Smaller Businesses Practitioner Panel
Financial Services Authority

c/o Panel Secretariat
25 The North Colonnade
Canary Wharf
London
E14 5HS

RESPONSE TO HM TREASURY CONSULTATION PAPER CP 12/38

'CREDIT UNION MAXIMUM INTEREST RATE CAP'

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Introduction

The Smaller Businesses Practitioner Panel ('the Panel') welcomes the HM Treasury's consultation on 'Credit Union maximum interest rate cap'. On the whole, the Panel are supportive of raising the maximum interest rate that can be charged by credit unions from 2% to 3% per month on new, small, short term loans and we are pleased to be given the opportunity to respond.

Credit unions provide a credit and loan service to its community/employer-based members. They perform a range of functions and cater to all their members, including the segments that are often not serviced by mainstream lenders. Because of their ethos of providing to all, they often make losses on especially the low value loans. This means they are able to provide lower income consumers with short-term credit at much more affordable rates, where they would otherwise have had to resort to borrowing from very expensive doorstep/payday lenders.

An increase in the interest rate cap would mean a modest increase in payments by the consumer, but would be helpful in reducing the losses that credit unions make on these loans. As such, we are supportive of the proposals, although we do not believe that by themselves they can be enough to make the credit union sector fully sustainable.

Effects on consumers of raising the interest rate cap to 3%

Even with a 3% interest rate, we agree with the Government that credit union loans will remain substantially cheaper than alternatives for lower-income consumers who do not have easy access to mainstream sources of funding. In the absence of credit union loans these consumers often turn to payday lenders, who can charge steep rates, especially when compared on an annual basis. The comparison table below is an example of the cost of a £500 loan repaid over 1 year, outlining the cost of a credit union loan as compared to that of an example online payday lender:

Lender	**Interest Rate**	**Weekly Cost**	**Total to Repay**
Credit union 1% a month (reducing balance)	12.7% APR	£10.21	£530.92
Credit union at 2% a month (reducing balance)	26.8% APR	£10.83	£563.16
Credit union at 3% a month (reducing balance)	42.6% APR	£11.48	£596.96
Online lender example (Pounds to pocket)	278.1% APR	£18.25*	£949.01

*paid monthly at £79.09 per month

Source: ABCUL

As the consultation paper notes, the ethos of credit unions is such that raising the cap by itself will not necessarily mean all credit unions will charge more, and many do not currently charge the maximum of 2%. We are very aware that an increase in the interest rate for smaller loans will mean higher costs for the end consumer. However, given the administrative costs incurred in lending to this segment (see below) and the current high rates of credit union failure, we agree that an increase to 3% to improve the sector's sustainability is sensible. However, we also support the view that the cap should not be eliminated completely, and that credit unions should continue to be exempt from the Consumer Credit Act.

Effect on credit union solvency:

As outlined above, although an increase in the interest rate cap would be helpful in reducing the loss credit unions make on small loans, it is worth noting that the subsequent increase in earnings will still not be enough to cover the current administrative costs. In terms of smaller value loans (e.g. £200), it will always remain infeasible to raise the interest rates charged to a level as to make payments cover the cost of lending.

It is worth noting that there will be differences in strategies and longer term sustainability between larger and smaller credit unions. Larger unions, although continuing to service all members, have the majority of their business in higher value, longer-term loans. To a certain extent, they have therefore been able to subsidise the smaller loans and remain relatively more sustainable. However, the majority of credit unions remain very small, and do not have this option.

We appreciate the Government's recognition that by itself, this initiative will not be enough to make credit unions sustainable over the long run, especially not smaller credit unions. We agree that other proposals should also be considered to further support the credit union sector, and we know that work in this area is currently on-going.

Conclusion

Overall, we have been pleased to see the recognition that has been given to the important role played by credit unions in the economy, and their social function in providing lower cost loans to those who may otherwise only have had access to payday lenders. While the Panel agrees that raising the maximum interest rate cap to 3% is a helpful move towards making smaller credit unions more sustainable, this cannot be achieved in isolation and has to be part of the wider sustainability project.