September 2024
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FAIR BANKING FOR ALL

Unlocking Access to Credit: Why the UK Needs a Fair Banking Act

A Fair Banking Act will:

- Lead to a **13-fold increase in affordable credit provision** by purpose-driven finance institutions in the UK.
- Increase the capacity of purpose-driven finance institutions to lend to individuals **by up to £2.16 billion** - more than matching the amount owed to illegal money lenders across the UK
- Increase turnover of small- and medium-sized businesses (SMEs) to **£3.9 billion**, which could create and maintain **9,900 full-time jobs** over five years.

Millions of individuals and thousands of SMEs and social enterprises are locked out of access to affordable credit

Anyone can face a financial shock, and many people will struggle to meet an unexpected essential cost from their regular income. Affordable credit is an essential lifeline for people who might otherwise have to turn to high cost credit or risky and illegal lenders. Affordable credit can also allow businesses to grow and thrive, creating jobs and supporting growth across the country.

Increasing access to affordable credit would particularly benefit people on low incomes, people of colour, women and communities in the most economically deprived parts of the UK - all of whom are more likely to be denied access to affordable credit by the mainstream finance sector.

- Even before the pandemic, over 10 million people could not access affordable credit, forcing over 3 million people to turn to very high-cost providers such as pay-day lenders, whose interest rates can be over 1,000%.
- While the very nature of illegal lending makes it hard to quantify, a mid-point estimate of available research suggests that **between 200,000 and 1 million people** are using loan sharks.
- 14 million people have less than £100 in savings, with little resilience to unexpected costs or financial shocks without relying on credit or loans.

SMEs and social enterprises receive a tiny share of bank lending and face a multi-billion pound financing gap. This particularly affects under-served regions outside London and the South East, and marginalised communities.

A banking system which works for everyone and supports local economies to flourish

The Fair Banking Act is inspired by the success of the Community Reinvestment Act (CRA) in the United States, which expects financial institutions to meet the credit needs of their communities. As a central pillar of a broader national financial inclusion strategy, a Fair Banking Act would create a step change in the supply of affordable credit.

The Fair Banking Act would do this by spotlighting the size of the affordable credit gap and mandating the Financial Conduct Authority (FCA) to close it by:

- Requiring the FCA to analyse the performance of mainstream banking institutions - according to asset size - on providing equitable access to credit for individuals, SMEs and social enterprises.
- Creating a published rating system that shows which banks are doing well and which need to improve. The majority of the data needed to reach rating decisions will already be collected by the FCA through its consumer credit Product Sales Data reporting framework.
- Mandating the FCA to use its range of existing regulatory tools to drive change amongst institutions that are not taking sufficient action to improve access to affordable credit.

Banks could improve their rating by:

- Expanding their own provision of affordable and ethical lending to underserved communities and businesses.
- Creating partnerships with purpose-driven banking institutions such as credit unions and Community Development Finance Institutions (CDFIs). Such partnerships would enable these specialised organisations to expand their services and support.

Once the Fair Banking Act is established, a review period could consider whether the criteria should be expanded so that mainstream banking institutions could also improve their rating by providing fair services across a broader range of functions, such as access to branches. This would be informed by the progress of other policy initiatives to address wider aspects of financial exclusion.

> **“I needed to borrow money and went to my bank. I was working and they could see I could afford it, but I was refused. I had to use a payday loan, I’m not proud of it. The problem is though, little things can happen, that’s how they get you and they keep you in that kind of loop - getting the money, paying it back, but then getting halfway through the month and having nothing left. I got stuck in this cycle of payday loans.”**

Creating a step change for the purpose-driven finance sector

The Fair Banking Act would help to redress the imbalance of power between small purpose-driven finance institutions and mainstream banks, channelling significant resources and capital to these sectors. Institutions such as credit unions and CDFIs can provide a lifeline for individuals, families and businesses, partly because they are often much more able to holistically assess the needs of an individual or small business, and provide tailored services and wraparound support.

While some banks have engaged in voluntary arrangements with credit unions and CDFIs to improve access to affordable credit, market failure persists.

A comprehensive national approach is therefore needed to tackle the issue.

The Fair Banking Act would dramatically increase individuals' access to affordable credit

> **"I felt shameful... I was really nervous... But they [The Co-op Credit Union] welcomed me with open arms, told me not to worry, that they would help me. They were really fantastic. Since using the credit union I now own my own house, I've set up my own business. Without the help from the credit union, I don't think I'd be where I am today. I can't thank them enough."**

Based on an analysis of the impact of the CRA in the US, the Fair Banking Act could lead to a **13-fold increase in the lending capacity of purpose-driven finance institutions. Increased lending to consumers could be of a scale equivalent to the total amount owed by individuals to illegal money lenders.**

Such an increased supply of affordable credit would enable millions of people across the UK to manage financial bumps in the road, preventing families from spiralling into problem debt and helping to build long-term financial resilience.

A Fair Banking Act would drive regional growth and unlock the potential of SMEs

- SMEs are the heart of our economy and provide around 60% of private sector employment, yet they have suffered from chronically low investment and struggle to secure bank loans. 46% of small firms think credit availability is quite or very unaffordable.
- The Fair Banking Act would lead to significant growth for financial institutions that specialise in SME services, such as CDFIs. 99% of businesses supported by CDFIs in 2023 had already been declined by a mainstream finance provider, yet they went on to create or safeguard 11,813 jobs.
- 93% of CDFI business lending was made outside London and the South East. CDFIs are much more likely than mainstream banks to lend to ethnic minority-led businesses, women-led businesses and businesses in the UK's most deprived areas.
- We estimate that the increased lending capacity of responsible lenders driven by the FBA could increase SME turnover up to **£3.9bn per year**, and create or maintain up to **9,900 full-time jobs** over five years.

> **"Purple Shoots [a CDFI] understood that with a little humanity, I could turn things around for me and my daughter, and I did. It saved my life. Within 18 months of Purple Shoots helping me with only £3,000, I'd paid them back early, I was free of benefits and I was running a successful business."**

Fair Banking for All

The Fair Banking Act has the potential to transform the lives of millions of people and unlock economic growth. We believe it should be a key commitment for the UK Government.

The Fair Banking for All Campaign is an alliance of organisations, including civil society organisations, anti-poverty groups, fintechs and purpose-driven banking institutions. Further research and policy papers are available at www.fairbankingforall.org.

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Unlocking Access to Credit: The Impact a Fair Banking Act could have for the UK

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FAIR BANKING FOR ALL

Unlocking Access to Credit: The Impact a Fair Banking Act could have for the UK

Summary

Millions of individuals, small and medium-size businesses (SMEs), and social enterprises are locked out of access to affordable credit. This holds back individuals and communities by preventing them from fully participating in the economy. While affordable credit is not the answer to insufficient income, by pushing people towards expensive or even illegal lending, a lack of access to affordable credit can be a source of significant insecurity and hardship. This market failure mainly impacts those on low incomes, disproportionately affecting people of colour, women and communities in the most economically deprived parts of the UK.

The government has the tools to change this. As part of a national financial inclusion strategy, a **Fair Banking Act** would require regulators, mainstream finance institutions and **purpose-driven finance institutions** such as **CDFIs and credit unions** to work in partnership to extend lending to financially excluded communities.

This could transform the life chances of millions of people, and help thousands of small businesses to grow and thrive.

We calculate that a Fair Banking Act could lead to a **thirteen-fold increase** in the level of annual lending by purpose-driven finance institutions, from an estimated £250 million per year now, up to £3.3 billion per year with a Fair Banking Act in place.

We hypothesise this increased lending would be split between individual consumers and SMEs.

We estimate that the increase in consumer lending could be **equivalent to, or higher than, the total amount** currently owed by individuals to illegal lenders.

The increased lending to SMEs could **increase SME turnover by up to £3.9 billion, supporting up to 9,900 jobs over five years.**

Purpose-driven finance

The UK has a network of specialised finance institutions which work to increase access to affordable credit. Grounded in local communities and with the best interests of members and customers at the heart of their operations, Community Development Finance Institutions (CDFIs) and credit unions are well-placed to assess the context and needs of an individual or small business.

As a result, they can provide more holistic support and design products around the specific needs of groups who are often excluded by mainstream finance, ensuring that those individuals can access affordable credit and do not have to turn to high-cost or illegal lenders. CDFIs and credit unions sit within a broader ecosystem of institutions which can be described as 'purpose-driven finance'. This includes ethical banks and building societies, nascent regional mutual banks, and others including some fintechs. The figures for this research extrapolate from those for CDFIs in the States, where 'CDFIs' include credit unions. As such, 'purpose-driven finance' in this paper refers to the CDFI and credit union sectors.

> **"I'd been with the same bank for years, I'd been paying bills, I had a job, I could prove I'd been consistent. I asked to borrow £1,500, I thought perhaps they might offer me less, but it was just a no. It felt like I was talking to a machine. The only option I had to borrow money was high cost credit. It took over everything. I had no power to negotiate, I just watched as the tally on the debt went up. The amount I owed versus the amount I'd borrowed trebled.**
>
> **I felt embarrassed and isolated. I didn't want to tell anyone about the situation I'd got myself into. You just end up in this stress cycle where it adds up and adds up, taking more and more energy, despite you doing everything you can to get out."**
>
> Financial exclusion workshop participant.

Scaling purpose-driven finance: the Community Reinvestment Act

Although it already plays an important role in providing affordable credit to both individuals and small businesses, the UK's purpose-driven finance sector is currently small, with a lack of capital representing a key barrier to the sector's growth and it fully realising its potential in closing the affordable credit gap. Fortunately, there is a model to follow to scale up the sector.

In the United States, the Community Reinvestment Act (CRA) has helped to drive significant growth in the size and capacity of lenders such as credit unions and CDFIs. This has allowed them to provide services to millions of people who would have otherwise had nowhere to turn for affordable credit.

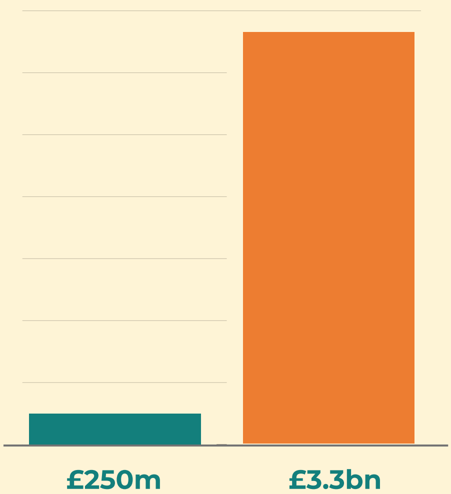
The CRA has tasked mainstream banks with supporting purpose-driven finance institutions to deliver services to underserved communities and SMEs where the mainstream banks are unable or unwilling to do so. By our conservative estimate, under the CRA, purpose-driven finance institutions were able to lend up to $24.6 billion to financially excluded consumers and businesses in the 2020 fiscal year alone.

The CRA is not the only policy to support US credit unions and CDFIs. Government policies including the CRA, CDFI Fund and the New Markets Tax Credit Programme have led to the growth of the broad CDFI sector in the US, particularly since the 1990s. However, it is the practical application of the CRA specifically that has led to mainstream financial institutions partnering with a range of CDFIs to meet the credit needs of communities, including by dramatically increasing the scale of capital they can deploy.

> **"Having managed the CRA team at Citibank, I believe that without the CRA, billions of dollars of credit would not reach low/moderate income households, and small and minority owned businesses. Banks have developed products and credit processes that have now long demonstrated that such portfolios can perform well and be profitable, and achieve much of this by working closely with CDFIs. The very granular customer demographic data that banks provide to ensure that there is equitable access to credit is crucial, and ensures that deposit taking institutions do not just take deposits from certain customer segments, but also lend to them."**
>
> Bob Annibale, Managing Director Citi Community Development & Inclusive Finance (2010-20).

A UK CRA: The Fair Banking Act

Current vs potential lending by purpose-driven finance providers



The UK could learn from the US by introducing its own version of the CRA: the Fair Banking Act (FBA). Like the CRA, the Fair Banking Act would encourage mainstream banks to work with purpose-driven finance providers to fill gaps in existing services and increase lending to financially excluded people & SMEs.

Based on estimates of the lending of CDFIs and credit unions in the US under the CRA, we calculate that the Fair Banking Act would significantly increase the lending capacity of purpose-driven finance institutions in the UK **from around £250 million annually to as much as £3.3 billion annually**.

The Fair Banking Act and consumers

This would have a significant impact on access to affordable credit across the country, particularly for women, people of colour and people on low incomes.

- For consumers, **the increased lending capacity of purpose-driven lenders under the Fair Banking Act could be equivalent to the total amount owed by individuals to illegal moneylenders**. (1)
- This could be equivalent to the total debt owed by more than 700,000 people to illegal moneylenders.

Illegal lending is an extreme outcome of a lack of access to affordable credit. This figure therefore demonstrates both the scale of the current crisis and the scope of the Fair Banking Act to significantly increase affordable credit options for those who currently borrow from illegal or high-cost lenders because they have nowhere else to turn.

“The credit union offered me something, not the full amount I asked for, but something. They took into consideration everything, I think the bank didn’t do that. [At the credit union] you were interacting with a live person face-to-face, rather than a computer saying no... They made me feel human, like an individual.

The property was empty, we didn’t have any furniture... we can’t be sleeping on the ground in the winter. So that support from the credit union it went a long way - I got a bed for me and the kids... we all slept in that one bed.

The interest was fine, what I was paying was fine, I was able to pay it back stress free... I can’t say highly enough about the credit union, I’m so grateful my friend recommended them.”

Credit union member, London.

“Credit unions are financial co-operatives, so we're owned and governed by our members - that means we're closer to, and understand, the people who come to us for loans and savings. We see first hand the need for increased supply of affordable credit, and the positive difference it can make in building the financial resilience of our communities. As membership numbers continue to increase reach (now at their highest recorded figure), we know people want the sector to grow the exemplary care and services it has always offered. ABCUL supports calls for a Fair Banking Act to make sure affordable credit is available to everyone who needs it.”

Robert Kelly, CEO Association of British Credit Unions Limited (ABCUL).

The Fair Banking Act and SMEs/social enterprises

> **"Access to finance is crucial to allow smaller businesses to grow and prosper. A one size fits all approach can't hope to meet the needs of the UK's small and medium sized businesses. We need lending that understands the needs of SMEs and can respond accordingly. Then the market can better support SMEs to thrive - creating jobs and driving inclusive economic growth across the UK."**
>
> Martin McTague, National Chair of the Federation of Small Businesses (FSB).

A Fair Banking Act would also have significant benefits for businesses and social enterprises that are currently unable to access affordable credit, loans and other financial services. These businesses are disproportionately based in the most economically deprived parts of the UK.

We estimate that the increased lending capacity of purpose-driven lenders driven by the Fair Banking Act could lead to **an increase in SME turnover of up to £3.9 billion**. This could support up to **9,900 full-time jobs over five years**.

This would be a significant boost to SMEs currently unable to access the financing they require to expand. It would offer real downstream effects, bringing economic dynamism and jobs to areas in real need.

> **"Community Development Finance Institutions (CDFIs) invest into underserved places and people, unlocking potential for businesses, social enterprises and households. For economic growth to happen, we need lenders that get to know businesses and understand people's lives, make fair lending decisions that take these into account, and offer affordable finance.**
>
> **In 2023, CDFI lending reached a record high of £287 million, creating and safeguarding over 12,000 jobs. 99% of the businesses which borrowed from CDFIs had previously been declined by another lender, and most are based outside London. However, the demand for affordable finance from businesses which can't yet meet traditional lenders' criteria is much greater. We need incentives to ensure that growing demand for affordable, ethical, credit can be met. That's why Responsible Finance is part of the campaign calling for a Fair Banking Act."**
>
> Theo Hadjimichael, CEO Responsible Finance.

The Fair Banking for All Campaign

The Fair Banking for All Campaign is an alliance of organisations, including purpose-driven finance institutions such as CDFIs and credit unions, anti-poverty groups and other civil society organisations, fintechs, and academics.

The campaign is calling for a Fair Banking Act as a bold approach to closing the affordable credit gap, a key part of a broader cross-government national financial inclusion strategy.

Several organisations have recently recommended a Fair Banking Act, or Community Reinvestment Act for the UK, including the Co-operative Party, the APPG on Fair Banking, Fair By Design, Fair Credit Charity, Financial Inclusion for Scotland, Plend, and Responsible Finance. The campaign was recently referenced in the Big Issue as a policy response to high-cost credit, and was recommended in a report by the Scottish Government Minister for Employment and Investment.

This paper and its supporting Background and Methodology Paper build upon the policy proposal set out in the briefing *Unlocking Access to Credit: Why the UK Needs a Fair Banking Act*, which provides an update to the policy proposals set out in the paper *Fair Banking for All: Why the UK Needs a Fair Banking Act to Tackle Financial Exclusion*.

This paper has been authored by the Fair Banking for All Campaign, with research from Jesse Griffiths and Tom Shields at the Finance Innovation Lab.

We're grateful to the organisations who peer reviewed this paper and its accompanying methodology paper, including Centre for Responsible Credit, Fair By Design, Fair4All Finance, the Joseph Rowntree Foundation, and Responsible Finance.

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[1] Figures approximating the scale of illegal lending vary significantly, with credible estimates ranging from £0.6 billion and £3 billion. We have taken a mid-point estimate of approximately £1.8 billion. We estimate the lending capacity of purpose-driven finance institutions under a Fair Banking Act to increase by up to £2.16 billion for consumers, so more than equal to the amount that we estimate is owed to illegal lenders. See the supporting background and methodology paper for further detail.