Can payday loan alternatives be affordable and viable? An evaluation of London Mutual Credit Union's pilot scheme

Summary Report June 2013

Background:
London Mutual Credit Union (LMCU) had become increasingly alarmed by the escalating and often detrimental use of costly payday loans by already overindebted households. Moreover, it was witnessing first hand a growing number of its own membership using this form of short-term credit despite already having access to affordable credit lines.

It was within this context that it launched a pilot scheme, funded by the Friends Provident Foundation and the Barclays Community Finance Fund, to develop, deliver and test an affordable payday loan product. The automated online application and assessment infrastructure was developed in order to replicate the ease, speed and instantaneousness of the high-cost payday companies but all this within the loan pricing structure of a credit union loan, charged at 26.8% APR. Thus, the theory was that by offering a real alternative it could attract both new and existing members. Moreover, by bringing new people into the credit union it was hoped that they would go on to use and generate sufficient income to make the product financially sustainable.

The evaluation report looks to measure the success of the pilot project, examining actual performance over its 12 month lifetime, profiling of these new and existing borrowers together with their attitudes and behaviours towards the payday loan service and finally assessing subsequent patterns of financial service usage amongst new members to help determine the actual cost implications of delivering such a payday loan product.

Key findings:

- **-The affordable payday lending product offered by LMCU proved extremely popular** with a total of 6,087 applications received (or 500 each month), asking for just under £1.5million or an average requested loan amount of £238.
- **A total of 2,923 payday loans with a value of £687,757 were distributed over the course of the year-long pilot** to 1,219 different borrowers.

"I think it's a brilliant resource and I would just like to say thanks for helping me get out of the trap of high-interest

- **An average of 2.39 payday loans were made to each borrower with 62% becoming repeat payday borrowers with LMCU.** The main reason for taking out the payday loan was to cover utility bills (14%) and home improvements (12%), while 32% did not indicate the specific reason.

- **Applicants liked the option of repaying payday loans over a longer repayment term.** Just 29% of loan applicants wanted to borrow over the traditional one month term, with the majority (59%) opting to repay over three months.
- **When surveyed, the primary reason given for borrowing through LMCU was the low cost compared to other payday lenders (66%).** Others liked the fact that it was offered by a credit union (19%) together with the longer repayment option (10%).
- **There is demonstrable demand amongst existing credit union members for access to short-term borrowing** with eight in every ten payday loans being given to (888) existing members .
- **Just over a quarter of all those borrowing during the pilot were new members, specifically attracted into the credit union by the payday loan product.** A total of 331 new members joined in order to take out a payday loan – on average they borrowed fewer times (1.8 loans compared to 2.6) but loaned higher amounts (£249 compared to £226) compared to existing members.

"Thank you for being ethical and helping me financially when I needed it the most."

- **Delinquency levels appear to be relatively low with 6.3% of all LMCU payday loans being at least one month in arrears compared to 28% of all payday loans across the industry being rolled over[1],** as identified by the Office of Fair Trading (OFT). Arrear levels amongst new members (12% of loans) are over twice the level of existing members (4.8%).
- **An affordable payday loan product has the potential to save significant amounts for borrowers.** According to the OFT, the average loan amount is £265 and the average cost of a payday loan is £25 for every £100 borrowed. This typical loan repaid over one month would therefore cost at least £66, compare to just £5.30 with LMCU. **By borrowing through LMCU instead of high cost payday lenders, the 1,219 who borrowed during the pilot have collectively saved at minimum of £144,966 in interest charges alone, equivalent to almost £119 per borrower.**
- **If the 7.4million and 8.2million payday loans taken out in 2011/12[2] from high cost lenders had been through a credit union alternative, we estimate that between £676 million and £749 million would have been collectively saved.** This would equate to an average saving of at least £91.43 for every payday loan made through the credit union.
- **Before accessing their first LMCU loan, 74% of surveyed borrowers had taken an average of 3.2 over the 12 months before their first payday loan from LMCU.** Worryingly, 17% of these had taken six or more loans.
- **Payday lending through a credit union is an effective way of diverting borrowers away from high cost lenders** – over two-thirds of surveyed users would be unlikely to borrow from other payday companies again.

[1] LMCU believe that the vast majority of those recorded as being one month in arrears are not actually behind with their payments but relates to how the number are recorded on their system (See section 5). When the number of loan in two months or more arrears are calculated this falls to only 80 delinquent loans (or 2.7% of all loans) or just over £15,000 of the total loan value dispersed (2.2%).
[2] Office of Fair Trading (2013) – Payday Lending Compliance Review: Final Report.

- **Satisfaction levels with the credit union are very high with 74% very satisfied** and 24% fairly satisfied. All those payday users surveyed were willing to recommend friends/family.
- **Crucially, new members do go on to utilise and benefit from accessing other financial services offered by the credit union:**
  - **LMCU membership actually encourages recent joiners to build financial resilience through the accumulation of savings.** Almost £18,000 was accumulated by the 331 new members during the pilot – a £53 average saving level per member. This rises to £95 for new member who had been with LMCU for at least nine months.
  - **Almost a quarter of all new members opened a current account with LMCU -** furthermore, 71% of those surveyed stated that they are fairly or very likely to open a credit union current account.
  - **New members were initially attracted by access to short-term borrowing but 27% of the 331 who joined the credit union during the pilot then went on to take out longer-term loans.** LMCU lent out an additional £90,000 in non-payday credit, which will generate over £15,000 in interest – borrowing an average of £1,044 over 17.9 months.
  - **The proportion of new members who have longer-term loans with LMCU increases dramatically the longer they have been a member.** Over 40% of all new members who have been with LMCU for at least six months take out a longer term loan, which increases to 52% with at least nine months of membership.

"I cannot thank you enough for your affordable payday loans and recognising the fact that people who genuinely use payday loans are financially struggling. High interest is something we could not afford like other payday loan providers."

- **Each payday loan generates an average income of £12.02 with a total income of over £35,000** – 77% of this revenue is from loan interest (or £9.23 per loan), 21% from the option for instant transfers (£11 per transfer) and just 2% from joining fees (£2).
- **It also cost over £35,000 to administer all the payday loans made during the pilot – an average cost of £11.99 for every loan given.** LMCU estimates that the actual cost for making a first loan is £18.57 but is significantly less for repeat loans at £4.00 as it is fully automated and requires no external checks. There were also costs of over £4,500 to administer refused or ineligible loans.
- **Just over £15,000 of the total amount lent during the pilot was determined as delinquent** together with just over £400 in credit control costs. The outstanding loan amount has been included as a cost but continues to be pursued by LMCU's existing credit control team.
- **The 'loss leader' model adopted during the payday pilot may not be financially viable if only when the actual additional income from subsequent longer term borrowing by new members is factored in.** On this basis, the overall payday loan pilot generated an actual loss of £6,725 at the point of evaluation, representing an average loss of £2.30 for each loan. However, projecting the additional income generation levels amongst those new members who have been with LMCU for at least nine months across all new members, **the payday loan pilot would actually realise an overall profit of at least £8,950 or £3.06 for every loan given, making the model financially sustainable.**

Pilot project and evaluation research funded by:

Friends Provident Foundation is a grant-making charity that focuses on exploring the role of money and financial systems as a force for social good. As part of its Financial Inclusion programme (under which it supported the London Mutual Credit Union initiative, but which is now closed) it worked to create the conditions throughout the UK for improved access to appropriate financial services for those who are currently excluded, particularly those on low incomes or otherwise vulnerable to market failure.

Established as part of the demutualization of Friends Provident Life Office in 2001 and the floatation of Friends Provident PLC, it is independent and has its own board of Trustees.

www.friendsprovidentfoundation.org

Barclays Community Finance Fund, is part of Barclays' strategy to tackle financial exclusion in order to improve the capacity of the community finance sector's personal and business lending operations in the UK.

Managed by Transact, it has provided over £1million of funding to support the delivery of affordable credit to those who may otherwise be restricted to high cost credit or illegal loans.

www.transact.org.uk/bcff

Report produced by:

The Financial Inclusion Centre were commissioned to undertake the evaluation work between February and April 2013. The report was researched and written by Gareth Evans, (Associate Research Manager) and Mick McAteer (Director).

The Financial Inclusion Centre is an independent research and policy innovation think-tank dedicated to promoting financial inclusion and fair, efficient, competitive and accountable financial markets.

www.inclusioncentre.org.uk