lipkin M, (2015) Small loans become profitable with employers on board: payroll deductions are a key part of lowering risk. San Diego business journal, Vol.36 (29)
[28] Cf https://trueconnectloan.com/
[29] Ibid, quotation taken from the website
[30] Coelho C A, De Mello J M, Funchal, B (2012) the Brazilian payroll lending experiment. Review of Economics & Statistics. Nov 2012, Vol. 94 Issue 4

consequent increase in the volume of personal credit. To assure that lending remained affordable, legislation required that the principal and the loan interest amounted to no more than 30% of the borrower's income.

The paper argues that the introduction of payroll lending to private sector workers and social security beneficiaries produced a large shift in the supply of personal loans in Brazil. In fact, it was the social security beneficiaries who constituted the largest market for payroll lending (50% in 2008). Payroll deduction from benefit thus enabled large numbers of financially excluded individuals to access credit and avoid high-cost credit providers.

Returning to the UK, Bland writing for CIPP[31] argues that payroll deduction plays a key role in empowering individuals to achieve financial stability and resilience. Bland is the CEO of a UK credit union, and he writes from his experience of offering payroll deduction facilities to thousands of credit union members. He stresses that credit union payroll deduction schemes offer the opportunity to reduce the interest rate on loans. But this he considers is only half the story. For Bland, more important is the way that payroll deduction can assist in turning borrowers into savers and thus help them to build financial resilience.
In his credit union, for borrowers, the payroll deducted amount for loan repayment always includes an agreed proportion that goes automatically into savings. It is a save as you borrow (SAYB) repayment plan. This is an arrangement between the credit union and the member. The employer does not know if the deducted amount is for loan repayment, for savings or both. Once the loan is repaid, in most cases the payroll deduction continues and goes now entirely into savings. Members go with the flow and let their savings amass. Of course, they can opt out and cancel or reduce the payroll deducted amount at will. Bland argues that: -

> *"By harnessing the insights of 'nudge' and pioneering thinkers like Daniel Kahneman, the SAYB technique – coupled with payroll deduction – can truly transform the savings behaviours of your workforce, with untold benefits for you as an employer, in terms of both reduced cost from poor health and absenteeism, and the enhanced commitment and loyalty that comes from being valued as an employee for whom their employer takes a real interest in their well-being".*

### Benefit lending literature review

Historically, the most well-known and popular form of loan related to repayment by welfare benefit deduction was the **Social Fund Budgeting Loan** scheme, established in 1988 but abolished with effect from April 2013. This social fund aimed to respond to the exception and intermittent needs of claimants and was repaid directly from the welfare benefit payment.

Several studies were undertaken into the delivery and impact of the social fund, all of which revealed the positive regard it was held in by beneficiaries. There were often criticisms about eligibility for the loans and about the level of repayment, but the facility of having

[31] Bland M. (2021) The power of payroll deduction to empower individuals. The Chartered Institute of Payroll Professionals, London, UK. https://www.cipp.org.uk/resourceLibrary/the-power-of-payroll-deduction.html

repayment deducted at source was highly valued. Whyley, Collard and Kempson[32] reported that: -

> *"Very positive views were expressed about the direct deduction of repayments from benefit, and several people regarded it as an incentive to use the scheme. On the whole, people did not miss the money that was being deducted, or else quickly adjusted to managing on less benefit. It meant that they were not tempted to spend the money, and they did not have to worry about falling behind with the repayments.*
>
> *'I think in a way it is a good thing, because it is coming straight off your money, so you are not having to remember to pay it every week... if it didn't come off your Income Support and you had to pay them direct, you could forget or not bother, say 'I will miss it this week', then you have got double to pay the following week, so I think it is better.' (57-year-old single woman, caring for her grandson, Budgeting Loans Scheme applicant)".*

In 2002[33], Jones found a similar response in his study, where interviews with social housing tenants and Citizens Advice Bureaux clients revealed that, *"Social Fund loans were valued and appreciated as important sources of credit. Primarily, people were attracted to Social Fund loans because they were interest free, because repayments were deducted directly from benefits and, in some cases, because there was no other option open to them".*

In 2005, Collard and Kempson[34] also found that, "Users liked the fact that loan repayments are deducted directly from benefits as this minimised the risk of falling into arrears".

There seems to be no other example of welfare benefit linked loans in the United Kingdom until the introduction of the child benefit linked loan repayment currently being offered by a growing number of credit unions. However, in the Republic of Ireland, there is the example of the **Personal Micro Credit Scheme** known as the "It Makes Sense" loan[35], which was established in 2017. This credit union loan scheme is aimed at those in receipt of welfare benefits, particularly those who have used or have considered using high-cost credit. Credit unions receive no capital from the state to fund these loans, however, weekly repayment is via deduction from welfare benefits through the Household Budget Scheme, run by An Post (the Post Office)[36]. The Department of Social Protection pays the 25 cents weekly transaction fee for credit unions to access the deduction system.

Credit unions must assess the affordability of an "It Makes Sense" loan in the normal manner. In case of default, the credit union bears the loss in the same way as for any of its

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[32] Whyley C., Collard S, and Kempson E, (2000) "Saving and Borrowing: Use of the Social Fund Budgeting Loan scheme and Community Credit Unions", Department of Social Security.
[33] Jones, P. (2002) 'Access to credit on a low income', Manchester: The Co-operative Bank.
[34] Collard S and Kempson E. (2005) Affordable credit, The way forward. Published for the Joseph Rowntree Foundation by The Policy Press.
[35] https://www.creditunion.ie/it-makes-sense-loan/
[36] https://www.anpost.com/Money/At-the-Post-Office/Household-Budget

other loan products. There is no State guarantee in place. The minimum loan amount is €100 and the maximum amount which can be borrowed under this scheme is €2,000. Some credit unions only offer a certain loan amount such as €500. "It Makes Sense" loans are offered by more than 100 credit unions throughout the Republic of Ireland, yet take-up appears to remain low. No systematic evaluation of the "It Makes Sense" has taken place in Ireland.

**Literature relating directly to benefit deducted lending in the United Kingdom appears to be limited.** A forthcoming report, authored by Harris, Warbrick and Jones[37], presents an analysis of the **Family Loan and Saving Scheme** offered by Pennine Community Credit Union (PCCU) in Lancashire. The study gives the background to the introduction of this loan product in May 2019, aimed at supporting struggling low-income families. The product offers a first loan of up to £500, with access to subsequent top up loans up to a total value of £1,000, charged at 42.6% APR and with loans conditional on being repaid by child benefit.

The PCCU report is based on a survey of loan beneficiaries and discussions with other credit unions offering a similar product and with several stakeholders such as money advisors. The results of the survey were particularly informative. At the time of the survey conducted in July 2021, PCCU had 3,008 child benefit linked loans representing a total borrowing of £2.5m. At the time of the writing of the report in August 2022, this had risen to 5,400 loans with a total borrowing of £4.3m.

In total, 500 of the 3,008 borrowers responded to the survey (a 17 percent return rate). In terms of demographic profile, 93 percent were women, the majority single parents, 79 percent aged between 25 and 44, 71 percent having one or two children, with the remainder more than two children, 57 percent were living in private rented accommodation and 35 percent in social housing. 81 percent stated that they had a transactional bank account, with the remainder (19 percent) managing with a Post Office Card Account, by using the account of friends or family, or with no account at all. 16 percent were living on an income of less than £1,000 a month, 61 percent on less than £1,500 a month before housing costs. 80 percent were living on less than £2,000 a month before housing costs. Interestingly there were people on higher incomes accessing this child benefit loan product, probably because of ease of application and repayment, and the fact that it opened another line of credit. 39 percent were working full-time, part-time or on zero hours contracts, 23 percent were unemployed, with remainder (38 percent) looking after the family, on long-term sick, in education or unable to work for other reasons.

The survey revealed the high value that borrowers placed on the child benefit loan scheme. 98 percent agreed that the Family Loan and Saving Scheme helped them a lot and 100 percent agreed that they would recommend the Family Loan and Saving Scheme to a friend. 98 percent were happy with the service provided by PCCU. Interestingly, 89 percent of borrowers did not save regularly before taking out the Family Loan but do save now. In addition, 91 percent planned to continue saving after repaying their Family Loan.

[37] Harris D., Warbrick T, and Jones P.A., (2022 forthcoming) "The Family Loan and Saving Scheme". Pennine Community Credit Union and Swoboda Research Centre.

## Appendix 2 – Salary Advance

### Literature Review

**Summary findings from a review of UK-based and international research:**

- Salary advance, also termed 'earned wage access', can be a better solution than payday loans, in particular as it is generally much cheaper.
- Some employers and some providers place a cap on the percentage of pay that can be advanced.
- Salary advance providers are not seen as lenders and do not test affordability, which presents a risk to the financial welfare of the employee receiving salary in advance.
- There is a further risk that the salary advanced cannot be 'caught up', so that the advance is a constant requirement.
- Technology could enable salary advance providers to evaluate future expenses in relation to a salary advance request in coming to an advance decision.

**Literature review findings**

A growing trend in companies, both in the UK and the US, and supported by innovative technology, is to offer employees payroll advance on their salary or wages for a small fee. This facility is normally offered through a third-party Fintech company that enables the salary advance transaction to take place conveniently and efficiently. The advance is deducted automatically from salary at the next pay day. Often the amount that can be advanced is a set limited percentage of pay. Many of the Fintech payroll advance companies are purely commercial, but some do present themselves as social lenders interested in the financial well-being of employees. Salary advance is not a service that could be organised through a credit union.

Tergesen38 examines the motivations and operations of payroll deduction systems. The employer motivation, she argues, arises from a concern about the impact money problems are having on productivity levels and worker retention. Instead of their having to resort to a high-cost payday lender, employees who are strapped for cash in a particular month can accelerate a portion of their next salary for a fee that amounts only to a few dollars. For larger amounts that cannot be reimbursed entirely at the next payday, most salary advance third-party companies also offer loans that can be paid by payroll deduction over a longer period.

Overall, Tergesen seems to consider salary advance positively and points out that Colombia University found that found that payroll borrowers had, on average, an annualized attrition rate 28% lower than the rate for all employees. She also refers to the benefits of salary advance in several companies. She notes that since Walmart introduced salary advances in

[38] Tergesen A. (2019) Some Companies Offer a New Benefit: Payroll Advances and Loans; Employers aim to improve productivity, lower attrition via services for cash-strapped workers, Wall Street Journal (Online), New York, N.Y. 02 Sep 2019.

late 2017, it has seen employees rely less on payday loans and bank overdrafts. At Walmart, employees pay $6 a month to use the PayActiv app39 which includes a budgeting tool. Walmart covers the cost for one month per quarter and caps the amount workers can advance at 50% of pay.

However, she does indicate some concerns, particularly in relation to the legal status of salary advances, given that providers claim that these are not loans, a claim that may undermine some elements of consumer protection. She also quotes an associate director of the National Consumer Law Center, who was concerned that payroll-advance services may create "a cycle of chronic early spending.

Hawkins40 offers a comprehensive and detailed analysis of the salary advance market in the US, which he terms earned wage access and sees as an alternative to payday loans. He assesses the likelihood of earned wage access displacing payday lending, given its much lower cost. However, he also reveals some of the dangers of salary advance lurking, as he puts it, under its low-cost surface.

Given the availability of the information companies have about borrowers and the efficiency of the payroll deduction and modern technology, a salary advance service is provided at low cost to the borrower. So, at a stroke, earned wage access solves the problem of employees accessing high-cost and sometime extortionate payday loans.

So, it is understandable, as he explains, that the salary advance market is exploding and clearly has tremendous growth potential. In the US, earned wage access companies are partnered with major employers including such giants as McDonald's, Taco Bell, Walmart, and Wendy's. And it is the same in the UK, where there is an increasingly high demand for the product. As Hawkins notes, earned wage access companies have raised substantial capital and are ready to expand even further.

The Hawkins paper offers an analysis of the many and varied business models and fee structures adopted by earned wage access companies and the complexities that these involve. He recognised the value and the benefits of salary advance for employees and rejects the notion that salary advance is just payday lending in disguise.

But he is also conscious that earned wage access is not without its dangers and it is certainly not a completely harmless product. For one thing, on the basis that advances are not regarded as loans, salary advance companies can allow any employee in a partner business to obtain an advance without any assessment of affordability, even for over-indebted or financially vulnerable borrowers.

One of the biggest dangers, according to Hawkins, of earned wage access comes from the fact the companies can so easily recover the advance next payday. Employees cannot easily not repay the advance in order to meet other pressing commitments. The advance is

[39] https://www.payactiv.com/

[40] Hawkins (2021). Earned Wage Access and the End of Payday Lending, Boston University Law Review 706

deducted from salary before the employee ever sees the money. To illustrate this point, Hawkins gives this example:

> *"If an employee obtains a $300 advance to pay her rent and then on payday needs the $300 for expensive medicine for her child, she might want to breach the promise to repay the advance in order to obtain the medicine. The exceedingly efficacious collection mechanism, however, eliminates this choice."*

Employees have few protections and could easily become trapped in endless cycle of continual alary advances just to make ends meet one month to the next. Hawkins explores in detail the consequences of the uncertain status of earned wage access and its impact on borrower rights and protections. Salary advance companies argue strongly that salary advances are not loans and so that are free of the requirements for consumer protection under consumer credit legislation. Hawkins challenges this view and calls for the elimination of regulatory uncertainty and the enaction of consumer protection policies. One regulation he feels should be introduced without delay is the requirement to disclose the consequences obtaining an advance at the time an employee requests one. He writes: -

> *"Earned wage access companies often have access to all of the employee's bank records, so these companies could evaluate future large expenses shown in the history of the employee's accounts and point these expenses out to an employee requesting an advance.*
>
> *For instance, after receiving a request for an advance, the app might say, "If you access $200 of your wages now, on payday, you will only get approximately $452. Will you have enough to pay your rent of approximately $600 due October 1?" Regulators would have to evaluate exactly how to write this policy into a rule, but most companies are technologically capable of providing this form of disclosure."*

### Stakeholder comments about salary advance

A number of comments were made during the employer stakeholder interviews, regarding salary advance, summarised below.

There were mixed opinions from the employer stakeholders regarding the merit and virtue of salary advance. On the positive side for example, some employers who offered salary advance, alongside their credit union and payroll lending offer, viewed it as an important part of the holistic package of support they were trying to put in place for their employees. They saw it as being complementary to the credit union offer, in effect helping to provide different options to meet different needs when people needed access to finance – "*I just think it's important for us to provide our employees with access to as many benefits as possible".* Alternatively, some negative comments about the concept of salary advance were also highlighted, principally focused on the perception that it encourages and keeps people in debt, once they have taken their first advance payment. Some also saw it as competition to credit unions and voiced scepticism as to the motivation of commercially driven salary advance companies.