A review of the credit union movement in Wales

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Realising the Potential: a review of the credit union movement in Wales

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Realising the Potential: a review of the credit union movement in Wales

This is a report of research commissioned by the Welsh Assembly Government into the credit union movement in Wales. The objectives of the research were to investigate the profile, operation, governance, support structures, current performance and services, and future development and sustainability of credit unions in Wales.

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Preface

In 2009, the credit union movement in Wales stands at a crossroads. In 20 years it has been transformed from a collection of fledgling community organisations to a position where there is nationwide coverage by credit unions, many of which are endeavouring to develop as professional financial co-operatives. Leighton Andrews AM, Deputy Minister for Regeneration, noted that 'Credit Unions in Wales have seen a fourfold increase in membership since the establishment of the Welsh Assembly Government.'[1] With the support of the Welsh Assembly Government, credit union membership has grown from approximately 11,000 in 2000 to 42,000 in 2007 – a significant achievement by any standards.

2009 marks the conclusion of 8 years of sustained investment by the Welsh Assembly Government, supported by EU 'Objective 1' funds, taxpayer support and significant charitable funding, totalling more than £8m. It is timely therefore to assess the impact of this positive policy environment and financial investment, and to seek to analyse the organisational and financial performance of Welsh credit unions over this period; to identify success stories and suggest how they can be replicated; and to report on how lessons can be learned from some of the challenging experiences that credit unions have faced during this time. To do this, a variety of methods have been used to gain information from credit unions, policy professionals and key stakeholders: interviews; focus groups; literature and document review and analysis; and analysis of financial returns provided by credit unions to the Financial Services Authorities (2004-2007).

While knowledge of the existence of credit unions is widespread, there are also differing views and understandings among politicians, policy-makers and 'opinion-formers' in local communities about their structure, purpose and potential in a modern financial services market. This report will work towards addressing these issues and to promote a shared understanding of the role, potential and support needs of Credit Unions.

It is clear from our findings that credit unions in Wales have the possibility of an exciting future ahead of them. However, it is a time of change and challenge for credit union boards, managers and staff as they endeavour to build sustainable business models and to develop products and services that are attractive to members and the population at large. Forthcoming legislation will enable, but also challenge, credit unions to develop the nature of their business significantly. The choice for many at the crossroads is between remaining small-scale community operations and going onward to build a strong, expansive financial co-operative sector in Wales.

In this report, we set out a number of challenging, but achievable, targets for development and growth. We sketch out and comment upon future scenarios and make recommendations about how future Welsh Assembly Government support might be targeted. Ultimately, though, we know it will be the members, boards and management teams within each credit union that will determine which path to development they choose to take.

[1] Cofnod y Trafodion/The Record of Proceedings of the National Assembly for Wales, 14th November 2007.

Introduction

A credit union is a co-operative financial institution that is owned and controlled by its members and established to serve the needs of a community that shares common characteristics and a shared sense of identity, i.e. a "common bond" between its members. Common bonds include, for example, geographical location - living or working within a defined area (e.g. Merthyr Tydfil Borough Credit Union Ltd.): Fig. i.1 maps the 'live and work' common bond areas in Wales as of 2009. Other types of common bonds include working for a particular employer (e.g. Transave Credit Union Ltd.); belonging to a political party (e.g. Undeb Credyd (Plaid Cymru) Credit Union Ltd.), trades union, or church (e.g. St Therese's (Port Talbot) Credit Union Ltd.).

Credit unions in Wales have played a significant role in reaching under-served and excluded communities. They have been a particular safety net for many in rural communities who have increasingly restricted access to affordable financial services. However, many Welsh credit unions, as well as others throughout Britain, have recognised that if they are going to effectively serve low-income and financially excluded communities, they first have to succeed as viable co-operative businesses.

This report firstly situates Wales in a broader UK and international context. The purpose of section 1 is to draw lessons from the development and growth of credit unions in other parts of the world that may be relevant and applicable to credit union development in Wales.

Section 2 examines credit unions in Wales, using key indicators that have been recognised in the global credit union movement as providing insight into performance and viability. The framework used for this analysis is 'PEARLS', a management and performance analytical tool originally developed in Latin America, and which is used and promoted in Britain by the Association of British Credit Unions (ABCUL) under licence from the World Council of Credit Unions (WOCCU).[2]

In the third part of the report, success factors and challenges identified during the process of our research are presented. This section considers role definition and financial sustainability; contribution to a financial inclusion agenda; capacity and skills development; and the changing operational context including partnerships and mergers.

The final section includes a number of recommendations for government, credit unions and key stakeholders to consider. The primary aim of the recommendations is to support the development of a strong, sound and effective Welsh credit union movement.

Throughout the report, we have integrated profiles of several Welsh credit unions to illustrate both similarities and diversity within the credit union movement in Wales.

[2] For more information PEARLS, see Richardson, (2002). For more information on WOCCU's work particularly in developing countries and transition economies, visit http://www.woccu.org/bestpractices/pearls

Fig i.1 Map of ‘live and work’ common bonds for Welsh Credit Unions, 2009

Please note: some common bond areas may have changed since publication of this map. For example, Bridgend Lifesavers Common Bond also covers the County Borough of Neath Port Talbot.

1. Placing Wales into a UK and International Context

Wales is a country of strong political and cultural heritage. It has diverse, discreet communities, some of which exist today despite having lost the industries on which they were based. As a nation with two official languages, it has both English- and Welsh-speaking communities. The rural / valleys / urban make-up of Wales offers practical and logistical opportunities and challenges for credit unions and we can see some of this reflected in the locations, size and membership in Wales. Many of the issues now facing Welsh credit unions are echoed in the experiences of credit unions in different places, at different times, and at different stages of country-level and organisational development. Some of these issues include government policy and intervention[3]; growth and efficiency, including mergers and acquisitions, sustainability, and professionalisation[4]; good corporate governance and management[5]; roles in relation to social deprivation and financial inclusion[6]; and identity[7]. Many credit unions in Wales have sought models and ideas from credit unions at home and abroad: most notably Ireland and North America. This section provides some insights from other countries, some with substantial credit union memberships and distinct national experiences that may be useful to policy-makers and credit unions in a Welsh context.

In Wales as in Ireland, Spain, Canada and other parts of the world, the development of co-operative banks and alternative financial systems arose because of the financial needs of certain communities. In Spain, for farmers and small entrepreneurs, the push towards urbanisation left many without access to conventional banking systems[8]. In Canada, the initial growth in credit unions – or *caisses populaires* – was in serving the francophone populations of Québec (the Mouvement Desjardins) and outlying Acadian communities (Acadian Credit Unions). Like the Basque region of Spain, and Ireland, the Canadian credit unions combine co-operative principles and identity with a strong cultural and community identity – in this instance, French-speaking, often Catholic communities[9]. In Ireland, the economically excluded Catholic communities were able to access financial services through the establishment of credit unions, heavily supported by the Catholic Church.

In Ireland, there is a mix of credit unions run by paid staff, and those run by volunteers. In contrast to England, Scotland and Wales, credit unions in Northern Ireland have not received any financial support from central or local government and, from the outset, appealed to a wide and diverse socio-economic membership, adapting and re-shaping according to the needs identified by community and members. This 'organic' development is seen by some as an essential difference

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[3] See Chambers and Ryder (2008) Current Developments: the funding of credit unions – where has all the money gone? *Journal of Social Welfare and Family Law*, 30(2), pp 243-252

[4] See, for example, McAlevey et al (2006) New Zealand credit union mergers, available from http://www.melbournecentre.com.au/files/MS&T.pdf

[5] See Chaves et al 2008 Co-operative Governance: the case of the Spanish Credit Co-operatives, *Journal of Co-operative Studies* 41(2), pp 30-38

[6] See Byrne et al (2007) Money-Lending and financial exclusion, Public Money & Management, Feb, pp 45-55

[7] Thomas et al,(2008)'Straight from the horse's mouth': an empirical exploration of the Irish Credit Union Movement, in *Journal of Social Welfare and Family Law*, 30 (2), pp 107-116

[8] Chaves et al (2008), as above

[9] Côté, 2001 Les Holdings Coopératifs: typologie, questionnements, et scenarios de solution, in Côté, D (ed) *Les Holdings Coopératifs: evolution ou transformation definitive,* deBoeck Université, pp 385-402

between the Irish experience and that of many British credit unions 'given the task by the UK government of tackling financial inclusion before becoming sufficiently developed and entrenched in their local communities.'[10] Thomas *et al* (2008)[11] comment on tensions regarding the role and purpose of credit unions within both the Scottish and Irish credit union movements, where credit unions do not necessarily see themselves as vehicles for tackling the complex problems of social and financial exclusion, or as a "panacea for local problems".

These tensions between the social and economic roles of credit unions can be seen at the heart of recent history in Britain, where many credit unions initially developed according to a particular model in response to poverty and disadvantages experienced in many communities throughout Britain.[12] In many ways, this model emphasised the social objectives of credit unions, to the exclusion of the economic objectives required for long term sustainable development. Instead of fostering the growth of a volunteer-led, professional co-operative financial service, able to meet the financial needs of large numbers of people, this model helped promote the image of credit unions as 'marginal' and 'poor people's banks' and may have contributed to the restricted growth of credit unions, even within the low income communities to whose needs the credit unions had aimed to respond. These tensions are pertinent to the development of the credit union movement in Wales, as they highlight the need for balance between financial and social goals and interests. We can see the relatively low levels of actual-to-potential memberships for Great Britain when compared to other countries, as shown in Fig. 1.1, below.

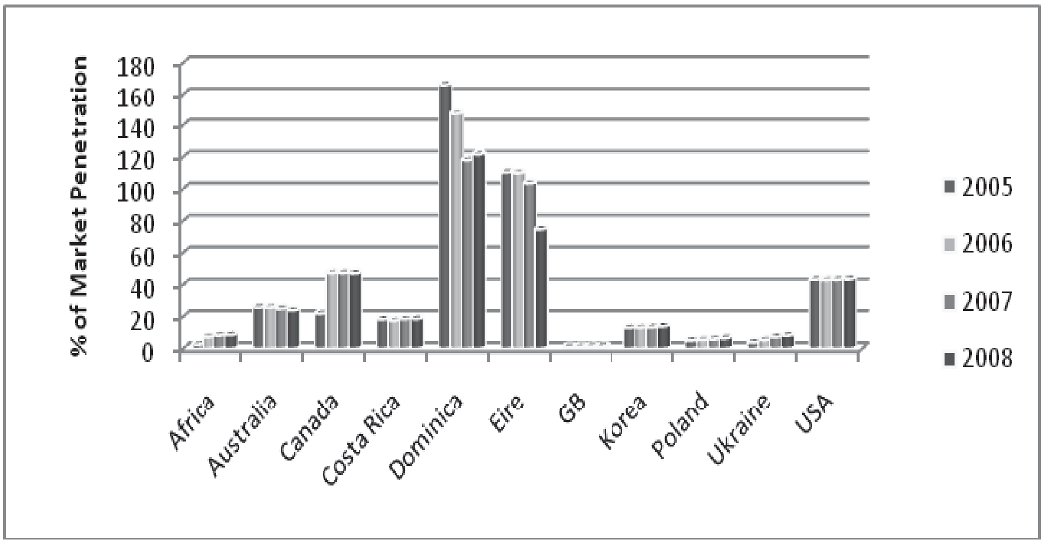

Fig. 1.1 Credit Union Market Penetration 2005-2008

The graph shows the World Council for Credit Unions credit union market penetration trends from 2005 to 2008 for selected countries.[13] WOCCU derives market penetration percentages by dividing the total number of reported credit union members by the economically active population. What we can also see from Fig. 1.1 is that market penetration is aggregated for England, Scotland and Wales (Great

[10] Thomas et al (2007) as above
[11] Ibid, 2008 – p 112
[12] Jones (1999), Towards Sustainable Credit Union Development. ABCUL, Manchester.
[13] WOCCU, 2009 - http://www.woccu.org/publications/statreport

Britain). However, calculations for our research suggest that the most recent rates of penetration for England, Scotland and Wales are 0.94%, 5.58% and 1.82% respectively.[14] So, although we noted earlier that the total coverage of the Welsh population by credit union common bonds is a significant achievement, penetration of the market is still relatively low. The difference in penetration for Great Britain compared to other countries may also be affected by the availability and access to other financial mutuals (such as building societies) and basic bank accounts. High percentages (over 100%) are explained by multiple memberships of adults in more than one credit union.[15]

In other parts of the world, including the new European member states, credit unions can also be seen to have a democratising role to play in transitional economies. For example, WOCCU's statistical information on market penetration shows a steady growth pattern for Poland: currently standing at 6.7%. Poland – still held up as a beacon of credit union development and sustainability – invited the WOCCU[16] to provide initial support for the development of credit unions. The existing credit unions, at that time, served over 250,000 members. Over a seven year period, 3.8 million US dollars were invested. For every dollar invested, 40 US dollars of new assets were generated. This financial and technical support was targeted at the infrastructural and development needs identified on the ground, and demonstrates an inclusive and 'bottom-up' approach to support and development. By 2008 there were over 1.8 million members in 62 affiliated credit unions[17].

The figures (above) for Canada show a significant leap from 22% market penetration in 2005 to a steady-state 47% in the following years. Canada is particularly advanced in credit union development. There is significant high street presence of credit unions in each of their common bond areas. In Halifax, capital city of the province of Nova Scotia, for example, this includes: Credit Union Atlantic (9 branches), Heritage Credit Union (6 branches)) – all with paid staff and regular opening hours and a range of services. In addition, there are smaller or more focused credit unions such as iNova (previously the credit union for Nova Scotia Postal workers and based in the city postal and distribution facility); the Public Service Commission Employees' Credit Union and Teachers' Plus Credit Union, both of which operate on a part-time basis. However, all credit union members can access linked ATM services throughout the province. The credit unions themselves benefit from centralised support services such as: the Nova Scotia Credit Union Deposit Insurance Corporation (NSCUDIC), The CUMIS Group Ltd (CUMIS) – which provides a range of products, services and tools for credit unions, and Credit Union Central. The credit unions also combine to administer the Nova Scotia Credit Unions Charitable Foundation.[18]

Credit Union Central is an essential and critical support for credit unions at both provincial and federal levels. It provides a common banking platform and information

[14] Financial Service Authority figures 2006, www.fsa.gov.uk
[15] WOCCU, 2009 - http://www.woccu.org/publications/statreport
[16] WOCCU is seen as one of the leading development agencies for microfinance and credit unions and provides a range of technical assistance programmes, which supports the establishment and growth of credit unions in developing and transitional economies.
[17] http://skok.pl.english/
[18] See http://www.ns-credit-unions.com/

technology resources and back-up. It can provide back-up services for individual credit unions – for example, providing supplemental mortgages if local credit unions have insufficient funds. In addition, Credit Union Central provides monthly analyses of financial data supplied by credit unions, which is also used to benchmark credit union performance across a province (for example, Nova Scotia is a province and about the same geographical size as England). Most importantly, though, Credit Union Central undertakes audits and inspections of credit unions. These are usually carried out by a team with technical knowledge and experience of working in the sector and provide a vital 'health-check' for the credit union. For example, if the percentage of assets is too low, or operational costs exceed the recommended maximum (5%), then advice and remedial action can be given.

Closer to home, in Scotland, the Scottish Credit Union Assistance Fund (SCUAF), which is administered by the Social Economy Unit, has provided 53 grants totalling £940,000 to assist credit unions to purchase premises, upgrade IT facilities, and train members of staff and volunteers. Furthermore, the Scottish Executive has provided an additional £400,000 a year for credit unions under the Scottish Credit Union Service of General Economic Interest Approval Scheme. The result of this substantial government support has been a rapid increase in the growth and viability of credit unions in Scotland, with membership rising from 189,317 to approximately 250,000 by 2006[19]. Between 2006 and 2009, eight credit unions in Scotland also benefited from government funds through the Financial Inclusion Growth Fund[20] – a sum totaling just over £3.6 million[21].

A recent review of credit unions in Scotland[22] pointed to the development of services to include the Credit Union Current Account offering an ATM cash withdrawal card, a direct debit and standing order facility or pre-paid debit cards, which also offer withdrawal facilities. Some credit unions are able to receive BACS Direct Debit payments and some offer Child Trust Funds, cash ISAs and a variety of insurance products.[23] One of the conclusions from this report is that critical to the expansion and self-sustainability of credit unions is the recruitment of more affluent members, and recommends that the government should provide funding to promote credit unions in order to support 'their endeavours to attract those with higher incomes and savings who might not previously have considered using a [credit] union.'[24]

International credit union experiences indicate that while there is not a 'one-size' fits all model of credit union or credit union development, there are some identified common characteristics or types of organisational activities that are seen as key to successful credit union development anywhere. These have been tabulated in Box 1.1 and are seen as fundamental to credit union expansion and progress in Wales.

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[19] Chambers, C. and N. Ryder (2008). "Current Developments: The funding of credit unions - where has all the money gone?" *Journal of Social Welfare and Family Law* 30(3): 243-252.
[20] See http://www.dwp.gov.uk/other-specialists/the-growth-fund/ for information on this UK government initiative
[21] Scottish Affairs Committee (2009) Credit Unions in Scotland: second report of the session 2008-2009
[22] Scottish Affairs Committee (2009) Credit Unions in Scotland: second report of the session 2008-2009
[23] ibid(2009)
[24] Ibid, 2009, p 14

Box 1.1: Common aspects of successful credit union development from UK and International Experience[25]
• Management and financial competencies and skills throughout the credit union • Sound governance procedures • Management and operational efficiency and financial discipline • The development of a sustainable business model • Balance between social and financial goals • Balance between member needs (participation, democracy, co-operative values) and economic and financial drivers • Meeting the financial needs of the whole population of a common bond, rather than a focus solely on 'the poor' • Diversification of a range of products and portfolio of services • Awareness of the dynamics of a pathway to financial inclusion • Capacity building for credit unions to reach financially excluded individuals and communities • Appropriate credit union legislation and policy to support infrastructure development • Technical and targeted financial support (as demonstrated by WOCCU interventions) • Supportive infrastructure (such as trade associations, development agencies) • Supportive and external inspection and audit of operational and financial systems as seen in the Canadian system

1.1 Applying international experience to a Welsh context

Welsh credit unions are fortunate to find themselves operating within an extremely supportive policy framework. Both politicians and officials working for the Welsh Assembly Government see them as playing a crucial role in achieving financial inclusion targets. As one key stakeholder put it:

> Credit unions in Wales provide vital access to financial services for many of our most vulnerable citizens. The Welsh Assembly Government supports credit union development, and I look forward to seeing the movement in Wales continuing to grow. (Welsh policy-maker).

This rhetorical support is backed up by considerable financial support. Financial support is currently available from the Welsh Assembly Government on the basis of Service of General Economic Interest contracts (SGEI) and from the Westminster Government through the Department for Work and Pensions' (DWP) Financial Inclusion Growth Fund. A number of Welsh credit unions have used the Growth Fund to both improve their overall financial position and to work more directly with financially excluded people in their common bonds. See Box 1.2 for details of Financial Inclusion Growth Fund Allocation in Wales.

[25] Chaves, R., Soler, F., and Sajardo, A (2008) Co-operative Governance: the case of the Spanish Credit Co-operatives, *Journal of Co-operative Studies* 41(2), pp 30-38; Côté, D (20050 Loyalty and Co-operative Identity: introducing a new co-operative paradigm in *Revenue Internationale de L'Économie Sociale RECMA* # 295, pp 50-69; Evans, A.C., and Richardson, D.C (1999) *Polish Credit Union Development: building a sustainable network of financial services to serve low income masses*, Research Monograph Series Number 17. Madison, WI: World Council for Credit Unions; Northern Ireland Assembly (2008), *The Role and Contribution of Credit Unions in Great Britain* , Research Paper 115/08 (Belfast: Northern Ireland Assembly); Richardson, D. C. (2000a), 'Model Credit Unions into the Twenty-First Century', in Westley, G. D. and Branch, B. (eds.), *Safe Money: Building Effective Credit Unions in Latin America* (Washington, DC: Johns Hopkins University Press), pp. 91-115.; Richardson, D. C. (2000b), 'Unorthodox Microfinance: The Seven Doctrines of Success', *Microfinance Bulletin*, 4: 3-7 (Washington, DC: Calmeadow)

Box 1.2 Growth Fund Allocation in Wales (June 2009 – Department of Work and Pensions)[26]	
Active Contracts	9
Inactive contracts	5
Total value of contracts:	£3,686,172
Revenue	£809,685
Capital	£2,420,238
Capital Expenditure	£456,249
Loans to June 2009	8781
Average value of loans	£470
Loans to new members	4183
Applicants:	
Female	73%
Male	27%
Ethnic breakdown:	
White British	8476
White non-British	47
Mixed British	9
Mixed non-British	3
Asian/Asian British	7
Black/Black British	11
Chinese/Chinese British	0
Other	40
Not stated/unknown	188

This fits squarely with the Welsh Assembly Government's Financial Inclusion Strategy for Wales and some of the credit unions with the highest growth rates in our research sample are in the Growth Fund. However, some of these same credit unions also have high loan delinquency rates. This is discussed more fully later, but it highlights the need for strategic deliberation by credit unions in applying for and using funds to support the development of their organisational goals and objectives, as well as contributing to government priorities. It also challenges financial and managerial competencies in complying with the rigours of application and reporting procedures. As seen from Canadian experience, the input of 'critical friends' in the form of Credit Union Central audits and reviews backed up with advanced skills and technical expertise can offer vital support in providing due diligence in loans processing and tackling issues such as debt recovery. Although there is developmental and remedial support offered through the Wales Co-operative Centre, this level of technical expertise and inspection is not currently available to credit unions in Wales.

Where management of external funding and project development works well, it is where credit unions are financially 'healthy', where their management and governance procedures are 'fit for purpose' and where there isn't an over-reliance on external funding. As seen both from international and more local Scottish experience, this links to developing an asset base which includes a diversity of members.

Some Welsh credit unions have also taken up opportunities for restructuring, again supported and facilitated by funding from the European Union, Welsh Assembly

[26] Personal correspondence

Government, UK Government and other charitable sources. This has seen many credit unions extend their common bond areas to enable the all-Wales geographical coverage. A number have entered into mergers with neighbouring or complementary credit unions, and most are now employing professional staff to support the management and administration of their services. This means that potentially every person living and working in Wales is able to join their local credit union, but overall, relatively few people actually take up this opportunity. In the year 1999/2000, the collective membership of Wales's credit unions stood at fewer than 10,000 members. Today, the latest figures available (collated as part of this research project) show that the movement's membership has now reached a total of 42,982 full adult members with a further 7,682 junior savers. Fig 1.3 shows the distribution of members across credit unions. The growth patterns for the most recent 5 years can be seen illustrated in Fig 1.4.

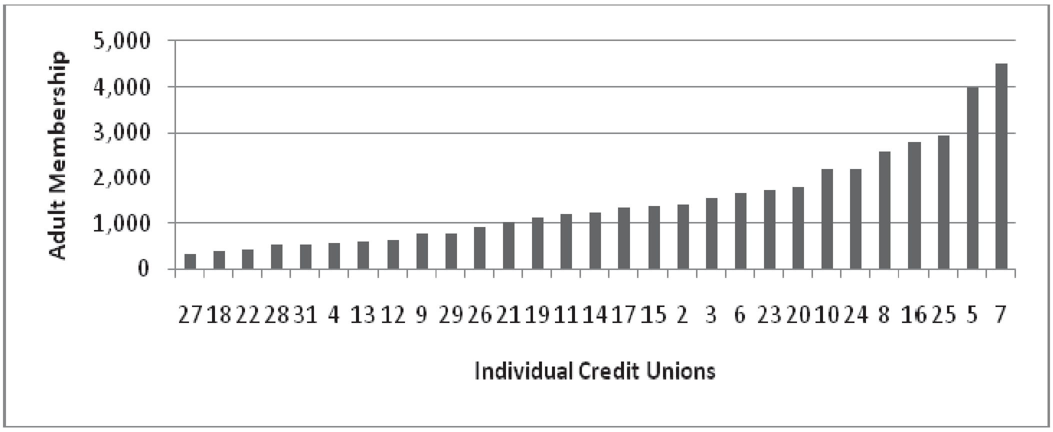

Fig 1.3 Distribution of adult membership across credit unions in Wales (Information collated from questionnaires for 29 credit unions)

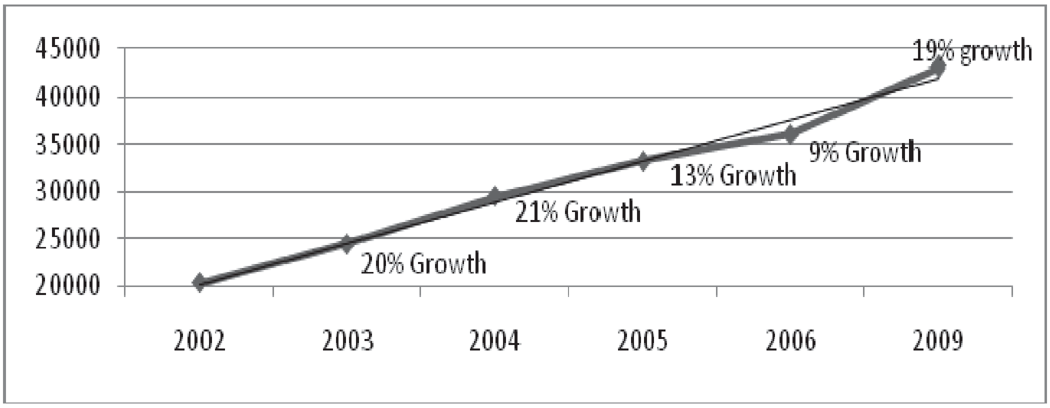

Fig 1.4 Growth trend in membership of Welsh credit unions, 2002-2009
(Based on FSA data for 2002-6; 2009 data from research survey)

Fig 1.4 shows a positive upward trend in the number of Welsh people who are members of a credit union but, as stated earlier, actual market penetration is just over 1.8%. There is also considerable variation to be seen between particular credit unions. One Welsh credit union has attained a 12.8% membership penetration rate in their local community, whereas only 0.5% of local people have joined the credit union with the lowest membership penetration rate. See Fig 1.5, which illustrates the current market penetration across the credit unions: the columns represent the proportion of the adult population within the common-bond area who are members of the credit union.

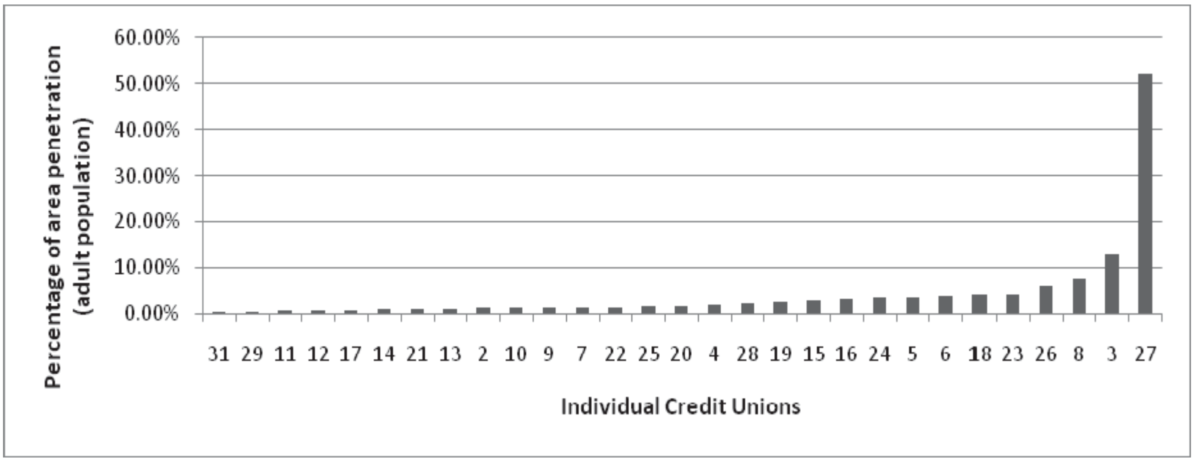

Fig 1.5 Common bond penetration (adult population)[27]

A review of credit union coverage reveals that all of 100 most deprived Lower Super Output Areas in Wales[28] are covered by one or more credit unions. However, this does not necessarily mean that there are high numbers of active members from these communities. The issue of member attraction is looked at later when considering credit unions' role in tackling social exclusion in their local common bond areas.

Growth can also be looked at in terms of members' assets, and here the pattern of growth is encouraging, with a fairly consistent upward trend for the years in which FSA data is available. This is illustrated in Fig. 1.6.

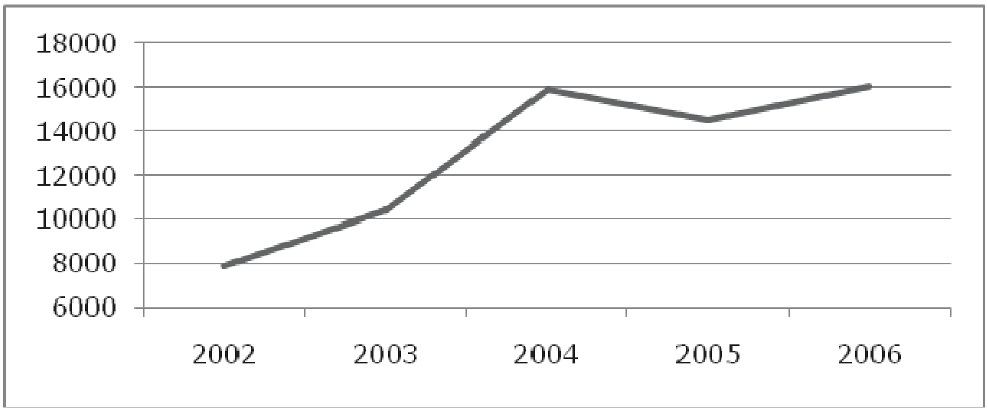

Fig 1.6 Member assets

However, credit unions rely on the interest they earn from lending savers' money out to earn a return and achieve their business targets. So, more importantly, the

[27] The high penetration figure shown in the graph is related to a community interest credit union with specific closed membership and organisational boundaries

[28] As identified and described in Wales Index of Multiple Deprivation statistics 2005 and 2008, for information, visit www.wales.gov.uk

proportion of loans as a percentage of assets is a critical success indicator. These percentages are illustrated in Figure 1.7, where the rates for England, Scotland and Wales are compared for the years 2002 to 2006.

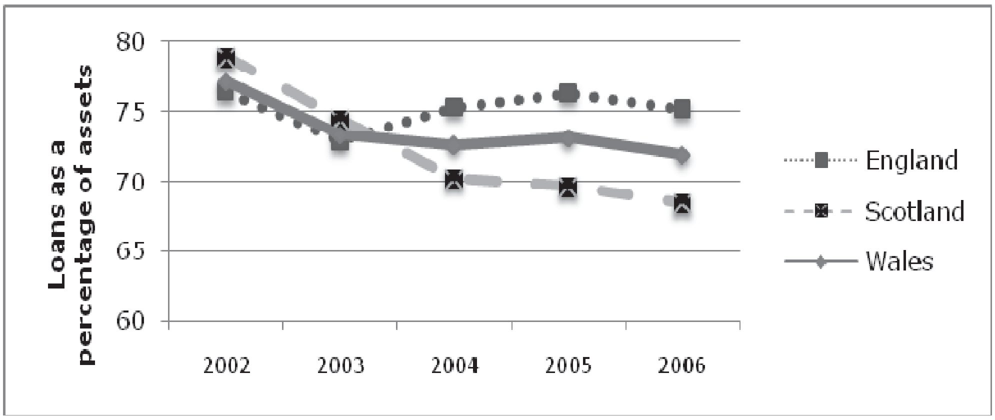

Fig 1.7 Loans as a percentage of assets: England, Scotland and Wales 2002-2006

The downward trends shown in the above graph are of concern, as they indicate a declining proportion of loans relative to total assets. When we look more specifically at the performance of Welsh credit unions using the PEARLS analysis (see next section, page 19), it is of further concern that in 2007, only 2 credit unions (out of 22) met the PEARLS target of between 70% and 80% of assets to be out on loan with members. More disconcerting is that 64% of this sample were lending at less than 60% of their assets.

A number of credit unions reported a change in their ability to process loans over the last two years and are fully aware of and concerned about their 'cash rich' status and the effects of the current economic downturn. While some credit unions are looking at ways in which to stimulate borrowing, this may well prove difficult for some to achieve and, if accompanied by a downturn in repayments from previous borrowing, this may well have a detrimental effect on overall performance and viability in some instances.

As part of a restructuring, partnering and merger process, some credit unions have also been developing their portfolio of products and services, which, as we saw earlier, is seen as a factor in building the strength and capacity of credit unions. A number of credit unions in Wales offer Child Trust Fund Accounts, 'instant loans' and variable rates of interest, based upon an assessment of the varying costs and risks associated with lending to different members (for example, charging more than the traditional 1% per month on outstanding balances for very small loans or loans to high risk or new members).

There are also examples of partnerships with Post Offices and the 'Pay Point' network. Llandudno Credit Union offers the 'Credit Union Current Account' as well as an increasing range of competitive and flexible products and services. Other credit unions are actively procuring pre-paid debit cards to give their members more flexible access to their money. However, the extent to which further product diversification will be the key to growing the credit union movement remains a matter of some debate among credit unions. In contrast to Llandudno, some credit unions believe that their future lies in increasing their market share in the core savings and loans market and only adopting extended services (such as their partnership with local Post Offices) where these help to facilitate and support this objective.

Credit Union Profile: Llandudno and District Credit Union – new products and services

Llandudno and District Credit Union (LDCU) was established in 1996 and began its operations from an office in a Social Services building with a dedicated band of volunteers who hoped that it could become self-financing without recourse to external funding. The original motivation was primarily to provide services to the financially excluded. By 2000, they had opened 3 collection points and had 500 members. When EU Objective 1 funds became available, they took the opportunity to employ paid staff and move to high street premises. Alongside these developments, they worked with Conwy Council to extend their common bond to cover the whole of the borough. The membership of the credit union has grown by 460% over the last 7 years, and its assets have increased by 351%, making it one of the fastest growing credit unions in the whole of the UK. Membership stands at 2,200, of whom 80% are located in the coastal strip at the North of the borough and the rest in the more rural areas. Approximately 40% of the members are on benefits, 40% are working people on low to moderate incomes, with the remainder a mix of the retired, the infirm and others. Today, the credit union is run by a board of 10 people who work in partnership with the manager and key volunteers in the leadership and governance of the credit union, with a number of directors still involved in day-to-day operations. However, although many of the directors operate at high levels of skill and competence, it is acknowledged by both themselves and the board that the board does need strengthening. The current staffing comprises 3 full-time and 3 part time posts of which one full-time and 2 part timers are funded through a DWP Growth Fund contract. Llandudno has been an enthusiastic advocate of the 'new model' for credit unions – breaking the link between savings and loans, charging variable interest rates on lending, aiming to pay a dividend on savings, and introducing new products. These have included Child Trust Fund Accounts and DWP backed instant loans. Plans are being developed to introduce the new 'Saving Gateway' Account when this becomes available next year, and LDCU is the only credit union in Wales actively seeking to introduce the Credit Union Current Account in partnership with Co-operative Bank and ABCUL. To this end, it is seeking a merger with neighbouring credit unions to form a single institution for North Wales, large enough to deliver the current account effectively and at a reasonable cost. From 2002-2009, LDCU has received project grants and contracts amounting to over £690,000 in total. They have received substantial funds from the Welsh Assembly Government (£187,000) and from the Department of Work and pensions (£60,000) specifically to develop the banking project.

Credit Union Profile: SAVEEasy Credit Union, Llanelli – increasing market penetration for core services

Llanelli and District Credit Union (trading as 'SAVEEasy') was established in 1998 by a group of 22 local Labour and Co-operative Party activists, (who were inspired by the example of the Save Easy Credit Union in Arizona in the USA), within the constituency of the now retired local Labour MP, Rt. Hon. Denzil Davies, who was a key mover in the passing of the Credit Union Act 1979. Working from offices in Llanelli town centre, the common bond has gradually been expanded to include Carmarthenshire and a number of wards in West Swansea. It currently employs a General Manager, Operations Manager and 4 full-time staff. There is also a part-time doorstep collector (insured through Co-operative Insurance), and a part-time Child Trust Fund worker. The services of a cleaner, an IT consultant and accountant are paid for on a contract basis for several hours a week. The initial employment of paid staff was supported by EU Objective 1 funds received through the Welsh Assembly Government. Currently, 10 local post offices act as collection agents, 3 members run collection points in their shops, and a 'save and collect' service is offered at local bingo halls and social clubs. The board consists of 15 members from a variety of business and professional backgrounds, who work in close partnership with the staff in leading and directing the business. SAVEEasy chose not to take part in the DWP Growth Fund, preferring instead to concentrate on increasing its penetration of the core savings based loans market – currently growing at a rate of 3-4% per annum. The impending increase in its common bond area will increase the potential number of members by 64%, which is seen as a key growth opportunity, and plans are progressing towards a significant investment in expanded and refurbished offices. They will be considering how to introduce the new 'Saving Gateway' accounts when these are launched, and have proposed the development of a nation-wide savings stamp scheme for primary schools. Prior to 2006, SAVEEasy received over £200,000 from the Welsh Assembly Government to support its post office initiative.

On the whole, the last ten years have seen significant developments within the credit union movement. There is a general acceptance of the need to service whole populations in common bond areas and to achieve diversification of membership. At present, although there has been a trend of increased membership from 2002 to 2009, there is also a general slowing of recruitment of new members as shown by the PEARLS analysis (see pp 26-27). Where credit unions have high growth, this has tended to be because of restructuring and mergers rather than new member recruitment. Over 40% of credit unions have a static or declining membership and one reported a 30% drop in members in 2007. As suggested later, this may well be due to increased vigilance in processing dormant accounts.

Credit unions in Wales are developing new and diversified products and services. Many are taking advantage of capital funding and project monies for marketing and targeted membership drives. Some are taking advantage of training and technical support and building the skills capacities of their Board and a number of credit unions have paid staff.

Two key dimensions, identified from UK and international experience, which contribute to the health of a credit union are management and operational efficiency, including financial discipline, robust procedures for accountability, governance and effectiveness, and these are considered in the next section.

2. Measuring Financial and Operational Performance

All credit unions were asked for Financial Services Authority (FSA) returns for the period 2004-2008 in order to undertake a comparative assessment of their financial and operational performance. Due to the timing of data collection, 2008 returns were not always available, so 2007 was the last complete year of financial and operation information collated. Information from 27 of 31[29] credit unions was analysed using the World Council of Credit Union's (WOCCU) financial management tool, PEARLS[30].

PEARLS is a standard analytical tool for credit unions throughout the world[31]. As a management and performance assessment framework, PEARLS is capable of measuring key areas of credit union operations, both in terms of financial structure and growth, and it enables credit unions to identify problems and find solutions to deficiencies. PEARLS sets standards for credit unions in the following areas, the first letters of which create the acronym for the monitoring system:

- **P**rotection – which refers to the adequacy of loan loss provisions to cover actual and potential bad debts
- **E**ffective financial structure – which measures loans, assets, savings deposits and reserves as a proportion of total assets
- **A**sset quality – which measures the level of loan delinquency and the amount of non-earning assets
- **R**ates of Return and Costs – which measures the net income into a credit union and the level of operational expenses and costs.
- **L**iquidity – this measures the level of liquid investments and reserves against potential savings withdrawals.
- **S**igns of growth – measurements of the growth rates of total assets, loans, savings deposits, capital reserves and membership.

PEARLS consists of over 40 interconnected financial ratios. For each ratio a goal of excellence is set – initially by the World Council of Credit Unions and then adapted for use within the British movement. Often these goals of excellence go beyond the current requirements of the Financial Services Authority. The importance of PEARLS for credit unions turns on the fact that ratio analysis reveals the interconnectedness of issues within the internal financial, organisational and operational structure of the credit union. Low levels of loans made, for example, result in high liquidity, and low rates of returns on assets. PEARLS analysis allows for more informed strategic decision-making and governance.

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[29] There are currently 29 credit unions in operation. Two credit unions merged with other credit unions but had supplied financial information; one was newly formed in 2007 so data was unavailable and one credit union did not supply any information for the period.

[30] This was undertaken in collaboration with the Association of British Credit Unions Ltd.

[31] PEARLS, which was originally developed in Latin America, is promoted in Britain by the Association of British Credit Unions (ABCUL) under licence from WOCCU. In Wales, all but four credit unions are members of ABCUL.

Out of the 40-plus indicators, WOCCU identifies a number of key indicators – thirteen in all - that provide an overview of credit union performance and viability. These have been adapted by ABCUL to be country specific and to mirror British practice and experience. It is these ABCUL priority indicators that have been used as an analytical tool within this study (see Table 2.1).

Table 2.1: Key PEARLS ratios

	P-E-A-R-L-S RATIOS	Goals (Excellence)
P	**P**rotection	
P2	Net Bad Debt Provisions / Required for Delinquent loans. 1-12 Months	Provision to cover 35% of all delinquent loans outstanding for between 1 and 12 months
P6	Solvency	Minimum 111%
E	**E**ffective financial structure	
E1	Net Loans / Total Assets	70-80% of assets to be out on loan
E5	Savings deposits / Total Assets	70-80%
E8	Institutional Capital / Total Assets	Equal to or more than 10%
A	**A**sset quality	
A1	Total Delinquency / Gross Loan Portfolio	Less Than or Equal To 5%
R	**R**ates of Return and Costs	
R9	Operating Expenses / Average Assets	5% or less
R11	Other income /Average Assets	Minimal
R12	Net Income / Average Assets (ROA)	Enough to reach the FSA goal of 10% institutional capital
L	**L**iquidity	
L1	Liquid Assets – Short Term Payables / Total Deposits	15-20%
S	**S**igns of growth	
S10	Membership	Minimum 12%
S11	Total Assets	More Than Inflation + 10%

2.1 What PEARLS analysis tells us about Welsh credit unions.

Previous research (Jones 2005[32]) has demonstrated that credit unions grow faster when they plan and manage their business based on quantifiable and robust data, and credit union personnel are increasingly recognising that quantifiable and objective analysis of financial performance constitutes an essential standard business practice. The data and evidence produced through PEARLS analysis challenges board members, managers and credit union staff to make decisions based on evidence and fact, rather than on opinion, and to identify areas for improvement. In this way, PEARLS analysis identifies problems and assists credit unions to determine solutions for institutional and operational deficiencies. The information presented here

[32] Jones. P.A., (2005) *Creating wealth in the West Midlands though sustainable credit unions.* An Action Research Report. ABCUL

highlights current strengths of credit unions in Wales, but also areas for improvement.

There are some data gaps in the information gathered from credit unions. This is due to some credit unions being relatively new; others merging during the period; original data not being provided; or, in some cases, incomplete or mismatched financial and operational data. However, sufficient information has been gathered to provide a sound overview of the 'state of health' of credit unions, based on submitted information. In order to provide a summary comparative analysis, 2005 and 2007 data are used and credit unions have been allocated a unique identifying number (1-31) to preserve anonymity.

Protection

Protection of assets is fundamental, and the first measure (indicator P2) evaluates how adequately credit unions have made provision for loan losses, that is, allowance for bad debt or loans that may not be repaid (i.e. may have to be written off). In this instance, protection is deemed sufficient if credit unions can demonstrate provisions to cover 35% of all delinquent loans outstanding for between 1 and 12 months.

In our sample, of the 22 credit unions reporting for both 2005 and 2007, 95% and 91%, respectively, of credit unions reported provision exceeding 35%, with 64% showing provision of 70% or more. By 2007, 59% had seen a decrease in their loan provision, although the majority were above the goal of 35%, and 18% of credit unions had been able to increase their loan provision in the two-year period. However, only 30% of credit unions had fully charged off delinquent loans (over 12-months in arrears) in 2007 compared to 45% in 2005, which suggests, as highlighted earlier in the report, that some credit unions are experiencing an increased problem of bad debt.

Solvency is a second critical indicator (P6). This measures the degree of protection that a credit union has for the savings of its members in the event of liquidation of the credit union's assets and liabilities. However, it is important to note that the PEARLS standard is set higher than a basic measure of solvency, where positive net worth is calculated at 100%, which demonstrates that assets of the credit union are able to meet its liabilities. The PEARLS standard is greater or equal to 111%, indicating that credit unions can more than meet their liabilities. The reason for this higher standard is to build credit unions as strong and stable organisations, well protected against future financial difficulties.

By 2007, data collected for a total of 22 credit unions showed positive net worth (over a 100% ratio - despite 40% of credit unions showing a slight decrease in protection), compared with 95% in 2005. However, only 27% met the PEARLS solvency standard in both 2005 and 2007, indicating that over 70% of the group need to prioritise building their financial strength through amassing reserves.

Effective financial structure.

The net loans/total assets ratio (E1) measures the percentage of total assets invested in the loan portfolio. It is only when assets are out on loan that they generate income to cover costs and to build reserves, while at the same time serving members with the loans they need. The PEARLS target is for 70% to 80% of assets to be out on loan with the members. Fig 2.1 presents Loans to Assets ratio percentages for individual credit unions.

In 2007, only 2 credit unions out of 22 (9%) met the PEARLS target. Two credit unions (9%) were lending more than 80% of assets. This probably indicates a high demand for loans in these particular credit unions, and a high level of member service, but at the same time, it also risks problems of liquidity.

Many more, 14 credit unions in total (64%), were lending less than 60% of their assets. The percentage of assets out on loan declined in over a third (36%) of credit unions between 2005 and 2007. This suggests that many credit unions are not maximising their potential as credit-granting institutions and it may indicate a need for more effective loans policies and credit administration. However, as indicated earlier in the report, this is also a trend across England, Scotland and Wales and may be indicative of more macro-economic factors and borrower/lender behaviour change as a result of the 'credit crunch'. It is also important to note that some Financial Inclusion Growth Fund credit unions may have been in receipt of DWP funds for on-lending but had not yet converted those funds into loans. This would reduce their loan to asset ratio.

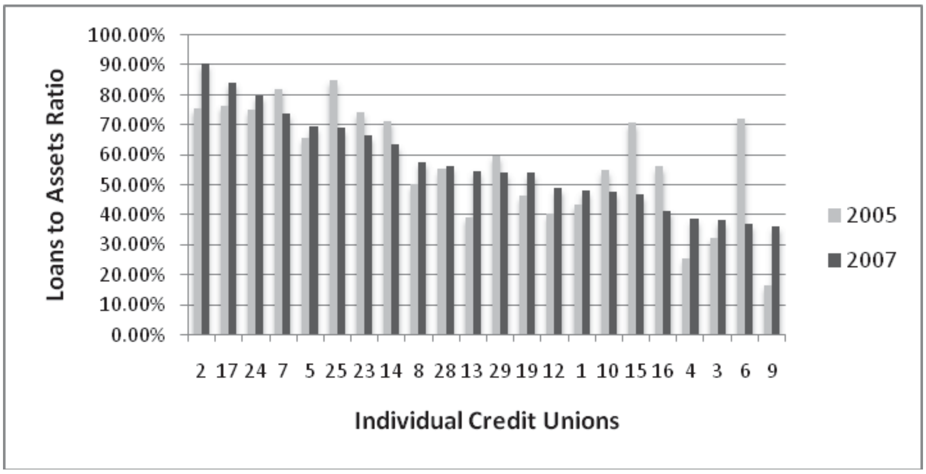

Fig 2.1: Loans to asset ratio

In the current economic climate, being able to assure members that their savings are well covered by liquid assets and applying a cautious approach to new lending demonstrates an understandably prudent approach. However, long-term financial sustainability is dependant upon getting more members' savings out on loan and earning a return.

Another key indicator is the ratio of savings to assets. The goal for savings deposits / total assets indicator (E5) is between 70 and 80%. Welsh credit unions have been funded primarily through savings, rather than by external funds granted for on-lending. A healthy percentage of savings deposits can demonstrate that a credit union may, for example, have well-developed targeted marketing and may be on its way to achieving financial self-sustainability[33]. In 2005, the overall average savings

[33] Richardson (2002) 'Unorthodox Microfinance: The Seven Doctrines of Success', *Microfinance Bulletin*, 4: 3-7 (Washngton, DC: Calmeadow).

to asset ratio was 81% (22 credit unions). There was a 7% decline from 2005 to 2007 to 74%, most likely due to the Financial Inclusion Growth Fund.

Finally, in this particular set of standards is the measure of institutional capital (E8) – or statutory reserves - in relation to total assets. As a last resort, institutional assets can be used to absorb losses from loan losses or operational deficits, although it is more prudent to create adequate loans loss provisions, as seen earlier. The target is a minimum 10% capital / assets ratio.

In Britain, credit unions are registered under the Financial Services Act as 'Version 1 or 'Version 2' credit unions[34]. Version 1 credit unions - which apply to all Welsh credit unions - do not have to meet any particular institutional capital target at this time. However, it seems clear that the FSA will introduce a minimum capital requirement, as yet undetermined, in the near future. It is envisaged that this could possibly be around 3%. In 2007, of 22 credit unions for which full data is available, nearly 70% met this 3% capital / asset target.

However, a 5% capital / asset ratio is an important measure for Version 1 credit unions, as attaining this ratio enables additional activities to take place. From 2007 for example, Version 1 credit unions were able to pay different dividends on different accounts, provided that, at the time of payment, they had a capital/asset ratio of at least 5% and the payment of the dividend did not reduce the ratio to below 5%. 41% of the group had a capital asset ratio higher than 5%.

Furthermore, according to PEARLS, credit unions are recommended to have at least 10% capital adequacy. In 2007, 10% of the group met the PEARLS institutional capital standard (none in 2005) and one credit union had a negative capital ratio of -8%. However, remedial action has since been taken with this credit union and it continues to trade solvently.

Asset Quality

Assets can be looked at in two ways – assets that accrue or generate income and those that are non-earning. Non-earning assets can negatively affect credit union performance so it is important to identify the potential impacts of these assets. The total delinquency / gross loan portfolio ratio (A1) measures the percentage of outstanding delinquent loan balances in the loan portfolio. It measures the amount of loans on the books that are vulnerable to default and write-off.

The PEARLS target is that the delinquency ratio should be less than or equal to 5% on loans one month or more in arrears. In the British context, where delinquency is measured only on loans three months in arrears, this ratio target should be lower than 5%. However, for ease of calculation, ABCUL adopts the 5% target as standard. From Fig. 2.2, below, in 2007, 23% of credit unions appear to be controlling bad debt within the PEARLS limit. This compares with 41% of credit unions in 2005.

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[34] Part IV of the Financial Services and Markets Acts defines credit unions as either 'Version 1' (offering a traditional range of savings and loans services and being subject to somewhat stricter regulation) and 'Version 2' (which are larger and financially stronger and so are permitted to undertake a wider range of services, larger loans etc). For more detail, see ABCUL's information sheet 'Version 1 and Version 2 – what is the difference?' at http://www.abcul.coop/lib/liDownload/908/Version%201%20and%20Version%202%20-%20what%20is%20the%20difference.pdf

In 2007, 41% of credit unions had bad debt ratios over double the PEARLS recommended target ratio. This was up from 32% of credit unions in 2005. There are some credit unions where loan delinquency has become a significant problem, even reaching over 27% in one case. However, despite the onset of the 'credit crunch' during the period under review, the median bad debt in the group of 22 is 7.75% which is a slight increase from the median 7.14% in 2005. Rising bad debts are a critical problem for credit unions and ultimately lead to insolvency. The problem of bad debt merits further investigation in several credit unions to seek out underlying causes and improvements sought to achieve on target results.

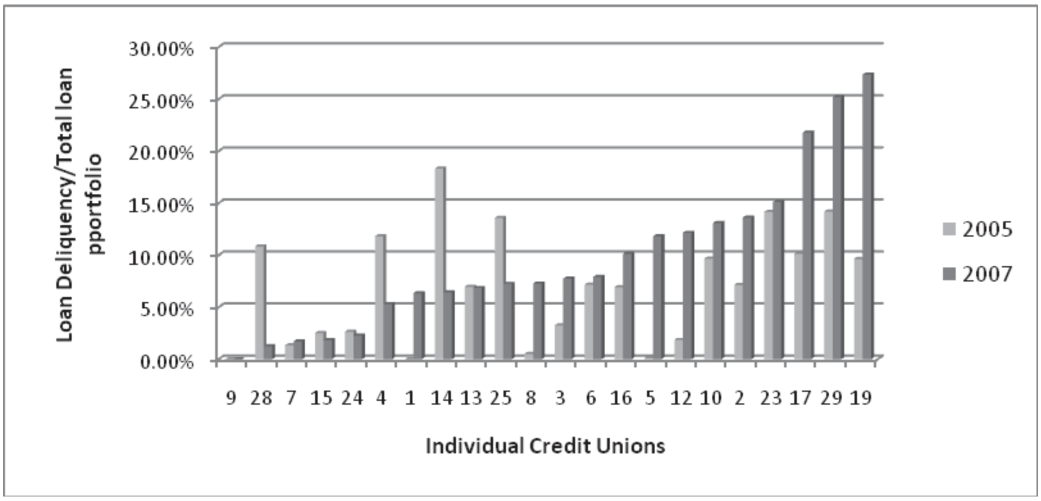

Fig 2.2: Loan delinquency in 22 credit unions.

Rates of Return and Costs

The operating expenses / average assets (R9) measures the cost associated with the management of all credit union assets. This cost is measured as a percentage of average assets from the current and previous years. This indicates the degree of operational efficiency or inefficiency. According to PEARLS, efficient credit unions have a ratio less than 5%. Inefficient credit unions with high expense ratios may find it difficult to pay real rates of return on savings and to charge competitive rates on loans

In 2007, 3 out of 22 credit unions were operating within the PEARLS efficiency standard[35]. These were small volunteer operations, without paid staff costs and without any external funding. All credit unions with staff had higher operating costs.

Over 60% of the 22 credit unions more than double the target level of 5% of operating costs / average assets. Some staff costs and operating costs have, in the past, been underwritten through Welsh Assembly Government and European funds, and will continue to be supported to some extent through the SGEI contracts and the DWP Financial Inclusion Growth Fund. However, in the longer term, sustainability depends on greater awareness of dangers of grant dependency and unearned income that might disguise organisational inefficiencies.

Grants received by credit unions, along with donations and other external financial support, are classed as 'other income'. PEARLS calculates the ratio of other income

[35] This figure applies when looking at information supplied for 27 credit unions for 2007.

as a proportion of assets (R11) and recommends that the aim is to minimise other income in order to ensure that costs are generated from the business itself.

In the Fig 2.3 shown below, the operating expenses ratio (R9) is plotted against the grant income ratio for 2007 (R11) for each of the 22 credit unions for which this data is available. It is clearly seen how high operating expenses are offset by external grant income in about 40% of credit unions. Credit unions without external income tend to keep operating expenses low. The challenge for Welsh credit unions that have expanded the business with external financial support will be to drive down operating costs as a proportion of assets to ensure long-term sustainable development.

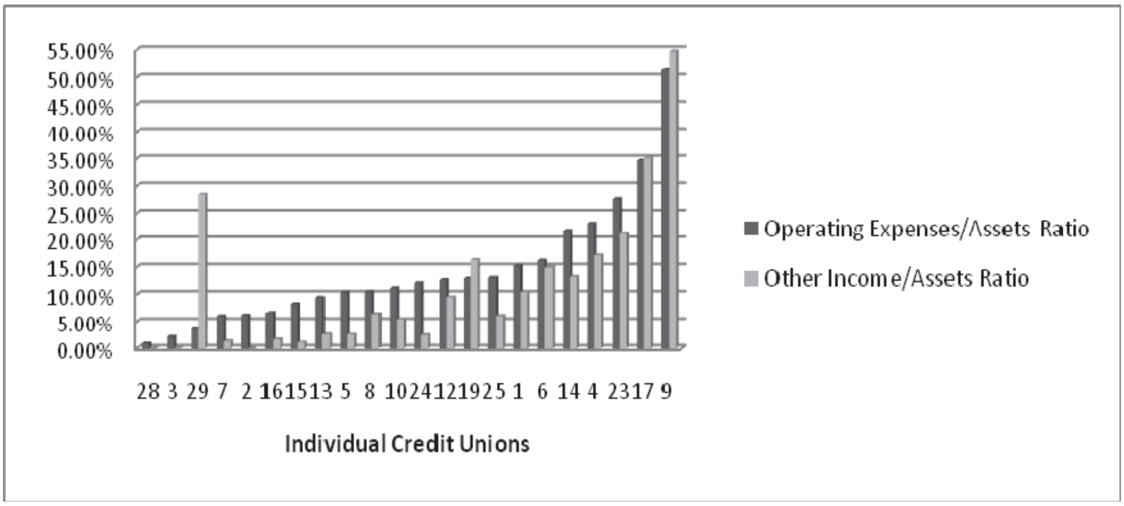

Fig 2.3: How grant income offsets high operating costs in Welsh credit unions (2007 figures)

A key activity is building statutory reserves or institutional capital, and PEARLS provides a means of measuring the adequacy of earnings and the capacity to build to do this (R12). It measures the net income after all costs, expenses and dividend payments on savings have been met. The ratio should be sufficient to increase net institutional capital as a proportion of total assets to 10%. A positive figure demonstrates capacity to build the capital of the credit union. A negative figure indicates that the credit union may be running at a loss.

In 2007, 68% of 22 credit unions had positive net income. The remaining 22% with negative net income were potentially running at a loss over the year. While there may be specific local circumstances to explain this fact, these credit unions will need to seriously consider their position if positive net income was not generated again in 2008.

Liquidity

The maintenance of adequate liquid cash reserves is a key ingredient of sound financial management, and this indicator (L1) measures the adequacy of the liquid cash reserves to satisfy savings withdrawal requests and to pay all immediate short term payment obligations (due in less than 30 days). The PEARLS ratio target is for this to be between 15-20% of total savings deposits. This compares with the FSA requirement that a credit union ‘must at all times hold liquid assets of a value equal to at least 5% of its total relevant liabilities' (10% for version 2 credit unions, of which there are none in Wales). [36]

Total relevant liabilities are savings that are 'treated as freely withdrawable', and not frozen by attachment to outstanding loans, junior savings and other liabilities with an original or remaining maturity of less than three months. In practice, the liquidity requirements of the FSA are much lower than those of PEARLS.

In 2007, out of 22 credit unions, 100% met the FSA standard for liquidity and 91% exceeded the PEARLS target of holding 15-20% of assets as liquid reserves. The figures for 2005 are 95% in both instances. In 2007, 45% of credit unions had a liquidity ratio of over 50%, compared to 32% in 2005. In a number of cases, this was likely to be a result of overcautious approaches to lending and / or of difficulties in building the loan portfolio. However, the high level of assets in Financial Inclusion Growth Fund credit unions is likely to be as a result of DWP deposits not yet lent out to members. In 2007, only one credit union had too little liquidity, according to the PEARLS standard, undoubtedly due to building the loan portfolio. See Fig 2.4 for a full breakdown.

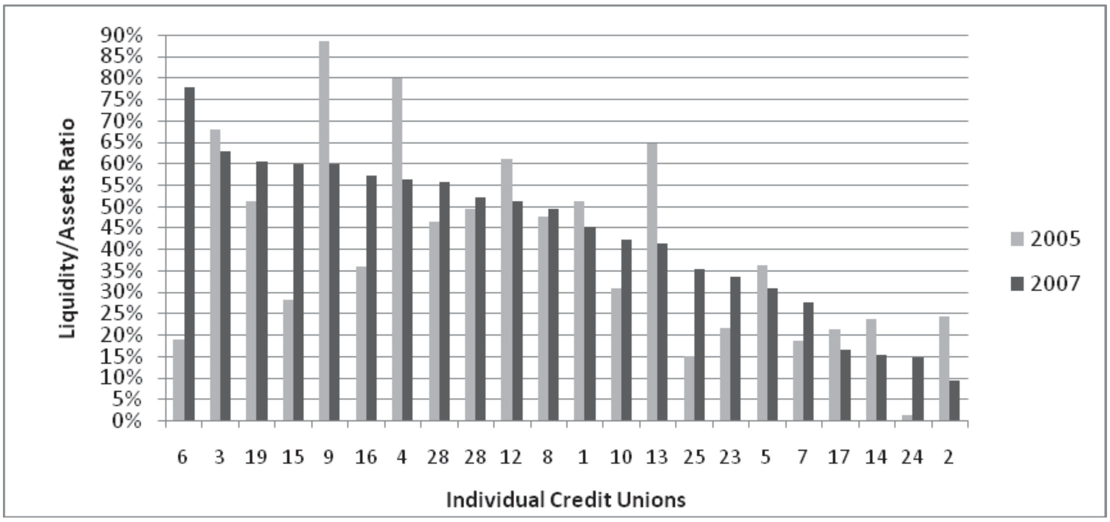

Fig 2.4: Liquid Assets / Total Deposits

Growth in membership

The final standards look at different measures of growth, profitability and increased potential for sustainability. One of the two ratios that help to indicate growth for credit unions in Wales is growth in membership (S10). This ratio measures the year-to-date growth in membership. The international PEARLS target is to attain a yearly increase of more than 15%. In Britain, ABCUL have a suggested growth target of 12% as more feasible.

Looking at figures for all collated information for 2007 (27 credit unions), 48% in the group exceeded 12% growth and 37% exceeded 15% growth. It is to be noted that several high growth credit unions will have gained members through mergers rather than new member recruitment.

[36] FSA CRED 9 refers to requirements on liquidity. The FSA CRED is the Credit Union Sourcebook, which sets out regulatory requirements for credit unions, see http://fsahandbook.info/FSA/html/handbook/CRED

The comparison data between 2005 and 2007 is useful to see the fluctuation in membership numbers. Only 17 complete datasets are available and Fig. 2.5 indicates percentage rate of growth for the two years.

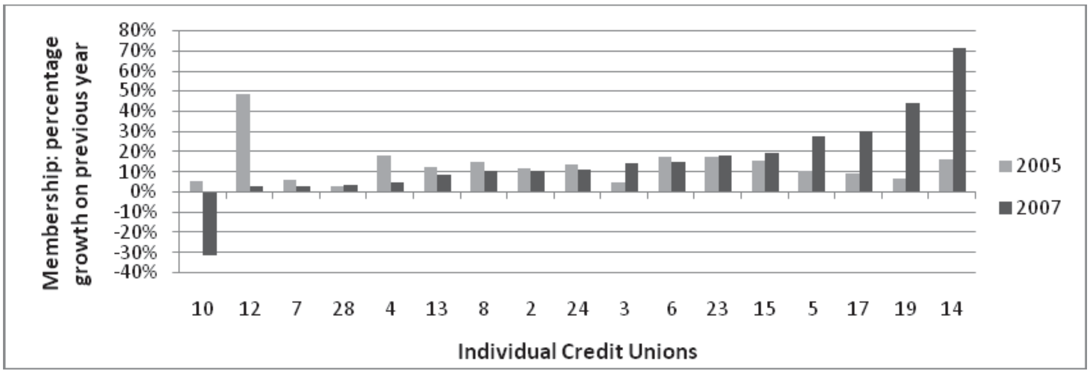

Fig 2.5: Annual percentage membership growth in credit unions – 2004/5 and 2006/7

In 2007, two credit unions were only able to sustain a growth rate of less than 3% and one credit union lost over 30% of its members, probably by clearing its books of inactive members. However, it is noticeable from Fig. 2.5 that the rate of growth of membership has slowed down in 9 credit unions out of the 17 for which data for both years is available. In 8 of the credit unions, growth rates are increasing.

The final growth ratio measures the year-to-date growth of total assets (S11). The aim is for a 10% plus inflation annual growth rate. This is estimated at 12% for 2007. Fig 2.6 indicates some significant growth in assets. However, it is important to note that for Financial Inclusion Growth Fund credit unions, the deposit of external funds into the credit union does increase this ratio. This explains the high increase in certain instances.

Of the 17 credit unions for which data was available for 2005 and 2007, 14 exceeded the PEARLS asset growth target.

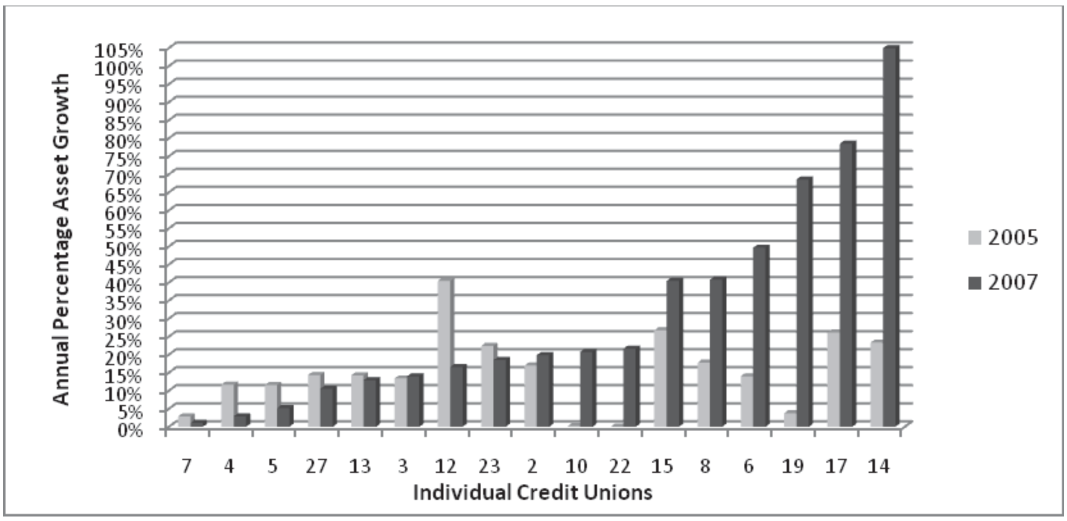

Fig 2.6: Annual percentage asset growth in credit unions – 2004/5 and 2006/7

Summary of data

A number of the key common success factors noted in the first section of the report relate to financial management. These along with a summary of key measures and headline indicators are outlined in Box 2.1.

Box 2.1: Key PEARLS indicators of Welsh credit union performance 2005 and 2007

Bad debt provisions

- Over 90% of the credit unions had adequate provision against bad debts in 2007 (P2).
- However, 59% had seen a decline in loan provisioning from 2005.

Solvency

- 27% of the credit unions in 2005 and 2007 met the PEARLS solvency standard.
- All credit unions in 2007 had positive net worth, up on 95% in 2005 (P6).

Loan to asset ratio

- In 2007, the amount of money out on loan was below target in 64% of credit unions (E1). Only 9% of credit unions met or exceeded the loan to asset standard in 2007 (40% in 2005). The percentage of assets out on loan declined in 36% of credit unions between 2005 and 2007.

Savings deposits / total assets

- Welsh credit unions are funded through savings and not primarily by external funds granted for on-lending. The overall average savings to asset ratio is 81% (E5).

Institutional capital

- 41% of the credit union group had a capital asset ratio higher than 5%.
- 70% of the group had a capital asset ratio greater than 3%.
- 10% of the group of credit unions met the PEARLS international 10% institutional capital standard in 2007 (none in 2005) (E8).

Loan delinquency

- Only 23% of the group met the delinquency standard (41% in 2005) (A1).
- The median bad debt ratio in the group, in 2007, was 7.75%, up from 7.14% in 2005.
- In 2007, 41% of credit unions had bad debt ratios, over double the PEARLS recommended target ratio.

Operating expenses

- In 2007, operating expenses were high. Only 3 credit unions met the expenses ratio standard (R9.
- In about 40% of the group, high operating expenses were compensated for by grant income**.**

Net income

- 68% of the group of credit unions had positive net income in 2007(R12), demonstrating their capacity to grow as safe and sound financial institutions.

Liquidity

- 100% of credit unions met the FSA standard for liquidity in 2007.
- 91% exceeded the PEARLS target of 15-20% compared to 95% in 2006 (L1).
- 45%of credit unions had a liquidity ratio of over 50%.
- One credit union had insufficient liquidity, most likely due to building the loan portfolio.

Membership growth

- In 2007, 55% of the credit unions in the group exceeded 10% growth and 37% exceeded 15% growth (S10).
- In 2007, despite slowing membership rates, only two credit unions sustained a growth less than 3%.

Asset growth

- 14 out of 17 credit unions met or exceeded the asset growth standard in 2007.

Common aspects of successful credit union development to note here, include:

- Management and financial competencies and skills throughout the credit union
- Sound governance procedures
- Management and operational efficiency and financial discipline
- The development of a sustainable business model
- Balance between social and financial goals
- Technical and targeted financial support (as demonstrated by WOCCU interventions)
- Supportive infrastructure (such as trade associations, development agencies)
- Supportive and external inspection and audit of operational and financial systems as seen in the Canadian system

As well as using PEARLS and data to benchmark across credit unions, PEARLS also gives a profile of individual performance. This is because a credit union may focus on 'good' performance in one or two areas rather than 'whole' performance across all indicators. PEARLS analysis therefore provides a useful 'stock take' of performance and an audit of key indicators. If, for example, we look at one of the sample credit unions with a reasonably sized membership, we can see its performance profile by mapping the PEARLS key indicators - see Fig 2.7.

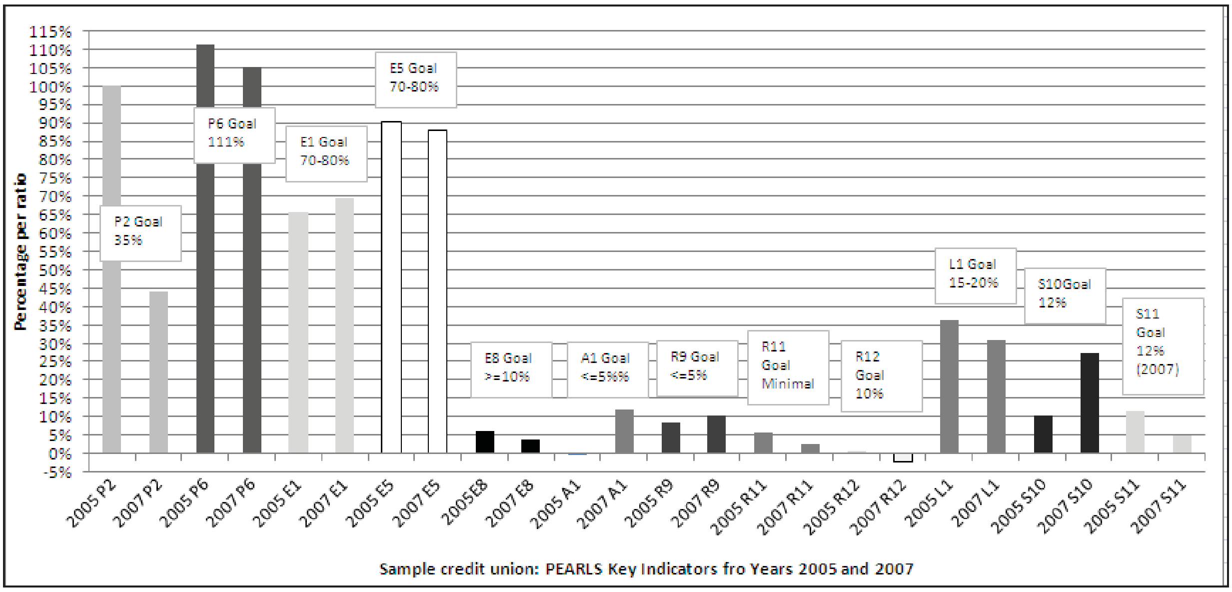

Fig 2.7 PEARLS profile for sample credit union

Looking briefly at Fig 2.7, we can see that this credit union is working well towards some of the key indicators (P2, E1, E5, L1, R11 and S10). However, there are areas that need to be looked at more closely to see why, for example, P6 solvency goals, which were on target in 2005, are now below the recommended 111% (although it should be noted that positive net worth still exceeds 100%). Other areas for examination include: operating costs (R9); loan delinquency (A1 – an increase from 2005); net income/average assets (R12) and total assets (S11). The figures provide a platform for strategic discussion and decision-making and may be explained by particular circumstances or events as seen in the earlier PEARLS commentary. The profile may provide an indication for a need to intervene and for targeted activities to get a credit union back on track and to support continued development.

What we can see from both international credit union experience and the PEARLS ratio analysis is that defining and understanding 'success' for credit unions is multi-faceted: success factors and challenges for Welsh credit unions will be looked at in the next section.

3. Success factors and challenges to delivering sustainability and growth

In addition to the dimensions identified from the international credit union movement and the key financial indicators through PEARLS, the following key success factors were identified by credit union members, employees and board members during the focus group stage of this research:

- High levels of trust between credit unions and their local communities;
- High level of membership relative to the size of the common bond;
- Focus on lending money as well as taking deposits;
- Strategic and goal focussed approach policy developments, for example SGEIs, that takes into account the business objectives of the credit union itself;
- Professional and entrepreneurial attitudes among credit union managers;
- Support from the local authority, where available, which could also help to underpin the credit union's success.

This section examines opportunities and challenges for successful growth and sustainability of credit unions in Wales, in particular: role definition and sustainability, including credit unions' role in combating financial exclusion; the 'modernisation dilemma'; performance management; capacity building; and image and branding.

Credit Union Profile: Employee-based Credit Unions in Wales

There are 4 credit unions whose membership is based on working for a particular employer, and 1 which is based upon membership of another organisation. Employee-based credit unions often enjoy in-kind support from employers, such as office space, access to payroll deduction facilities and the opportunity to visit workplaces. As yet, they have all adhered to a traditional model of savings and loans and chosen not to participate in the broadening of services agenda or to apply to government or other grants schemes. The largest of these are:

- Plaid Cymru Credit Union(for members of Plaid and their families) with 520 members;
- Transave Credit Union, and
- Penny Post Credit Union (for postal workers in the West Midlands and Wales) with 362 members in Wales.

The employee-based credit unions rely upon trade union representatives, new staff induction procedures and periodic visits by staff to workplaces to recruit members, and Plaid relies on a combination of word of mouth and a regular round of mailings to party members. All these organisations are well-established and financially self-sustaining. They are seeing a steady growth in membership and there is a clear community of interest among members and perceptions of a high quality, personal service. Planned change for Plaid Credit Union is the possibility of broadening its common bond to include Cornish and Scottish Nationalists and to offer membership to local party branches as well as individuals.

Transave is a major UK-wide credit union for employees of the bus and train company First Group PLC with a total membership in excess of 7,000 people. Within Wales, the company employs 1,000 people, of whom 492 are currently members of the credit union. This is the highest member penetration of any credit union in Wales and has been achieved and maintained through a number of activities that could be replicated by any credit union with members whose employers are willing to operate payroll deduction. Whenever a new worker joins First, mention of the credit union is included in their basic induction to the company. This is backed up by trade union shop stewards in each workplace, who try to recruit members to the credit union at the same time as they join the trade union, and by occasional formal presentations in the workplace from Transave staff. The excellent level of service on offer means that word of mouth amongst colleagues reinforces these positive messages from management and the unions.

3.1 Tension over Role Definition and Financial Sustainability

Credit unions are facing a difficult tension between their role as a co-operative business and their 'mission' of providing financial services to members of society excluded from mainstream banking and financial services. As one respondent explained:

> There obviously is a tension between wanting [credit unions] to be financially viable and wanting them to provide a service to the poorest people, who may not be able to save enough to support it. So if you really wanted to target the most in need with this service you will have to support it to some extent. (Credit Union Director).

Furthermore, as one key stakeholder pointed out, members of credit unions have different motives when they join:

> Credit unions are basically for providing access to financial services for everybody, but specifically for people who cannot easily access mainstream financial services. I have been a director of a credit union for over 12 years, so I am greatly aware of the types of people credit unions attract; generally 65-70% members are on low incomes. The remaining 35-30% of people don't *have* to be members of the credit union but *choose* to be, in preference to a bank account. Credit unions need both kinds of people – people who are inclined to save, but also people who are more inclined to borrow, as this is the only way credit unions can generate income for their sustainability. Credit unions are for everybody, but they do have a clear target market, which is different to the target market of banks and building societies. (Credit Union Director).

Both these quotes highlight the need for balance between social and economic goals and between members' needs and economic and financial drivers. They also point to the tension between using government and other funding to build membership or services, while having an eye to the continued financial stability and sustainability of the business. In the words of a policy-maker in the Welsh Assembly Government:

> … I don't think that we should be looking to a time where the government will continually have to support the credit unions, but I don't think we're anywhere near the stage yet that we can cut them adrift. (Welsh Assembly Government policy-maker).

One concern expressed by some related to public funds being invested in financial institutions which also have members who are 'comfortably off'. However, it is recognised by credit unions that viability of their organisations relies on a balance of membership between richer and poorer members, and between savers and borrowers, and there is recognition among policy-makers that credit unions will continue to depend upon external funds to support some aspects of their operations for the foreseeable future.

Some respondents suggested that credit unions are one of a number of public or human service organisations (e.g. Citizens' Advice Bureaux, housing associations, local development agencies, housing and homelessness agencies) working to meet targets of a social and economic agenda. They recognised that, for the most part, this work is non-income generating. As such, it may be possible to account for this work separately (such as with activity-based costing and accounting) and this could then be a subsidised part of the overall credit union activities, separate from but complementary to the main business of being a viable financial co-operative.

Credit Union Profile: Undeb Credyd y Llechen Cyfyngedig (Caernarfon & Yns Mon)

Undeb Credyd y Llechen Cyfyngedig was established in 2000, following the formation of the original Study Group in 1997, which consisted of local community activists in Bangor. The original Common Bond was applied to those who live and work in Bangor and the surrounding area, but has now been expanded to cover all Ynys Mon and Gwynedd. The common bond covers a total population of 187,400 people across 3,262 Km^2. Building a membership base is clearly the major task, and this is well recognised by the Board and staff. Y Llechen is relatively young, and serves a difficult area geographically, having a low population density, no large towns, a separate island community and many people who are geographically excluded by poor public transport. Additionally, it is a strongly bi-lingual area, and serving the needs of both languages adds an administrative cost burden, as well as making marketing more difficult. The credit union operates from small shop-fronted, rented premises and has 3 paid staff and 71 volunteers who staff the shop and operate the 8 Collection points across the area. Y Llechen has received £232,124 in grant support over the last 3 years, which is equivalent to £300.29 per member, which is considerably higher than the Wales average of £77.82. It has 773 active members, which represents the second lowest market penetration in Wales at 0.52%. Y Llechen has received substantial financial support from the Welsh Assembly Government. In the last three years, the credit union has received over £230,000 in funding.

3.2 Serving Wales's Poorest Communities

Many Welsh credit unions serve areas which are economically deprived and where many people live on low incomes. All the most deprived one hundred areas identified in the Welsh Index of Multiple Deprivation 2008 fall within one or more of the credit union common bond areas. The actual rates of membership in these areas are not currently known (or recorded by credit unions). In a recent HM Treasury review carried out by Experian[37], only Llandudno Credit Union was identified as currently serving the financially excluded. However, it should be noted that the review starts with the assumption that the Financial Inclusion Growth Fund is a strong indicator of capability and so the weighting favours those credit unions that have taken part, or show willingness to take part in the growth fund.

Llandudno's current common bond area covers one identified lower layer super output area[38] (LSOA), which, according to the 2008 Welsh Index of Multiple Deprivation, is currently ranked at 44 with an overall deprivation score of 60.6. We can compare this to Newport Credit Union, which received an Experian rating of 0 (not serving the financially excluded) which includes 7 LSOAs in its common bond, of which 4 are ranked at less than 44 (22, 31, 36 and 41). Clwyd Coast Credit Union covers 5 of the 100 most deprived LSOAs, of which 3 are in the 5 most deprived areas (ranked at 1, 4 and 5). Clwyd was given a rating of 3 by Experian: it 'currently serves the financially excluded, with potential to grow'. The other credit union receiving this rating in Wales was Dragonsavers, which covers 12 of the LSOAs, of which 3 are in the 20 most deprived areas (ranked 10, 12 and 16). Cardiff Credit Union - which now includes Vale of Glamorgan - has the potential to cover the

[37] HM Treasury (2007), Review of the GB cooperative and credit union legislation: a consultation. HM Treasury, London

[38] An LSOA is a geographical area with a population of approximately 1500 people used for statistical purposes. The areas have names such as Neath North 2, or Rhyl West 1

highest number of the most deprived LSOAs in Wales (i.e. 19 of the top 100 LSOAs) and received an Experian rating of ‘1’ with ‘limited potential to serve the financially excluded’. This may reflect Cardiff Credit Union’s concentration on payroll deductions and their lack of shop-front location rather than the geographic areas they cover. However, this may change as they are now involved with Community Housing Cymru in developing shop-front affordable lending schemes in Wales.

Many Welsh credit unions have become involved with the DWP Financial Inclusion Growth Fund as part of their mission to tackle the problem of financial exclusion. This raises particular challenges for credit unions, with new management and administration demands, accommodating new systems and developing new skills in working with new members’ requirements. Some of the new members that the Financial Inclusion Growth Fund has brought to credit unions are not necessarily potentially active members and tend to be less able to manage their money. This has had a perceived negative impact on the business in some cases. One respondent suggested that if ‘Growth Fund people’ became a “disproportionate large number within the membership then this would cause difficulties for any financial organisation”. While not always ‘growth fund people’ per se, the socio-economic conditions of members can affect the viability of credit unions and a balanced membership across all income groups is one of the key dimensions already identified for an active membership and a sustainable credit union.

Other respondents pointed to the need for training and specialist advice skills when dealing with vulnerable members of a community, such as those recruited through Financial Inclusion Growth Fund loans – skills which go beyond basic customer care and quality services for members. These respondents were concerned that credit unions may not appreciate the full burden of this ‘client group’ or have the skills to provide holistic services that could be required (including debt advice and financial capability skills development for members). There are risks too of negative impacts if credit unions are unable to maintain control of their loan portfolios and some credit unions have found their short and medium-term viability undermined.

However, there are other credit unions that have used the Financial Inclusion Growth Fund to successfully build their membership and to strengthen their overall financial position. These credit unions have not only been able to integrate the Financial Inclusion Growth Fund within their overall business strategy, but to competently manage the day-to-day delivery of Financial Inclusion Growth Fund loans, ensuring that good lending and loan recovery procedures are in place.

In both cases, there is continued need for rigorous approaches to evaluating and managing the administration and the risks associated with project and outreach work.

Key variants were identified from the research, that impact on financial strength and market penetration between credit unions. For example, in Wrexham, the Credit Union has high growth despite not taking deposits or issuing withdrawals in cash. In Bargoed, the credit union has achieved a high level of market penetration with very few collection points. In Llanduddno and Clwyd Coast, the credit unions have made use of the Financial Inclusion Growth Fund to offer instant loans at higher risk levels and have achieved excellent market penetration and low loan delinquency rates, despite the high levels of deprivation. Box 3.1 shows the key variants identified and compares these with common success factors.

Box 3.1 Key variants impacting on financial strength and market penetration	
Variants	**Success factors**
• Number and location of offices and collection points; • Opening hours; • Use of cash or other methods of depositing and withdrawing funds; • Integration into local networks; • Marketing efforts and methods used; • Payroll deduction arrangements negotiated; • Loan risk assessment methodology; • Use of Growth Fund or other loan guarantee arrangements; • Use of ICT and Web technology.	• Diversification of a range of products and portfolio of services • Meeting the financial needs of the whole population of a common bond, rather than a focus solely on 'the poor'. • Supportive infrastructure (such as trade associations, development agencies) • Sound governance procedures • Management and operational efficiency and financial discipline • The development of a sustainable business model • Balance between social and financial goals • Technical and targeted financial support

Given the changes occurring in the financial services sector in the UK – nationalisation of banks, stricter criteria for lending, and low interest rates, then there is continued need and a role for credit unions as part of a growing spectrum of services for low income and financially excluded individuals and communities. A number of credit unions expressed interest in the Saving Gateway as a way of establishing a government subsidised savings scheme for those in low-paid work or on particular benefits.

Credit Union Profile: Dragonsavers Credit Union – merging to facilitate growth

Dragonsavers was established 1981 as the Glyncoch Credit Union. Since then, they have been involved in two significant mergers – with Rhydyfelin in the early 1990s, and then with all the other credit unions in the Rhonda Cynon Taff County Borough in 2003. Its Common Bond includes 12 areas in the most deprived 100 (out of 1896 Lower Super Output Areas) in Wales and it currently has almost 2,200 members spread across the largest local authority population in Wales. The area is geographically difficult to cover, consisting of 3 principal valleys, and transport links are largely north to south, so travel between valleys is difficult. The CU has organised a well documented programme of 34 Collection Points, covering the entire area, in addition to its 3 permanent offices. The business model has reverted to traditional savings-based lending, with members being expected to save for 8 weeks before borrowing. They have recently improved their website to support access to members' accounts, established a page on Facebook, and are planning a booklet to be delivered through every door in RCT. The board has members who have specific experience in Human Resources and Financial Management respectively, and the organisation is principally staff led with 4 full-time and 3 part-time staff, as well as around 100 regular volunteers. Dragonsavers is currently working in two primary schools where it has approximately 40 junior savers out of the credit union's total of 788 junior savers. It reports a very high transition to full adult members of those who are mostly recruited via parents and grandparents, and is currently working with Business in Schools on their programmes, and also takes a small number of year 12 pupils on work experience. In future, they would like to greatly increase the number of payroll deduction members, and develop a system of ATM machine access for members. Although Dragonsavers has withdrawn from the Financial Inclusion Growth Fund, the credit union has received substantial grant aid and contract funding from external sources, including the Welsh Assembly Government. In the last three years, the credit union has received funding amounting to over £413,000.

3.3 The Modernisation Dilemma

There is a second tension facing credit unions which can be called the 'modernisation dilemma'. Credit unions have pride in the face-to-face contact they have with members and in offering a personal approach. The phrase 'Computer says "no"' arose several times in focus groups as a way of expressing the increasing impersonal nature of high-street banking, in contrast to the friendly face and supportive approach demonstrated by credit unions. This tie-in to local communities is undoubtedly a key dimension of many successful credit unions and links to building social capital, mutual trust and participation among members. Knowledge of local communities and members can provide a platform for building broader links and networks and can underpin actions that encourage both regular savings and timely loan repayments.

The drive to modernise, together with a focus on quality and value-added services has led to a call for increased 'professionalisation' of credit unions: to improve overall management and governance of organisations, especially those in receipt of public monies or charged with a public service agenda. In turn, this links to the development of appropriate business skills in credit unions (including a move from voluntarism and the use of volunteers to professionalism and paid staff – although professionalism and voluntarism are not mutually exclusive). The 'professionalisation' of the movement, with paid staff, larger common bond areas and a move away from local volunteer-run collection points, can appear to some members to be symptomatic of a distancing of the organisation from the community. However, to achieve critical mass of membership and skills and assets necessary to ensure sustainability, credit unions do need to grow – both physically and developmentally. They need to do so in ways that also retain a sense of closeness to community and co-operative values.

Credit Union Profile: Robert Owen Montgomeryshire Credit Union (ROMCUL) – innovation and diversification

ROMCUL was established in 1994 as an initiative by the Wales Co-op Centre's Credit Union Development officer, who lived in the area. He recruited a volunteer 'Study Group' which worked on a Feasibility Study, funded by the Co-op Centre, which enabled them to visit Eire, where they developed a twinning arrangement with Mitchelstown Credit Union. The original common bond area was the SY postcode and over the years, the area has extended to cover all the old Montgomeryshire County, which is over half the current county of Powys. ROMCUL has received over £79,000 of Assembly Government support over the last three years. This is less grant support per member than other credit unions in Wales (£46.19 per member against a Wales average of £77.82).It has been actively involved in the Growth Fund, and has embarked on the development of a number of innovative members' services working with: British Gas to provide a fuel poverty advice and budgeting service, 'Monergy'; Powys County Council to provide a rent guarantee scheme to assist private sector tenants; and has launched a linked Community Development Finance Initiative (CDFI) - the Robert Owen Community Banking Partnership. This is part of an initiative developed by the National Association of Credit Union Workers (NACUW), New Economics Foundation (nef) and the Rebuilding Society Network at 7 pathfinder locations across the UK. The Community Banking Partnership enables ROMCUL members to access a bill payment service in conjunction with Street UK, which provides all the functionality of a standing order or direct debit service, effectively eliminating the need for a bank account for credit union members. ROMCUL has 7 paid staff and 7 volunteers, and operates 4 Collection Points across an area of over 3,000 Km^2. ROMCUL is active in schools, with 531 junior savers, around half of whom have been recruited from the 11 primary and 1 secondary. They make regular visits and presentations to the schools, and are keen to increase this activity in the future. ROMCUL recognises that its membership remains concentrated around the market towns in the area, and needs to develop new ways of working, to allow easier access to those in remote locations. It is looking for information technology solutions to assist in this.

Everyone needs and deserves financial products and services to be delivered professionally, irrespective of their personal income or geographical location. Meeting this demand is a challenge for credit unions with their small scale and voluntary roots, but it is one that many are managing with great skill. The Robert Owen Montgomeryshire Credit Union, for example, appears to have managed this tension particularly effectively, with innovative services and a clear connection with the local community.

3.4 Performance management

It is important that credit unions have access to analytical information about their financial and operational performance to guide the board and management in making decisions about both day-to-day operational priorities and longer-term strategic planning. In recent years, the Wales Co-operative Centre has worked in partnership with the Welsh Assembly Government and the Welsh credit unions to develop a 'Health Check' framework as a way of aiding credit unions' strategic management and understanding their financial and operational performance as effective member-based organisations.

Examination of the reports from the early version indicated that it focussed largely on organisational health in terms of governance, communication and volunteering, and did not look at issues surrounding the financial health of the credit union. The new version of the Health Check was designed for 2007/08 SGEI applications and consists of detailed questions about the history, development, governance, policies and procedures, management, personnel, ICT use, marketing and financial strength. It also incorporates the 10 'key' PEARLS ratios. However, the Health Check has not been widely taken up. Only 8 credit unions recalled using it.

All but four of the credit unions belong to ABCUL, which is licensed by WOCCU to provide and administer PEARLS. PEARLS provides a consistent and well-recognised framework for quantitative assessment of performance. It is now possible for credit unions to submit information on-line to ABCUL and receive regular financial analyses (this development is similar to the service offered by Credit Union Central in Canada, as mentioned earlier). Given that credit unions are asking for streamlining of reporting and accounting procedures (for example, when submitting grant applications and providing end of year reports), the Health Check need not duplicate what is already provided through PEARLS analysis (except perhaps for non-ABCUL members, for whom this information would be useful).

There are also more qualitative measures required to assess overall competence and performance. These can be in relation to strategic objectives, leadership and operation management, for example: milestones and outcomes measures; application of co-operative values; social and environmental reporting; skills gaps analyses and training needs assessments; governance structures and processes; and succession planning. This would also help to identify the need for intervention to support the development and build the capacity of members, staff and directors.

Credit Union Profile: Newport Credit Union

Newport Credit Union was established in 1999 and was initially called the 'Newport North West Credit Union' with a common bond covering the wards of Bettws, Malpas, Rogerstone and Shaftesbury, later extended to Newport County Borough. The extension of the common bond has seen a change in the pattern of membership and recruitment: there are still clusters of members in the union's traditional area (especially in Bettws) and recruitment is now taking place city-wide. Newport Credit Union now operates from offices in Newport City Centre with 3 part-time paid staff and 24 volunteers. Approximately 150 members access the credit union's services each week in person, about half visiting the office, and the rest spread between 5 collection points in community centres and 1 in a member's home. In addition, 32 National Health Service workers contribute through payroll deduction and 4 through the Seren Housing Group. The recent link with Seren Housing Association has offered the use of meeting rooms for board meetings, the introduction of payroll deduction for Seren staff, one of whom has joined the credit union board, and will hopefully be a useful way to recruit tenants into membership. The credit union has 234 Junior Savers, the majority of whom are recruited through older members of the family, and they have a good record of taking them on to full membership. A collection point has been run in the past at Bettws High School and one is planned to begin in September at Bettws Junior School. Over the last 3 years, the credit union has received £3,500 from DRAMA in 2007, following the Farepak collapse; £13,842 in 2008 under the SGEI contract scheme to pay for an Accounts Administrator; and £550 in 2007 from the Welsh Church Fund to pay for an IT upgrade. Previously, it had received £106,000 between 1999 and 2002 from the WEFO/ERDF project, and £1,150 from the Welsh Church Fund in 2005 to pay for leaflet printing and as a contribution to funds. In the short-term, the credit union sees its objective as being to grow the membership within its current area and to continue to improve in managing credit control and debt recovery.

3.5 Building the capacity of credit unions

For legal reasons, and to ensure that potential members have confidence in credit unions, it is important that the boards and management of all Welsh credit unions exercise 'due diligence' in carrying out their work. This is particularly important when making decisions on issues such as entering into a merger with another credit union, introducing a new product or service, or entering into a contract or funding agreement with a third party. Despite high levels of commitment and motivation on the part of both employees and directors, the research indicated that in a number of instances, these sorts of important decisions have not been critically evaluated in advance or the likely risks identified and managed effectively. Improving performance in this critical area is essential for the future survival and growth of the sector and will need to be achieved by a combination of improved training, recruiting new and more strategically minded individuals to key roles, and the use of expert advice on issues such as mergers.

Another notable weakness in terms of capacity is around software to support the administration of the credit unions. At present, there is no agreement about which software should be used; what there is may not meet all the requirements and it tends to be expensive, relative to many credit union budgets. This is preventing credit unions from using IT as effectively as they could to reduce their other costs and improve information collection and analysis.

There are models in other countries such as Canada for the use of shared administrative back-office services to deliver these functions. Whether or not this would be practicable or desirable to replicate in Wales would have to be the subject of a separate detailed feasibility study. However, collaboration is now accepted as a key factor in the future development of credit unions and indications are that to achieve economies of scale, many aspects of a credit union back-office may have to be organised on a Great Britain rather than a single country basis. A recent review in Scotland has also proposed a study to research the benefits of setting up a 'central credit union service.' This third tier organisation ('analogous to the Bank of England') would coordinate the work of credit unions and act as a source of support and expertise and could also hold some central investment. Although the feasibility has yet to be studied, the report suggests that this could be a positive resource for credit unions as they expand and may be working in potentially higher financial risk activities. Furthermore, ABCUL has recently started work on a project, which will help its members to collaborate and to bring economies of scale to credit union operations. This move towards greater collaboration will assist credit unions to raise standards and to improve quality through consistency in the delivery of key services to members[39].

Credit Union Profile: Bargoed and Aberbargoed Credit Union

Bargoed and Aberbargoed Credit Union was established in 1991. With the support of the two local churches and with help from the Wales Co-op centre, they achieved registration by the Registrar of Friendly Societies in 1992. The original 'Common Bond' was those living in the villages of Bargoed, Aberbargoed and Gilfach. This has now been extended to a 'Live and Work' covering the original area plus the adjoining village of Brittania. In 1999, they were awarded a Lottery grant to purchase their current shop-fronted building, with 20% match funding (£10,000) coming from Caerphilly County Borough Council. However, part way through the award process, the National Lottery reinterpreted its policy and reclaimed the grant. The Board of Directors decided to continue anyway and used their reserves to complete the purchase. As a result, they now own their premises outright. The Credit Union continues a pattern of steady growth, and is run mostly by 23 volunteers plus one part-time member of staff. Their business model is traditional, with loans linked to savings, and members are only eligible to borrow after 13 weeks saving. They do, however, offer reduced interest rates for secured loans to members with a good repayment history. They have a healthy Junior Savers' section, which is recruited entirely via parents and grandparents coming to the shop. They have no schools collection points, and only 3 adult collection points. The collection points are relatively busy with up to 30 users each session. They have very few payroll deduction members, but were early adopters of 'PayPoint' in 2002, which allows members to pay in money at other locations in the area and across the UK. Their future challenge is to continue to increase market penetration, which is already the highest in Wales for a geographic Common Bond at 12.77%. They have no plans to merge with other Credit Unions or to expand their Common Bond in the foreseeable future, and see their growth being based on local residents.

3.6 Working in Partnership

Through its *One Wales* commitments[40], the Welsh Assembly Government has made clear its view that credit unions have a vital role to play in contributing to the building of financial literacy into school curricula. This aspect is popular among policy stakeholders, although there is some confusion about what it means in practical terms, for example, whether credit unions should have dedicated schools workers on their staff.

The policy of taking credit unions into schools has had a significant impact on the activity of the credit unions studied. These are small organisations, which rely on volunteer time to function. If a significant proportion of this time is taken up with making visits into schools - no matter how positive that may be for the credit union - it can negatively affect their other work. It is also questionable how much credit unions gain from work in schools, since their junior savings cost heavily in terms of time and expense to administer but bring only a tiny amount of money with them. There is also a lack of information regarding the success, or otherwise, of credit

[39] For more information, see http://www.abcul.coop/page/news.cfm#616
[40] See http://wales.gov.uk/about/strategy/?lang=en for details

unions transitioning junior members, recruited in schools, into adult membership. A new initiative, developed by the Wales Co-operative Centre in conjunction with pupils at Dyffryn School and Neath Port Talbot Credit Union, may be a way forward in increasing secondary school-age members. This on-line learning resource, funded by the Welsh Assembly Government, includes a basic introduction to what a credit union is, why young people might want to join, and how to go about running their own collection point[41].

Credit unions also face the challenge of working effectively with a range of partners, some of whom may be offering similar services. A key player here is the Post Office and it became clear during interviews that policy-makers are working hard to establish a positive partnership between the Post Offices and credit unions, both of whom play an important role in supporting community life.

Housing associations are also keen to work in partnership with credit unions as part of their commitment to support their tenants and to serve financially excluded and vulnerable individuals and families. Moneyline Cymru – a Community Development Finance Institution (CDFI) launched while the research project was under way – will develop a number of high street access points and is aiming to provide loan services to individuals who, at the moment, would not qualify for a loan from a credit union. From the housing association perspective, the initiative is seen as a springboard for moving their tenants and others, using the new facility, into credit unions and to access more mainstream banking services (such as the basic bank account). In order to provide this high risk service, the CDFI has applied for Financial Inclusion Growth Fund monies and will charge high rates of interest (above the current Financial Inclusion Growth interest rate of 26.82% APR), aiming to become self-sustaining within three years and to maintain sustainability after this period[42]. There is mixed reaction to the project from credit unions: constrained by a maximum interest rate and by limited income generation from such high risk loans, they are unable to serve low income communities and high risk borrowers without external funding. However, some credit unions are actively involved in CDFI development and see opportunities for partnership. Given the level of need in Wales, there are synergies that can be gained from joint working, but this will require the establishment of clear protocols on operations and practice.

3.7 Raising the Profile

The issue of profile and 'brand' was agreed to be a problem by all the credit union representatives and other key stakeholders who participated in the research. Credit unions are not clearly identifiable - one policy-maker referred to them as a 'best kept secret' - and even where they have been a secure part of the landscape of financial services for a long time, many local people do not understand their role or the services they offer.

Interviews with key stakeholders revealed that many who work in areas of policy relating to financial exclusion and regeneration had not heard of credit unions before

[41] For more information, see http://www.walescoop.com/summer-2009/n/1/i/1171
[42] For more information on high risk lending, see Kempson, E., Ellison, A., Whyley, C., and Jones. P (2009) *Is a not-for-profit home credit business feasible?* York: Joseph Rowntree Foundation, available at http://www.jrf.org.uk/publications/not-for-profit-home-credit

they came into contact with them through their work. Too many members have only come across them by accident. However, there was a shared sense that the credit crunch offers a particular opportunity to engage in marketing the special role that credit unions can play: 'This is the right time to be talking about how money works'. Or, in the words of another key stakeholder, 'It isn't a coincidence that it is the mutual financial institutions that have survived better… There is an important message there.'

Although 'credit union' is a global 'brand', there was some doubt expressed by those who work for and are members of credit unions about the strength of the current identity of the movement, as exemplified by this comment:

> Every time you use the words 'credit union' you are building a wall between you and the person you are talking to. Either they don't like the word 'credit' or they don't like the word 'union' or they don't like the two together. And so it puts a ten-foot wall in front of you that you have to climb over to explain who you are. (Credit Union Member).

The focus-group participants who work for credit unions were positive about the idea of creating a shared brand for Welsh credit unions. As one said, 'Unifying branding gave people confidence' and that gives credit unions credibility.

4. Findings and Recommendations

The development of the credit union movement in Wales owes much to the support of the Welsh Assembly Government over the past ten years. This has formed part of a general commitment to a mutual approach to economic life in Wales, illustrated by the introduction of significant policy initiatives to develop social enterprise, co-operatives and the third sector, both within the remit of the Social Justice and Local Government Department and across the Assembly Government.

Over the last ten years, many credit unions have strengthened organisational management and their approach to the business, have opened premises and have endeavoured to modernise their financial products and services to respond more effectively to the needs of members and consumers, particularly in low-income communities. The research study has revealed that those who wish to do so are now at a critical point – a crossroads - in their development, where they are in a position to scale-up their operations and outreach and to make a greater collective contribution to the development of community-based financial services throughout Wales, but still require support and development in order to make this leap. All levels of government (Westminster, Welsh Assembly and local authorities) have a continued role to play in providing targeted support, capital and funding for staff costs, overheads, training and the research and development of new services, technology and products (such as the Credit Union Current Account). This could also include supporting non-income generating work such as financial education (in schools).

In turn, credit unions need to focus on business development, service development and sound management and governance procedures to improve leadership and strategic planning to move towards self-sustainability. This includes achieving a balance between social and economic goals and attracting a wide, economically diverse membership. To achieve credit union potential, one of the significant challenges will be to find board members and staff with the requisite business expertise and skills.

Appropriate support and development from trade associations and development agencies also need to reflect the changing needs of credit unions in Wales with a range of appropriate services, training opportunities, tools and frameworks that build the management and financial competencies of credit union directors, staff and volunteers, to promote active engagement and participation of members. Some of this support is already provided by ABCUL and the Wales Co-op Centre (WCC) and some mechanisms are already in place (such as PEARLS analyses and WCC's health check) that can be further developed. In addition, the development of a third tier agency – such as Credit Union Central (Canada) or the proposal for a 'central credit union' (Scotland) – could provide much needed technical and business development expertise, as well as having a supportive audit and intervention role.

An issue raised on several occasions has been the burden of extra administration to deal with difficult funding streams and service-level agreements / contracts. There is room for some streamlining of application processes and accounting procedures at an appropriate level for both grant and organisation size. However, it is also acknowledged that there is support and guidance available from both government departments and development agencies to support these processes. Continued dialogue between government and credit unions is also welcomed and the network meetings organised by the Welsh Assembly Government are recognised as valuable.

Current and widespread dissatisfaction with the banking sector has prompted an increasing interest in mutual and co-operative financial institutions, including credit unions. Policy-makers and members of the credit union movement now believe that this has helped to build an atmosphere favourable for a credit union breakthrough in national profile and in levels of recruitment. While not all credit unions in Wales (as in other parts of the world) offer the same services, there are some common products and there is commonality of purpose and vision. Welsh credit unions need to be developed and regarded as financial institutions for all, and as much attention needs to be given to ensuring that credit union products and services are as relevant and useful to moderate and higher income working people, as they are to lower income and financially excluded groups. It is also important that credit unions are encouraged and supported in their efforts to reach and attract people with higher incomes and a readiness to save, who would not previously have considered joining a credit union in the areas in which they live or work. This is an area that would benefit from targeted government support, linked to increases in membership to achieve greater market penetration in common bond areas.

Some credit unions are already looking for opportunities for joined-up or unified services. One such service might be a Wales-wide savings stamp for school-age children. Other services and products are being achieved through economies of scale (partnerships, networking and mergers). Standardisation of products, where possible, helps to raise awareness of services offered by credit unions.

Mergers may be an increasing part of the credit union movement in Wales. It is important that members and local communities do not feel they have lost their 'local' credit union where these do occur, and mergers between different credit unions need to be considered carefully. While it is a matter for individual credit unions to decide upon mergers, there are signs that independent expertise may be required to help credit unions undertake due diligence in terms of exploring and agreeing mergers. This would support the development of sound governance, as well as management and operational efficiency, and financial discipline.

The following recommendations aim to support the development of a strong, sound and effective Welsh credit union movement, which takes account of recognised common factors of the successful development of credit unions within a global movement.

4.1 Recommendations for the Welsh Assembly Government

The Welsh Assembly Government should interpret its *One Wales* commitments to credit unions in general, and to universal geographical credit union coverage in particular, in terms of enabling all Welsh consumers to access quality credit union financial products and services, irrespective of where they live or work. The underlying policy should focus on promoting the benefits which credit unions offer all the people in Wales, on supporting them to meet this challenge, and on recognising that they can only make a positive contribution to financial inclusion and social cohesion from this sound basis.

4.1.1 In order to support credit union growth, the Welsh Assembly Government should:

i. Set a target for the credit union movement to count 6% of the Welsh population in its membership by 2020[43]. (This has already been exceeded by two individual credit unions and would only require an average doubling of size for a further cluster of five);

ii. Lead from the front by encouraging its own staff to join credit unions via its existing payroll deduction scheme and, where appropriate, to use their voluntary time to support them;

iii. Launch a high-profile campaign to ensure that all MPs and AMs, as well as a significant proportion of Welsh local councillors, become members of their local credit union by the end of 2010;

iv. Issue guidance to all public sector employers in Wales, encouraging them to establish payroll deduction facilities for credit unions and to promote membership to their staff. This should be supported by generic publicity materials, produced by the Welsh Assembly Government in consultation with credit unions;

v. Consider making a Payroll Deduction Grant available to larger employers (200+ staff) who commit to setting up credit union payroll deduction facilities;

vi. Support credit unions to roll out the 'Savings Gateway Account' as a useful way to build their capital base, to encourage saving among lower income parts of the population and to keep locally generated funds circulating within the local economy.

4.1.2 In order to support the promotion of credit unions, the Welsh Assembly Government should:

i. Work with credit unions to support the development of a unified Welsh credit union identity, including an identifiable colour and logo, and a Wales-wide publicity campaign;

ii. Fund a high profile campaign, focussing on the four key aspects of credit union success:

   a. their superior financial terms (including rates of interest, and death-in-membership benefits);
   b. the reliability of mutual financial organisations;
   c. the safe haven they represent for deposits; and

[43] The figure of 6% is based on the current credit union membership rising 12% per annum in line with the PEARLS target for membership growth.

d. the link with local communities and employers;

iii. This would use a variety of media, but in particular it is recommended that ‘back of bus’ advertising, and the use of existing Assembly Government publications and mail-shots be considered;

iv. Seek to work with trade associations and infrastructure organisations, such as the Federation of Small Businesses, Pre-School Learning Alliance and Wales Council for Voluntary Organisations, to publicise the opportunities for community groups and small and micro enterprises to become members of credit unions;

v. Explore the possibility of funding generic advertising on the leading internet search engines so that searches using keywords such as ‘credit union’ or ‘affordable loan’ lead to a page directing the searcher to their local credit union.

vi. Communities First partnerships should be funded to make staff available on the ground to promote knowledge and awareness of credit unions; they should work in collaboration with credit unions.

4.1.3. In order to provide targeted financial support, the Welsh Assembly Government should:

i. Continue to regard the financial support of credit unions as a long term investment and should ensure that funds are directed at implementing sustainable capabilities;

ii. Make public investment in credit unions contingent to meeting specific, transparent and rigorous management criteria;

iii. Make financial support conditional upon the achievement of financial and operational targets, which should focus not just on membership growth, but also on growth in savings, loans and assets over time;

iv. Make capital grants available to improve back-office facilities, to purchase premises, computers and software and to develop new products and services;

v. Give due consideration to supporting and facilitating moves to negotiate with pre-paid debit card providers collectively, rather than each credit union doing so separately;

vi. Prioritise funding and support on supporting credit unions' aspirations to grow their membership and provide the range of services which they can show (a) their members demand, and (b) will generate enough funds to become self-sustaining in the medium term;

vii. Make revenue grants available to participate in collaborative back-office initiatives, as with the current SGEI contracts (note: collaborative back-office initiatives may necessarily have to be developed on an all-Britain basis, given the scale of the movement nationally);

4.1.4 In order to support good governance and promote 'best practice', the Welsh Assembly Government should:

i. Take account of the successes and failings of credit union support policy from UK and international experience within the credit union movement: it is important to the development of any credit union movement to have practical examples of effective credit unions that serve as an inspiration and role-model for others;

ii. Investigate the accredited training that is available for credit unions and explore how this might be adapted to meet the needs of Welsh credit unions;

iii. Support the provision of high level training for directors and managers of credit unions to exercise their roles in strategic leadership and good governance most effectively;

iv. Support the establishment of an independent 'due diligence' service for credit unions that are considering mergers or fundamental changes to their operational model (such as the introduction of the Credit Union Current Account). This service would be provided free of charge;

v. Initiate a series of twice yearly liaison meetings with Welsh credit unions to help build the sense of a common movement; the credit unions should contribute fully to the agenda;

vi. Explore the possibility, in association with credit union trade and support organisations, of creating a new post of credit union advocate and adviser. This expert adviser to credit unions would focus particularly on matters relating to legislation, regulation and national development. This 'Credit Union Advocate' might be based in one of the larger credit unions;

vii. Commission further research to explore the feasibility of a 'central credit union / credit union central'. There may be opportunities for links to Scottish feasibility research and ABCUL's investigations.

4.1.5 In order to reach out to new markets, the Welsh Assembly Government should:

i. Commission further research to explore the impact of working with hard-to-reach and financially excluded communities including Welsh speaking communities, faith and ethnic communities. This links to the potential for membership expansion, common bond penetration, communities of interest and the potential this might have on the future development of credit unions;

ii. Consider the feasibility of establishing a collaborative pan-Wales infrastructure. This might include pooled back-office services and a single contract with the Post Office, as well as servicing collective marketing initiatives and facilitating schemes such as an all-Wales savings stamp scheme for primary schools. There may be scope for collaboration with ABCUL;

iii. Work through the bi-annual meetings of credit union representatives, and with ABCUL, to develop a single framework agreement with Post Office Ltd.

iv. The credit union targets for schools and young people should be interpreted widely, building on the work funded by the Assembly Government and already being undertaken at the Wales Co-operative Centre, and when the *One Wales* commitments are revised, it should be made clear that it refers to all young people, whether or not they are in school

v. In terms of the formal curriculum, credit unions should be seen both as a core part of the financial literacy work covered under Maths and PSE, and as part of the Enterprise Learning agenda. As such, credit union workers who participate in classroom work should be trained and remunerated.

4.2 Recommendations for Welsh credit unions

4.2.1 Credit unions need to:

i. Prioritise strategic planning to position their organisations competitively within the marketplace. Where credit unions employ professional managers, their remit should be to deliver this strategic plan as well as oversee day-to-day operations;

ii. Recruit and regularly appraise credit union managers on the basis of high level skills in leadership, strategy, business and financial management. Employing managers who are primarily administrators rarely results in credit unions achieving strategic objectives;

iii. Prioritise both recruiting skilled board members and enhancing the skills of current members through further training. The study has identified a perceived lack of high level skills among some board members, as well as a lack of provision of appropriate levels of training, especially in areas relating to human resources, financial and legal matters;

iv. Carefully assess the risks and opportunities presented by forthcoming legislative and regulatory reform, in particular with regard to extending their range of services, broadening their membership (e.g. by admitting organisations into membership), and extending their area of operation;

v. Be mindful of the legal duty to exercise ‘due diligence’ in reaching decisions on important issues such as mergers. To this end, they should take advantage of specialist legal and financial advice before concluding such negotiations and making recommendations to their members;

vi. Be mindful of the likely forthcoming changes in minimum capital requirements. They should initially seek to achieve a minimum capital / asset ratio of 3% as soon as possible;

vii. Address the need to get more of their members’ deposits out on loan as a way to generate more income and to move towards financial sustainability. To this end, they should make full use of the options now available to charge variable interest rates on loans, based upon the actual risks and costs associated with serving a particular member;

viii. Continue to work with the Welsh Assembly Government to roll out the Saving Gateway Account as a way to promote membership and savings among lower income people, and to provide a further source of funds for lending;

ix. Prioritise the introduction of electronic payment cards (such as Pay Point), pre-paid debit cards and, if appropriate and resources allow, the Credit Union Current Account. This is essential to support the growth and broaden the membership of credit unions, particularly among young people and those in rural areas;

x. Urgently review how to most effectively use the valuable time donated by volunteers. This study has shown that most of the 754 credit union volunteers in Wales are engaged in operating 210 collection points, serving an average of 16 members each per week. Maintaining collection points for a few hours per week, used by very few members, may not be the most effective way of using the time donated by their volunteers compared, for example, with supporting work in schools or other outreach schemes;

xi. Collectively support the development of a unified Welsh credit union identity, in consultation with the Welsh Assembly Government, including an identifiable colour and logo, and a Wales-wide publicity campaign. This campaign should focus on four aspects of credit union success: the superior financial terms, including rates of interest, and death-in-membership benefits; the reliability of mutual financial organisations; a safe haven for deposits; and the link with the local community and employers.

4.3 Recommendations for credit union trade and support organisations:

i. Credit union trade and support organisations need to ensure that appropriate levels of accredited training opportunities are made available, marketed and promoted throughout Wales The development and take-up of high level training opportunities among board members, managers and operational staff is of high priority;

ii. The Health Check currently provided by Wales Co-operative Centre needs to be reviewed in collaboration with the Welsh Assembly Government and credit unions to link with identification of training needs, skills gaps, succession planning and governance issues as well as funder requirements and accountability needs.

4.4 Recommendations for Welsh local authorities:

i. Welsh local authorities that do not already do so, should introduce payroll deduction schemes and actively encourage their employees to become members of a credit union;

ii. Welsh local authorities should consider what support they could provide to credit unions, including encouraging staff to become volunteers and Board members, helping with marketing and sharing premises for collection points;

iii. Where there is vacant local authority owned commercial property, this should be offered to credit unions on preferential terms;

iv. Where the local authority is also a provider of social housing, it should encourage its tenants to become members of a local credit union

4.5 Recommendations for housing associations and other partner organisations:

i. Housing associations and other registered social landlords should actively build partnerships with local credit unions. This could include, but should not be limited to, the following:

- actively encouraging all tenants to join a credit union;
- encourage housing officers and other staff to become involved in running the credit union as members, volunteers and directors;
- providing a facility for members to make payments to the credit union through housing offices and with their rent;
- where appropriate, offering shared premises and office facilities to credit unions;

ii. This may be achieved through a framework agreement between each housing association and the relevant credit union(s);

iii. The new Welsh CDFI that is being funded by housing associations in south Wales should endeavour to work in active partnership with credit unions rather than duplicate or compete with their services;

iv. Where appropriate, housing associations may wish to take advantage of legislative changes to reach an agreement to deal with a single credit union for all its tenants, provided that credit union is willing to extend its sphere of operations to those tenants.