Kent Savers
fair loans. safe saving.

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20th June 2014

Kent Savers Credit Union – Capital appeal

I am writing to ask for your council's support to enable Kent Savers Credit Union (KSCU) to continue to grow and offer affordable loans and savings products to support local people in Kent and Medway. As I am sure you know, KSCU offers an affordable alternative to payday and other high interest lenders which helps residents, including many from your area, to reduce the cost of borrowing and avoid indebtedness.

Following the financial crisis the new regulations now require UK banks to hold increased levels of capital to underpin their day-to-day business operations. Credit unions are no exception to this and have seen the capital requirement for them increase from the 1% capital to asset ratio in 2012 to an expected level of 3% by 1st October 2014. This is proving to be extremely challenging for many credit unions, especially relatively young ones like Kent Savers, as their main source of income is loan interest. The projection in the KSCU business plan is to generate enough loan interest and other income to be self-supporting by 2016/17.

Kent County Council has kindly stepped in to provide some help through a subordinated loan to help us meet the new capital requirement. However on its own this is not enough to meet the gap that exists over the next two years, and particularly to meet the higher ratio that we must operate under from October 2014.

I am now writing to the Leaders of all twelve District Councils in Kent and to the Leader of Medway Unitary Authority to ask for your combined support to help KSCU at this very difficult time. All of you have supported KSCU since its launch, and some of you have offered revenue funding. I am now seeking help from you all with a £10,000 subordinated loan to KSCU over a period of between 5 and 10 years. Our target is to raise a minimum of £40,000 by 1st October 2014 with further sums committed by 30th September 2015.

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If each council agreed to support KSCU in this way then together, and with the help already offered by Kent County Council, KSCU will be able to thrive and grow. This means we can make a real difference and impact for residents across all income brackets, but especially those who will benefit from cheaper loan finance. In the event of KSCU not being able to raise sufficient capital in time then growth plans will restrict us to offering core products only and lending to people most in need of affordable finance will be reduced. With your support this will not happen.

Earlier this year in March KSCU launched very competitive low interest rates for larger loans over £5,000, and is about to launch an on-line loan application facility to make it easier to apply for loans. These measures will increase the level of loan interest income but will take time to build our capital reserves, time we do not have if we are to meet the new capital requirements by October. An increased level of capital will also allow KSCU to offer other products and larger loans.

Please have a look at the information contained in the attached document. KSCU's General Manager, Chris Hunt, will be able to answer any detailed queries that you may have.

I would be most grateful if you could let me know as soon as possible, and ideally by 12th July, whether your Council is able to allocate a small proportion of reserves to support your local credit union in the way that I have proposed. If all District Councils and Kent County Council get behind KSCU then we will deliver the credit union services that are so very much needed to help the people of Kent and Medway.

Yours sincerely

Gail Devries

Gail Devries
President of Kent Savers Credit Union

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Summary

This document describes the regulatory capital needs for credit unions and how this affects Kent Savers Credit Union.

Kent Savers urgently needs to increase its regulatory capital to support its operation in two important ways:

- To enable Kent Savers to meet the new regulatory requirement of 3% capital to asset ratio by 1st October 2014
- To enable Kent Savers to offer new advanced products and services

Credit unions

Credit unions are authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority.

Credit unions offer simple and easy to use financial services including savings accounts and loans, and are non-profit-making. Credit unions are co-operatives owned by their own customers.

Credit Unions are actively supported by central government, by trades unions, by housing associations and in the last 12 months by the Church of England who are running a campaign to empower church volunteers throughout the country to work with their local credit union.

There are around 400 credit unions in Britain, and collectively they have over 1 million members.

Kent Savers

Kent Savers Credit Union was launched in 2010 with funding and support from Kent County Council and several district councils and housing associations.

Kent Savers has grown to become a 1,600 member organisation with shares (members' deposits) of over £1 million and a loan book of £550,000. During its four years of operation Kent Savers has loaned out over £1.3 million, with the majority of loans going to people on low incomes.

Members taking loans from Kent Savers have made great savings as the typical small loan from Kent Savers has been at 26.8% APR whilst pay day and other high interest lenders may offer rates running into several thousand per cent APR.

Regulatory requirements #1

The Prudential Regulation Authority requires credit unions to hold sufficient capital. For 2013/14 the minimum capital requirement is equal to 2% of assets. From 1st October 2014 the minimum capital requirement rises to 3% of assets[1].

> *Kent Savers needs to secure additional capital in the next three months to enable it to meet the new 3% threshold and to continue to meet the new threshold as it grows and expands.*

Regulatory requirements #2

Credit unions with lower levels of capital (soon to be 3%) are limited by regulators to providing a core level of services to members.

Credit unions with additional capital (typically over 5%) are permitted to offer some additional services. Three services in particular are governed by capital:

- Paying interest on deposits
- Paying different returns on different classes of deposits[2]
- Issuing loans larger than £7,500[3]

Kent Savers needs to secure additional capital to enable it to offer the additional services.

Advanced products and services

Credit unions offer affordable products and services because their aim is to provide good value to their members. Some other lenders charge far more for their services and with this income they are able to invest in cutting edge technology.

During 2014 to 2016 there is an opportunity for Kent Savers to transfer its operation across to a modern banking platform, and this will offer the services that people now expect such as mobile access, current and budget accounts, and automated services. The technology is being made available through a programme funded by the Department for Work and Pensions called the Credit Union Expansion Project.

Kent Savers needs additional capital to transfer to the new platform.

Business needs

There is a clear business need amongst the people of Kent and Medway for the opportunities that the increased capital will permit.

Ease of use

People use pay-day loan companies partly because they feel they have nowhere else to turn, but partly also because they offer a very quick service. Because the process is so easy people often overlook the costs of credit with these companies.

Kent Savers loans are much better value to those on low incomes, but the problem is to become attractive to those customers. To effectively compete with the new lenders, Kent Savers has to provide a good modern user interface and a fast service. The new platform will provide mobile access to credit unions and improved processing and automated decision making.

With a higher level of capital Kent Savers will be able to transfer its operation across to the <u>new modern banking platform</u> which has a mobile interface and extensive automation.

Current accounts

Research has shown that over 1 million people still do not have access to a current account. Current accounts allow people to save money with payments made by direct debit, and offer payment methods that reflect the modern age. They can also be used to manage the new Universal Credit when it is rolled out.

A current account provided by a locally trusted organisation such as a credit union and supported and promoted by local agencies will be of great benefit to people.

With a higher level of capital Kent Savers will be able to offer a <u>current account</u> to members from the new banking platform.

Budget accounts

Some people might find a current account hard to manage, and so for them a budget account is the better solution. Budget accounts allow people to set money aside for their priority payments. Budget accounts are the preferred choice for members to manage the new Universal Credit when it is rolled out.

A budget account from Kent Savers in conjunction with local housing providers will be of great benefit to people.

> *With a higher level of capital Kent Savers will be able to offer a fully featured budget account to members from the new banking platform.*

Encouraging saving

In today's climate with price comparison websites flourishing, savers have more and more choices for investing their money. Historically credit unions have shared their surpluses amongst members in the form of a dividend on their shares. This means that when a member makes a deposit, they will not know the return that they may make on that deposit. This represents a risk that many people are reluctant to take.

> *With a higher level of capital Kent Savers will be able to offer interest bearing shares with the interest rate being set in advance. This surety will encourage more members to place their trust and their funds with Kent Savers.*

Secure platform for lending

Kent Savers needs a solid base of members' shares to support its lending activity. The default savings account is a no notice account, but this represents a risk to Kent Savers lending capital. Today banks and building societies offer different rates for different products; those needing instant access to their savings will receive a lower rate to those who are able to put their savings away for a specified period.

Kent Savers needs to build up a tranche of long term (e.g. 1 year plus) investors, and paying a higher dividend will encourage these investors to put their money away for a longer period. With these savings locked away Kent Savers will be able to lend its funds out with greater confidence.

> *With a higher level of capital Kent Savers will be able to offer several different dividend classes.*

Large loans

Kent Savers average loan size is just over £1,000. Smaller loans to those on low incomes are typically high risk and are also expensive to manage, and Kent Savers needs a balanced portfolio of high value low risk loans and low value high risk loans. Homeowners and people on good earnings often need to borrow larger amounts that the current cap of £7,500 will allow, for items such as cars.

> *An increase in capital will enable Kent Savers to build up its portfolio of higher value low risk loans, which will in turn enable it to offer more social loans.*

Kent Savers capital position

Kent Savers currently has capital support from Kent County Council and from a fund provided by the Department of Work and Pensions in 2010.

Kent Savers' current forecast shows that we will have assets of £1,200,000 and capital of £20,000 on 1st October 2014, a capital to asset ratio of 1.67%.

There are further risks with this position which could take the forecast capital even lower:

- If members' share deposits between now and 30th September are higher than forecast this will increase assets and reduce the key ratios.

- If insufficient loans are issued between now and 30th September to replace loans being repaid, this will reduce income and capital, reducing the key ratios.
- If bad debt is higher than forecast during the next three months this will increase expenditure and reduce capital, reducing the key ratios.

Kent Savers capital requirements

Kent Savers needs to increase its capital by at least £40,000 by 1st October 2014, with further sums committed by 30th September 2015.

£40,000 on 1st October 2014 will result in a capital to asset ratio of 5%. Further capital of £40,000 in 2015 will enable Kent Savers assets to grow to £2 million during the year to September 2015 and maintain a capital ratio of 5%. Increased capital will:

- Give Kent Savers protection against variations in its business that will affect the capital ratio and ensure that it remains above 3% at all times
- Enable Kent Savers to offer the additional services that become available when the capital ratio is above 5%
- Enable Kent Savers to plan a migration to the modern banking platform and deliver the advanced products and services available through the platform

Increasing capital

There are a number of ways to increase the capital of a credit union, and the method used most often is through a subordinated loan. Other methods include gifts of capital and corporate deferred shares.

Subordinated loans are used regularly to support credit unions, for example:

- The Public and Commercial Services Union made a subordinated loan of £150,000 to the PCS Credit Union in 2012.
- The Magee Charitable Trust made a subordinated loan of £75,000 to Community Savings and Loans (Berkshire Credit Union) which is not repayable until December 2017.
- Other examples include Harrow Council and M for Money credit union, Islington Council and London Capital Credit Union

Subordinated loans

A subordinated loan[4] is a loan to Kent Savers over a term that exceeds 5 years.

Kent Savers are inviting corporate supporters to provide capital funding to the credit union in the form of 5 to 10 year subordinated loans.

The loans will attract interest of 1% paid annually on the anniversary of the loan. Lenders can opt not to receive the interest in which case the interest payable will be paid into a special reserve for the benefit of those members on low incomes.

The loans will be repayable in full on their maturity.

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[1] Credit Unions Sourcebook CREDS 5.3.1
[2] Credit Unions Sourcebook CREDS 4.2.6
[3] Credit Unions Sourcebook CREDS 5.3.10
[4] Credit Unions Sourcebook CREDS 5.2.1 (4)