# Can payday loan alternatives be affordable and viable?

## An evaluation of London Mutual Credit Union's pilot scheme

**Final Report**

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Produced by Gareth Evans, Associate Research Manager and Mick McAteer, The Financial Inclusion Centre.

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## Pilot project and evaluation research funded by:

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

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

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

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

**www.transact.org.uk/bcff**

## Report produced by:

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

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

**www.inclusioncentre.org.uk**

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## Executive Summary

**Background:**

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

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

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

**Key findings:**

- **The affordable payday lending product offered by LMCU proved extremely popular** with a total of 6,087 applications received (or 500 each month), asking for just under £1.5million or an average requested loan amount of £238.
- **A total of 2,923 payday loans with a value of £687,757 were distributed over the course of the year-long pilot** to 1,219 different borrowers.
- **An average of 2.39 payday loans were made to each borrower with 62% becoming repeat payday borrowers with LMCU.** The main reason for taking out the payday loan was to cover utility bills (14%) and home improvements (12%), while 32% did not indicate the specific reason.
- **Applicants liked the option of repaying payday loans over a longer repayment term.** Just 29% of loan applicants wanted to borrow over the traditional one month term, with the majority (59%) opting to repay over three months.

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

- **When surveyed, the primary reason given for borrowing through LMCU was the low cost compared to other payday lenders (66%).** Others liked the fact that it was offered by a credit union (19%) together with the longer repayment option (10%).
- **There is demonstrable demand amongst existing credit union members for access to short-term borrowing** with eight in every ten payday loans being given to (888) existing members .
- **Just over a quarter of all those borrowing during the pilot were new members, specifically attracted into the credit union by the payday loan product.** A total of 331 new members joined in order to take out a payday loan – on average they borrowed fewer times (1.8 loans compared to 2.6) but loaned higher amounts (£249 compared to £226) compared to existing members.
- **Delinquency levels appear to be relatively low with 6.3% of all LMCU payday loans being at least one month in arrears compared to 28% of all payday loans across the industry being rolled over[1],** as identified by the Office of Fair Trading (OFT). Arrear levels amongst new members (12% of loans) are over twice the level of existing members (4.8%).
- **An affordable payday loan product has the potential to save significant amounts for borrowers.** According to the OFT, the average loan amount is £265 and the average cost of a payday loan is £25 for every £100 borrowed. This typical loan repaid over one month would therefore cost at least £66, compare to just £5.30 with LMCU. **By borrowing through LMCU instead of high cost payday lenders, the 1,219 who borrowed during the pilot have collectively saved at minimum of £144,966 in interest charges alone, equivalent to almost £119 per borrower.**
- **If the 7.4million and 8.2million payday loans taken out in 2011/12[2] from high cost lenders had been through a credit union alternative, we estimate that between £676 million and £749 million would have been collectively saved.** This would equate to an average saving of at least £91.43 for every payday loan made through the credit union.
- **Before accessing their first LMCU loan, 74% of surveyed borrowers had taken an average of 3.2 over the 12 months before their first payday loan from LMCU.** Worryingly, 17% of these had taken six or more loans.

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

- **Payday lending through a credit union is an effective way of diverting borrowers away from high cost lenders** – over two-thirds of surveyed users would be unlikely to borrow from other payday companies again.

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

[2] Office of Fair Trading (2013) – Payday Lending Compliance Review: Final Report.

- **Satisfaction levels with the credit union are very high with 74% very satisfied** and 24% fairly satisfied. All those payday users surveyed were willing to recommend friends/family.

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

- **Crucially, new members do go on to utilise and benefit from accessing other financial services offered by the credit union:**
  - **LMCU membership actually encourages recent joiners to build financial resilience through the accumulation of savings.** Almost £18,000 was accumulated by the 331 new members during the pilot – a £53 average saving level per member. This rises to £95 for new member who had been with LMCU for at least nine months.
  - **Almost a quarter of all new members opened a current account with LMCU -** furthermore, 71% of those surveyed stated that they are fairly or very likely to open a credit union current account.
  - **New members were initially attracted by access to short-term borrowing but 27% of the 331 who joined the credit union during the pilot then went on to take out longer-term loans.** LMCU lent out an additional £90,000 in non-payday credit, which will generate over £15,000 in interest – borrowing an average of £1,044 over 17.9 months.
  - **The proportion of new members who have longer-term loans with LMCU increases dramatically the longer they have been a member.** Over 40% of all new members who have been with LMCU for at least six months take out a longer term loan, which increases to 52% with at least nine months of membership.
- **Each payday loan generates an average income of £12.02 with a total income of over £35,000** – 77% of this revenue is from loan interest (or £9.23 per loan), 21% from the option for instant transfers (£11 per transfer) and just 2% from joining fees (£2).
- **It also cost over £35,000 to administer all the payday loans made during the pilot – an average cost of £11.99 for every loan given.** LMCU estimates that the actual cost for making a first loan is £18.57 but is significantly less for repeat loans at £4.00 as it is fully automated and requires no external checks. There were also costs of over £4,500 to administer refused or ineligible loans.
- **Just over £15,000 of the total amount lent during the pilot was determined as delinquent** together with just over £400 in credit control costs. The outstanding loan amount has been included as a cost but continues to be pursued by LMCU's existing credit control team.
- **The 'loss leader' model adopted during the payday pilot may not be financially viable if only when the actual additional income from subsequent longer term borrowing by new members is factored in.** On this basis, the overall payday loan pilot generated an actual loss of £6,725 at the point of evaluation, representing an average loss of £2.30 for each loan. However, projecting the additional income generation levels amongst those new members who have been with LMCU for at least nine months across all new members, **the payday loan pilot would actually realise an overall profit of at least £8,950 or £3.06 for every loan given, making the model financially sustainable.**

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# 1. Introduction

## 1.1 Background

London Mutual Credit Union (LMCU) had become increasingly alarmed by the widespread and escalating use of payday loans together with rising detriment amongst often already overindebted households. Moreover, it was witnessing the growing use by its own membership of this form of short-term high cost credit despite already having access to affordable credit lines.

It was within this context that it embarked upon an 18-month pilot project, funded by the Friends Provident Foundation and the Barclays Community Finance Fund, which enabled the development, delivery and testing of an alternative payday loan product. It developed an automated online application and assessment infrastructure that replicated the ease and speed of the high-cost payday lenders but within the credit union's pricing structure for loans. Thus, offering a real affordable alternative that would be attractive to both new and existing members.

It wanted to offer a short-term credit facility at significantly lower cost and meet the needs and aspirations of borrowers, but without the detrimental practices evidenced within the payday loan industry[3], including:

- **Significant numbers of people are given loans they cannot afford because of poor vetting practices.** Evidence shows that the majority of lenders are not conducting adequate affordability assessments and nor do they carry out a credit check on potential borrowers. Therefore, unsuitable loans are being made to unsuitable consumers with very low incomes and existing loan commitments. Customers are able to borrow sums equal to and above their monthly income and in a number of cases are shown not to have a bank account.
- **When borrowers can't repay the loans, they are allowed and often encouraged to extend them, aggravating their financial difficulties.** In practice around half of the payday industry's revenue comes from loans which are rolled over or refinanced. Providers allow loans to rollover continually and in many cases are actively promoting this as a 'feature' at the point of sale. As a result, many are amassing huge debt mountains through additional interest and charges, causing real distress and hardship for a significant number of payday users.
- **Many lenders are not treating borrowers in financial difficulty with understanding or forbearance.** A number of firms use aggressive debt collection practices which fall far below the industry standards.
- **Continuous payment authorities to reclaim monies owed are poorly explained and often misused.** This is causing considerable misery to a considerable minority of consumers, in some cases leaving them with insufficient funds to cover their most basic needs. Many firms also penalise early repayment.

[3] As identified within the OFT report into the practices of payday loan firms.

By doing this, the theory was that it would divert people away from these more expensive payday companies and facilitate their greater financial stability, as a member of a credit union. The expectation was that a range of other credit union services would be taken up over time, such as; longer-term loans, current accounts and saving products. These would not only help improve the financial well-being of the member but also help the credit union cover the cost of delivering such a high-risk product with potentially low profit-margins. If the pilot project can successfully attract and meet the expectations of customers as well as be sustainable to deliver, the aspiration is that this product has the potential to be expanded or replicated nationally across the credit union sector.

This evaluation report looks to measure the success of the project, examining actual performance over the lifetime of the pilot, profiling these new and existing members and identifying their attitudes and behaviours towards payday loan services. Finally, it will assess the subsequent pattern of service usage amongst new members following their membership of the credit union to help determine whether delivering the product is actually financially sustainable.

### 1.2 Evaluation aims

The evaluation aims to 'provide an overview of the effectiveness of LMCU's payday loan project to determine if it offers a viable alternative that can meet the needs of borrowers.

### 1.3 Research methodology

The approach adopted by the research team in undertaking the project evaluation consisted of two main components:

**Quantitative analysis of LMCU data recorded during the payday lending pilot**

LMCU recorded and maintained comprehensive information on the key outputs and performance indicators relating to the payday loan project, including:

- Number of loan applications received by LMCU, including demographic information on applicants.
- Number of successful payday applications – including proportions from new and existing members.
- Proportion of declined loan applications and the reasons for refusal.
- Demographic profiles of all members using the payday loan service.
- Amount and repayment periods for all payday loans distributed.
- Levels of delinquency in terms of number of months in arrears and the outstanding amounts.
- Member account information for new members showing subsequent use of additional LMCU financial products including details on the other loan products, current accounts and different saving accounts subsequently taken out during the timespan of the pilot.

This data together with information about the payday loan product was provided to the research team for the period from the pilot commencement on 04 February 2012 to 20

February 2013. As a result, the analysis of the data is reliant upon the accuracy and integrity of the final data made available by LMCU.

**Consultation with LMCU payday loan users**
The evaluation also consulted with a sample of new and existing members who have taken out a payday loan to determine their experience of using LMCU's payday loan product including any potential improvements to the service, together with their previous and future use of both payday loans and other potential LMCU services.

**Appendix 1** provides the full questionnaire.

The survey was conducted throughout March 2013 using an online structured questionnaire that was sent to all 1,219 borrowers who had used the service during the first 12 months of lending. The initial distribution was followed up with a subsequent reminder and resulted in a total of 210 completed surveys, representing 17% of all those using the payday loan service.

**Assumptions and limitations of the research**
During the evaluation work we have made a number of key assumptions and identified a number of limitations during the analysis of the data and development of the model. These are summarised below, but have been highlighted and explained further in the relevant sections:

- We have assumed that both new and existing borrowers are using the LMCU payday loan product instead of, rather than in addition to, other more expensive payday loan options. There is evidence from the consultation that the majority of borrowers would be unlikely to use another provider again (68% of those surveyed) but it does uncover a proportion that state they would be likely to still use other payday loan companies (25% of those surveyed).
- Delinquent loan amounts are written off for the purposes of the financial modelling and assume that no additional funds are recovered at a later point through LMCU's credit control or bad debt recovery actions.
- Delinquency levels for those recorded as being one month in arrears have not been included as a loss as the majority are not actually behind with their payments and is instead a function of how the data is recorded by LMCU.
- The costs involved in undertaking the credit control activities for delinquent payday loans have been estimated and incorporated within the costs of delivering the payday loan product, again for those loans which are two months or more in arrears. These do not include any costs associated with court proceedings as the loan values do not make such actions cost-effective.
- In terms of additional income from the use of other credit union services by new members, only income resulting from the interest charged for additional longer-term lending has been included. Direct income from insurance products, transactional accounts and other services have not been included neither has the potential income that could be generated from lending (or bank interest) accumulated savings from new members.

- Income from additional longer term loans granted to new members has been included as a net figure and therefore includes assumptions for delinquency levels and costs of credit control delivery, estimated assuming similar unit costs for assessment and credit control together with delinquency loan levels have been used to those seen across all LMCU's loan portfolio. The only credit control costs that it has not been possible to estimate are those associated with court costs as these are unknown and are understood to only happen in a limited number of cases.
- Estimates for administration service costs associated with delivering the product are an estimate for processing an average loan application and include estimates for the staffing costs that include tax/NI contributions, overheads and management costs.
- No promotional or marketing costs have been included within the expenditure estimates as limited marketing costs were actually incurred with the majority of the promotional activity being undertaken at the development stage and particularly internally with existing members and externally through employers and stakeholders – both of which had low direct costs.
- We have assumed that the lending capital does not cost the credit union to raise. LMCU has significant spare saving capital/assets that it has used to fund the lending and would not be generating any significant profit if it was being unused.
- No set up costs including branding and website development have been included in the final financial analysis – as the evaluation was keen to test the ongoing viability of the model and has assumed that other credit unions wishing to replicate such a payday loan product would either develop their own stand-alone infrastructure (resourced either with their own funds or external grant funding), or alternatively could work in partnership with LMCU or the Association of British Credit Unions Ltd (ABCUL) (with any potential universal payday loan product for the sector). Instead, the start-up costs have been detailed with figures for the various budgets areas to give an indication of the potential costs of developing a similar product.
- We have estimated the potential income that would have been generated from the approved loans actually distributed during the pilot had they all been given at the proposed new interest rate of 42.6% APR instead of 26.8% APR. We have assumed that this higher interest rate will not lead to greater levels of delinquency because the change in the repayment amount is minimal that it is unlikely to make a significant difference. For example, a £400 loan taken over 3 months would cost just under £11 extra in interest.

# 2. LMCU payday loan pilot scheme

## 2.1 About London Mutual Credit Union

Operating for almost 32 years, London Mutual Credit Union (LMCU) is one of the largest and most successful credit unions in the UK. It has a membership of over 16,000 people who live, work or study within Southwark, Lambeth and most recently Westminster and Camden. It has assets of over £9 million and a growing loan portfolio in excess of £7 million making it one of the most financially established and robust credit unions.

LMCU gives access to a comprehensive range of affordable financial services to some of the most excluded and deprived - an estimated 55% of its current membership are deemed to be financially excluded. It offers a variety of saving accounts, a Credit Union Current Account (CUCA) operated by almost 7,000 of its members, together with a range of affordable loans and insurance products, delivered by its 32 staff across five branch offices together with fully transactional online and telephone banking facilities.

It has been at the forefront of modernising the credit union movement, often responding to the needs and requirements of its members in developing new product and service innovations that have gone on to become common place across the sector. These have included; bill payment accounts (regularly referred to as 'jam jar' accounts), online transactional banking, text balance services, capacity-based lending (based upon an affordability assessment rather than the traditional multiple of amount saved) and the CUCA.

More recently, it had recognised that a growing number of its members were taking out payday loans, despite having access to affordable credit through the credit union. LMCU estimated that just amongst members with a CUCA, it had made payments totalling over £300,000 to various payday lenders over the two-years prior to the pilot. In addition, it was regularly receiving loan applications to clear mounting debts with payday loan companies.

This situation is mirrored in the United States, where it is estimated that between 10% and 20% of credit union members also borrow from payday lenders. Numerous US credit unions have successfully introduced online alternatives that attempt to address key factors for payday loan usage, including; the need for small, short-term cash loan products that can be accessed quickly and conveniently together with the fear of refusal and inconvenient credit union branch hours[4].

LMCU proactively responded by being the first credit union in the UK to develop and trial its own payday loan product called 'CUOK' by creating a comprehensive online application and assessment platform that provides the ability for 24/7 loan application, decision making, approval and loan dispersement.

[4] Pierce, N. (2008) - Payday Lending: The Credit Union Way White Paper. CUNA lending Council & National Credit Union Foundation.

## 2.2 Overview of the LMCU payday loan pilot project

### The model for alternative payday lending through credit unions

The desire within the credit union movement to address the growing use of expensive payday loans is huge. Yet, the fundamental barrier to delivering a comprehensive and viable payday lending product has been assumed to be the limits on the maximum chargeable interest rates. Existing legislation caps interest rates on all credit union loans at a maximum of 26.8%APR[5]. Thus, it has been deemed not to provide sufficient financial returns to make such short-term, high risk loans immediately profitable.

The model adopted by LMCU for the pilot is that potential payday loan users will be attracted into the credit union by the much cheaper loan product under the payday loan banner. It was hoped that once they become members, these new payday loan clients would go on to become long-standing members who use the range of affordable financial services offered by LMCU. The subsequent use of these other financial products, particularly more sustainable borrowing with longer repayment periods, by a proportion of these new members should provide sufficient income generation to cover any potential initial shortfalls (see section on financial viability).

This 'loss leader' approach had already been adopted by LMCU for its Credit Union Current Account (CUCA) that makes a net loss of approximately £14.41 per account[6] but is successfully cross subsidised because 60% of these members go on to take out loans and 83% build up savings.

The overall aims of the LMCU payday loan project were to:

I. Improve access to affordable credit for households – diverting them away from more expensive payday lenders.
II. Increase awareness and uptake of credit union membership.
III. Save clients money by using LMCU payday loans.
IV. Increase users' financial stability by moving them towards other financial services through the credit union.
V. Establish if delivering a payday loan product is financial sustainable.

### Project development and funding

The development of the project commenced in September 2011 following the securing of £112,500 of grant funding to establish and run the payday loan pilot from;

| | |
|---|---|
| Friend Provident Foundation | £62,500 |
| Barclays Community Finance Fund | £50,000 |

[5] Consultation closed in March 2013 on proposals to increase the maximum interest rate that credit unions can charge, from 26.8% APR (or 2% per month) to 42.6% APR (or 3% per month).
[6] As of LMCU Financial Account of 30th September 2010.

The resources were utilised to fund the project development and operational costs including:

- **Infrastructure development costs -** the creation of a fully automated database engine and online application system to enable instant ID authentication and credit checking, establishing the faster payment hardware / software, purchasing of additional ICT hardware and developing the stand alone CUOK branding and website.
- **Marketing and branding costs -**, producing the associated marketing, promotional and PR materials/activities.
- **Project management costs** such as central development and training, external legal advice and project evaluation work.

| Area of expenditure: | Total Cost |
|---|---|
| **Infrastructure development:** | |
| ICT hardware | £21,427 |
| Database engine development (Experian) | £21,600 |
| Faster payment hardware / software | £24,000 |
| Online application development (providing ID authenticate/credit scoring) | £9,600 |
| Legal advice and support | £2,400 |
| Brand / logo / web design | £14,760 |
| **Marketing:** | |
| Marketing materials design and print | £5,400 |
| Launch | £1,200 |
| **Project management:** | |
| Project consultancy costs | £6,000 |
| Evaluation | £6,000 |
| **Total costs** | **£112,387** |

All lending capital for the payday loans pilot was met by LMCU with an initial £50,000 lending budget established for the 12 month lending period. The popularity of the service was significantly greater than originally anticipated and LMCU lent over fourteen times this initial amount during the pilot.

It took over six months of project development to establish the payday loan scheme with lending starting on 04 February 2012. LMCU's payday loan product attempts to offer some of the elements that make commercial payday companies' products and services so attractive, such as; easy 24 hour access and instant decisions and fund transfer. Yet, it also wants to offer this within the credit union's existing pricing structure that makes it significantly more affordable than the average payday lender. According to the recent OFT Report, the average payday loan costs £25 for every £100 borrowed[7], whereas with LMCU it would be just £2 for every £100[8].

Moreover, LMCU has attempted to 'design-out' some of the more damaging aspects of payday loans that can lead to financial detriment, to help protect those at greatest risk. This includes the ability to repay over longer periods than just one month without having to roll one loan over into another and refinancing delinquent loans, affordability checks and not applying additional fees when payments are missed.

In order to do this, LMCU's payday loan scheme has established a comprehensive online application and assessment infrastructure delivered through a new standalone website – www.cuok.co.uk. It has been designed to be clear, simple and quick to complete – mirroring the usability and ease of the leading payday companies. This provides the portal for prospective applicants to find out information about the payday loan product and to make an application. Applicants must complete and submit an online application, which requests information on their personal details (including five psychometric questions), employment information and details about the loan they wish to take.

Once submitted, the online system has been built to give an immediate decision with identification verification and bank account authentication checks undertaken instantly (together with checks against names and addresses of local employers for those stating that they work within LMCU's common bond). Each loan application is automatically assessed using its new credit scoring system that measures creditworthiness and includes an external credit search with Experian to identify current borrowing levels[9], their default records and any actions taken against the applicant.

Should any of these checks fail the loan application fails and is referred for checking and manual decisions by LMCU staff.

Once a loan is approved, the applicant simultaneously becomes a formal member of the credit union using the personal information, ID verification checks and the agreement already captured. Funds to cover the £2.00 mandatory one-off membership fee and their minimum £5.00 deposit into their new credit union savings account are deducted from the first loan amount following approval.

For each successful loan application, the system prescribes the maximum loan amount available to that member given the affordability checks. Subsequent payday loan applications from repeat borrowers are directed through a separate part of the online system that provides instant decisions against this assigned amount (subject to information not having changed).

[7] Office of Fair Trading (2013) – Payday Lending Compliance Review: Final Report.
[8] If taken over a one month repayment period.
[9] It should be noted that the credit score and checks undertaken by LMCU are not able to identify the level of borrowing from other payday lenders.

**Main characteristics of LMCU payday loans**

- Open to both existing members as well as new applicants.
- Available to anyone who qualifies to become a member of LMCU – so must live, work or study in Southwark, Lambeth, Westminster and Camden – those who are not eligible are identified and directed to their local credit union.
- Additional eligibility criteria for new applicants includes being employed and earning more than £12,000 per annum, having a current account where a salary is paid that includes both a valid debit card and has a Direct Debit facility.
- Interest is charged at 26.8% APR on the declining balance of the loan.
- First payday loans are available for amounts between £100 and £400.
- Repayment period can be over one, two or three months.
- Subsequent loans can be for up to £1,000 payable over six months, depending on previous repayment record and their initial affordability checks.
- Applicants can choose to either have their funds transferred instantly (which costs £11.00 and can be added to the loan amount) or to have it paid via BACS transfer (which is free).
- Repayments are taken automatically from the borrower's bank account on the agreed date(s).
- Unlike most other payday lenders, there are no late payment penalties when repayments are not received on the agreed time - but interest continues to be charged until the loan amount is cleared or further action is taken.
- There are no charges or penalties for early repayment (with interest charged on the daily balance up to the point of settlement).

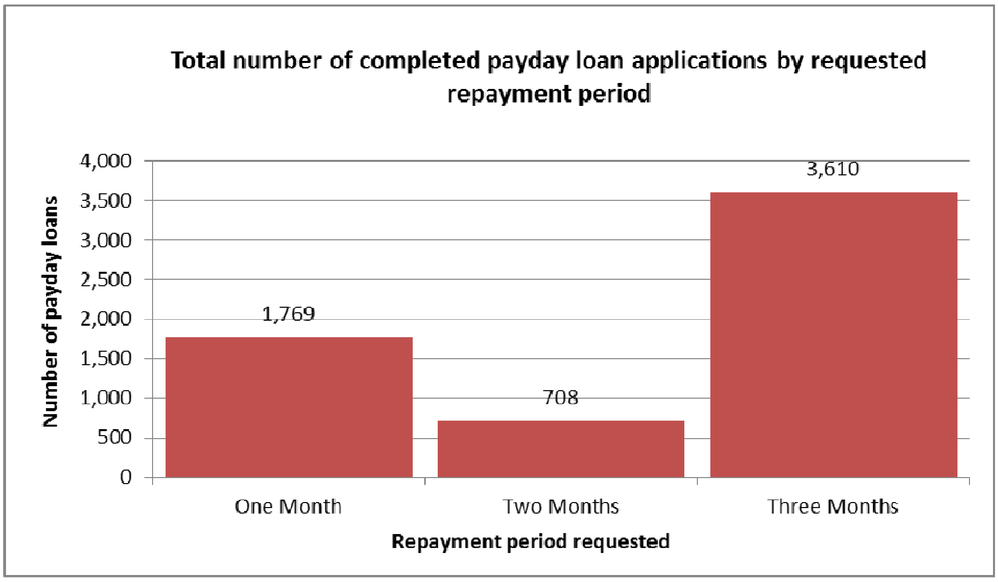
# 3. Actual performance of the payday loan pilot

## 3.1 Number of loan applications received

The new website experienced high levels of traffic during the course of the pilot with over 180,000 visitors during the first 12 months, equating to an average of over 400 each day.

A total of 6,087 fully completed online applications were submitted through the www.cuok.co.uk website requesting loans totalling almost £1.5 million.

The popularity of the longer repayment period is evident, with 59% of applicants wishing to spread the cost over the maximum three month period, compared to 29% over the traditional one month term and just 12% over two months.




## 3.2 Number of approved payday loans

A total of 2,923 payday loans were approved from 1,219 different loan applicants with a total value of £687,757 distributed during the pilot lending period.

### Reason for declining loan applications

Despite the first question on the online application sought confirmation of the applicant's geographical eligibility, 16% of applications still came from people outside the credit union's common bond. Applications were received from across the country with each receiving an email informing them of how they could identify their local credit union.

| Applicant breakdown | Count | % | Action |
|---|---|---|---|
| Total payday loans approved | 2,923 | 48% | Loan approved and distributed |
| Not eligible as not in common bond | 997 | 16% | Email sent to applicant with link to www.findyourcreditunion.co.uk website |
| Applicant unemployed | 932 | 15% | Contacted to confirm and given option of becoming a member and opening a CUCA and thus having access to other LMCU loan products |
| Duplicate application | 543 | 9% | Email sent to applicant informing them that their original is being processed or existing PDL loan not completed |
| Application refused | 328 | 5% | Applications are still assessed with full authentication and credit checks done |
| Applied but not fully completed | 364 | 6% | Contact was attempted to establish the missing information but could not be completed |
| **Total** | **6,087** | **100%** | |

A similar proportion (15%) was made by people who were unemployed and therefore were ineligible for a payday loan[10]. These residents were still invited to join the credit union and open a CUCA, which would give them access to other borrowing channels. Unfortunately, data on the level of subsequent take-up could not be ascertained by LMCU for the purposes of the evaluation.

Almost 10% of all received applications were from those who had not finished paying back their current payday loan or already had a loan decision pending. Just 5% of loans were refused because of either their credit score showed poor affordability/ creditworthiness or that they failed certain authentication checks.

## 3.3 Profile of LMCU payday loan borrowers

### Proportion from existing members and new members

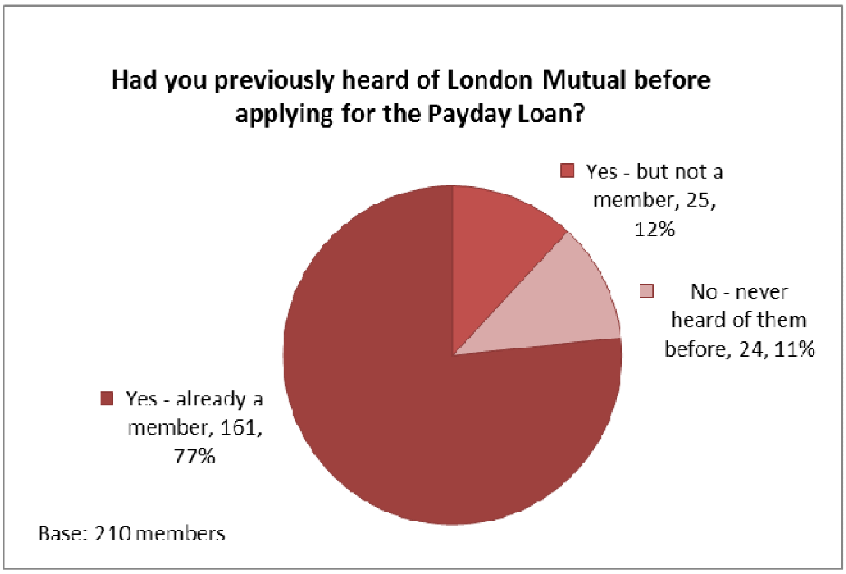
While the majority of payday loan borrowers were already members of the credit union (888 members), 331 people actually joined the credit union as a direct result of being given a payday loan.

The large number of existing members using the payday loan product in comparison to new members is likely to have resulted from a combination of factors including:

[10] It should be noted that a number of payday loans were given to existing members who were not employed as they could demonstrate track records of loan repayment and met affordability checks.

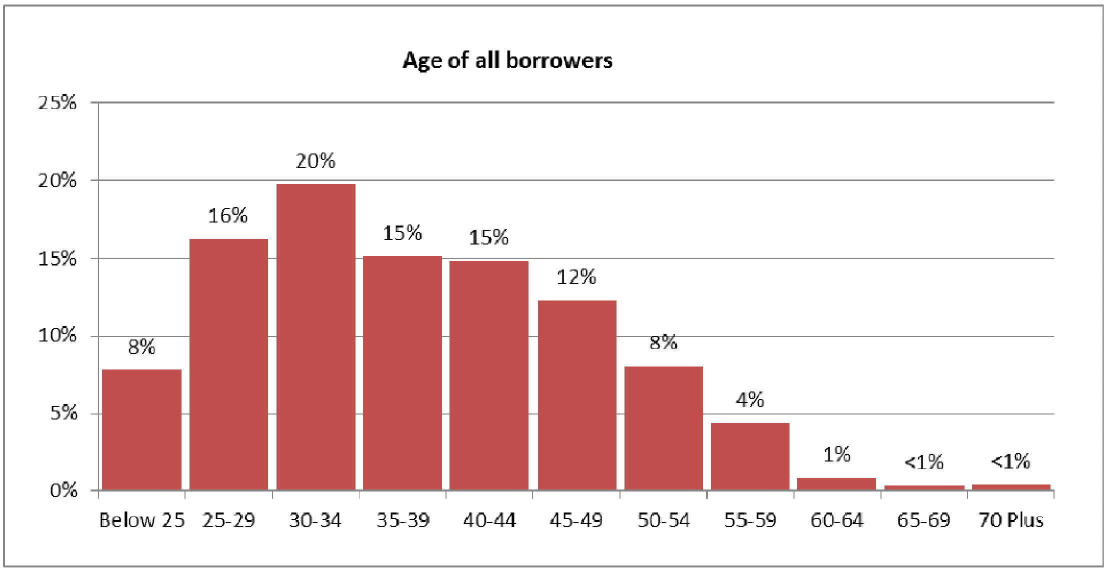
- The focus of initial promotion was amongst its existing membership in order to organically grow demand during the first few months.
- Wider promotion and marketing to non-members only properly commenced once LMCU had ensured that the new application/assessment systems and processes were robust and had the capacity to handle potential demand.
- Internal marketing is focused at a 'captive audience' that has established trust and the appreciation of the services offered by the credit union. General marketing externally is more difficult to ensure effective penetration and has primarily focused on established links with local employers (delivering payroll deduction schemes with LMCU) and local stakeholders and media.
- It take longer for such a new product offer to establish itself externally especially as a large number of new members had never heard of a credit union before and only learned about the service through word of mouth from friends, family or colleagues.
- With existing members, LMCU has accumulated significant knowledge and understanding of their financial activities and track record of borrowing, which may have made increased the approval rate compared to new members.

When new members were surveyed, it was interesting to note that the payday loan product attracted equal proportions of people who had never heard of credit unions before as well as those already aware of them but who had not thought of joining.



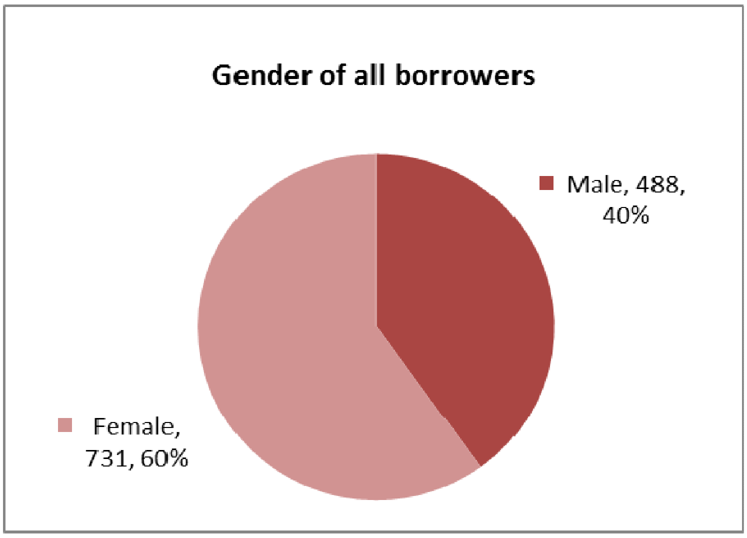
## Age

There was a diverse age profile amongst all borrowers, ranging from 18 to 77 years old. The average age of a LMCU payday borrower being 38 years old, while the age profile of new members was slightly younger (average age of 36 years old) than existing members (average age of 39 years old).




## Gender

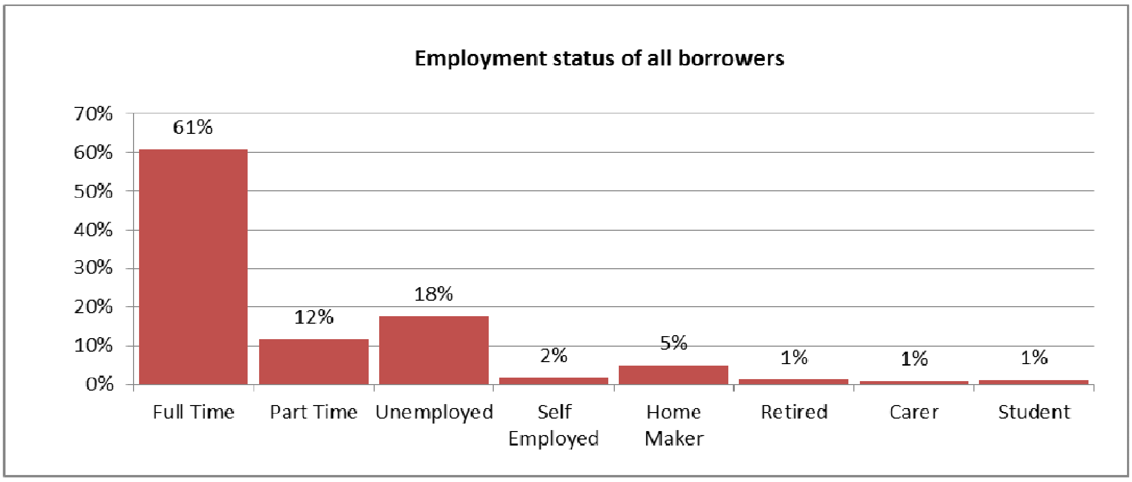
The majority of all payday borrowers were women (60%) compared to men (40%). Yet, when you look at the gender profile of new members, the split is almost equal.



**Employment status**

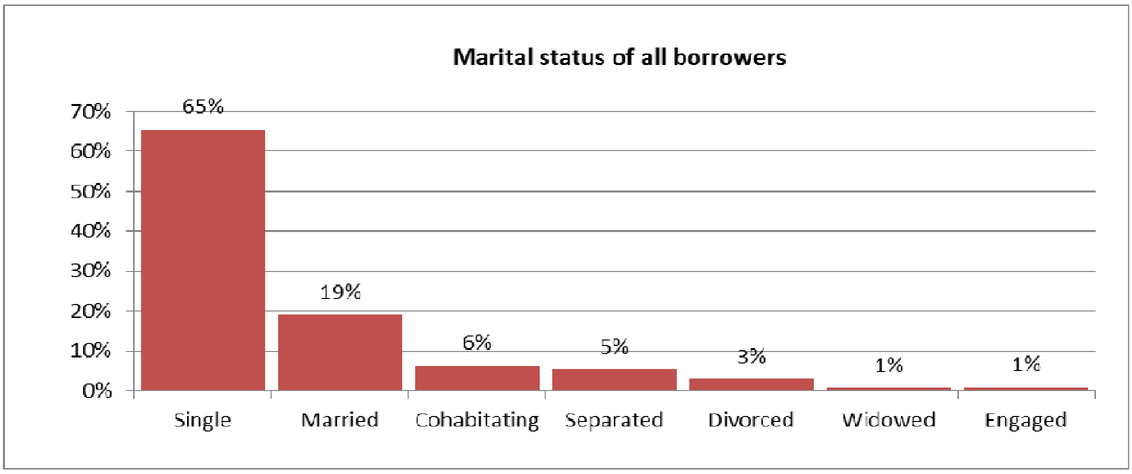
The vast majority of all borrowers were in employment with 61% working full-time, 12% working part-time and 2% self-employed. Amongst new members, 94% of those receiving a loan were actually in some form of employment, compared to 67% amongst existing members.

Borrowing history is taken into account for the credit scoring of existing members and therefore supports more payday loans being given to those without formal employment such as unemployed, home makers, retired, carers and students.



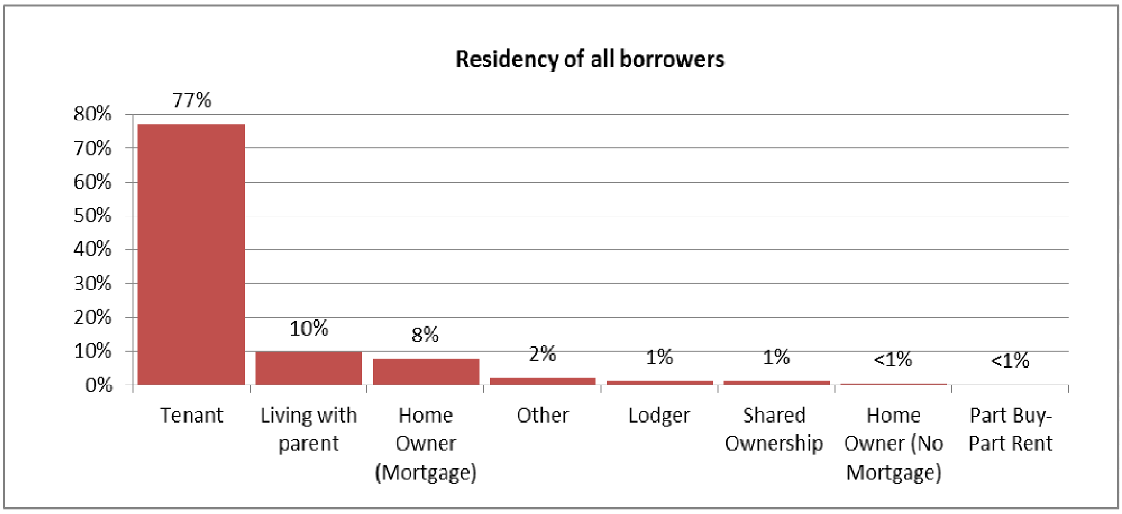

**Marital status**

Almost three-quarters of all payday loans were given to borrowers who stated that they were not in a relationship with single being the predominant marital status given (65%). The marital status profile of both new and existing members were almost identical.



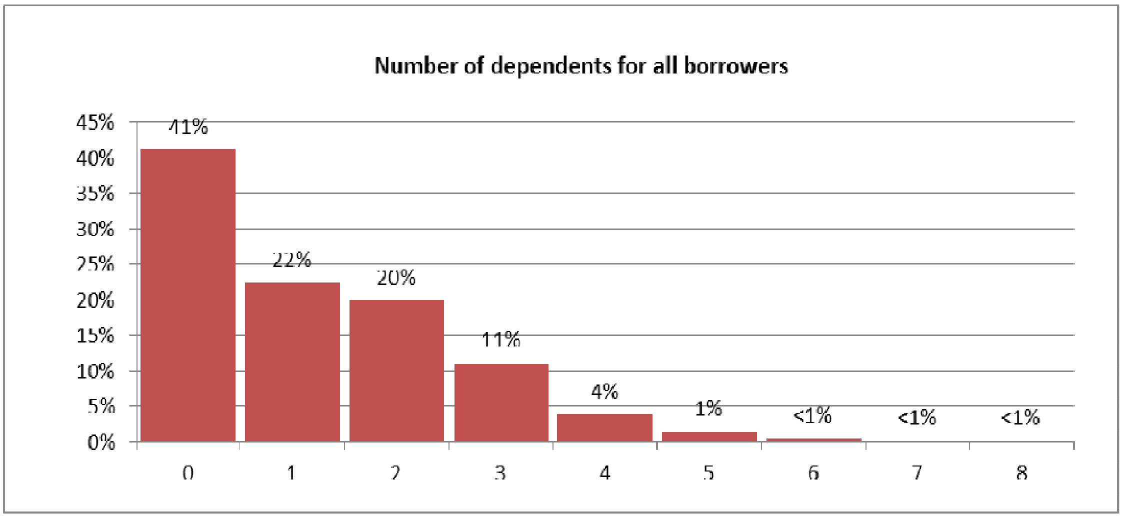
**Residential status**

Nine out of ten borrowers who took out a LMCU payday loan did not own their own home with the vast majority, 77% being a tenant and 10% living with their parents. Again the residency profiles of new and existing members were very similar.




**Number of dependants**

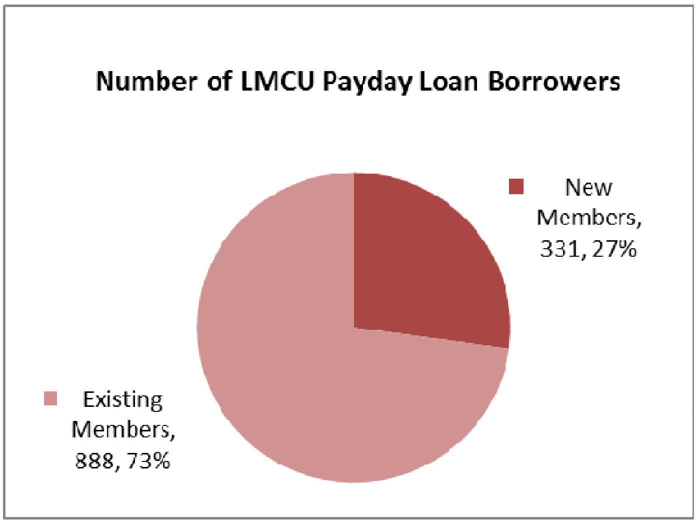
Six in every ten LMCU payday borrowers have at least one dependent. The average number of dependants across all borrowers was 1.2, with new members tending to have fewer dependents with an average of 0.7 dependents compared to 1.4 dependents amongst existing members.

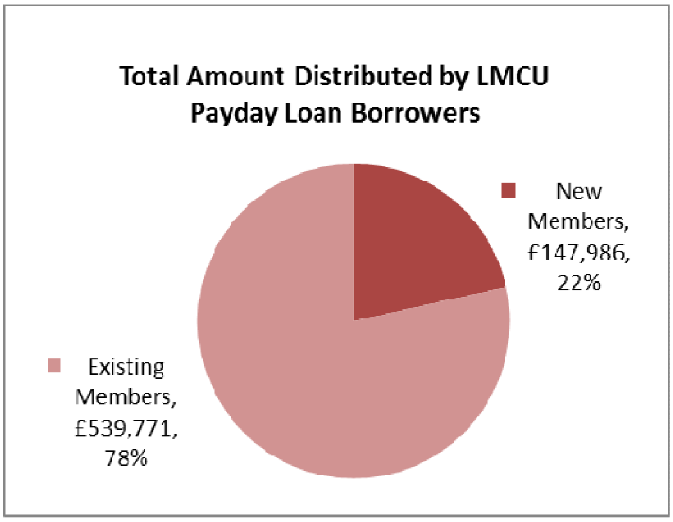


## 3.4 Characteristics of payday borrowing with LMCU

### Number of loans and amounts borrowed

On average, each borrower took an average of 2.4 payday loans with an average value of £235 per loan. New members appear to have taken far fewer loans (1.8 loans per new member) compared to existing members (2.6 loans per existing member). However, they borrowed larger sums with the average payday loan amount given to new members being £249.55 compared to £231.66 amongst existing members.




| | All | New members | Existing members |
|---|---|---|---|
| **Total number of PD borrowers** | **1219** | **331** | **888** |
| Proportion | 100% | 27% | 73% |
| **Total number of PD loans** | **2923** | **593** | **2330** |
| Proportion | 100% | 20% | 80% |
| **Average number of PD loans** | **2.40** | **1.79** | **2.62** |
| **Total value of PD loans** | **£687,757** | **£147,986** | **£539,771** |
| **Average value of PD loan** | **£235.29** | **£249.55** | **£231.66** |

Over 60% of all those who took out a payday loan became repeat borrowers, which was significantly higher amongst existing members than new joiners. Looking at the number of repeat loans given to borrowers, shows that 57 borrowers (5% of all borrowers) took out 6 or more payday loans with LMCU, with eight of these (1% of all borrowers) taking out ten or more loans during the pilot[11].

[11] Borrowers need to clear their existing loan fully before they can apply for another payday loan (i.e. there is no ability to 'top-up'). However, during the pilot, once this condition has been met a small proportion appears to apply regularly for a payday loan if they need additional borrowing.

We have identified this as a concern with the way that the payday loan product is currently being operated and recommended that LMCU should give close consideration when going forward how it can address high level repeat borrowing. LMCU has noted this issue and already provides access to debt advice and encourages payday borrowers to consider taking longer term loans when they wish to borrow again. However, we believe that as well as reviewing this dialogue and processes, the following could also be considered:

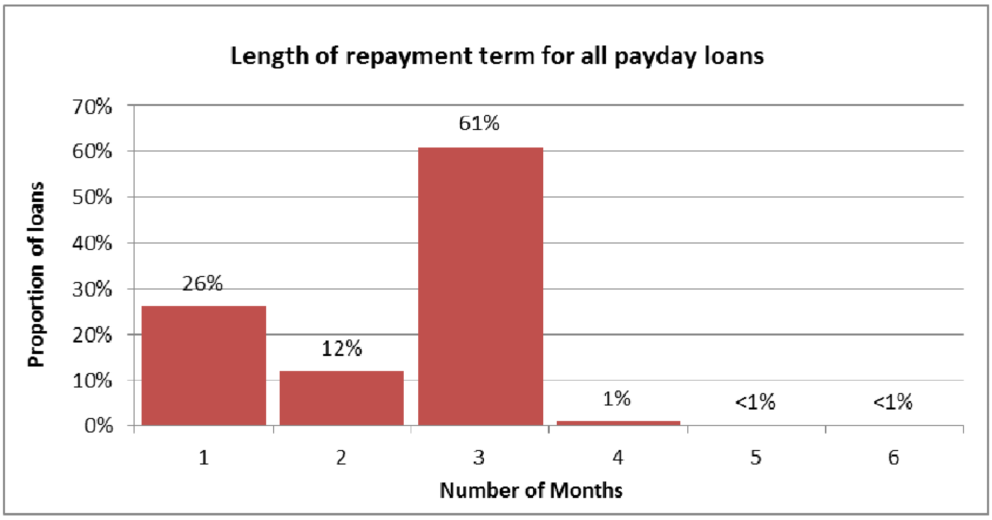
- Limiting the number of loans that a member can receive in a fixed period,
- Limiting the time between the completion of one payday loan and the provision of another,
- Specific contact to high usage payday loan borrowers to identify any financial issues and provide general advice and money management information, direct links to debt advice partners and fast-track longer term loans to stabilise their finances.

We do however; recognise that some of these potential interventions would drive borrowers back to more expensive providers and therefore, it should be carefully addressed in any remedial actions.

| Number of PD loans per member | All | % | New members | % | Existing members | % |
|---|---|---|---|---|---|---|
| 1 | 465 | 38% | 172 | 52% | 293 | 33% |
| 2 | 305 | 25% | 91 | 27% | 214 | 24% |
| 3 | 205 | 17% | 45 | 14% | 160 | 18% |
| 4 | 127 | 10% | 19 | 6% | 108 | 12% |
| 5 | 60 | 5% | 0 | 0% | 60 | 7% |
| 6 | 25 | 2% | 2 | 1% | 23 | 3% |
| 7 | 14 | 1% | 1 | 0% | 13 | 1% |
| 8 | 7 | 1% | 0 | 0% | 7 | 1% |
| 9 | 3 | 0% | 1 | 0% | 2 | 0% |
| 10 or more | 8 | 1% | 0 | 0% | 8 | 1% |
| **Total** | **1219** | **100%** | **331** | **100%** | **888** | **100%** |

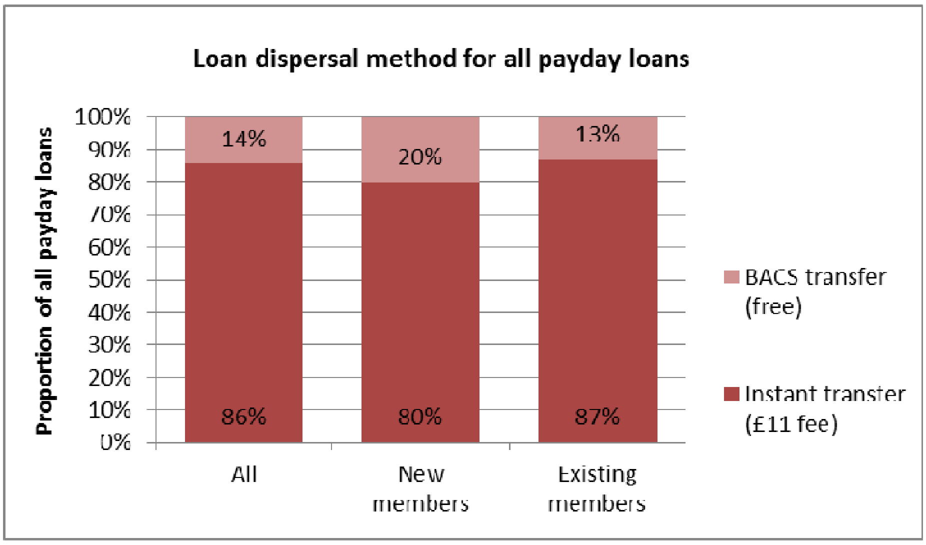
**Loan repayment period (term)**

The popularity for payday loans with longer repayment periods is apparent with only a quarter of all payday loans distributed by LMCU being taken over the tradition single calendar month. By far the most frequent repayment period was three months with almost two-thirds of all approved loans given for this term. There was limited interest in subsequent payday loans with longer repayment periods. Just 29 loans had repayment periods greater than three months (which are only available for loans subsequent to the first one anyway).

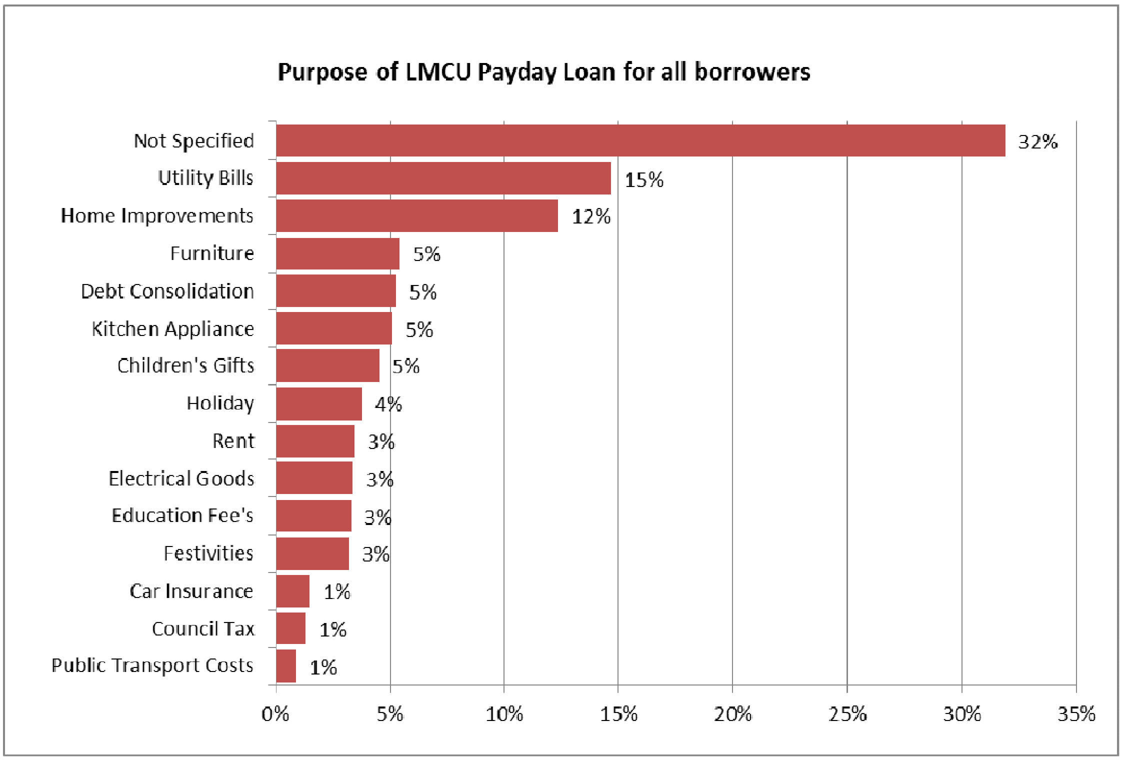



## Loan dispersal method

All applicants for a LMCU payday loan have the choice of how their funds are transferred into their bank account. They can pay nothing to have their loan paid into their account via BACS transfer or can choose to pay £11 to have it instantly transferred. The vast majority of borrowers actually elected to pay to have their funds transferred instantly with 86% of all loans dispersed by LMCU using this method.

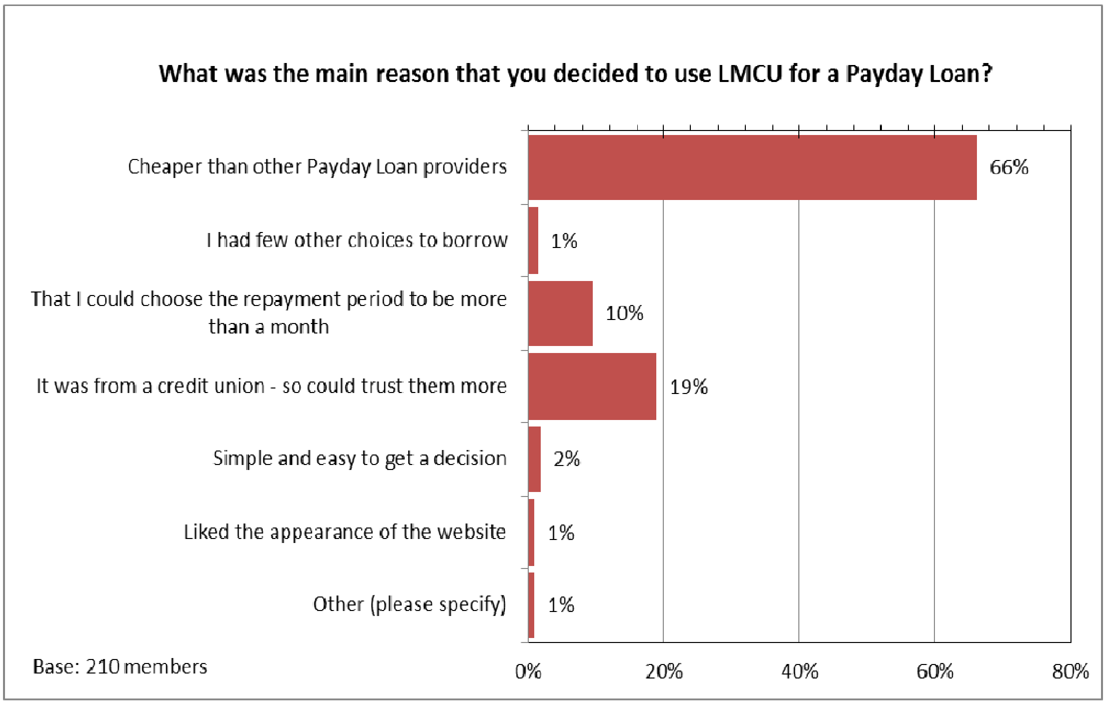


**Purpose of the payday loan**
Almost a quarter (32%) of all borrowers did not specify the exact reason for taking out their payday loan with LMCU[12]. When the purpose was specifically identified, the most frequent reason for taking a loan was for utility bills (15%) and home improvements (12%). Five per cent of borrowers were consolidating other credit with their LMCU payday loan.




**Reasons for choosing to borrow with LMCU payday loan**
When asked about the main reason for taking out a payday loan with LMCU, two-thirds of those surveyed stated it was because of the affordability of LMCU's loans. Interestingly, other prevalent factors included; borrowing from a credit union brought an element of trust (19%) but also that they could repay over a number of months (10%).

[12] Please note that due to the way that the purpose of the loan is recorded on the system, only the reason given by each borrower for taking their most recent loan has been reported.


What was the main reason that you decided to use LMCU for a Payday Loan?
Cheaper than other Payday Loan providers
66%
I had few other choices to borrow
1%
That I could choose the repayment period to be more than a month
10%
It was from a credit union - so could trust them more
19%
Simple and easy to get a decision
2%
Liked the appearance of the website
1%
Other (please specify)
1%
Base: 210 members
0%
20%
40%
60%
80%

### 3.5 Delinquency levels with payday loans

Levels of delinquency identified during LMCU's payday pilot appear to be lower than those identified by the OFT amongst other payday lenders. In total 183 of the 2923 loans were classified as being at least one month in arrears[13] (or 6.3% of all loans) or just over £36,000 of all funds lent (5.2%) have become delinquent. When the number of loans in arrears by two months or more is calculated this falls to 80 delinquent loans (or 2.7% of all loans) or just over £15,000 of the total loan value dispersed (2.2%).

According to the OFT, 28% of payday loans across the industry that are being rolled over at least once (i.e. at least one month in arrears).

| Number of months in arrears | | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **All Members** | 2923 | | | | | | | | | | | |
| Number of PD loans in arrears | **183** | 103 | 24 | 11 | 7 | 16 | 7 | 7 | 4 | 3 | 0 | 1 |
| Proportion PD loans in arrears | **6.3%** | 3.5% | 0.8% | 0.4% | 0.2% | 0.5% | 0.2% | 0.2% | 0.1% | 0.1% | 0.0% | 0.0% |
| Total amount lent | £687,757 | | | | | | | | | | | |
| Amount delinquent | **£36,076** | £21,018 | £5,746 | £1,714 | £1,032 | £2,835 | £1,544 | £831 | £758 | £329 | £0 | £269 |
| **Proportion of total lent** | **5.2%** | | | | | | | | | | | |
| **New Members** | 593 | | | | | | | | | | | |
| Number of PD loans in arrears | **71** | 31 | 7 | 7 | 4 | 10 | 4 | 5 | 1 | 2 | 0 | 0 |
| Proportion PD loans in arrears | **12.0%** | 5.2% | 1.2% | 1.2% | 0.7% | 1.7% | 0.7% | 0.8% | 0.2% | 0.3% | 0.0% | 0.0% |
| Total amount lent | £147,986 | | | | | | | | | | | |
| Amount delinquent | **£13,303** | £6,262 | £1,798 | £1,119 | £622 | £1,477 | £963 | £670 | £200 | £193 | £0 | £0 |
| **Proportion of total lent** | **9.0%** | | | | | | | | | | | |
| **Existing Members** | 2330 | | | | | | | | | | | |
| Number of PD loans in arrears | **112** | 72 | 17 | 4 | 3 | 6 | 3 | 2 | 3 | 1 | 0 | 1 |
| Proportion PD loans in arrears | **4.8%** | 3.1% | 0.7% | 0.2% | 0.1% | 0.3% | 0.1% | 0.1% | 0.1% | 0.0% | 0.0% | 0.0% |
| Total amount lent | £539,771 | | | | | | | | | | | |
| Amount delinquent | **£22,773** | £14,757 | £3,948 | £595 | £410 | £1,358 | £581 | £161 | £558 | £136 | £0 | £269 |
| **Proportion of total lent** | **4.2%** | | | | | | | | | | | |

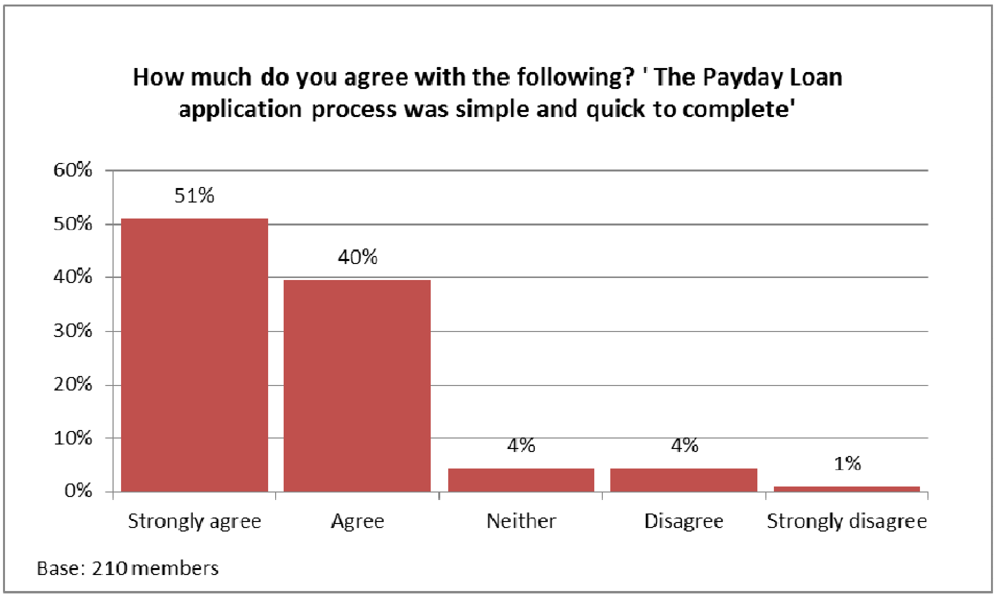
[13] LMCU believe that the vast majority of those recorded as being one month in arrears are not actually behind with their payments but relates to how the number are recorded on their system (See section 5).

Delinquency levels appear to be significantly higher amongst new members compared to existing members with the proportion of loans in arrears with new members (12.0%) over twice the level of existing members (4.8%).

We believe that this could be a result of LMCU having more information about the repayment track record of existing members enabling a more accurate credit assessment. Additionally, existing members may also feel more ownership or loyalty towards the credit union and thus do not want to miss repayments or jeopardise this line of affordable credit.

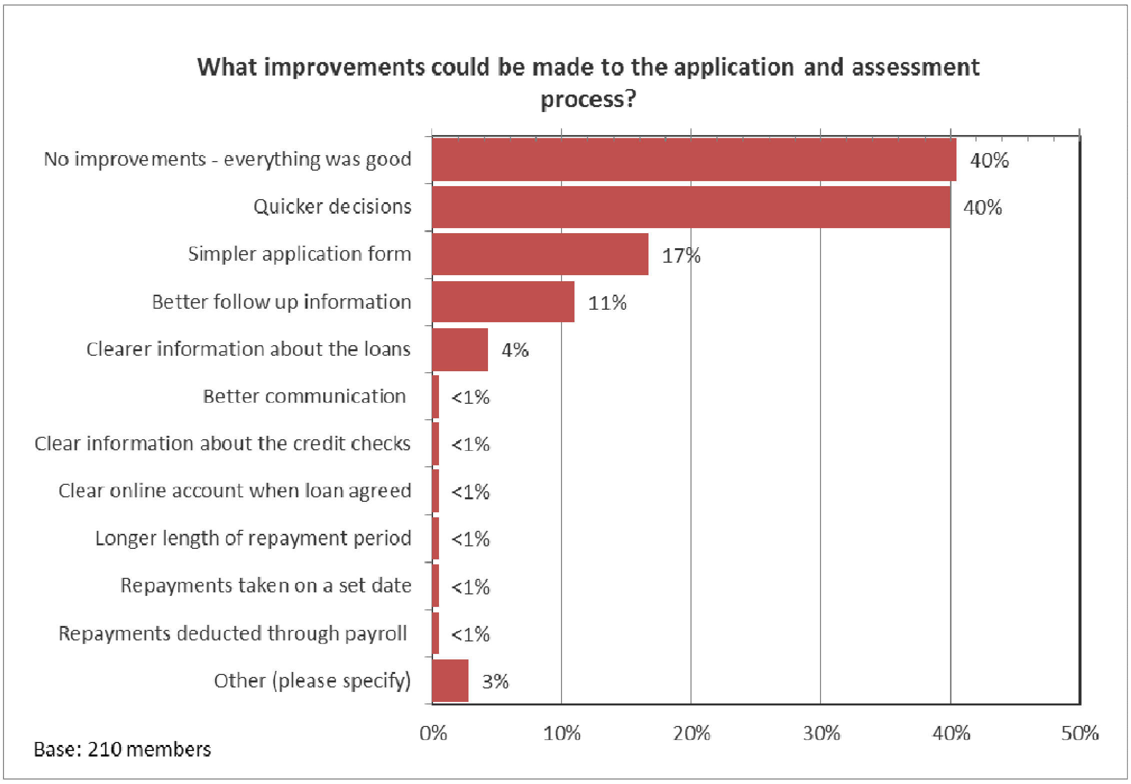
### 3.6 Satisfaction and improvements with the payday loan product

It appears that LMCU's online application and assessment system met the expectation of payday loan borrowers, replicating the speed and ease of other payday loan companies. Satisfaction levels with the loan application process were extremely high with over 90% of those surveyed agreeing that it was 'simple and quick' to complete.




In terms of improvements that borrowers thought could be made to service, 40% of all respondents thought that nothing could be improved. Yet, 40% of all respondents thought that decisions needed to be quicker[14], 17% wanted the application form to be simpler and 11% wanted better information following loan approval.

[14] Approximately, 80% of all initial loan applications are unable to be automatically assessed and therefore require manual input from staff, which can delay the process by one or two working days.


What improvements could be made to the application and assessment process?
No improvements - everything was good
40%
Quicker decisions
40%
Simpler application form
17%
Better follow up information
11%
Clearer information about the loans
4%
Better communication
<1%
Clear information about the credit checks
<1%
Clear online account when loan agreed
<1%
Longer length of repayment period
<1%
Repayments taken on a set date
<1%
Repayments deducted through payroll
<1%
Other (please specify)
3%
0%
10%
20%
30%
40%
50%
Base: 210 members

## 4. Analysis of longer term financial impact for borrowers

The concept behind the payday loan pilot was that by offering access to affordable payday loans it would save borrowers money and divert them away from using more expensive loans in the future. Moreover, amongst newly attracted members, they would go on to use the other financial services offered by the credit union and thus help develop financial stability. We have already seen that by offering the service, large numbers of existing and new members have utilised the short-term lending offered by LMCU. Nevertheless, the important question is; has delivering a payday loan product benefited those using the new service?

### 4.1 Savings made by accessing LMCU payday loans

The actual interest cost of every payday loan provided during the pilot has been calculated[15], totalling almost £27,000 in interest costs for the £687,757 loaned. This is equivalent to an average interest of £9.23 for every loan (or £22.13 for every borrower).

| | All | New members | Existing members |
|---|---|---|---|
| **LMCU Payday Loans: Interest (26.8% APR)** | | | |
| Number of borrowers | 1219 | 331 | 888 |
| Number of loans | 2923 | 593 | 2330 |
| Total loan value | £687,757 | £147,986 | £539,771 |
| **Actual total interest cost** | **£26,974** | **£5,851** | **£21,123** |
| Average interest cost (per borrower) | £22.13 | £17.68 | £23.79 |
| Average interest (per loan) | £9.23 | £9.87 | £9.07 |
| | | | |
| **Estimate interest cost of total borrowing from other payday lenders[16]** | **£171,939** | **£36,997** | **£134,943** |
| Average interest cost (per borrower) | £141.05 | £111.77 | £151.96 |
| Average interest (per loan) | £58.82 | £62.39 | £57.92 |
| | | | |
| **Cost saving by using LMCU (in interest costs alone)** | **£144,966** | **£31,146** | **£113,820** |
| Average saving (per borrower) | **£118.92** | **£94.10** | **£128.18** |
| Average saving (per loan) | **£49.59** | **£52.52** | **£48.85** |

[15] This has been calculated based upon the actual amount borrowed and assumes that each loan is repaid according to the repayment terms of the loan but actual interest costs could be lower if the borrower pays back early or could be higher if payments are missed (as interest is continued to be charged on a daily basis).
[16] Based upon all actual payday loans taken during the pilot but instead being repaid over one month and using the average cost of payday loans of £25 for every £100 borrowed.

If all the loans distributed by LMCU during the pilot had instead been taken out with higher cost lenders (using the average cost of £25 for every £100 loaned stated by the OFT) the total cost would have been at least £172,000 - 6.5 times greater.

Therefore, as a result of the LMCU pilot, the 1,219 borrowers have collectively saved at least £145,000 in interest alone, which equates to an average of almost £50 for every loan or £119 for each borrower during the pilot.

**Potential savings nationally of using a payday loan with a credit union**
The O FT estimates that between 7.4 million and 8.2 million payday loans were taken out during 2011/12. If all these loans had been taken out with an alternative payday product delivered by a credit union, the estimated savings would have been enormous.

| Total number of payday loans in UK | High cost payday lenders | | Alternative payday loan via a credit union | |
|---|---|---|---|---|
| | **7,400,000** | **8,200,000** | **7,400,000** | **8,200,000** |
| Interest cost of average £265 payday loan (repaid over one month) | £66.25 | £66.25 | £5.30 | £5.30 |
| **Interest cost on all loans** | **£490,250,000** | **£543,250,000** | **£39,220,000** | **£43,460,000** |
| Estimated additional interest costs – One roll over (28% all loans) | £137,270,000 | £152,110,000 | £10,981,600 | £12,168,800 |
| Two or three roll overs (5.5% of all loans) | £53,927,500 | £59,757,500 | £4,314,200 | £4,780,600 |
| Four or more roll overs (5.5% of all loans) | £53,927,500 | £59,757,500 | £4,314,200 | £4,780,600 |
| **Additional costs of rolling over loans[17]** | **£245,125,000** | **£271,625,000** | **£19,610,000** | **£21,730,000** |
| **Total estimated cost** | **£735,375,000** | **£815,140,000** | **£58,830,000** | **£65,190,000** |

We broadly estimate that the cost to borrowers of using payday loans in the UK in 2011/12 was between £490 million and £543 million in just the initial interest costs alone. When the additional interest costs associated with rolling over loans are factored[18], we conservatively estimate that the total costs would have been a minimum of between £735 million and £815 million.

[17] We have used the same proportions of loans rolled over identified within the OFT report to calculate the cost savings with the credit union but as identified later in the report, the actual delinquency levels experienced during the pilot scheme were much lower.

[18] Calculation for rollover costs have used the only available figures for the proportion of loans rolled over found in the OFT report. As a result of the broad categorising of the number of rollovers, where the exact breakdown figures for the proportion of loans rolled over were not available, we have had to significantly underestimate the costs. We also do not have data on the average fees charged for rolling over a payday loan – so have not been able to factor this into the costs.

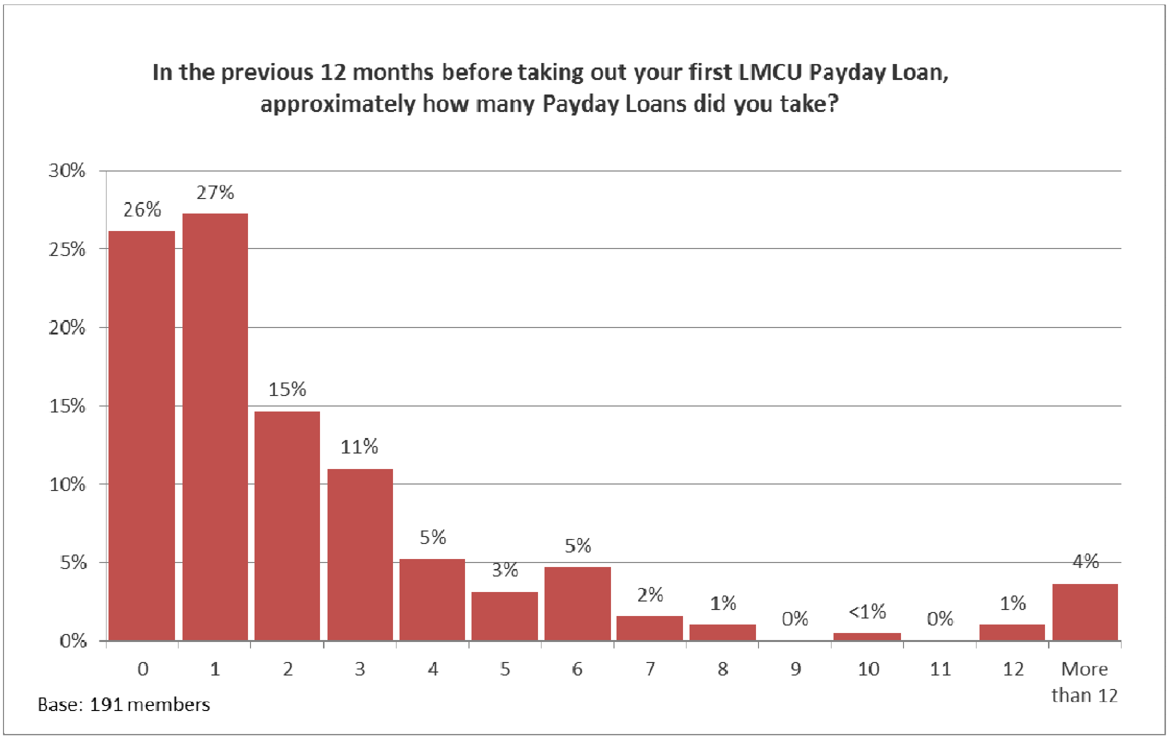
So if all these loans had been taken using a credit union, last year alone, we calculate that it would have collectively saved UK payday loan borrowers between £676 million and £749 million (which is made up of savings of between £450 million and £500 million in initial interest and a further £226 million and £249 million in additional interest costs resulting from delinquency).

This would equate to an average saving of at least £91.43 for every payday loan made through the credit union.

### 4.2 Preventing future use of expensive payday loans

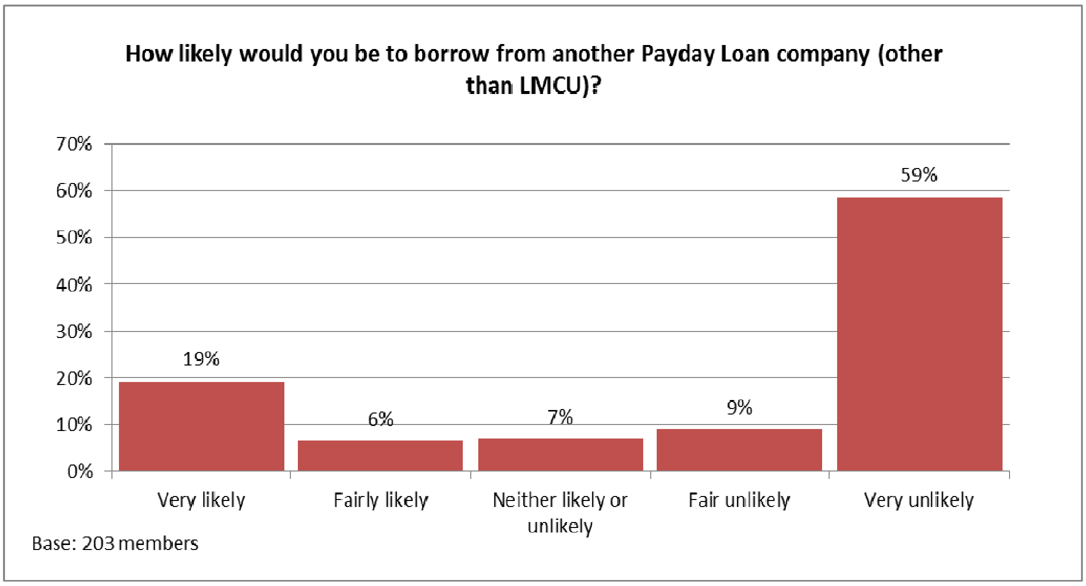
As part of our user survey, respondents were asked about their previous use of other payday companies during the year before taking out their first LMCU payday loan.

Amongst the 191 who answered the question[19], 74% had taken out at least one other payday loan in the 12 months before their first payday loan from LMCU. Based just upon those who had actually used a payday lender in the previous year, the average number of loans taken was 3.24 with 17% of these having taken six or more loans (and 6% having taken twelve or more loans).




[19] Removing the 19 people who 'preferred not to say'

One of the main aims of the pilot scheme was to divert borrowers away from future use of more expensive payday companies by providing access to payday loans from the credit union. Our survey with LMCU users shows that 68% of borrowers would be fairly unlikely or very unlikely to use other payday loan companies now they have used LMCU. However, a quarter of respondents still thought they may resort to taking out payday loans from another company in the future.




## 4.3 Subsequent use of other financial services by new members.

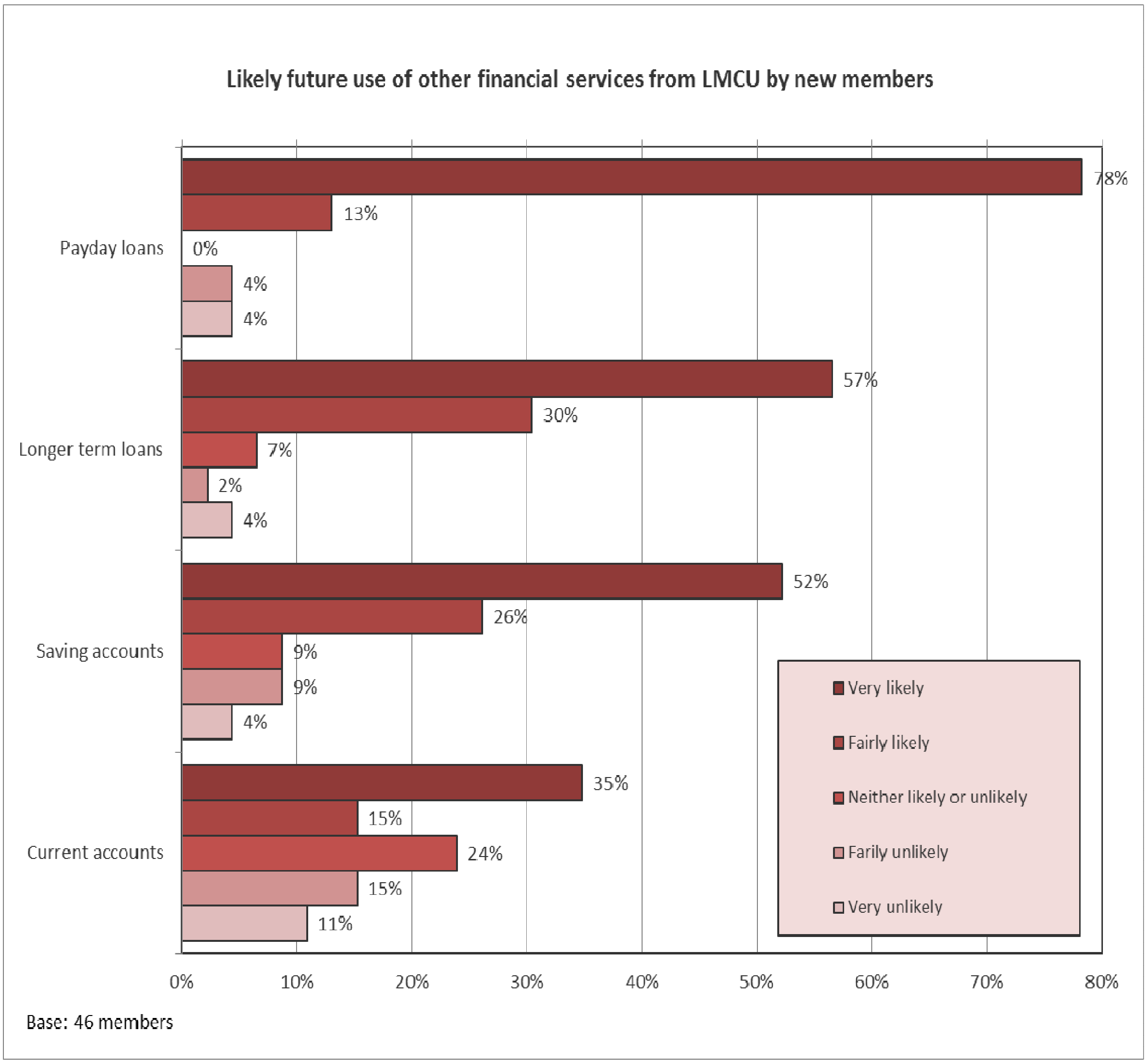
Based on the survey responses of new members only, we can see that once they have joined, their predicted future use of the other financial services offered by LMCU is extremely high.

In terms of LMCU loan products, 92% of new members responding to the survey thought that they would be likely (either fairly or very likely) to use the LMCU payday loan service again, while this falls slightly to 87% who thought that they were likely to use longer-term loans through LMCU.

Encouragingly, over three-quarters of new members thought that they would be either fairly or very likely to use their saving account, compared to just 13% who would be fairly or very unlikely.

Finally, half of new members would be either fairly or very likely to open a current account with LMCU, compared to just over a quarter who would not.

The actual take-up and usage of these other financial services by new members is explored further below.



Likely future use of other financial services from LMCU by new members
Payday loans
Longer term loans
Saving accounts
Current accounts
78%
13%
0%
4%
4%
57%
30%
7%
2%
4%
52%
26%
9%
9%
4%
35%
15%
24%
15%
11%
Very likely
Fairly likely
Neither likely or unlikely
Farily unlikely
Very unlikely
0%
10%
20%
30%
40%
50%
60%
70%
80%
Base: 46 members

**Use of longer term loans with LMCU**

One of the main assumptions behind the payday loan pilot was that by attracting new payday lenders into the credit union, they would go on to use other LMCU loan products with longer repayment periods and lower interest rates, thus providing an opportunity to stabilise their finances.

Over a quarter of new joiners took out longer-term loans with LMCU, borrowing over £90,000 of additional funds through its three different loan products. A total of 108 additional loans were distributed to 87 new members, equating to an average of 1.26 additional (non-payday) loans for each new member, who on average borrowed just over £1,000 with a repayment period of almost 18 months.

| | All Members | | | | Joined in months 0-3 | Joined in months 4-6 | Joined in months 7-9 | Joined in month 10-12 |
|---|---|---|---|---|---|---|---|---|
| **Longer term Loans** | **Growth Fund** | **Premier** | **Booster** | **Total** | | | | |
| **No of new members** | | | | **331** | **65** | **87** | **105** | **74** |
| **No of borrowers** | 61 | 23 | 3 | **87** | **34** | **29** | **18** | **6** |
| Proportion | 18% | 7% | 1% | 26% | 52% | 33% | 17% | 8% |
| **Number of loans** | **79** | **25** | **4** | **108** | **47** | **36** | **19** | **6** |
| Average No Loan | 1.32 | 1.09 | 1.33 | 1.26 | 1.38 | 1.24 | 1.06 | 1.00 |
| **Interest rate** | **24%APR** | **12.89%APR** | **24%APR** | **-** | **-** | **-** | **-** | **-** |
| Average Term (months) | 17.4 | 20.3 | 12.5 | 17.9 | - | - | - | - |
| **Total amount borrowed** | **£51,910** | **£34,900** | **£3,000** | **£89,810** | **£38,355** | **£30,405** | **£15,450** | **£6,600** |
| Average amount per borrower | £865 | £1,517 | £1,000 | **£1,044** | £1,128 | £1,048.45 | £858.33 | £1,100 |
| Average loan size | £657 | £1,396 | £750 | **£832** | £816.06 | £844.58 | £813.16 | £1,100 |
| **Total interest** | **£10,405** | **£4,429** | **£419** | **£15,253** | **£6,536** | **£5,525** | **£2,118** | **£1,074** |

Importantly, the use of longer term loan products by new payday loan borrowers increases with the length of time they have been with the credit union. Of those members who joined within the first three months of the pilot, 52% became longer-term borrowers, taking out an average of 1.36 loans during the pilot. As identified in the table above, there is relatively high take up of longer term loans amongst new members joining throughout the pilot, with 33% of those joining in months 4-6 of the pilot taking out subsequent loans,  17% amongst those joining in months 7-9 and finally 8% of those joining in the final three months of the pilot.

Moreover, the average loan size per member appears to be on a downward trend with those joining in the final three months of the pilot borrowing an average loan of £1,100 which drops to £816 for those joining in the first three months[20].

Just under a quarter of all longer-term loans were through LMCU's 'Premier Loan' product which has an interest rate of 12.89% APR, half the interest rate charged on the payday loan product, while all others were charged at 24.00% APR for the 'Growth Fund' or 'Booster Loans'.

The collective cost of borrowing the £89,810 is estimated to be £15,253 (or an average of £141 for each loan). Had these loans been taken from other potential sources of credit available to these borrowers, the costs would have been significantly greater than those realised through LMCU. We have calculated the potential cost of borrowing the exact same longer term loans against some of the other sources of credit to give an indication of the potential interest costs.

| Type of Credit | Annual Interest Rate | Example lenders | Estimated interest cost of borrowing |
|---|---|---|---|
| **Credit Union** | **Between 12.89% and 24.00% APR** | **London Mutual Credit Union** | **£15,253** |
| **Authorised Overdraft** (Average) [21] | 19.54% APR | - | £15,580 |
| **Credit Card** (Credit Repair) [22] | 29.9% APR | Vanquis Bank (29.8% APR), Capital One (29.9% APR) and SAV Credit (32.9% APR) | £24,495 |
| **Online Credit Lenders** (Fair/Poor Credit Score)[23] | 75.3% APR | Everyday Loans (between 75.3% APR and 98.6% APR) | £68,434 |

[20] It would require a longer evaluation period to fully conclude that the trend in new members' borrowing patterns is reducing over time as a result of requiring smaller subsequent repeat loans.
[21] Bank of England Data - monthly interest rate of UK monetary financial institutions of overdraft households (average) at 31 March 2013.
[22] Rates taken from www.moneyfacts.co.uk/compare/credit-cards/ and search under Credit Repair (09/05/13).

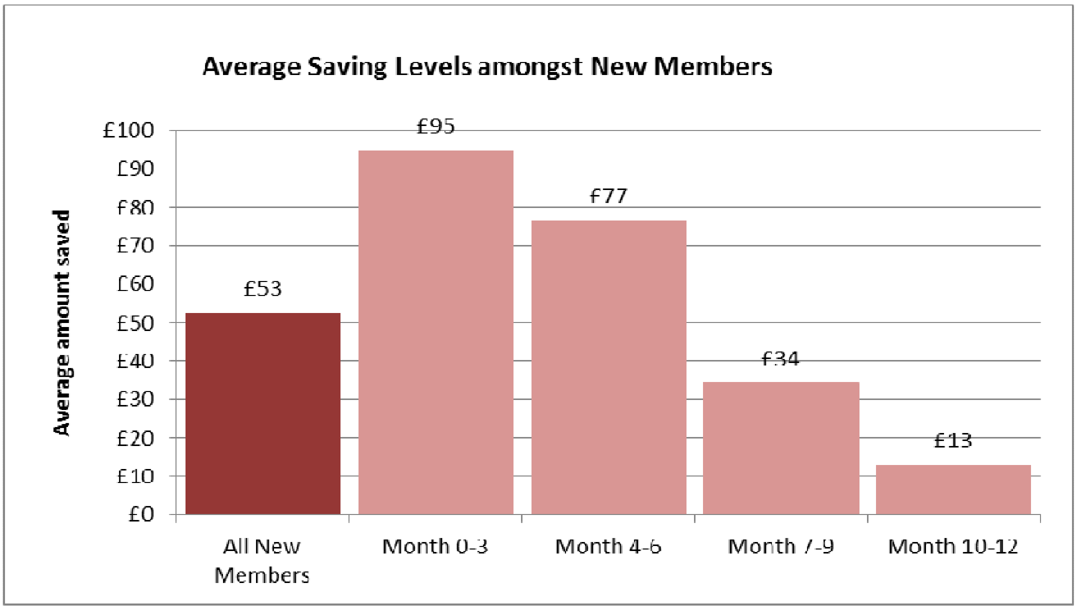
**Savings with LMCU**

All new members are required to open a main savings account and deposit a minimum of £5 when they join and they are encouraged to save regularly with the credit union. However, with new borrowers needing to access short-term credit quickly, it was thought unlikely that significant numbers would become savers during the pilot.

Nevertheless, the results from the pilot scheme show that subsequent levels of saving with LMCU are actually high and indicate that by offering access to more affordable short-term lending, a significant numbers of borrowers can also move towards becoming savers.

An impressive £53 of savings was accumulated on average by each new member. A total of £17,405 was collectively saved over the 12 months by the 331 new members who joined the credit union to access the payday loan product or an additional £15,750 beyond the initial saving deposit requirement.

Importantly, the amount of savings accumulated by new members tends to grow steadily the longer they have been with the credit union. Those who had been members of the credit union for less than three months had on average saved £13, which is more than double their initial required saving deposit. Amongst those who had been with the credit union for more than nine months, the average level of saving rose to £95 – almost 20 times their initial £5 deposit.

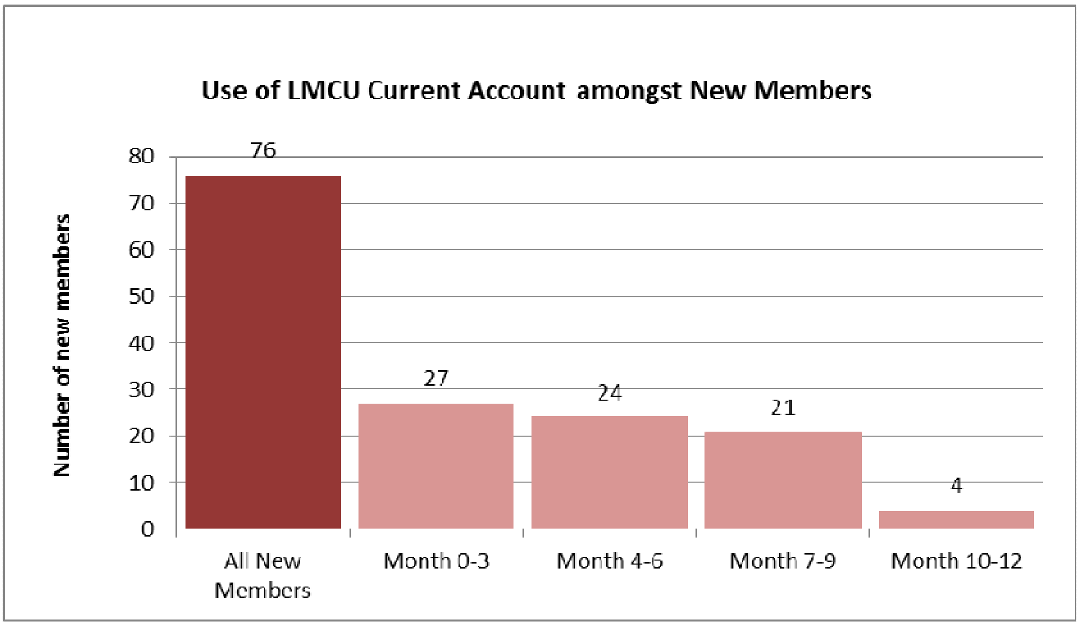



[23] Rates taken from www.moneyfacts.co.uk/compare/loans/loan-calculator/ and search under personal loans for fair or poor credit rating (09/05/13).

There was also evidence of new members utilsing other LMCU saving products that help them save for the future, including 41 people who opened 'Holiday Saving Accounts'(equating to 12% of new members), four who had funds in a 'Christmas Saving Accounts' and one new member who had opened a 'Junior Saving Account' for their child.

**Opening LMCU Current Accounts**

Almost a quarter of all new members (76 members) went on to open a Credit Union Current Account (CUCA) after joining the credit union. Again, the length of time with the credit union influenced usage, with 47% of those joining in the first three months of the pilot having opened an account by the end, compared to just 5% who joined in the last three months.



# 5. Financial sustainability of an alternative payday loan product

Finally, our evaluation research considers the financial costs of delivering the payday loan service to determine if it is financially viable for credit unions to deliver an alternative. LMCU has provided the research team with the estimated costs of administering the service for both approved and declined loans, which together with the delinquency figures we have used to estimate total expenditure. In terms of income, we have calculated the total interest that is likely to be generated from the actual loans dispersed together with any fees generated from delivering the service and the potential income from the use of other credit union financial services and products by new members.

## 5.1 Estimated income from delivering payday loans

There are three potential streams of income generated by delivering the payday loan product, through new membership fees, the interest generated on payday loans and income from the optional transfer fee.

We estimate that the payday loan product directly generated over £35,000 of income for the credit union, equating to an average of £16.19 for every loan, from the distribution of the 2,923 loans during the pilot.

Over three quarters (77%) of this income directly generated by delivering the payday loan product was through interest on loans. However, as 86% of all the payday loans were transferred instantly, 21% of the total income was generated through the fees associated with this type of dispersement (see Section 3.4 -Characteristic of payday loans).

| Income from delivering payday loans | All | Existing Members | New Members |
|---|---|---|---|
| New membership fee[24] | £662 | £0 | £662 |
| Total Interest earned | £26,974 | £21,123 | £5,851 |
| Optional automated payment income (net)[25] | £7,506 | £6,084 | £1,422 |
| **Subtotal income** | **£35,142** | **£27,207** | **£7,935** |
| Average income per PD loan | £12.02 | £11.68 | £13.38 |

In addition, we believe further income may also be generated from new members taking out additional insurance products or transactional accounts. Moreover, there is also a potential income that could be generated from productively utilising the saving assets accumulated by

[24] New membership fee is £2.00 per new members.

[25] The cost to the credit union of instantly transferring funds to a bank account is £8, so the net income is £3 if the customer is charged £11.

these members either through bank interest or more profitably by using the funds as loan capital. We have not incorporated estimates for any of these addition income streams.

### 5.2 Estimated income from other LMCU products and services

In terms of additional income from the use of other credit union services by new members, only income resulting from the interest charged for the additional longer-term lending has been included. We have not included the potential income to be derived from lending out accumulated savings nor any fees generated from the CUCA.

We have calculated that the income from the 108 additional loans totalling almost £90,000 that was actually delivered to new members during the pilot would generate approximately £15,000 of additional income (gross income) – or £46 for every new member[26]. However, as additional borrowing is shown to increase with the length of membership, the potential for additional income also rises. The average gross income generated by those who have been members for at least nine months more than doubles to over £100 so if all 331 new members were to realise these levels of additional income after at least nine months, at least £33,000 (gross income) would be generated.

| **Additional gross income from subsequent use of LMCU services** | **All** | **Existing members** | **New members** | **0-3 months** | **4-6 months** | **0-6 months** |
|---|---|---|---|---|---|---|
| **Long term lending interest (gross)** | **£15,253** | **£0** | **£15,253** | £6,536 | £5,525 | £12,061 |
| Average gross income (per new member) | - | - | £46.08 | £100.55 | £63.50 | £79.35 |

However, operating these longer-term loans also has a potential cost implication of both the resources to assess and distribute the loan but also any potential delinquency costs associated with both chasing the bad debt and any amount of delinquent loans written off.

To calculate this, LMCU has provided their estimated average unit costs for delivering each longer-term loan (equating to 52 minutes of a senior loan officer's time or £9.21 for each loan assessed and distributed) as well as the average cost of undertaking credit control for such loans (equating to 45 minutes of a senior credit control officer's time or £7.97 for every delinquent loan). **Appendix 2** provides a breakdown of these unit costs and the processes and time allocation for each. We have used their current delinquency rate of 6% of their total loan portfolio as an estimate of likely bad debt associated with this new lending and have had to assume that all this is written off.

[26] As identified in the section above, this is based on the prospective interest generated on the 108 loans distributed to new members during the pilot which averaged at £1,044 per loan over the average term of 17.9 months.

We have estimated the potential costs of delivering the £89,810 worth of longer-term loans as £1,961, which includes the costs of issuing the 108 loans, estimates of writing off potential levels of delinquent loans and estimated costs of undertaking the credit control work. This means that the net profit generated from new members taking out additional longer-term loans was approximately £13,000 or equivalent to £40.16 for every new member. However, the level of additional income increases dramatically the longer the new member has been with the credit union. Those who joined the credit union within the first three months of the pilot, each generated the credit union approximately £87.51.

| Additional income from subsequent use of LMCU services | All | Existing members | New members | Joined 0-3 months | Joined 4-6 months | Total (joined 0-6 months) |
|---|---|---|---|---|---|---|
| **Long term lending interest (gross)** | **£15,253** | **£0** | **£15,253** | £6,536 | £5,525 | £12,061 |
| Loan issue costs (no of loans x £9.21) | £994.68 | £0 | £994.68 | £432.87 | £331.56 | £764.43 |
| Estimated delinquency amount (write off) | £915.17 | £0 | £915.17 | £392.14 | £331.49 | £723.63 |
| Credit control costs (6% of all loans x £7.97) | £51.65 | £0 | £51.65 | £22.48 | £17.22 | £39.69 |
| **Net Profit from LT lending** | **£13,291.35** | **£0.00** | **£13,291.35** | **£5,688.17** | **£4,844.63** | **£10,532.80** |
| Average Net Profit (per new member) | | | £40.16 | £87.51 | £55.69 | £69.29 |

## 5.3 Estimated cost of operating the payday loan product

LMCU have calculated their estimated direct costs and staffing time associated with operating the payday loan service both to administer successfully approved loans as well as those applications turned down[27]. **Appendix 2** provides a full breakdown of the individual costs for each activity undertaken by LMCU to deliver the payday loan product.

We have calculated that the estimated expenditure to deliver the service during the pilot was just over £35,000 for costs relating to approved applications. This means that it costs on average £11.99 to administer every successful payday loan.

In addition, we estimate that it costs just over £4,600 to assess the unsuccessful applications received during the pilot project. These relate to the costs for processing the 997 geographically ineligible loan applications (£1,146) and the costs of assessing the 328 loan applications that were refused loans because they were deemed not to be credit worthy (£3,470).

[27] The evaluation team have been unable to validate the costings provided by LMCU.

| **Expenditure from delivering payday loans** | **All** | **Existing members** | **New members** |
|---|---|---|---|
| **PD loan expenditure (approved applications)** | | | |
| Cost of automated application/assessment for first loan[28] | **-£22,637** | **-£16,490** | **-£6,147** |
| Additional cost of manual assessment for first loan (80%)[29] | **-£3,901** | **-£2,842** | **-£1,059** |
| Cost of automated application/assessment for repeat loan[30] | **-£8,520** | **-£7,210** | **-£1,310** |
| **Subtotal expenditure** | **-£35,058** | **-£26,542** | **-£8,516** |
| Average expenditure per PD loan | -£11.99 | -£11.39 | -£14.36 |
| **PD loan expenditure (ineligible / refused applications)** | | | |
| Estimated costs for geographical ineligible loan applications[31] | -£1,146 | | |
| Estimated costs for application/assessing refused loan applications[32] | -£3,470 | | |
| **Subtotal expenditure** | **-£4,616.79** | | |

## 5.4 Estimated cost of delinquency from payday loan products

As identified earlier within the report, 80 loans with an outstanding value of just over £15,000 of all the loans made during the pilot were determined as actually delinquent. The outstanding loan amounts for delinquent loans have been included as costs for the purposes of these calculations and assumed that they would be written off if they are unable to be recovered. Yet, the credit union continues to pursue these through their existing credit control team and will recover additional funds, particularly from those that are only a few months in arrears.

We have also estimated that the credit control function to attempt to recover these funds would have cost approximately £426 (or £5.32 for every delinquent loan - **Appendix 2** provides the unit cost breakdown).

| **Expenditure from delinquency** | **All** | **Existing Members** | **New Members** |
|---|---|---|---|
| **Delinquency amount**- at least two[33] missed payments outstanding | -£15,058 | -£8,016 | -£7,042 |

[28] LMCU estimate the cost to be £18.57 of administering each approved loan
[29] LMCU estimate that the staff time of manually assessed loans cost on average £4.00.
[30] LMCU estimate that each repeat loan costs £5.00 to administer.
[31] Each application refused because it is outside of LMCU's common bond is estimated to cost £1.15.
[32] LMCU estimates that the refused loans that have been fully assessed cost on average £10.58.
[33] We have included the total outstanding amounts for every payday loan that has at least two missed payments. We have not included those that LMCU identify as having missed one because the way that they are recorded on LMCU system means that a significant proportion of these would include payments not collected yet and therefore are not actually in arrears and there is no method of separating these.

| | | | |
|---|---|---|---|
| **Cost of credit control** for delinquent loans[34] | -£426 | -£213 | -£213 |
| **Sub total** | **-£15,483.31** | **-£8,228.75** | **-£7,254.56** |
| Average delinquency costs (per member) | -£12.70 | -£9.27 | -£21.92 |
| Average delinquency costs (per PD loan) | -£5.30 | -£3.53 | -£12.23 |

This means that expenditure relating to delinquent loans cost an average of £5.30 for every payday loan issued (or £12.70 for every member).

### 5.5 Overall financial viability of the payday loan service

Looking simply at the estimated income and the expenditure (relating to processing both successful and unsuccessful loan and the costs relating to those loans that go into arrears) from the payday loan pilot project, a £20,016 loss would have been generated (equating to an average loss of £6.85 on every loan). The shortfall is accounted for with £7,563 loss from the loans to existing members (or £3.25 for each loan), £7,836 loss from loans to new members (or £13.21 for each loan) and the £4,616 costs of assessing unsuccessful loan applications.

The 'loss leader' model of delivering the payday loan service does however hold true amongst new members and shows that offering a payday loan pilot can ultimately be shown to be financially viable. When the £13,291 additional net profit generated by new members through their subsequent longer-term borrowing is incorporated, the pilot still shows an overall loss of £6,725 equivalent to an average loss of £2.30 for each loan. Yet, loans just to new members when the actual additional income from their use of other services is incorporated generates an estimated £9.20 net profit on each loan.

Furthermore, if the additional use of longer-term lending seen amongst those new members who had been with for at least nine months (identified as an average net profit of £87.51 for each new member) was replicated across all 331 new members, we believe that new members alone would therefore generate a net profit of £21,130[35].

Therefore, this would mean that overall, LMCU will realise a net profit of at least £8,950[36] as a result of the payday lending pilot, or £3.06 for every payday loan (£7.34 for every member).

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[34] Number of payday loans with at least two missed payments by the average cost of undertaking credit control activities being £5.32 for every delinquent loan (40 loans amongst existing members and 40 loans amongst new members).

[35] This is calculated by potential net profit for each new member who had been with the credit union for at least nine months (331 x £87.51 = £28,965) minus the total loss made from delivering the payday loan product to all new members (-£7,836).

[36] This is calculated by adding the potential profit from new members (£21,130) to the loss made by delivering payday loan product to existing members (-£7,563) and deducting the costs for assessing unsuccessful payday loans (-£4,617).

**Overall financial viability of the payday loan service**

| PD Loan Income | All | Existing Members | New Members | Joined 0-3 months | Joined 4-6 months | Total joined 0-6 months |
|---|---|---|---|---|---|---|
| New membership fee (£2.00) | £662 | £0 | £662 | £130 | £174 | £304 |
| Total Interest earned | £26,974 | £21,123 | £5,851 | £1,676 | £1,923 | £3,599 |
| Optional automated payment income | £7,506 | £6,084 | £1,422 | £366 | £390 | £756 |
| **Subtotal income** | **£35,142** | **£27,207** | **£7,935** | **£2,172** | **£2,487** | **£4,659** |
| Average net income (per PD loan) | £12.02 | £11.68 | £13.38 | £14.11 | £14.05 | £14.08 |
| Average net income (per member) | £28.83 | £30.64 | £23.97 | £33.42 | £28.59 | £30.65 |
| **PD Loan Expenditure (Ineligible / Refused applications)** | | | | | | |
| Estimated costs for geographical ineligible loan application | -£1,146 | | | | | |
| Estimated costs for application/assessing refused loans | -£3,470 | | | | | |
| **Subtotal expenditure** | **-£4,616.79** | | | | | |
| **PD Loan Expenditure (Approved applications)** | | | | | | |
| Cost of automated application/assessment for first loan | -£22,637 | -£16,490 | -£6,147 | -£1,207 | -£1,616 | -£2,823 |
| Additional cost of manual assessment for first loan (80% of first loans) | -£3,901 | -£2,842 | -£1,059 | -£208 | -£278 | -£486 |
| Cost of automated application/assessment for repeat loan | -£8,520 | -£7,210 | -£1,310 | -£445 | -£450 | -£895 |
| **Subtotal expenditure** | **-£35,058** | **-£26,542** | **-£8,516** | **-£1,860** | **-£2,344** | **-£4,204** |
| Average net expenditure (per PD loan) | -£11.99 | -£11.39 | -£14.36 | -£12.08 | -£13.24 | -£12.70 |
| Average net expenditure (per member) | -£28.76 | -£29.89 | -£25.73 | -£28.62 | -£26.94 | -£27.66 |
| **Delinquency amount**- at least two missed payments outstanding | **-£15,058** | **-£8,016** | **-£7,042** | **-£1,807** | **-£2,294** | **-£4,101** |
| **Cost of credit control** for delinquent loans | -£426 | -£213 | -£213 | -£48 | -£80 | -£128 |
| **Subtotal expenditure** | **-£15,483** | **-£8,228** | **-£7,254** | **-£1,855** | **-£2,373** | **-£4,228** |
| Average delinquency amount (per PD loan) | -£5.30 | -£3.53 | -£12.23 | -£12.05 | -£13.41 | -£12.78 |
| Average delinquency amount (per member) | -£12.70 | -£9.27 | -£21.92 | -£28.54 | -£27.28 | -£27.82 |
| **Profit / Loss from PD Loan Product** | **-£20,016** | **-£7,563** | **-£7,836** | **-£1,543** | **-£2,231** | **-£3,773** |
| Average profit / loss (per PD loan) | -£6.85 | -£3.25 | -£13.21 | -£10.02 | -£12.60 | -£11.40 |
| Average profit / loss (per member) | -£16.42 | -£8.52 | -£23.67 | -£23.73 | -£25.64 | -£24.82 |

| | | | | | | |
|---|---|---|---|---|---|---|
| **Additional Income from Subsequent Use of LMCU Services** | | | | | | |
| Long Term Lending interest (gross total) | £15,253 | £0 | £15,253 | £6,536 | £5,525 | £12,061 |
| Cost of Loan issue | -£994.68 | £0 | -£994.68 | -£432.87 | -£331.56 | -£764.43 |
| Delinquency amount (write off) | -£915.17 | £0 | -£915.17 | -£392.14 | -£331.49 | -£723.63 |
| Credit control costs | -£51.65 | £0 | -£51.65 | -£22.48 | -£17.22 | -£39.69 |
| **Net profit from additional longer term lending** | **£13,291** | **£0.00** | **£13,291** | **£5,688** | **£4,845** | **£10,533** |
| Net average profit (per new member) | | | £40.16 | £87.51 | £55.69 | £69.29 |
| **Overall net profit / loss from delivering LMCU Payday Loan Pilot** | **-£6,725** | **-£7,563** | **£5,456** | **£4,145** | **£2,614** | **£6,759** |
| Average net profit/loss (per PD loan) | -£5.52 | -£8.52 | £16.48 | £63.78 | £30.05 | £44.47 |
| Average net profit/loss (per member) | -£2.30 | -£3.25 | £9.20 | £26.92 | £14.77 | £20.42 |

| | | | | | | |
|---|---|---|---|---|---|---|
| **Overall net profit / loss - If all new members generated additional income as identified amongst joiners 0-3 months** | **£8,949.92** | **-£7,563** | **£21,130.12**[37] | | | |
| Average net profit/loss (per PD loan) | £7.34 | -£8.52 | £63.84 | | | |
| Average net profit/loss (per member) | £3.06 | -£3.25 | £35.63 | | | |

[37] Calculated by taking the loss from payday loans provided to all new member together with the projected additional income (£87.51 per new member) from all new member (331 new members)

## 5.6 The effect of the proposed increased credit union interest rate cap.

Finally, we modelled payday lending undertaken during the pilot project to identify the impact of the proposed increase of the credit union interest rate cap from 26.8% APR (or 2% per month) to 42.6% APR (or 3% per month). This would mean that for every £100 borrowed over one month the cost would only increase to £3.55 (rather that the current £2)

As a result, the estimated income generated from interest on the loans increase from the current £26,974 to a total of £43,009. Assuming that all other income and expenditure had remained the same, the increased profit margins on each loan would have resulted in an £9,311 profit (when the additional income from use of other LMCU services). The projected overall net profit of £25,000 would have been realised if all new members generated additional income as identified amongst joiners in 0-3 months.

| **Income from delivering payday loans (charged at 42.6% APR)** | **All** | **Existing Members** | **New Members** |
|---|---|---|---|
| New membership fee | £662 | £0 | £662 |
| Total Interest (at 42.6% APR) | £43,009 | £33,680 | £9,329 |
| Optional automated payment income (net) | £7,506 | £6,084 | £1,422 |
| **Subtotal income from PD loans** | **£51,177** | **£39,764** | **£11,413** |
| Average income (per PD loan) | £17.51 | £17.07 | £19.25 |
| **Expenditure from delivering payday loans** | **-£35,058** | **-£26,542** | **-£8,516** |
| **Expenditure from refused applications** | **-£4,617** | | |
| **Expenditure from delinquency** | **-£15,483** | **-£8,229** | **-£7,255** |
| **Profit / Loss from PD loan product** | **-£3,981** | **£4,993** | **-£4,358** |
| **Income from subsequent use of LMCU services** | **£15,253** | **£0** | **£15,253** |
| **Overall profit from delivering PD Loan Pilot** | **£9,311** | **£4,993** | **£8,934** |
| Average profit (per PD loan) | £3.19 | £2.14 | £15.07 |
| **Overall net profit - If all new members generated additional income as identified amongst joiners 0-3 months** | **£24,985** | **£4,993** | **£24,608** |

We have estimated above the potential income that would have been generated from the approved loans actually distributed during the pilot had they all been given at the proposed new interest rate of 42.6% APR instead of 26.8% APR. We have assumed that this higher interest rate will not lead to greater levels of delinquency because the change in the repayment amount is minimal that it is unlikely to make a significant difference. For example, a £400 loan taken over 3 months would cost just under £11 extra in interest.

# 6. Conclusions

With the spotlight firmly focused on the detrimental practices of the payday lending sector, the need for an affordable alternative has never been greater. The desire as well as the opportunity from within the credit union movement to address the growing use of expensive payday loans with a more affordable alternative continues to be strong. Yet, as well as needing to demonstrate that an effective delivery infrastructure is practicable, the overwhelming concern has always been the ability to deliver a more affordable alternative within the constraints of the credit unions' interest rate cap.

The findings from this evaluation of London Mutual Credit Union's twelve month pilot indicates that operating such an alternative payday lending product that can compete with the high cost lenders, is achievable, beneficial and viable.

The results of the payday lending pilot have been hugely encouraging for LMCU and will hopefully be well received by the wider credit union sector. Its success can be measured in the realisation of all five of the project's initial aims.

Not only has it provided access to a more affordable and fair form of short-term borrowing but the service provides struggling households the option of moving away from the high costs and often detrimental impacts of the wider payday loan industry. By accessing the service, the majority of surveyed users have indicated that they are highly unlikely to use more expensive lenders again.

The payday loan product has proved an affective mechanism for drawing a new customer base into the credit union. One of the pilot's successes has been its ability to attract new members into the credit union who are in the main employed and who had previously either no knowledge or had never been motivated to join the credit union. This is a valuable seam of potential new member who can be attracted into the sector by using the widely understood payday loan 'tag'. Moreover, it has proved extremely popular with existing members of the credit union, many of whom were already borrowing from expensive payday lenders to meet their immediate need for short-term cash. This should reduce their need to resort to high cost lenders for this type of borrowing but should also mean that they have more ability to repay any credit union loans promptly as their finances will not be littered with expensive repayments to payday loan companies.

The use of a payday loan product within a credit union has the potential to save borrowers significant amounts of money within household budgets that are often extremely precarious or at best tight. The pilot itself saved the clients using the service in excess of £145,000 in interest charges alone. Moreover, with the scale of the current payday lending epidemic has the potential to collectively save over £676 million a year if all payday loan were taken through a credit union.

These new recruits have been shown to not only go on to use other financial services, particularly larger more sustainable longer-term loans, but also accumulate savings assets that will help stabilise and improve their household finances. The fact that the credit union can now establish new long term relationships with these new members is a hugely important outcome of the project that will hopefully continue to deliver mutual benefits for both member and credit union. The likelihood of this new customer loyalty is evidenced by the extremely high satisfaction levels identified amongst surveyed users of the payday product.

Critically, the pilot has shown that the adopted 'loss leader' model can actually work in practice. By drawing new members into the credit union, a significant proportion quickly move on to utilsing other profitable services and thus support a payday loan product to be financial viable. Nevertheless, it is only this income cross-subsidy that enables the product to deliver an overall profit. Without it, it appears to be unsustainable. Yet, it is important to note that such income will continue over successive years as these new members become established active members.

Significantly it appears that if any credit union wants to purely make money from directly providing payday loans at the current interest rates, then this appears to not be the product for them. As LMCU's Chief Executive, Lucky Chandrasekera commented at one of the initial project evaluation meetings, "We are not running the payday loan product as a separate cost centre. If we were, we would probably have terminated that cost centre a long time ago". It is the ongoing income streams generated by attracting new members into the credit union where the ultimate value and thus viability rests.

The success of the payday loan pilot has already led London Mutual to conclude that it should retain the payday lending product within its portfolio of financial services. It will be both continuing and expanding its delivery of the service and thus plans to focus on reaching more potential new customers and distribute greater numbers of payday loans over the coming years.

It is hoped that other credit unions as well as other community lenders (such as Community Development Finance Institutions (CDFIs)) will be able to use the experience and learning accumulated during the LMCU pilot together with the findings of this evaluation as the basis for potential development and delivery of a similar payday loan alternative. By developing this tested affordable lending model at a local level it was always intended that, if successful, this pilot should encourage replication and adoption across the country by other credit unions and social lenders.

The development budgets have purposefully been detailed within the evaluation to provide others with an indication of the potential costs associated with implementing a similar service. Equally, these set-up costs have been kept separate from the financially viability estimates in order to provide a clear and definitive assessment of the revenue and expenditure costs of actually delivery payday loans.

The environment is ripe for the development of other such payday loan offerings within the credit union sector either through; the establishment of standalone services funded from individual credit unions' own funds or external grants, or delivered as a 'back-office function' in partnership with either LMCU or ABCUL. The latter offers the economies of scale nationally as well as the sizeable resources afforded through the Credit Union Expansion Project that will develop shared platform products and services of which payday lending should be a key element. Moreover, the proposed increase of the credit union interest rate from 26.8% APR (or 2% per month) to 42.6% APR (or 3% per month) could provide greater flexibility to increase the payday loan product's profit margins and make the product viable in its own right.

# Appendix

## Appendix 1 – LMCU Payday Loan User Survey

Thank you for participating in this short survey - it should take no more than a couple of minutes to complete.

Just to assure you that all your answers will be kept strictly confidential and will only be used in terms of what groups of people think or experience and not at an individual level.

1. **How did you hear about the Payday Loans from LMCU?**
   - I was an existing LMCU member
   - Through my employer
   - Online search
   - Newspaper / newsletter
   - Advert
   - Leaflet / poster
   - From a friend/family member
   - Other

2. **Had you previously heard of London Mutual before applying for the Payday Loan?**
   - Yes - already a member
   - Yes - but not a member
   - No - never heard of them before

3. **What was the main reason that you decided to use LMCU for a Payday Loan?**
   - Cheaper than other Payday Loan providers
   - I had few other choices to borrow
   - That I could choose the repayment period to be more than a month
   - It was from a credit union - so could trust them more
   - Simple and easy to get a decision
   - Liked the appearance of the website
   - Other (please specify)

4. **How much do you agree with the following statement? 'The Payday Loan application process was simple and quick to complete'**
   - Strongly agree
   - Agree
   - Neither
   - Disagree
   - Strongly disagree

5. **What improvements could be made to the application and assessment process?**

- Clearer information about the loans
- Simpler application form
- Quicker decisions
- Better follow up information
- No improvements - thought the process was good
- Other (please specify)

**6. In the previous 12 months before taking out your first LMCU Payday Loan, approximately how many Payday Loans did you take?**

- None
- 1
- 2
- 3
- 4
- 5
- 6
- 7
- 8
- 9
- 10
- 11
- 12
- More than 12
- Prefer not to say

**7. If you needed another loan in the future, how likely would you be to borrow from another Payday Loan company (other than London Mutual)?**

- Very likely
- Fairly likely
- Neither likely or unlikely
- Fair unlikely
- Very unlikely

**8. Could you rank the following financial services from LMCU in term of how likely you are to use them in the future?**

**Payday loans:**

- Very likely
- Fairly likely
- Neither likely or unlikely
- Fair unlikely
- Very unlikely

**Longer term loans**

- Very likely
- Fairly likely
- Neither likely or unlikely
- Fair unlikely
- Very unlikely

**Saving accounts**

- Very likely
- Fairly likely
- Neither likely or unlikely
- Fair unlikely
- Very unlikely

**Current /transactional bank accounts**

- Very likely
- Fairly likely
- Neither likely or unlikely
- Fair unlikely
- Very unlikely

**9. How satisfied have you been with LMCU since joining the credit union?**

- Very satisfied
- Fairly satisfied
- Neither satisfied or unsatisfied
- Fairly unsatisfied
- Very unsatisfied

**10. Would you now recommend LMCU to other friends or family members?**

- Yes
- Maybe
- No

**11. Finally, do you have any overall comments on the payday loan that you received from LMCU?**

## Appendix 2 – Breakdown of costs of delivering payday loan product

**a) Estimated average cost associated with assessing approved applications:**
Each first loan approved is significantly more expensive than subsequent repeat loans primarily because of the automated external checks with Experian and the allocation for system maintenance.

| Activity | Unit cost |
|---|---|
| Administration services[38] - staffing time to process and allocate membership/loans on to system | £3.50 |
| ID / credit / authenticate / bank checks | £5.00 |
| Process and send money | £1.50 |
| Process and getting repayments costs (allowed for three repayments) | £1.50 |
| Annual system maintenance | £7.07 |
| **Total** | **£18.57** |

LMCU estimates that the majority of the loan assessment process is automated using its comprehensive IT operating system and is estimated as 3 minutes to approve the loan, [and a further 3 minutes to make payment.

**Additional average unit costs for manual assessment of loans:** Furthermore, approximately 80% of all initial loans that are approved do not proceed automatically through the assessment process and therefore require manual intervention by staff.

| Activity | Unit cost |
|---|---|
| Additional staff administration time for manual assessment of approved loans | £4.00 |
| **Total** | **£4.00** |

**Additional average costs for processing of repeat loans:** As identified earlier in the report, all repeat loans are more straightforward to process as each borrower is allocated a maximum future loan amount and does not require further expensive external checks. Therefore, the costs associated with repeat payday loans are significantly less**.**

| Activity | Unit cost |
|---|---|
| Administration services for staffing time | £2.00 |
| Process and send money | £1.50 |

[38] All administration services incorporate estimates relating to gross staffing costs together with a proportion for additional elements such as overheads and management contributions.

| | |
|---|---|
| Process and getting repayments (allowed for three payments) | £1.50 |
| **Total** | **£5.00** |

**b) Unit costs associated with assessing unsuccessful applications:**
There are costs associated with receiving and assessing all loans that are unsuccessful either because they are ineligible through the common bond or are refused following full assessment. Those applications that are duplicates, are incomplete or that are from people who are unemployed can be identified and dealt with without direct associated costs.

**Average unit cost associated with checking common bond eligibility:** With all applications that are ineligible because the person does not meet the common bond requirements, there is a small cost in relation to an external authentication check.

| Activity | Unit cost |
|---|---|
| External authentication check | £1.15 |
| **Total** | **£1.15** |

**Average unit cost associated with assessing refused applications:** All loans applications that meet the eligibility criteria and are fully complete are automatically assessed. Those that are refused still incur certain costs in relation to the external checks and staff time to administer and manually assess loans.

| Activity | Unit cost |
|---|---|
| Administration services for staff time (45% of full approved loan admin costs) | £1.58 |
| ID/credit/authenticate/bank checks | £5.00 |
| Manual assessment of loans (additional staff time) | £4.00 |
| **Total** | **£10.58** |

**Average unit costs associated with delivering longer-term loans:** All longer-term loans issued to new members following a payday loan are undertaken by a loan officer at a rate of £10.63 per hour (which includes NI contributions and an element of overheads and management time).

| Loan Issue (loan officer time) | Minutes |
|---|---|
| Loan app information verification | 2 |
| acknowledgement of the app-SMS | 2 |
| Credit check | 5 |

| | |
|---|---|
| Progress SMS | 2 |
| Approval of the loan | 10 |
| Progress SMS - partial/full approval | 2 |
| Generate loan agreement / print | 5 |
| Note on CURTAIN - -Agreement ready. | 2 |
| Payment authorization | 2 |
| Member sign the agreement/ID check | 5 |
| Scan signed loan agreement | 2 |
| Issue cash | 2 |
| Matching agreement to loan app save | 2 |
| Loan allocated to CURTAINS | 2 |
| Contingency | 7 |
| **Total** | **52** |

| Minutes to process activities | Rate/hr | Unit costs |
|---|---|---|
| 52 minutes | £10.63 | **£9.21** |

**Average unit costs associated with undertaking credit control for payday and longer-term loans:** The estimated costs of undertaking the credit control function for both payday loans and longer-term loans are similar with the exception that LMCU believe that the complexities of larger loans means that an additional 15 minutes of contingency time has been added to the process for dealing with these bad debts. All credit control work is undertaken by a Credit Control Officer with an hourly rate of £10.63 (again including additional related costs).

| Credit control (Credit Control Officer time) | Minutes | |
|---|---|---|
| **Activity** | **Payday Loans** | **Longer-term Loans** |
| Email/telephone contact | 5 | 5 |
| Letter 1 | 6 | 6 |
| Letter 2 | 6 | 6 |
| Writing off | 6 | 6 |
| Contingency (15 minutes added for longer-term loans) | 7 | 22 |
| **Total** | **30** | **45** |

| Minutes to process activities | Rate/hr | Unit costs |
|---|---|---|
| Payday loans - 30 minutes | £10.63 | **£5.32** |
| Longer-term loans - 45 minutes | £10.63 | **£7.97** |