CarnegieUK TRUST

CHANGING MINDS • CHANGING LIVES

Scottish Government Consultation on Social Security in Scotland

Consultation Evidence

The Carnegie UK Trust was established by Scots-American philanthropist Andrew Carnegie in 1913 and works to improve the lives of people throughout the UK and Ireland, by influencing policy, and by changing lives through innovative practice and partnership work.

The Carnegie United Kingdom (UK) Trust welcomes the opportunity to submit evidence to the Scottish Government Consultation on Social Security in Scotland.

Summary

The Carnegie UK Trust was established by Scots-American philanthropist Andrew Carnegie in 1913 and works to improve the lives of people throughout the UK and Ireland, by influencing policy, and by changing lives through innovative practice and partnership work.

Since 2014 the Carnegie UK Trust has been working on the issue of financial inclusion through the lens of affordable credit (small, short term loans of £500 or less to be repaid within a year). For decades, many of the poorest members of our society have been unable to borrow through the mainstream channels accessible to the majority of the population. They are often compelled to turn to high-cost alternatives, such as payday lending or home collected credit incurring the so-called "poverty premium". As a result, credit is more expensive for those who can least afford it, compounding the financial inequalities in our society.

In our submission we ask the Government to consider how to embed financial inclusion within the characteristics and delivery of the new social security powers. We believe an intervention within the Scottish social security system which supports widening access to more affordable credit for the most disadvantaged groups in society would be consistent with its stated aim of advancing equality.

We make a specific ask of the government to consider what levers it may have within its new competencies to support the development a capital loan fund for affordable credit providers.

Evidence Base

1. The Trust has published two reports on affordable credit: Meeting the need for affordable credit: discussion paper and Gateway to affordable credit: report of the affordable credit working group. In June 2016 we established an Affordable Credit Action Group to oversee work on the recommendations set out in the Gateway to Affordable Credit report in Scotland. The Group is chaired by the Very Reverend John Chalmers, former Moderator, and currently Principal Clerk to the General Assembly of the

Church of Scotland. The group's members comprise of senior representatives from the private, public and voluntary sector, including representatives from Royal Bank of Scotland, Virgin Money, Scottish Government, Poverty Alliance, Young Scot, North Ayrshire Council and Wheatley Group.

Affordable credit and financial inclusion

2. There are many occasions when people need to borrow money on a short-term basis to cover unplanned and unexpected expenditure. There is some evidence that demand for credit is likely to be sustained or even increase over the coming years. The Bank of England reported in February 2016 that 'The annual growth rate in the stock of consumer credit picked up to 9.3% in February 2016), the highest since December 2005'. Subsequent reports continue to highlight demand in unsecured credit with the October report stating 'Consumer credit growth has been strong since late 2013.' Fundamental shifts in the labour market mean that over a third of temporary workers in the UK cannot find a permanent job, with lower levels of job security potentially impacting on people's ability to secure and repay loans. Further reductions to welfare payment levels within the UK context may place even greater pressure on the household budgets of those on the lowest incomes.

3. Currently, many people who are reliant on social security payments would struggle to access mainstream credit options due to low incomes, limited take up of financial products such as bank accounts, overdrafts, and credit cards and thin or poor credit history. Mainstream lenders such as banks do not offer the small, short term loan amounts which meet the needs of many people in this customer group

4. Those who cannot access mainstream credit instead often rely on high cost alternatives such as payday loans or doorstep lenders to meet their credit needs. Non-mainstream lending is significantly more expensive in terms of the interest rates charged on loans, usually presented as Annual Percentage Rate (APR). These interest rates appear incredibly high compared to those of mainstream loans. This has led to a perception among large numbers of policy makers and the general public that high APRs are inherently exploitative and unaffordable.

5. We would stress the limitations of using APR, an annualised measure, as a comparator when weighing up the relative affordability of shorter term loans. Moreover, there are a range of factors which make delivering small, short-term loans an inherently expensive operation. For example, the higher risk that this customer group may default on their loan, and the marginal returns and higher administrative costs of processing smaller loan amounts

6. Even with these caveats, the APR premium attached to commercially-offered, non-mainstream credit is significant and it means that obtaining credit is most expensive for those who can least afford it. We believe that the provision, at scale, of more affordable loans, delivered on a social, not-for-profit basis, would significantly improve the financial position and wellbeing of citizens excluded from mainstream financial services, saving hundreds of thousands of pounds a year in interest payments.

7. Cheaper, not for profit alternatives to payday and home credit lenders do exist in Scotland – principally credit unions and CDFIs (Community Development Financial Institutions) However, these sectors are currently miniscule in comparison with their commercial competitors, and face a number of obstacles to offering a viable, at-scale alternative to those who are excluded from mainstream lending.

8. There are a number of promising developments in the expansion of the affordable credit market. The Carnegie UK Trust is committed to supporting this expansion in Scotland with a £100,000 investment over the period 2016-2018, as highlighted in our pledge in the Fairer Scotland Action Plan. We are already working with a range of partners from different local areas to widen affordable credit offerings, through different mechanisms and providers, to those in need.

9. However, while widening the delivery base of affordable credit providers is the essential first step, a critical condition for long-term sustainability in the affordable credit model is access to lending capital that will allow affordable credit lenders to build infrastructure, train staff, innovate operationally to achieve sustainable margins, and have sufficient capital to provide loans which meet the diverse needs of their customers into the long term.

10. Attracting capital from commercial investors is difficult. This is partly because of the high risk appetite and high volumes required to generate returns from a business model which lends to a disadvantaged customer group. Moreover, while initial early investment from government is critical at start-up phase, ongoing substantial public sector support is ultimately detrimental if scale is desired. We have heard evidence that affordable credit lenders reliant on ongoing public sector funding can struggle to provide commercial investors with evidence of a sustainable business model. This creates a barrier to investment

11. We therefore advocate a blended funding stream as the best approach to demonstrate and achieve sustainability in the affordable credit sector. The availability of 'soft' loans – provided at a lower rate with a degree of flexibility in repayment terms - would provide significant help for affordable credit lends to meet their growth and sustainability ambitions.

12. To this end, we believe that within the new social security arrangements for Scotland, the Scottish Government should consider supporting the development of such a capital loan fund. We would ask that the Scottish Government consider the levers available to support and encourage commercial investment in CDFIs and credit unions. For example, the Scottish Government could consider underwriting a proportion of such a loan fund to reassure commercial investors.

The Carnegie UK Trust works to improve the lives of people throughout the UK and Ireland, by changing minds through influencing policy, and by changing lives through innovative practice and partnership work. The Carnegie UK Trust was established by Scots-American philanthropist Andrew Carnegie in 1913

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