Tackling Financial Exclusion Through Local Finance Partnerships

Barrow Cadbury Trust

Responsible Finance

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We are the voice of the responsible finance industry. We support a strong network of responsible finance providers who are increasing access to fair finance across the UK. At our heart is the idea of bringing social and economic benefits to people, places and businesses.

Our members provide finance to customers not supported by other lenders. They offer a supportive service and treat people fairly. They are professional social enterprises that re-invest profits to help more people and businesses access finance.

About the Barrow Cadbury Trust

The Barrow Cadbury Trust is an independent, charitable foundation committed to bringing about socially just change.

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About this publication

Tackling Financial Exclusion through Local Finance Partnerships was commissioned by the Barrow Cadbury Trust and is based on research conducted by Responsible Finance over eight months from June 2016 until January 2017.

The report was written by Theodora Hadjimichael and John McLean.

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We would like to thank the organisations that contributed to this research, listed in full in Appendix 1, who had input into the discussions that form the basis of this report, and Barrow Cadbury Trust for their support throughout.

This publication is available for download from www.responsiblefinance.org.uk

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Foreword: Alistair Grimes, Chair, Responsible Finance

Most people in the UK have access to a wide range of banking services and financial products. However, a significant number do not, including 2 million people who do not have a bank account. Responsible finance providers such as responsible loan funds and credit unions have in recent decades increased affordability and access to finance in underserved segments, but significant barriers to access persist. Responsible Finance wanted to look at how local partnerships could more effectively work to solve the problems of affordability and access by coming together and offering the right products, in the right way, to the right people. Our view was that if we could find, publicise and promote effective local partnerships then it would be possible to replicate them in other places and to support them to do good work at a bigger scale.

Working over a period of eight months with 22 local partners we investigated a series of case studies to build up a picture of the opportunities and challenges around local partnerships and how they were overcome. We held four focus groups on key topics for discussion to do with partnerships to look at issues and develop solutions. In those sessions, we engaged with organisations involved in local partnerships, those with a strategic interest in the future of community finance, and potential and existing service providers to partnerships.

We found out that effective local partnerships do make a difference to the availability of products and services to under-served businesses and individuals, we defined the models and considerations for partnerships, and we investigated how partnerships could move forward in the future to scale up, become more influential and continue to expand access to financial services.

Responsible Finance would like to thank the Barrow Cadbury Trust for funding this project and Clare Payne, Economic Justice Programme Manager, for her advice and support throughout the project.

Alistair Grimes

Chair, Responsible Finance

Section 1: Executive summary

The ability to access fair and affordable financial services remains a challenge for millions of UK residents and businesses. Unlocking better access and greater choice would to help manage everyday finances, and have significant beneficial knock-on effects for the wider economy and society. An array of interventions is targeted at the financial exclusion challenge, with reasonable success. These include locally-based responsible finance providers like credit unions and responsible loan funds (also called CDFIs), government funds to stimulate both on-lending and innovation, a mandate for banks to provide all consumers with bank accounts, and tighter regulation on high cost credit providers. And more recently the introduction of financial technology ('FinTech') firms and technology-based initiatives are helping to tackle financial exclusion through digital routes.

As with most complex market failures, there is no silver bullet solution to financial exclusion. It requires a range of proactive and reactive approaches. This research project explored the particular intervention of local finance institutions which provide alternative financial services (loans, savings accounts, advice), and how, through collaboration, the sector can scale its impact and become greater than the sum of its individual parts.

These initiatives are often locally-focused and pioneering, with innovative thinking about how to better tackle local issues. This report brings together the experience, learning and aspirations of existing partnerships to explore what partnerships can achieve, how they can work well and where they can go in the future. While it is important to acknowledge the limitations of partnerships, there are reasons for optimism given what they have achieved and the innovative, adaptive nature of local finance ecosystems. The report provides recommendations based on the success of existing models about how to build and manage partnerships so that they have real impact on increasing financial stability.

Recommendations

The research found that partnerships between local finance organisations increase access to a wider range of financial products and services and so increase consumer choice. Going into partnership also has benefits for the organisations involved: by providing organisational levers to achieve sustainability and scale.

The local finance partnership model has the potential to be replicated to increase access and build robust organisations that are well positioned to meet the demand for affordable alternative financial services. The following recommendations will enable local finance organisations and their stakeholders to establish effective, adaptive and innovative collaborations:

- **Going into partnership can be challenging in terms of aligning incentives and creating the necessary buy-in. To overcome this inevitable hurdle the creation of partnerships should be driven by the needs of the consumer and underpinned by the articulation of the organisational benefits.**

- **Strong leadership and a space for testing partnerships to meet market needs is required; this leadership should ideally come from external organisations, such as local authorities and trade bodies, to help overcome cultural resistance to change.**

- **Because of economies of scale, partnerships are a prime testing ground for innovation and process disruption, including adoption of new technology.**

- **Regulators should support the evolution of partnerships by using proportionate regulation to enable innovation and closer collaboration.**

Section 2: Introduction

Financial exclusion

The majority of people in the UK have ready access to the core products and services that make up the financial system: a bank account to receive a salary, scheduled direct debits, a savings account or pension, a credit card with an affordable rate of interest, a business loan or line of credit. The average person expects to have access to these products and services because they can demonstrate to banks and other financial firms their reliability, through regular salary payments, a good credit rating or ownership of assets.

However, a significant minority of the UK's population lacks access to this basic package of financial services. Two million people do not have a bank account and nine million people do not have access to mainstream credit options.[1] So at least 14% of the UK's population faces financial exclusion. Many of these people experience income volatility and have little if no savings, making it more important that they have access to the tools they need to manage their money. At a time where financial transactions are increasingly cashless (particularly in urban areas), not having access to a transactional bank account, having a poor or no credit history, or relying on high cost loans can put consumers in an even more precarious financial position.

The role of local finance partnerships

There is an established landscape of local financial services for people, households and businesses that experience financial exclusion. Currently, it is made up of a number of small-scale (compared to the size of mainstream banks) responsible finance providers. These sub-sectors of local financial services include:

- **Responsible loan funds:** Community-based loan funds, sometimes called community development finance institutions (CDFIs) that lend to consumers, small businesses, and social enterprises that cannot access finance elsewhere. Loan funds raise all of their capital to on-lend from external funders and investors, such as grants from local and central government, and trusts and foundations, loans from social and commercial investors and equity from individuals. Responsible loan funds tend to serve consumers that are relatively high risk since they cannot access finance elsewhere.

[1] Financial Inclusion Commission (2015), *Improving the Financial Health of the Nation*, http://www.financialinclusioncommission.org.uk/report

- **Credit unions:** Financial cooperatives for consumers and businesses brought together by a common bond, such as residing in a particular geography or working for a specified employer. Credit unions provide a range of products to their members, and the primary ones are savings accounts and loans. Credit unions with a geographic focus that covers deprived communities often have a membership base that overlaps partially with the demographics of consumers that loan funds serve. Credit union customers are referred to as 'members'.

- **Debt and money advice charities:** Organisations that provide advice in person, by telephone, or online on reducing debt levels and budgeting. A portion of both credit union and loan fund clients have a need for some sort of money and budgeting advice, as well as a segment of applicants that could benefit from debt advice rather than borrowing credit. Advice charities provide formal advice, although credit unions and responsible loan funds do provide informal advice as well.

Locally-based finance providers have a history of organic collaboration due to overlaps in goals and customer demographics, and the practical benefits of sharing resources and knowledge. A precursor to today's partnerships and a proof of concept of the model was the Community Banking Partnerships (CBPs) initiative in 2005-2008.[2] Seven CBP pilots were launched across England and Wales with over 150 local stakeholders involved. They emulated successful 'one-stop-shop' models in the USA and Ireland. Responsible loan funds were beginning to emerge around the country at this time, and the CBPs were an opportunity for them to establish a market presence.

Money and budgeting advice was core to the Community Banking Partnership model, in order to proactively reach consumers before they encountered over-indebtedness. These pilots' business models developed as the financial capability of the clients served evolved: they started off providing money management support, graduated to lending and savings, and finally provided more sophisticated products to help their customers build wealth. Although effective, nearly ten years on less than half of these partnerships still exist (for example, the Robert Owen Community Banking Fund) and in the meantime they have changed shape and size. Part of this evolution is due to the operating landscape for local finance organisations, and the broader consolidation that has taken place in the credit union and responsible loan fund sectors. The learnings from the Community Banking Partnerships have fed into subsequent partnerships across the UK that emulate the joined up product offer. A consistent challenge for CBPs was operational sustainability, which this research attempts to address.

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[2] National Association of Credit Union Workers (2004), *Community Banking Partnership: The joined-up solution for financial inclusion and community economic development*, http://www.nacuw.org.uk/sites/www.nacuw.org.uk/files2/pdf/Community_Banking_Partnership.pdf; National Federation of Community Development Credit Unions (2005), *Community Banking Partnership: Legal structures that work*, http://www.nacuw.org.uk/sites/www.nacuw.org.uk/files2/pdf/CBP_Legal_Structures_That_Work.pdf

Advantages of partnering

These organisations, often set up with a social purpose to tackle the multiple factors involved in social and financial exclusion, specialise in specific interventions such as affordable credit, savings or financial literacy. Together they reach over 3.5 million people and businesses each year – currently almost half of the excluded population.[3] Working together in partnership can mobilise local finance organisations to supply this sizeable market with a full range of alternative products and services, **expanding their own market reach and streamlining the consumer journey**.

Partnering also has **organisational benefits**. There are significant external pressures on organisations like credit unions and responsible loan funds to both deliver social impact while becoming more sustainable. Responsible loan funds, credit unions and other local finance organisations have small marketing budgets and so suffer from low profile. Loan management and back office systems are sometimes outdated and not fit for purpose. It is becoming more difficult to secure grant revenue and such operating models are not sustainable to shocks. Economies of scale gained through partnership mean that local finance organisations can gain access to a bigger market and consolidate back office and administrative services.

While partnership is not a substitute for a supportive operating and funding environment, it does offer levers that help local finance organisations achieve their goals.

Challenges of partnering

Working in partnership can be complex and challenging. Ultimately, each organisation has its own purpose, governance and operating structure and it can require behavioural change to align closely with other organisations, even within the same industry. Partnerships are based on trust, and the relationships between organisations need to be managed. The incentives and benefits must be 'win-win' both in terms of consumer outcomes and organisational benefits. Partners will also have to navigate regulatory requirements, which can add administrative costs and restrict the activities made possible by partnering.

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[3] Based on figures from the Association of British Credit Unions Ltd. (https://www.findyourcreditunion.co.uk/about-credit-unions/), Responsible Finance (http://responsiblefinance.org.uk/policy-research/annual-industry-report/), Citizens Advice (https://www.citizensadvice.org.uk/Global/Migrated_Documents/corporate/money-advice-services.pdf), and the Money Advice Service (https://www.moneyadviceservice.org.uk/en/corporate/record-number-of-people-benefit-from-money-and-debt-advice) (all figures as of March 2017)

Methodology

This research began with high level mapping of local finance partnerships in operation across the UK and desk based research into partnership case studies – both in the UK and the United States. Once significant initiatives had been identified, a series of interviews were carried out with stakeholders, primarily with the organisations driving the projects directly. The result of the interview round was the development of a partnership framework, including three different partnership models, and six key factors that determine the relative success of a local finance partnership, as outlined in Section 3.

The next round of research involved four focus group sessions aimed at broaching the challenges to partnership that require more sophisticated forward planning. The focus groups included multiple stakeholders from different sub-sectors within financial inclusion. The topics covered in the focus groups were culture and incentives, products and services, funding and regulation, and technology. The focus groups consistently showed that that robust coordination and creative thinking are required to find solutions that work for all partners and their target markets. What was found was that providing a forum for focused discussion was both a way to understand these topics in the partnership context and a necessary first step to overcoming some of the issues holding up progress. As such, the focus groups yielded both greater understanding on the part of Responsible Finance and practical links and discussions on the part of participants.

Findings and Recommendations

Individual local finance institutions can be inward-looking and will focus on promoting their own internal growth and sustainability. However, even with a supportive environment, these organisations cannot effectively tackle financial exclusion alone. Partnership offers a pathway for small scale organisations to find synergies and efficiencies that will improve their value-for-money proposition, and for larger scale organisations it can be an opportunity to gain access to new markets. For all organisations, collaboration provides a more holistic system for their customers to engage with, with access to greater choice and affordability.

Increasingly, organisations at a local level recognise that, if they pool their expertise of products and services with the right technology and knowledge of consumer demand, they can offer a more effective and sustainable response than operating on their own. **The research findings show how systematic partnership between local finance organisations has the potential to be replicated across localities – for a national approach.** If adopted on a large scale, partnerships can increase the impact that local finance organisations have in unlocking the financial system for many of those excluded from it across the UK.

The focus of this research is on partnerships between responsible loan funds, credit unions and advice agencies in the consumer finance market, but the principles can be applied to other potential partners, such as healthcare, education, traditional banking and charities, as well as to other markets, such as those supporting small businesses.

The research findings identify a framework for collaboration and key considerations for organisations when going into partnership. In addition four key recommendations emerged that can improve the future of partnership working and lay the foundations for a sustainable model for addressing financial exclusion through collaboration, replicable at scale:

- **Going into partnership can be challenging in terms of aligning incentives and creating the necessary buy-in. To overcome this inevitable hurdle the creation of partnerships should be driven by the needs of the consumer and underpinned by the articulation of the organisational benefits.**

- **Strong leadership and a space for testing partnerships to meet market needs is required; this leadership should ideally come from external organisations, such as local authorities and trade bodies, to help overcome cultural resistance to change.**

- **Because of economies of scale, partnerships are a prime testing ground for innovation and process disruption, including adoption of new technology.**

- **Regulators should support the evolution of partnerships by using proportionate regulation to enable innovation and closer collaboration.**

Section 3: Benefits of collaboration

Tackling financial exclusion and strengthening the UK's financial stability in the current environment does not necessarily require new entrants such as local banks, which are time and resource-intensive to set up and build a customer base. A more direct approach is for existing organisations to engage with each other in a more strategic way to achieve scale, given that they have existing infrastructure and their customers' trust. Existing local finance partnerships in the UK and the United States indicate that this model is effective in expanding the reach and impact of all organisations involved. The nature of existing partnership work ranges from knowledge sharing and networking groups to the co-delivery of programmes or products. Table 3.1 outlines the high-level benefits from a range of partnership activities.

Table 3.1 Benefits from partnership activity

Partnership activity	Benefit to organisations	Benefit to customer
Networking and knowledge sharing consortia; collective bargaining power	• Learn from other organisations • Implement best practices internally • Potentially lower cost access to external suppliers through collective bargaining	• Indirect benefits from the incremental changes as a result of organisations implementing best practice
Cross-referring customers	• Maintain relationship with consumer even if the organisation cannot support them directly • Access to new markets through referral partner	• Greater choice and options • Improved and more direct customer journey
Sharing of staff; back office; office space	• Reduced overhead costs	• Improved and more direct customer journey
Co-delivering programmes	• Access to funding • Opportunity for innovation on delivery	• Greater choice and options • Improved and more direct customer journey

Financial inclusion partnership case studies

Individual partnerships are driven by unique local circumstances, but there is often overlap in the goals they are set up to pursue and the considerations each project must take into account. The following case studies demonstrate partnership in practice, and are examples of the three partnership models identified by the research (explained further in Section 3): referral, consortium, and integrated.

Scotcash

About

Scotcash is a Glasgow-based responsible loan fund, launched in 2007 by Glasgow City Council. In its Financial Inclusion Strategy[4] Glasgow City Council identified the use of high cost credit as directly reducing social wellbeing through pushing consumers into over-indebtedness. At the time, there were more than 30 credit unions operating in Glasgow, but as the use of high cost credit was growing, the City Council identified the need for an additional intervention.

Scotcash was set up as a partnership model, acknowledging that the range of services that consumers may need should be more easily accessible. Scotcash itself is a loan fund, providing affordable short term credit. Its partner organisations provide the following products in-house:

- Free current accounts: RBS, Barclays, and Virgin Money
- Savings accounts: Glasgow Credit Union
- Money advice: Glasgow Citizens Advice Bureau, Pay Plan
- Energy advice: G-Heat, Home Energy Scotland
- Other counselling and advice: One Parent Families Scotland
- Housing Associations that raise awareness about Scotcash with residents: ng Homes, Glasgow based Housing Associations

Customer journey

The Scotcash model is structured to mobilise the supply side of finance options. For example, a proportion of consumers seeking affordable credit do not have bank accounts, so Scotcash's banking partners open current accounts for them directly in Scotcash's offices, and Scotcash advisors coach them on using a bank account. The same is applicable if a consumer presents needing budgeting or energy advice.

In this way Scotcash operates a referral model, where a customer is referred to the products and services best suited for them. The risk inherent in referral relationships is losing the customer during the point of handover given that it can create an additional step. To mitigate this, Scotcash's referral model is embedded and in house.

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[4] Glasgow City Council (2015), *Glasgow City Council Financial Inclusion Strategy 2015-18*, www.abcorg.net/item/download/138_cb230b4feeb1677c7c7b334444a3d01d

Scotcash shares office space with its partner organisations, has staff from its partners working in its branches, and vice versa. In addition to a smooth customer journey, this provides the benefit of a 'triage' approach where consumers can access multiple services at a single branch.

Scotcash also uses its partnerships to make more consumers aware of the options for affordable financial services. For example, its housing association partners promote access to affordable credit to social housing tenants.

Impact

The products that Scotcash and its partners offer immediately give a consumer greater choice (both within and between product segments) than if these organisations were operating separately and were not co-located. Since opening in 2007, Scotcash and its partners have improved their customers' financial health and wellbeing in a number of ways:

- Bank accounts opened with RBS, Barclays, and Virgin Money: 2,300
- Credit union savings accounts opened: 700
- Customers who received energy advice from G-Heat/Home Energy Scotland but otherwise would not have: 950
- Customer financial gains from Home Energy advice in 2016: £28,420
- Cases opened by money advice: 5,700
- Prevented over 370 evictions through helping the customer manage their finances

In addition, at least 300 customers who opened a savings account through Scotcash are still actively saving directly with a credit union. Over 30 of these customers improved their credit rating and subsequently took out a loan from the credit union at a lower interest rate than that available through Scotcash, demonstrating the credit building function that partnerships have. Scotcash has collectively saved its customers over £5 million in interest repayments compared with if they had taken the same loan with a high cost lender and helped consumers to collectively gain £5.5 million through the re-negotiation of debts and by claiming benefits they did not know they were entitled to.

Challenges

Although it is an effective model, Scotcash faces challenges in setting up new partnerships with other local finance organisations. This is caused by cultural differences, such as the perception that the benefits to partner organisations are mismatched. Where Scotcash has been successful in establishing new partnerships, it is driven by the overlapping missions of improving consumers' financial wellbeing and capability, and the Scotcash model clearly filling a gap in service provision.

Future of the Scotcash partnership

Scotcash continues to seek new relationships and establish branch locations across Glasgow, Edinburgh, and Inverclyde for the partnership to reach more customers.

Scotcash has invested heavily in technology, such as a loan management system, an online application process, automated loan decisions and marketing to increase reach, efficiency and customer satisfaction.

Sheffield Money

About

Sheffield Money was formed in 2015 to provide an alternative to a variety of high cost products, both through a telephone and online presence. It was launched by Sheffield City Council following its Fairness Strategy[5] to combat the extensive use of high cost credit in the city. Research found that 50,000 people in Sheffield use some form of high cost credit, such as payday loans and home collected credit, and as such they are at risk of becoming over-indebted. To address this, the City Council supported a model that pooled existing interventions and deployed them strategically, to meet the needs of those residents who would otherwise borrow high cost credit.

The Sheffield Money project brings together a range of organisations that provide an alternative product to high cost credit. Sheffield Money itself acts as the coordinator and broker of the partnership. The following products are offered through the Sheffield Money partnership:

- 3-18 month loan (alternative to home collected credit): Five Lamps (responsible loan fund)
- Short term loans (alternative to payday loan): Uberrima (online lender)
- White goods finance (alternative to Brighthouse): Five Lamps
- Savings accounts: Transsave Credit Union
- Payroll deduction: Neyber
- Advice: Stepchange, Pay Plan and local Citizens Advice Bureau

An individual challenge for each of the organisations involved is low profile. Being represented under the clear brand of 'Sheffield Money' helps to overcome this barrier. So, rather than a 'credit union loan' the customer receives a 'Sheffield Money loan'.

Customer journey

Sheffield Money manages the outreach to the consumer and coordinates the customer journey. Given the increasing role of technology and mobile in how consumers find and access credit, Sheffield Money has invested in having an online presence and search engine optimisation. Whether a consumer has an online or in person interaction, their profile is assessed by Sheffield Money and they are offered a range of options by Sheffield Money partners. Once the consumer selects the product they would like to apply for, they leave Sheffield Money and apply directly with the provider.

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[5] Sheffield Fairness Commission (2015), *Making Sheffield Fairer*, https://www.sheffield.gov.uk/content/dam/sheffield/docs/your-city-council/our-plans,-policies-and-performance/Fairness%20Commission%20Report.pdf

In this way, Sheffield Money acts as a broker, assessing the customer and directing them to the most appropriate provider. The partner organisations involved do not interact with one another when working with customers, but instead engage directly with Sheffield Money. Unlike the referral model, there are fewer opportunities to triage consumers with multiple products.

Impact

Although it is a new partnership bringing together a range of local finance organisations to provide alternatives to high cost credit, the Sheffield Money brand has been successful so far in its objectives. Within a year, it received 20,000 unique visits, which generated over 3,200 applications for loans. These are likely from consumers that previously were not aware of affordable alternatives, and would otherwise have borrowed from high cost credit.

At this early stage, a significant impact of the Sheffield Money partnership is on the organisations involved. Sheffield Money invested time and resource into finding the right partners and ensuring that products offered by different organisations were closely aligned. For the credit unions and the responsible loan fund, this meant reducing the loan decision time from multiple days to one working day. Initially, several partners used paper applications and made manual loan decisions, but after a year of working together, the responsible loan fund and credit unions have moved to online applications and make more automated loan decisions. This enables them to work with a higher volume of consumers at lower interest rates, because they are more efficient. It is likely that these improvements would not have taken place at this pace if the Sheffield Money partnership did not require them.

Challenges

Sheffield Money operates a consortium partnership model, acting as coordinator for a group of organisations. A challenge for consortium models is ensuring the coordinating role is financially sustainable. In this case, Sheffield Money takes a fee on successful loans; so the partnership must generate sufficient volume of loans to sustain its role. Maintaining sustainability of the coordinating organisation is a challenge that led to some consortia partnerships, such as the Community Banking Partnerships in the 2000s to dissolve after the initial funding for the project ended.

Future of the Sheffield Money Partnership

Sheffield Money aims to continue to develop its partners to grow the project's reach. While the target market is the 50,000 consumers using high cost credit in Sheffield, the partnership seeks to eventually become a one stop shop for all of Sheffield residents' financial needs. In early 2017, the Sheffield Money model was replicated in Lincoln, creating Lincoln Money but utilising the existing website portal, which has lowered the upfront cost of replicating the model.

Leeds Credit Union and Headrow Money Line

About

Leeds Credit Union is community based with a membership covering Leeds, Wakefield and Harrogate. Credit union regulation caps the loan interest rate at 3% per month, which means that credit unions cannot lend to their higher risk members because they cannot price the risk appropriately. Leeds Credit Union noted that it was declining 30% of its members' loan applications because they were higher risk, and started looking for solutions to support those individuals. In 2011, the credit union launched a responsible loan fund called Headrow Money Line to serve those higher risk members when the responsible loan fund model was identified as having more flexible loan pricing. The sister responsible loan fund was supported by Leeds City Council's financial inclusion programme, which was launched at the same time to reduce the £90 million high cost credit market in Leeds.[6]

In this integrated partnership model, Headrow Money Line is a corporate member of Leeds Credit Union. As is common for organisations within a group structure, Leeds Credit Union and Headrow Money Line benefit from shared systems and functions. The two organisations have arrangements in place to share premises, some office staff, and back office systems. In terms of governance, they have different chief executives and different boards. While they are closely aligned, integrated models like this must demonstrate arm's length and risk management, which is why they often have separate governance structures.

Customer journey

Headrow Money Line is an internal entity to Leeds Credit Union, and since it is not customer facing it only receives customers if the credit union declines their loan application. As such, the two organisations and their products are complementary. The Headrow Money Line loan is a credit building tool higher risk consumers can use to demonstrate creditworthiness and ability to repay. The consumer can continue to save with the credit union, and in the future potentially borrow from the credit union. By having the responsible loan fund in house, Leeds Credit Union can offer an affordable alternative to prevent their members from seeking out high cost credit if they are declined.

Impact

Headrow Money Line was launched specifically to serve the market that fell outside the parameters of Leeds Credit Union. The impact and benefits of the decision to build a partnership are easily measurable because the full footprint of the responsible loan fund is a direct result of that decision.

[6] Leeds City Council's submission to a call for evidence by the Financial Inclusion Commission (2014), http://www.financialinclusioncommission.org.uk/uploads/written/Leeds_City_Council_-_response_to_UKFIC.pdf

The partnership is still at an early stage, but has already had impact since setting up in 2014:

- 1,200 consumers received affordable loans from Headrow Money Line, drawn from the 30% of applicants turned away for loans by the credit union
- 1,200 new credit union members (Headrow customers became depositors in the credit union)
- An initial annual lend of around £75,000 in unsecured loans, which has grown rapidly and, in the last 12 months (to March 2017), over £400,000 has been lent out
- Local council engagement, including board members on Headrow Money Line's board

Challenges

The challenges integrated models, like Leeds Credit Union and Headrow Money Line, face mostly relate to the legal, regulatory and resource barriers of starting a new entity. Particularly for credit unions, which are subject to prudential regulation, starting a new lending arm is considered high risk. There are additional hurdles to overcome when setting up; as both entities are regulated, and need broking licenses to refer consumers back and forth – this can be a double regulatory burden for small scale organisations. There is an added cost to compliance and additional complexities arising from that, which needs to be managed.

Future of the Leeds Credit Union and Headrow Money Line Partnership

Headrow Money Line was piloted in a controlled trial period and received only internal referrals from Leeds Credit Union. Given proof of concept, Leeds Credit Union are now planning to expand the responsible loan fund and make it customer facing rather than internal. The success of the pilot will serve as the track record when raising external investment to grow Headrow Money Line.

Local Authority support

A common theme behind partnerships is that the local authority was a strategic driver behind identifying market gaps and supporting a partnership-based solution. The local authorities' strategic plans often identify a particular market segment that is facing financial and social exclusion, and suggest organisations – that it already has relationships with – that can address it through their products and services. This strategic guidance and independent perspective is often the impetus for setting up the partnership. The local authority recognises the importance of delivering outcomes through an organisation which can be seen as independent of political control, so they also benefit from the creation of a partnership.

Given the local presence, local authorities are well-placed to play a leadership role in creating the space for local finance partnerships to be tested and incubated.

Lessons from local finance partnerships in the United States

Local finance partnerships are not unique to the UK. Responsible loan funds, credit unions, and other financial inclusion organisations in the United States routinely seek the same benefits for their customers and organisations through partnership. The operating context in the US is different from the UK, with legislation, regulation, and funding that has enabled the sustainable growth of local finance organisations.[7] With larger organisations, the sector can reach a greater proportion of the population that faces exclusion and underbanking.

Even with greater market share, organisations choose to collaborate for the same reason UK organisations do, to extend their impact beyond the limitations of their individual models.

About the local finance ecosystem in the United States

The ecosystem and models for local finance organisations in the UK are akin to those in the US, with some notable differences. As in the UK, US **credit unions**[8] are member-owned financial institutions, with memberships also based on geography or employer; and as deposit taking institutions they are also constrained in terms of the risk profile of the consumer they can serve. Credit unions that predominately cover disadvantaged areas are given a 'low income designation' by the regulator, and therefore have access to additional funding, outside of member deposits. This funding includes *secondary capital* which is subordinated debt, and credit unions can use it as equity to leverage growth in the organisation. CDFIs are among those that can invest secondary capital into credit unions. Credit unions in the US also benefit from having access to very low cost debt financing, given their own low risk profile. Credit unions must undergo sophisticated financial reporting to their regulator, but typically do not track their social impact, and they do not typically secure funding from social funders and investors.

CDFIs in the US also have similar models to those in the UK. They are loan funds that have more flexible underwriting and must raise their capital to on-lend from external sources. As they are flexible in how they can raise their capital, they have access to more grant and philanthropic funding sources than credit unions do; and are also funded through the national CDFI Fund,[9] as well as by commercial banks. They have high quality social impact tracking systems, given that their funders often request social outputs.

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[7] Harvard Kennedy School (2015), *Tackling Financial Inclusion through Community Investment: How should the UK strengthen its community investment sector? Lessons from the US experience*, http://responsiblefinance.org.uk/wp-content/uploads/2016/05/Tackling_Financial_Exclusion_Through_Community_Investment-_Sakaue_Stansb-.pdf

[8] National Federation of Community Development Credit Unions, *What is a CDCU?*, http://www.cdcu.coop/about-us/what-is-a-cdcu/

[9] Community Development Financial Institutions Fund, *What does the CDFI Fund do?*, https://www.cdfifund.gov/Pages/default.aspx

Many credit unions and CDFIs in the US provide formal financial literacy advice directly. Some provide general money and debt advice, whereas others offer specialised advice, such as on mortgages. In addition, there are non-profit organisations that provide credit counselling and debt advice, as well as organisations that do broader community development work that often tackles issues such as financial inclusion.

Table 3.2 Partnership models in the United States

	Hybrid/Integrated	**Collaboration**
Example	HOPE Enterprise Corporation of the Delta and HOPE Credit Union in Mississippi. The Enterprise Corporation of the Delta (ECD), a CDFI, and HOPE Credit Union both existed separately, but joined together in a hybrid model after 7 years of operation in 2002. HOPE ECD's investment of secondary capital into the credit union helped it leverage growth, to more than 30,000 members and $120 million in loans. In turn the credit union provided capital to HOPE ECD to on-lend. By partnering HOPE ECD and HOPE Credit Union consolidated back office systems and management, and HOPE ECD opened access to savings and financial education through HOPE Credit Union, to its customers. HOPE ECD and HOPE Credit Union are one of the largest and most successful hybrid models in the United States.	Marisol Credit Union, Trellis, Raza Development Fund in Arizona. When Marisol Credit Union received low income designation from the government it sought to collaborate with CDFIs operating in the area that shared the same general mission. The partnership between Marisol Credit Union, Trellis (a CDFI) and Raza Development Fund (a CDFI) secured philanthropic funding to collaborate. Together the three organisations designed new products that bridged their existing offers. For example, for each mortgage loan provided by Trellis, a savings account at Marisol Credit Union was opened to create an insurance fund for those homeowners. In addition, Marisol Credit Union provided capital for on-lending to the CDFIs, and consumer and business customers now have a range of options for financial advice through the three partners.
About	Multiple entities within an organisational group, e.g. a low income designated credit union, and a CDFI.	Independent organisations working together to refer customers and collaborate on products; CDFI can access loan capital from credit union; CDFI can sell loans to a credit union.

	Hybrid/Integrated	Collaboration
Benefits	• CDFI can invest secondary capital in the credit union, which fuels its growth • Can closely manage the loan book through loan participations • Improved financial and impact reporting overall through sharing best practices • Credit union can benefit from the profile the CDFI generates through its fundraising activities	• Members/consumers can access more loan options and specialist advice • CDFI can access loan fund capital through credit union • Credit union can purchase loans from CDFI – which gives the CDFI fee income, and grows credit union's loan book
Impact	Investing and leveraging secondary capital can drive large scale growth into new markets – serving more customers	• More consumers and businesses have access to services they would otherwise not • CDFIs can access loan capital, particularly in a challenging economic environment (at potentially more affordable rates than borrowing commercially) • Credit union can grow its loan book and improve its performance on regulatory ratios

Also, similar to the UK, low income designated credit unions and CDFIs serve complementary market segments. Despite the similarities, there are two key activities that CDFIs and credit unions perform in the US that enable close partnership working that currently do not take place in the UK on a regular basis. First, credit unions provide loan capital to CDFIs, and, second, CDFIs and credit unions sell loans to one another (called loan participations). The latter helps generate income as well as manage the performance of the loan book.

The literature on local finance partnerships in the US[10] highlights two primary partnership models, outlined in Table 3.2.

[10] National Federation of Community Development Credit Unions & OFN, *The Power and Potential of CDFI Credit Union and Loan Fund Partnerships*, http://ofn.org/sites/default/files/6.22.16%20webinar%20presentation.pdf

Lessons from US partnerships

Many aspects of the local finance sectors and the partnership models in the US mirror the landscape in the UK. Despite being larger in size, organisations still view partnership as a key to scale and improving customer wellbeing. However, in the US, partnerships are driven by the key advantages it brings to the individual business, such as access to new funding, reach into new markets, and the potential to offer an expanded set of options to consumers.

In the UK, the organisational benefits of partnership are not as clearly articulated or broadly acknowledged. In the consumer market, the primary driver for partnership in the UK is the potential benefits for customers and there is still scepticism about whether other sub-sectors within local finance can stimulate consumer benefit. This is caused by a fundamental cultural barrier, which is discussed further in Section 3.

In addition, the lack of a secondary capital market for local finance organisations in the UK, which access to is an important incentive for partnering for US credit unions, means that partnership offers less of an opportunity for growth. Currently barriers exist to making secondary capital investments. UK responsible loan funds can put equity into credit unions by becoming corporate members, but a large commitment would be needed. Responsible loan funds must obtain a waiver from the regulator to make a subordinated loan to a credit union.

The US examples of collaboration show the potential for responsible loan funds, credit unions, and other local finance organisations in the UK, as they continue their journey for sustainability and scale. There is an opportunity for partnership to help them on that journey by leveraging the additional capacity and market reach enabled through collaboration. The US partnership experience also shows that despite having greater scale, some similar challenges exist for organisations going into partnership, namely in identifying appropriate partners, managing the relationship(s) over time, generating revenue to cover the additional coordination costs of the partnership, and the regulatory parameters of the organisations involved.

Some of the practical partnership activities in the US, such as the provision of loan capital by credit unions to responsible loan funds, selling and purchasing loan books and developing an integrated product continuum are explored further in the UK context in Section 3.

Section 4: Framework for partnering

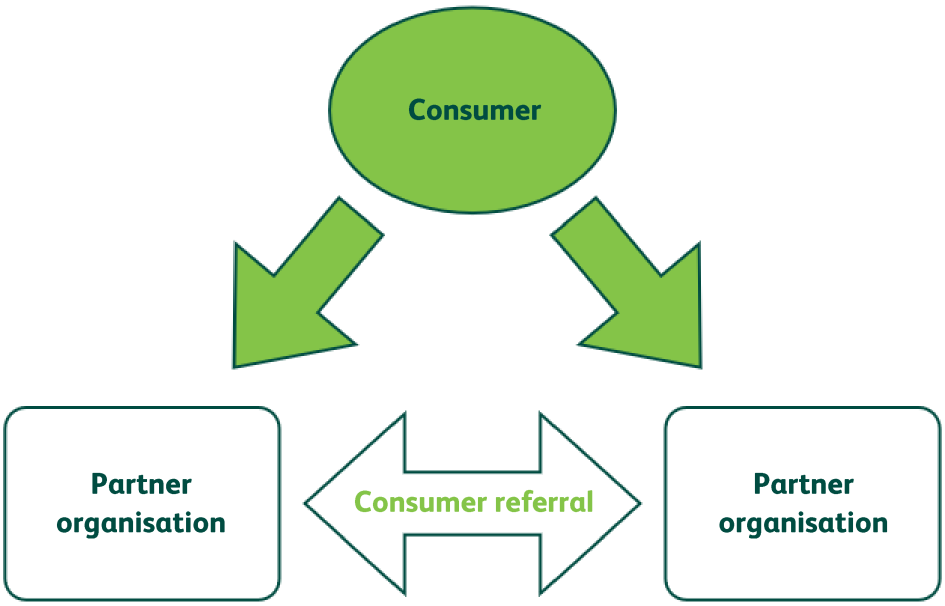
Models for partnership between local finance organisations

To build a holistic alternative financial services model that serves the specified gap in the market, organisations such as responsible loan funds, credit unions, housing associations and advice agencies tend to work in three categories of partnership models: **referral, consortium and integrated**. The model pursued is determined by the scope of the geography and target market, the organisations and products available locally, and the capacity and resources for coordination.

Referral

In a referral model, existing independent organisations cross refer consumers when there is demand they cannot individually serve. Some referral models are more embedded than others. For example, placing staff in partners' offices so that the client handover is seamless, and organisations can 'triage' a client with multiple products and services. For example, Scotcash operates an embedded referral model. This model is generally flexible in terms of adding or removing partners to meet demand, but the challenges lie in structuring the incentives to benefit all partners involved. While one partner may capture more financial benefit, all organisations involved benefit from their customer base having more choice and an easier customer journey.

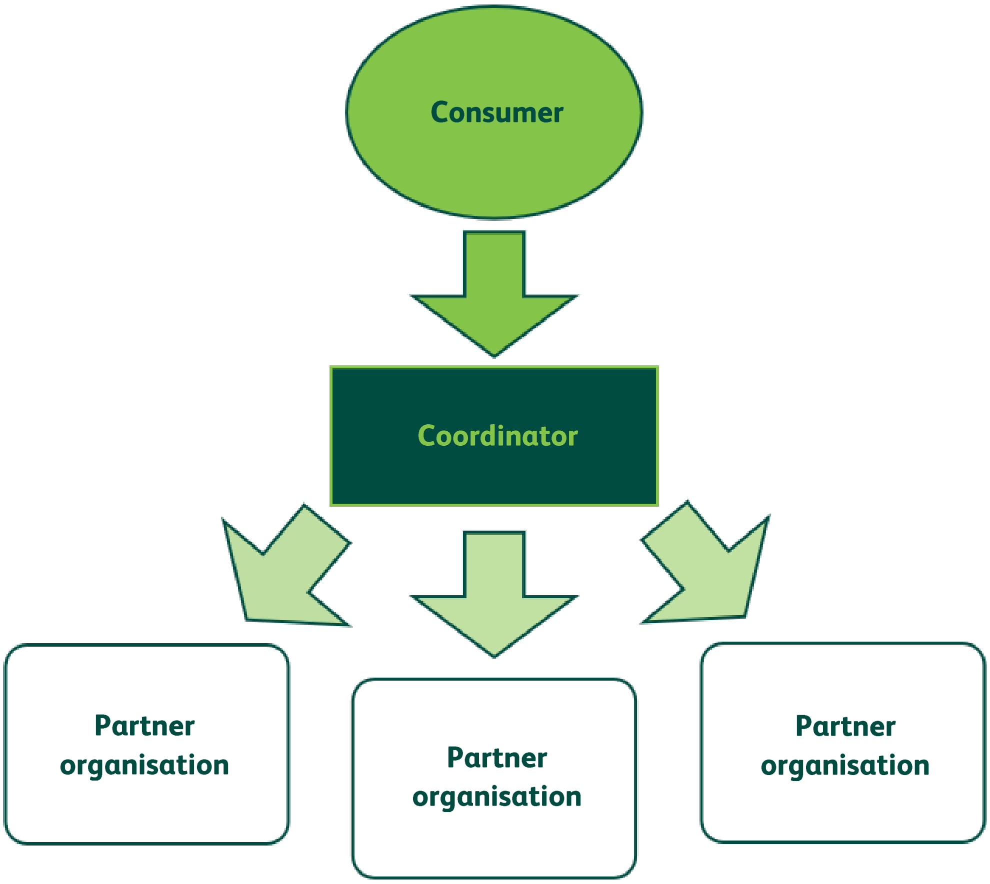
Figure 4.1 Referral model



Consortium

In a consortium model, one organisation coordinates a group of existing independent organisations. These organisations operate as they did before entering the partnership, but receive consumer referrals through the coordinating body. They may be required to comply with partnership rules and expectations. Sheffield Money is an example of the consortium model. It is both the coordinator and the brand of the partnership; it coordinates the range of partners and products and manages the customer journey. This model is also flexible as the products can be adjusted, but has potential challenges around the set up and sustainability of the coordinating company, marketing the brand and managing performance amongst consortium members.

Figure 4.2 Consortium model

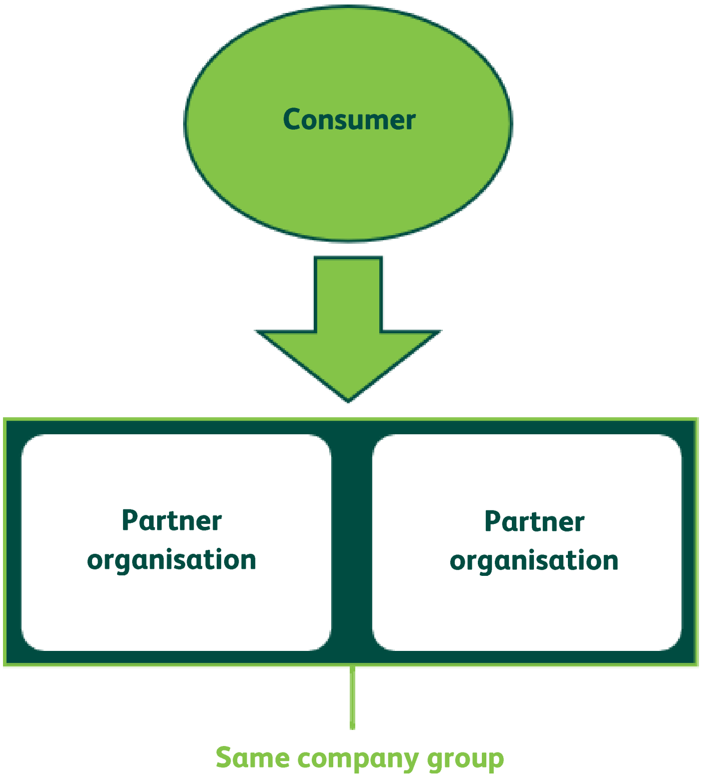


Integrated

The integrated model is where multiple entities exist within the same company group; for example, a credit union with a responsible loan fund sister company. Leeds Credit Union and its sister company, Headrow Money Line are an iteration of this model. The advantages include all entities being located under the same roof, a simpler customer journey and shared back office and administrative services.

However, this model has greater set-up costs and more regulatory barriers given that separate companies must be established and managed at arm's length. Because of this there is also less flexibility in terms of adding new products and services.

Figure 4.3 Integrated model



These three models give local finance organisations that are looking to partner blueprints of successful structures for doing so. The research did not identify one model as more advantageous than the others. There are similar benefits for organisations and consumers from all models, such as **a clearer customer journey and access to a wider range of products, greater market reach and efficiencies through consolidating back office costs.**

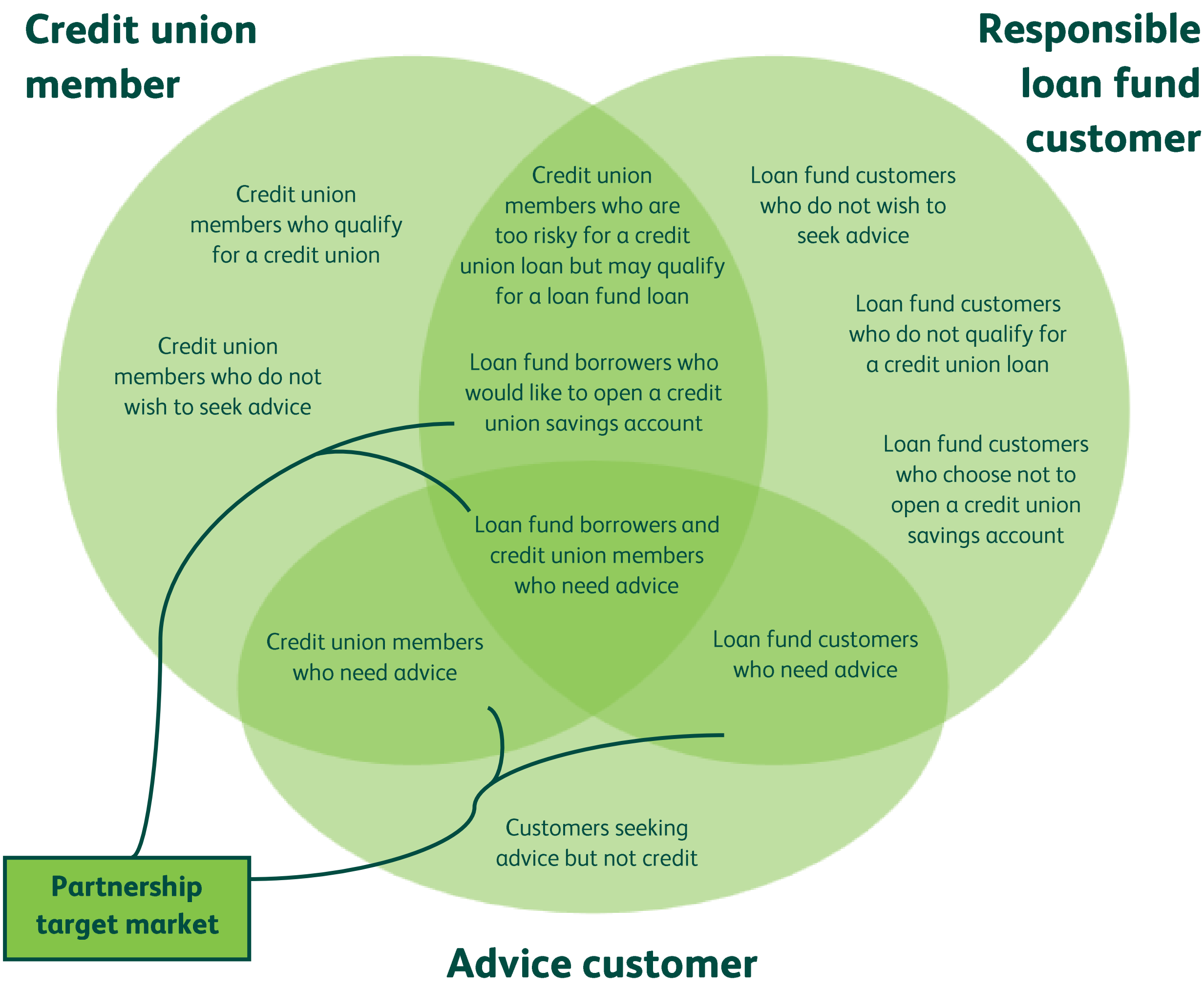
Key considerations when partnering

Across all three partnership structures, local finance organisations identified six key factors to consider when setting up the partnership: the target market, products, regulation, funding, culture and partnership management.

Target market

Defining a target market for the partnership (such as geographic and demographic) is an important first step because it establishes the partnership's objective(s). Although credit unions, responsible loan funds and advice agencies have similar broad missions (e.g. to improve consumers' financial wellbeing), the purpose of collaborating is to address a specific gap in the market. Evaluation research of local finance partnerships in the US found that a convergent mission, including aligning on the purpose of the partnership and the definition of the target market, is a key pillar for a successful partnership.[11] The same is true for organisations collaborating in the UK. A clearly defined target market not only focuses the partnership, but also articulates each organisation's role and the partnership outcomes. An important lesson from the partnerships involved in the research is that defining the target market is key to ensuring the collaboration is customer driven.

Figure 4.4 Target market



[11] National Federation of Community Development Credit Unions, *Partnerships for Financial Capability: Diagnostic Frameworks for Financial Institutions and Partners*, http://www.cdcu.coop/partnerships-for-financial-capability/

For example, the target market for the Scotcash partnership is Glasgow residents and households that would otherwise borrow from high cost credit providers. The purpose of the partnership is to provide an affordable alternative to high cost credit. While each partner's customer group is wider than this market, the collaboration between organisations focuses on this segment. The target market then informs the products on offer, and incentives and expectations for organisations involved. Figure 4.4 illustrates the overlap in target markets.

Products and services

After establishing the target market, the second factor to consider is the suite of products and services on offer. First identifying the market demand drives the appropriate product response, including identifying what partners are already delivering and what needs to be added into the mix to provide a comprehensive package to increase consumers' financial stability. This also impacts on the role and level of involvement from each organisation involved.

One of the purposes of collaboration is to create a product continuum – the full range of products and services needed by the target market. Just like a mainstream bank offers current accounts, credit cards, mortgages and business loans, among other products, local finance partnerships can emulate this 'one-stop shop' approach. This wider range of products and services can also help to create a ladder for a consumer to move from financial crisis to financial resilience. For example, by moving from using short term loans to building up savings.

As an example of how partnerships develop this range of products and services, Sheffield Money's target market was the roughly 50,000 consumers in Sheffield using high cost credit. As a product response, Sheffield Money identified affordable alternatives to high cost credit products that cause consumer detriment. Given that high cost credit is increasingly accessed online and through mobile, a key component of the Sheffield Money approach was developing a competitive online presence that appealed to consumers. Accessing high cost credit from commercial lenders is often a fast and efficient process, with the money deposited into the consumer's bank account within minutes if the loan application is successful. For Sheffield Money, the alternative product also needed to compete with this customer experience, not only the type and cost of products available.

Developing complementary products also helps organisations build their brand. For small scale, niche organisations like responsible loan funds and credit unions with marketing budgets a fraction of the size of the commercial lenders', public awareness of them is relatively low. On the consumer side, knowing that they may qualify for a loan or savings account and have a good experience is more important than fully understanding the credit union or responsible loan fund model. A simple brand and easy to understand products, like the one developed by Sheffield Money, can build consumer confidence and increase awareness of the individual organisations involved, for example, by word of mouth recommendation.

Focus group: Product innovation through partnership

Through a focus group with local finance providers, we found that although there are many advantages to partnership working, new product innovation is something that is likely to happen slowly due to the need to balance the different needs, target markets and ambitions of the partnering organisations. Several potential products arose from the research including:

- An improved offer to combat white goods weekly payment shops;
- An emphasis on social landlord partnerships in light of the arrival of Universal Credit and social landlords' concerns about how their tenants will manage the change;
- A challenger to store cards and catalogue credit that often come with complex and confusing terms that can result easily in missed payments.

There was consensus amongst partnerships involved in the research that there is no definitive product offer that can act as a replicable model. Although a basic savings product, access to affordable credit and advice services are all important elements in most successful partnerships, a combination also trialled by the 2005-2008 Community Banking Partnerships. To achieve a streamlined set of products, a coherent message and marketing plan for reaching those who are financially excluded is needed. The plan needs to be responsive to economic, social and market change effecting people, such as the introduction of universal credit and the continued use of high cost short term lenders for essential costs like utility bills.

Spotlight: Affordable Lending Portal

The Affordable Lending Portal (ALP) is an online portal launched in 2016 that directs consumers looking for finance on the websites of high street retailers to local finance providers. It came about after collaboration between Asda, a group of community lenders, and other Government and private sector supporters.

The ALP illustrates a successful route for balancing the distinct ambitions and concerns of partnering organisations through offering a coherent platform for existing services. The partnership was not driven by growth of a particular consumer need as but was instigated through a Government-led commission to address the needs of financial inclusion through building partnership working between community providers.

Rather than offering a joint product, the portal sees itself as offering a joint relationship: a partnership between private and local finance organisations with the principle aim to make it easier for consumers to access affordable loans. After 18 months of consultation and product development, the partnership opted for the consortium approach of acting as a portal for the existing products of the organisations as oppose to offering a new product range.

There was potential to offer a low value loan as a subset of the existing product offers, but it proved too difficult to align the range of issues the partnering organisations sought to address, with the outsourcing model deemed to be more effective.

The portal itself does not make credit risk decisions but instead aims to create and foster relationships with customers, passing them on to the appropriate service or product offered by a participating credit union, CDFI or advice service. This model means the portal has the opportunity to scale with good regional coverage based on the existing coverage of financial institutions, something they would have struggled to do had they sought to offer a standardised product.

Regulatory and legal frameworks

A third factor to consider is legal and regulatory compliance, which can influence how organisations and partnerships operate. Local finance organisations each operate within different legal and regulatory parameters. For example, credit unions are registered under the Credit Union Act and are regulated by the Prudential Regulatory Authority (PRA) and the Financial Conduct Authority (FCA) as both deposit takers and lenders, whereas responsible loan funds are social enterprises that span a range of company forms and are regulated by the FCA for consumer credit lending. Compliance factors affect how streamlined a product range can be, how integrated the collaboration between organisations is and how the consumer handover between organisations takes place.

As an example, when Leeds Credit Union explored how to create a more inclusive product offering, its legal structure and regulation prevented certain options. First, because of credit unions' interest rate cap of 3% per month,[12] Leeds Credit Union could not materially restructure its own products to serve its more vulnerable and higher risk members. Second, as credit union regulation also prevents credit unions from having subsidiaries[13] it could not launch an alternative loan fund. Therefore, the option left to Leeds Credit Union was to open a new sister organisation: a responsible loan fund.

As non-profit loan funds, responsible loan funds are generally more flexible in their underwriting, loan parameters and how they raise and utilise capital. However, operating two regulated entities under a single management structure essentially doubles the regulatory burden on a small organisation like Leeds Credit Union, making it difficult to scale both organisations.

All partnership models cope with navigating regulatory parameters, for example the need for organisations to have a broking license from the FCA to refer a customer, and rules around promotions can add additional barriers to partnership set-up. Also, where organisations were once able to do the necessary credit and identity checks on behalf of their partners (which streamlined the customer journey), this is now unlikely to be permitted by the regulators, for new partnerships. Scotcash has circumvented this regulatory barrier by having loan officers from banks in its offices on a regular basis, to open bank accounts when needed.

For this reason, the US model of 'loan participations', selling and sharing loan books, is not an option in the UK; although organisations can 'co-fund' a single loan. In addition regulatory constraints prevent the development of a secondary capital market in the local finance sector that would enable cross-investing to catalyse organisational growth.

For local finance organisations that operate in group structures established to tackle financial exclusion through a holistic approach, the regulators should seek to consolidate regulations to avoid an undue burden for these organisations as it ultimately limits the partnership's impact.

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[12] Association of British Credit Unions Ltd., *Credit union interest rate cap to be raised*, http://www.abcul.org/media-and-research/news/view/347

[13] Credit Unions Act (1979), *Section 26: Prohibition on subsidiaries.*, http://www.legislation.gov.uk/ukpga/1979/34/section/26

Funding

Another key consideration for partnerships is how they are funded, both in terms of revenue and capital. In terms of revenue funding, the set-up of a new partnership is time intensive, particularly when it comes to generating buy-in from partners, and applying for the relevant regulatory permissions. Seed funding from the local authority or another funder typically covers the set-up costs, but for many partnerships this is largely self-funded. With the exception of the consortium model, which allocates the partnership management function to the coordinator and resources it through referral fees, the ongoing management of the partnership is self-funded as well. This is an additional incentive for the partnership to be both customer and outcomes focused – so that the partners generate revenue through the provision of their products and services to more consumers, to cover the costs of delivering through the partnership.

Second, the partnerships involved in the research all used their existing sources of capital to on-lend; for credit unions that is the deposits from members, and for responsible loan funds it is social and commercial investment and recycled legacy funds. In the US partnership model in Section 2, organisations share funding and capital, credit unions invest in responsible loan funds and vice versa. In the local finance partnerships in the UK, credit unions and responsible loan funds do not pool funding, and there is little precedent of credit unions and responsible loan funds cross-investing. The section below explores why this is and if there is any potential to replicate the US model of pooling and cross-investing to balance organisations' funding needs.

Focus group: Responsible loan fund / credit union funding model

The focus group with local finance providers and other stakeholders on aligning credit union and responsible loan fund funding models session picked up on the underlying contrast in the two models. Responsible loan funds have limited capital to on-lend and the credit union sector has excess capital that it is not able to lend to satisfy its regulatory requirements; this is due to a lack of demand from creditworthy customers and a lack of infrastructure and profile to reach creditworthy customers. On the surface, this situation would appear to lend itself to a ready solution, with the credit union sector finding a mechanism to invest in responsible loan funds.

However, regulatory barriers present significant roadblocks to this goal. A sector-wide investment fund would take time to develop and would need to be locally-trialled first. The initial step would likely require a discretionary waiver being granted by the Prudential Regulation Authority (PRA) that allows selected credit unions to lend a larger share of their overall portfolio to corporate members (in this case, a responsible loan fund) than is currently allowed. This would mean lending at a greater concentration of risk than the restrictions are currently designed to allow.

Discretionary waivers have been granted in the past and regulators are becoming more open to the idea of more corporate lending from credit unions. The amount of capital that credit unions are seeking to lend is greater than even what responsible loan funds can absorb at this stage. So although there are barriers, credit unions investing into responsible loan funds should not discounted as a potential opportunity, given the synergies in target markets and mutually beneficial outcomes. More details on aligning funding models and the relevant regulations are found in Appendix 2.

In the US case studies in Section 2, credit unions provided loan capital to CDFIs as part of the partnership, and CDFIs invested equity into credit unions. This helped CDFIs to access affordable capital, and for credit unions to leverage the equity to grow in size. This arrangement has happened in the UK but is not common. However, it is a potential opportunity for the responsible loan fund and credit union sectors to work together in a different way. Aligning capital needs potentially tackles ongoing challenges for each industry: for credit unions to invest their excess capital into a vehicle that provides a return and is aligned with their purpose, and for responsible loan funds to access affordable capital to on-lend.

In an environment where access to capital to on-lend for responsible loan funds is relatively limited and constrains their impact, this relatively untested option may be more attractive to pursue. For credit unions, as well, the ability to generate a higher return may be welcome in the current challenging operating environment. There needs to be a space for credit unions and responsible loan funds to test this model on a small scale, and assess whether it is a viable approach.

Culture, incentives and building trust

The previous key considerations outlined in this section all relate to structural aspects of partnerships, such as regulation and funding. A fifth consideration for partnerships is the organisational and cultural variations that can arise within any partnership working. To work across traditional sub-sector siloes, organisations going into partnership need to consider incentives that benefit all organisations involved, including benefits to their customers and direct benefits to the organisation.

Cultural differences can be one of the biggest obstacles to establishing a successful partnership as it hinders the process of building trust. When working across sub-sectors, organisations are often competing for resources, political support, and profile. Organisations may also perceive other sub-sectors as part of the problem, not the solution. For example, advice agencies view credit unions and responsible loan funds as perpetuating over-indebtedness through their lending and credit unions often view responsible loan funds' interest rates as too expensive. These longstanding misperceptions between sectors prevent organisations from partnering. When organisations do partner it can dampen buy-in to the shared goals, thus hampering the project's feasibility.

Behavioural change, altering perceptions and building trust are all long-term processes. In the partnerships involved in the research, these took time to establish and in some cases are still ongoing, but the catalyst for the partnership is making an evidence-based case for improving customer outcomes. For local finance organisations with a social mission, customer wellbeing is the driver for seeking out partnerships to fill gaps in demand, and this practical objective can transcend sub-sector differences.

Misperceptions can be challenged by the incentive to improve the consumer's wellbeing and the evidence that it works. For example, in interviews credit unions viewed responsible loan fund interest rates as too high, but acknowledged that consumers would otherwise likely seek to borrow from a high cost credit provider, charging at least 5 times more than the responsible loan fund.

Additionally, credit unions are often labelled as the public policy solution to financial exclusion but, because of their interest rate cap, they struggle to price their loans to vulnerable and higher risk consumers. The credit union sector has undertaken major work to diversify its portfolio and become more efficient, in order to operate sustainably. Referring a higher risk customer to a responsible loan fund or debt advice agency enables credit unions to continue to meet the policy objective of addressing financial exclusion, while also maintaining the relationship with members, and focusing on more profitable market segments.

As such, organisations were most successful when they sold the partnership as the solution to a problem, rather than an ask for resources. Structuring partnership incentives like this is a practical way to break down cultural barriers to working together, so that partner organisations and their customers can benefit.

Focus group: Culture, trust and incentives

Historically divergent approaches to product design and target markets underpin what is a disparate approach to marketing and growing the profile of the community finance products and services on offer. Even with credit union, responsible loan fund and other financial inclusion sub-sectors, organisations tend to operate in a way that is disengaged from other, similar organisations. However, the financial inclusion sector has a general challenge in that many consumers do not fully understand the role those organisations play and the products and services they offer.

The focus group investigating cultural barriers suggested that a structured and collaborative approach to thinking about raising awareness could significantly benefit responsible loan funds, credit unions and other partners involved. Sheffield Money is an example of the success that can come from presenting a spectrum of financial products under a unified, easily understandable brand.

Spotlight: Structuring 'win-win' incentives for partnership

Although cultural differences between sub-sectors also exist in the US, the partnership case studies demonstrate how these can be overcome through practical consumer-focused incentives that provide organisational benefits as well. For example, organisations can use the partnership as a stepping stone to accelerate their individual journeys.

The wider local finance sector is ripe with opportunity to work together to leverage each other's assets, despite sectorally engrained perceptions that are difficult to change overnight. When defining the range of incentives for partnering it is important to consider what each partner can gain from the relationship, both financially and in terms of customer outcomes. To determine this, we explored the ways through which partnerships can increase organisational capacity as well as how new partnerships can appeal to the respective missions of the providers. The table in Appendix 3 provides an overview of the various and often interrelated incentives, drawing out the advantages in terms of both the consumer and the financial benefits to the institutions themselves.

A number of these advantages are being realised through partnership working already, whereas others can be considered aspirational. For example, though in theory partnership working could provide a credit ladder to customers to bring marginalised groups upstream in terms of their credit record, in reality the efforts of the sector are focused on preventing people from slipping further down towards a debt spiral. As such, consumer credit building could be an *aspirational* incentive for organisations to partner, but the initial goal might be to support people at risk of becoming entirely locked out of finance.

Partnership management

A sixth and final consideration for organisations going into partnership is the overall management of the project. Partnerships not only require buy-in and management when they are first set up but throughout the lifetime of the partnership. Partnership management includes the logistics of operating the partnership, such as: contracts or service level agreements (SLAs) between partners; setting clear expectations from each partner organisation; setting key performance indicators (KPIs); and reviews and controls. It also entails establishing a partnership 'lead'.

In the partnerships involved in the research, there was a contract or SLA in place detailing the organisation's role, expectations and contribution. Much of this detail is developed through the previous key considerations and the partnership structure. Even integrated models such as Leeds Credit Union and Headrow Money Line have an agreement in place detailing the sharing of staff, office space and back office systems.

It is also common and good practice for partnerships to measure KPIs, although few set targets at the outset. Measuring KPIs serves the important purpose of monitoring individual partners' performances, and assessing whether the partnership as a whole is achieving its objectives, as defined when determining the target market.

Partnership management is a key component for ensuring existing partnerships are successful, but also for demonstrating the value of partnerships in increasing financial stability through evaluation and sharing best practices. Throughout the research, technology was a recurring theme that held potential for the future of individual organisation's sustainability, as well as the future of partnerships' success. Technology has the potential for (a) marketing – to reach more customers, (b) organisational efficiency through back office systems and loan decision tools (which are already being developed)[14] and (c) for partnership management.

[14] The Association of British Credit Unions Ltd. (ABCUL) has been working with the credit union sector and technology providers to develop a sector-wide loan-decision tool. Automated Lending Decisions (ALD) has been credited with reducing bad debt and overheads, allowing for greater confidence in lending on the part of credit unions (http://www.abcul.org/media-and-research/news/view/661).

Focus group: Technology for partnerships

The focus group with local finance providers on technology revealed that technology is a factor that can have a three-fold impact on partnerships. First, enabling individual organisations to be more sustainable and therefore have greater impact within the partnership. Second, to convene organisations in useful ways, such as through collective bargaining. Third, measuring the impact of the partnership: including the full impact of the partnership rather than only its individual partners can, for example, be used to calculate and demonstrate a wider-reaching and more compelling social impact than an individual partner could in its own.

KPI measurement is a key part of partnership management and also a low hanging fruit in that most organisations capture metrics in some form. As we have seen, the cultural management of a partnership is a serious challenge, and although technology investments into new back office systems have long-term returns on efficiency for organisations, they have less impact on the short-term outcome oriented partnerships that exist or are in development today.

Spotlight: Open source partnership management

Open source development means the source code for technology platforms is freely available to the wider community. If a platform is built using open source, additional modules and modifications can be developed at low cost. This is particularly useful when thinking about shared platforms within partnerships because diverse organisations and working styles can be facilitated into a unified data platform where the interests of partners overlap. It also means the technology underpinning the collaboration can be easily adapted to growth or change within the partnership, or modified and replicated in other partnerships intending to work develop a similar solution.

Open data platforms bring the necessary flexibility to be able to adapt to the changing technology environment and consumer expectations. This does not contradict the impulse and necessity of partner organisations to maintain local autonomy and operational independence. While some uniformity is required to underpin a working, shared open platform, this amounts to the data categories agreed for upload, the timescales for working and the overall purpose of the project. At an individual level, a flexible open platform can maintain compatibility with data held in different formats and on different systems within each partner organisation. An open source system allows the wider technology community to contribute and avoids the eventuality of a small group of technology providers controlling access to cost-effective updates.

A well-executed open data collaboration can allow organisations taking part in a partnership present a single brand, which can in turn be leverage for attracting funding, investment and better terms. Greater data capabilities can be a source of valuable information for organisations such as debt advice agencies or credit reference agencies. Shared platforms that bring together larger market segments also bring participants into a shared negotiating position which can be leveraged for better terms on commercial contracts. A sophisticated approach to data and greater insight also allows a partnership to better demonstrate the value it brings and where it can add value, which is a crucial aspect of attracting socially-driven investment.

What's next for local finance partnerships in the UK

This section reviewed the framework that local finance organisations working in partnership follow to address market demand. This framework can be replicated by organisations starting a new partnership, or those developing an existing collaboration.

Table 4.1 Local finance partnership framework

	Models for partnering		
	Referral/Embedded referral	Consortium	Integrated
Considerations when partnering	Identifying a target market and shared objectives		
	Designing a product response		
	Legal and regulatory requirements		
	How the partnership is funded		
	Designing practical incentives for partners		
	Effective management of the partnership and sharing lessons and good practices		

There is potential for organisations to continue to innovate under this framework to scale up their own organisations and the partnership to increase their impact on financial inclusion and capability. Alternative funding models and testing new technology are examples of levers that can benefit individual organisations to make incremental improvements, but can also be adopted collectively to create innovative opportunities.

Section 5: Conclusion and recommendations

Financial exclusion and low levels of capability remain barriers for achieving financial stability and resilience. The uncertain economic outlook in the UK in the face of Brexit and stretched public finances puts more consumers and communities in a vulnerable financial position, so it is important that the ecosystem of interventions continues to evolve to tackle the challenge at hand. The local finance ecosystem has developed market knowledge and trust and is an effective intervention at a small scale. However, these institutions face pressures around establishing a sustainable and efficient operating model, which currently limits their impact.

As the US model demonstrates, partnership does not only help organisations achieve individual growth and sustainability; even large organisations partner to maximise their impact. This has been demonstrated in the UK by partnerships such as Scotcash, Sheffield Money, the Affordable Lending Portal and Leeds Credit Union, which all use collaboration as a way of creating access to a sustainable and affordable alternative to mainstream financial services.

Local finance organisations themselves can learn from the precedents set by existing partnerships, in terms of the framework outlined in Section 3. To build on and replicate successful partnerships, local finance organisations, stakeholders such as industry bodies, and regulators should consider the following recommendations.

Recommendations

1. Partnerships should take a customer-first approach

One of the most prominent messages from current and former partnerships in this research is that the partnership must be driven by building the financial resilience of customers. This ties back to first defining the target market and objectives, which then determines other elements of the partnership, including the organisational benefits. Selling the consumer benefits is the start of structuring the partnership model for mutual gain.

In cases where is the decision to partner was driven by funding or for greater profile without there being a clear target market, the partnership has struggled to achieve positive outcomes. For local finance organisations and their stakeholders going into partnership, starting off with and retaining a consumer focus is key. Structuring the incentives for organisational benefit will follow on from this.

2. Local finance organisations need the leadership and space to innovate

Lessons from historical partnership working indicate that it is an iterative process, particularly as consumer needs, regulation, and policy priorities can change. Organisations involved in the research that had not engaged in partnership expressed interest in a forum where opportunities can be explored.

While partnering for the sake of partnering is unlikely to be productive, in keeping with the customer driven approach, there needs to be a space for local finance organisations to collaborate on specific market issues. **There is a role for the industry trade bodies, and even for local authorities and other umbrella organisations, in fostering a forum for sharing knowledge and best practice, and promoting innovation.** This leadership is needed to get the partnership off the ground and to promote best practices and replicability.

Promoting this dialogue can not only foster new partnership working and test innovative concepts such as a credit union/responsible loan fund funding model and develop a more coherent brand for the sub-sectors of local finance.

3. Utilise flexible, fit-for-purpose technology

Technology is changing how finance is accessed and delivered, and the advent of new financial technology has clear potential to contribute to the creation of a more inclusive financial system. There are numerous opportunities for technology to transform the customer journey. For local finance organisations, FinTech can be used to make incremental improvements, such as increasing efficiency through online applications, the use of APIs[15] in building systems that conduct credit and identity checks, automated loan decision making, and smart marketing. These are all examples of technological gains that local finance organisations can collaborate on in different ways, such as through collective bargaining or joint investment.

Local finance organisations are inherently diverse given that they develop to address specific market conditions. It is often the wish of trade bodies, policymakers and funders/investors to converge all organisations onto a common referral platform or shared back office system to increase homogeneity across the sector. This is an ambitious goal. But in reality most organisations are in different stages of their growth journey, so consolidation onto unified platforms is often a long-term and complex task. However, local finance can still work towards convergence.

The local finance sector should take advantage of open source software development to help bring down development costs, and also enable organisations to use and share existing tools. A prime example of this is an open source data platform, where organisations can capture and report social impact and other KPIs. This has the potential to reduce the cost of partnership management while demonstrating impact and supporting the sector's narrative.

[15] Application Programme Interface

Successful and effective local finance partnerships are built on personal trust, which has inherent risks. Technology can help partnerships move beyond individual relationships, through referral portals and capturing impact, but it needs to ensure that the needs of the consumer are still prioritised.

4. Proportionate regulation to enable innovation in this sector

When partnering, navigating regulatory requirements can often be a complex and resource-intensive process. Acknowledging that regulation serves the crucial purpose of protecting consumers and their assets, it can create a disproportionate burden on small organisations such as local finance providers. One of the advantages of going into partnership is consolidating functions and costs, but compliance is one function that does not benefit from the economies of scale through partnership.

To enable partnerships to flourish, regulators should review their approach to the local finance sector in the context of its current activities. This will help the PRA and FCA determine fit for purpose and proportionate regulation that does not have a draw on the impact partnerships have. For example, consolidating regulatory requirements for integrated models, creating a small-scale testing ground for the credit union-responsible loan fund funding model and enabling secondary capital investments, and allowing organisations to collaborate closely on identity checks, loan origination and loan management, are all factors that would enable closer partnership working and a greater impact on improving financial capability.

Appendix 1: Contributing organisations

Thank you to the organisations involved in the research:

Affordable Lending Portal
Association for British Credit Unions (ABCUL)
Barton Hill Settlement
Birmingham CitySave
British Business Bank
Carnegie UK
Citizens Advice
Enterprise Credit Union
Five Lamps
Leeds Credit Union/Headrow Money Line
Liverpool City Council
Manchester Credit Union
Moneyline
National Federation of Community Development Credit Unions
New Economics Foundation
North London Credit Union/Financing Enterprise
Robert Owen Community Finance Fund
Scotcash
Scotwest Credit Union
Sheffield Credit Union
Sheffield Money
Smarterbuys Store
Social Finance
Street UK

Appendix 2: Credit union – responsible loan fund funding models

Taking into account regulatory requirements, there are two options for aligning funding between the two sectors. A local or regional funding model and a national investment funding model. The table below outlines the characteristics of each.

Table A2.1: Local and national credit union and responsible loan fund investment models

	Local/regional	National investment pool
How would it work	A responsible loan fund can join a credit union as a corporate member if a) the credit union accepts corporate members and b) the responsible loan fund fits within the credit union’s common bond.	Most credit unions reportedly do not lend at the optimal loan to asset ratio of 70%-80%, and are instead in the 40%-70% range. This means that 30%-60% of their cash is in the bank in a low interest rate environment. This potentially hurts a credit union’s profitability. Pooling excess cash into a bank account or shared Treasury management and investing a portion of it into responsible loan funds is a potential way to earn greater return on that cash. Responsible loan funds typically pay interest rates of 4%-8% when borrowing from commercial or social investors. It is also a way for responsible loan funds, whose lending is limited by access to capital to on-lend, to access a sustainable source of capital.
Relevant regulation	Credit union regulation states that corporate members must make up ≤10% of a credit union’s total membership, and ≤ 25% of total shares. The aggregate outstanding loan balance to corporate members must be ≤10% of the total outstanding loan balance.	The portion of excess cash that can be invested in responsible loan funds is determined by whether corporate member rules still apply in pooled Treasury management.

	Local/regional	National investment pool
Relevant regulation	Credit unions have maximum lending limits that apply to corporate members. This limit varies based on the size of the credit union, and the responsible loan fund's shares in the credit union. As an example, if a credit union has £1m shares, and a responsible loan fund deposited £15,000 in shares, the responsible loan fund could take out a £30,000 loan from the credit union.	There are also rules about how credit union capital can be invested (placing distinctions), which is typically in government securities.[16]

On a local level and smaller scale, credit unions and responsible loan funds can align capital to test the feasibility and viability of this option. The biggest barrier at the local level is the cap on loan size; credit unions will likely to lend in the tens of thousands, whereas responsible loan funds typically seek investments in the millions. Credit unions can make the case for a waiver from the cap from the PRA. The other challenge is that given the small-scale loans that credit unions are limited to, responsible loan funds would need to pool a number of loans, which is both time and resource intensive.

Between the two options, a nationally pooled investment fund offers potential synergies that benefit both credit union and responsible loan fund sectors, and the consumers they serve. Currently prudential regulation does not enable credit union to invest their excess capital into instruments outside of government securities, sensibly so as it is ultimately member savings. However, accessing a portion of excess credit union capital with a robust first loss mechanism in place to protect credit union funds is a model that can be explored in the future once a precedent is set on a local level.

[16] http://www.prarulebook.co.uk/rulebook/Media/Get/b06f7828-b181-4a5a-9cfc-6468f54ab46c/PRA2016-06/pdf

Appendix 3: Advantages of partnering matrix

The list of benefits to partnering is extensive. Through actively aiming towards shared objectives such as these, it is possible for organisations overcome, or at the very least, demote, their cultural differences to form working partnerships.

Table A3.1: Advantages of partnering

Incentive	Improvement to the business model	Benefit to the consumer
Improved reach and a streamlined message	Unlocks a range of markets and communication channels could boost demand overall. A new brand and joint marketing campaigns could lead to more customer demand as well as new opportunities for attracting funding.	Less risk of falling prey to predatory lenders. Higher cost local providers can reduce their rates if demand for their products and turnover increases.
Improved product choices	Being able to offer a spectrum of products is likely to keep more consumers 'in house'.	A holistic service offered through a partnership is less likely to turn a consumer away. This could lead to improved wellbeing of the consumer with related health benefits.
Product innovation	Sharing resources, expertise and unlocking new markets could enable new products which better meets, and potentially drives, demand.	Suitable products to meet evolving needs of the community means people are less at risk of falling prey to predatory lenders.
Financial inclusion and credit migration	An advantage for credit unions in particular: partnering with responsible loan funds could improve their ability to serve marginalised and otherwise financially excluded consumers whose credit scores are built up through a good lending relationship with the responsible loan fund.	A holistic product package could allow a customer to improve their credit record and move from higher cost to lower cost credit.

Incentive	Improvement to the business model	Benefit to the consumer
Improved public and political awareness	An advantage for responsible loan funds in particular: partnering with CUs allows them to tap into the more established political and public awareness of credit unions. Potential boost for sector funding as a result of increased political championing.	Potential to improve links with public services and drive policy change that better takes into account the needs of the most marginalised.
Improved efficiency with digital services	Partnerships can allow individual organisations to overcome the risk aversion linked to investing in digitizing and automating some services. Automated services can reduce operational costs through economies of scale. An online presence can help reach more people.	More access to suitable products and services through online portals means less risk of falling prey to predatory lenders. Cost savings from automated services can be passed on to the consumer.

Responsible Finance
Email: info@responsiblefinance.org.uk
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