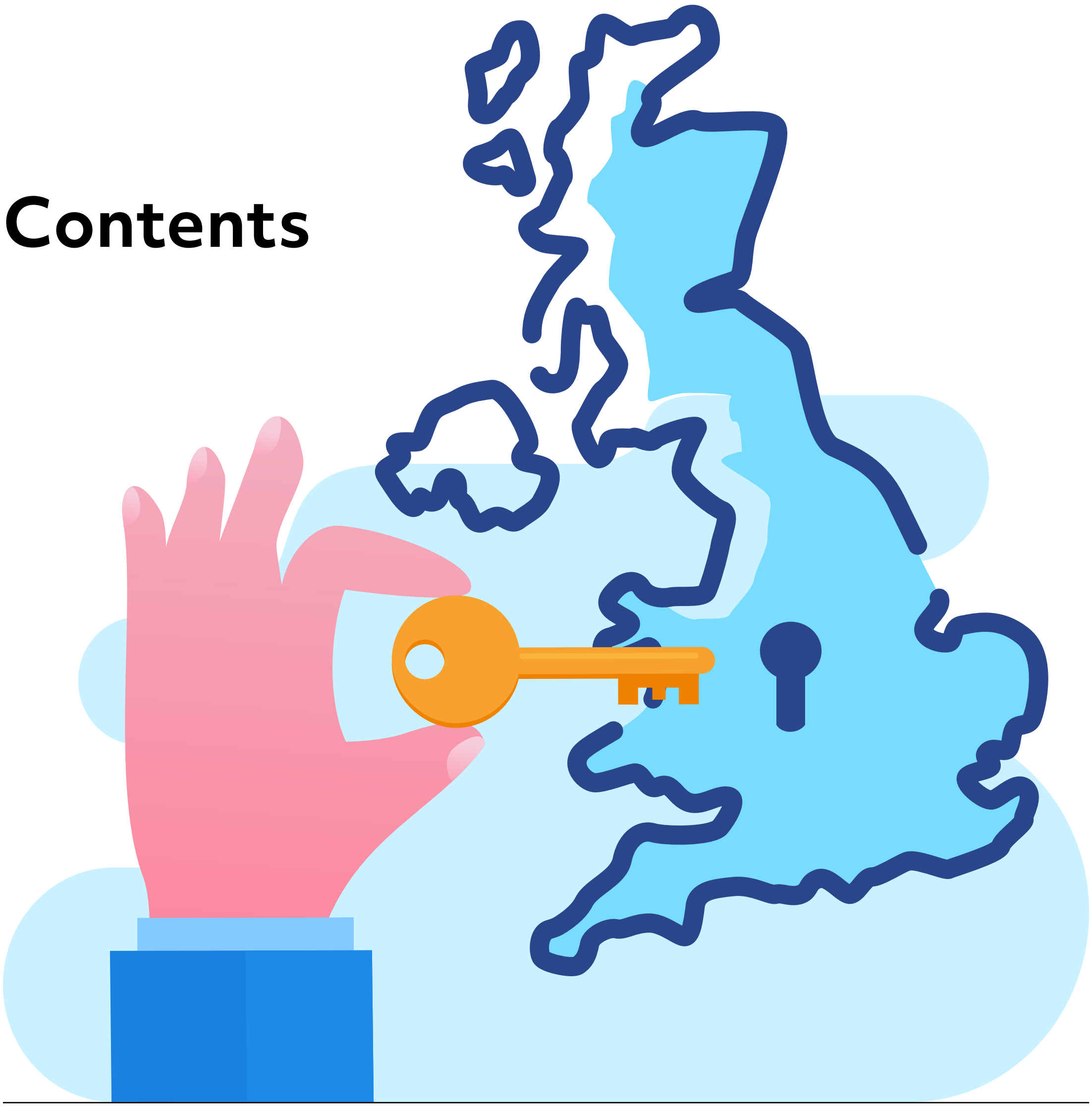
the payments association

Redefining community finance: unlocking pathways to financial inclusion

Supported by

Contents



Foreword

Pooja Bhachu
Director of Public Policy, UK & Ireland
Mastercard
Inclusion Working Group Lead

For many regions around the world, community finance is a key component of financial well-being, helping people from all backgrounds access financial services, manage their money, save for the future, and access responsible sources of credit. Yet this sector has long been overlooked as a viable solution to tackling financial exclusion across the UK.

The long and rich history of community finance institutions is slowly being lost in the UK. Community finance is often perceived as a last resort, seen as something to be used by those living on lower incomes or struggling with debt. This perception needs to change.

Community finance providers are vital to our financial ecosystem, and never more so than today, as cost-of-living challenges and continued financial exclusion continue to affect UK households. In such circumstances, these providers can be an important option, giving consumers meaningful choices for everyday financial services such as savings and credit.

They can also act as a safety net to prevent individuals who are unable to access credit from mainstream lenders from falling prey to unscrupulous, often illegal lenders. Accessing financial services via community finance organisations also enables individuals with limited credit history to build their credit file which can enable further financial inclusion and help them develop financial security and resilience in the long term.

However, there are barriers that prevent Community Development Finance Institutions (CDFIs) and Credit Unions from expanding their service offerings and customer bases, thereby limiting their positive impact on UK financial inclusion. These barriers include access to funding, societal perception, awareness and accessibility of solutions, and harnessing current and future technology that can support their solutions to meet the changing needs of consumers.

There is a significant opportunity for the financial services sector to come together to enable community lenders to benefit from the technological innovation already happening in payments. Technological innovations, such as open banking, have a huge role to play, with fintechs already introducing a host of new solutions to the market. However, we also need the government and policymakers to create an environment where these services and the community finance sector can flourish.

This isn't just the right thing to do, it's also the economically smart thing to do. For industry, supporting CFDIs and Credit Unions to help individuals regain their financial stability and boost their chances of accessing mainstream credit in years to come supports the long-term financial resiliency of consumers. Bringing more people into the financial ecosystem improves financial inclusion and boosts consumer confidence and spending ability, bringing wider benefits and growth opportunities for every region across the UK economy.

At Mastercard, we advocate for a society where equal access leads to equitable opportunity for everyone, transforming the communities, economies, and societies we serve. Across the country, businesses in the community finance space are doing hugely important work to make finance more inclusive and accessible for all. But to address the barriers to growing this important sector and to drive real impact we need to bring these organisations together with innovators from across financial services, the third sector and policymakers.

To do so would bring a multitude of financial inclusion and resiliency benefits that would be profound and far-reaching. Not only for the millions of people in desperate need of fairer, more affordable, and more accessible financial services, but to the entire UK economy. Change is long overdue - we must act now to build a fairer, more inclusive financial system that gives people equitable access to the products they need.

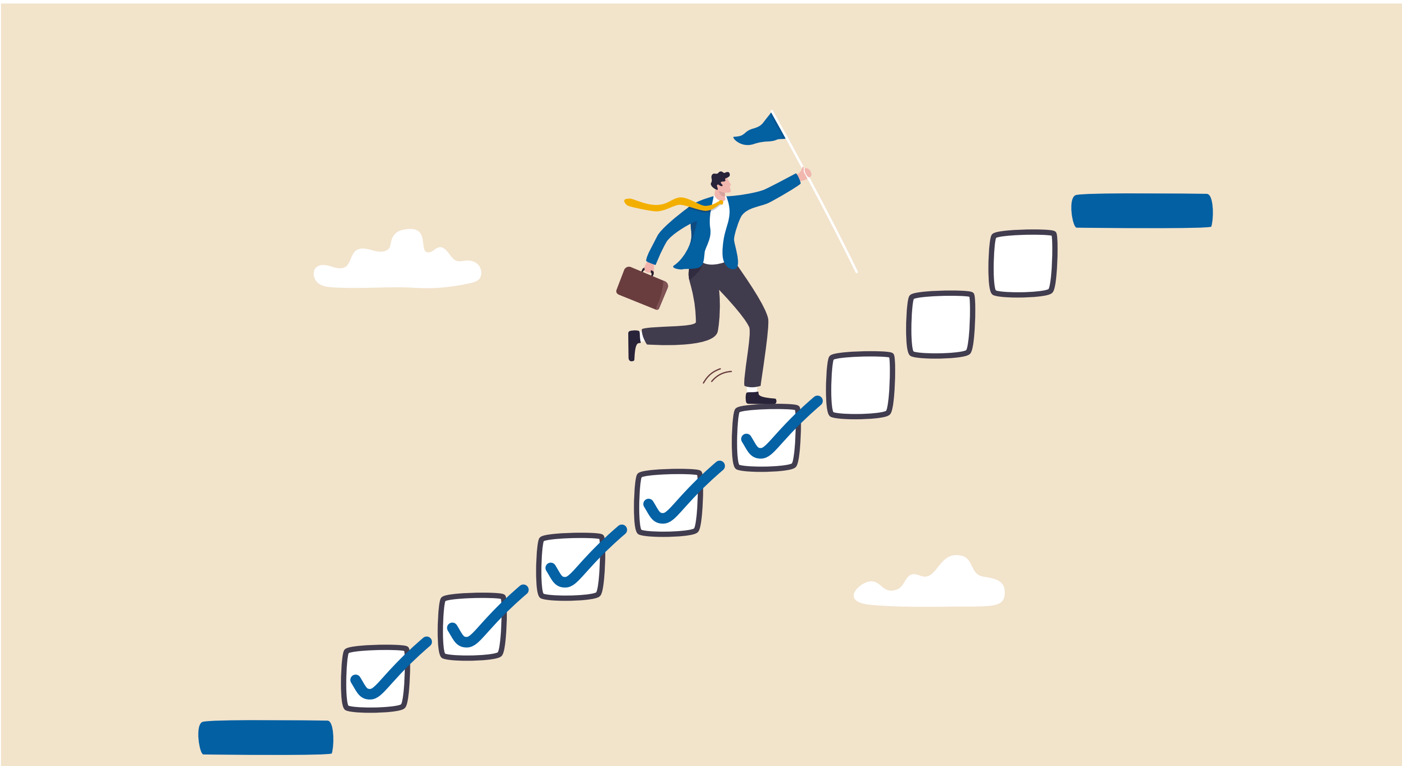
N.B. For the purpose of this report, the term 'community finance provider' refers to both Credit Unions and CDFIs.

Executive Summary

There is boundless potential for the community finance sector to transform the lives of millions of people in the UK who are struggling financially or unable to access appropriate financial services. But this potential will not be realised if the government, regulators, and financial services industry do not work together to introduce supportive policies to revitalise the sector and unlock it's potential for the coming decades.

With the promise of an election in the summer, this is the moment to come together as an industry and issue a call for systemic change in the community finance sector.

'Redefining community finance: unlocking pathways to financial inclusion' explores the biggest challenges and opportunities for the community sector to be a real solution to tackle financial exclusion across the UK and lays out a set of recommendations that we call on government, regulators, and the financial services sector to consider.



The policy recommendations outlined have been crafted following extensive conversations with experts across academia, the industry, the third sector and regulators, as well as a review of other studies which have looked at how the community finance sector can help tackle financial exclusion.

pa

Policy recommendations

Policy recommendations from The Payments Association's Financial Inclusion Working Group for the government, regulators, and wider financial services sector to consider:

Build a community finance sandbox.

The creation of a dedicated sandbox environment where Credit Unions, CDFIs, and the wider community finance ecosystem can come together with the fintechs that are innovating in this space to find new solutions that can help them widen their services and grow their customer base.

Adopt learnings from other markets.

Increased engagement from government and regulators with other markets, notably the US and Germany, to learn more about their successful community finance initiatives and how these could be replicated. For example, the creation of a central body that allows Credit Unions to pool resources to access finance and scale technology solutions, similar to the Credit Union Service Organizations (CUSOs) in the US.

Rethink the regulatory framework and business rates.

Address the current misbalance of fairness that is restricting the growth of the community finance sector by implementing a more agile regulatory framework that recognises its purpose, ethos, and mission. This should be combined with the extension of business rates relief for community finance organisations.

Introduce a kitemark.

Create an easily recognisable symbol of outstanding quality, safety, and trust for organisations working to support underserved consumers. This would help drive trust among the public and support people in need of help to better understand their options for community finance and know exactly where to turn. Such a kitemark would rely on appropriate signposting measures from both central and local government.

Incentivise and legislate greater engagement with the community finance sector.

This could include targeted investment incentives for community finance institutions to draw upon and forms of support such as mentorship programmes and better signposting initiatives.

Relax the common bond.

Community finance providers should work with regulators to explore how they can navigate the challenges created by the common bond to standardise successful initiatives across the wider sector.

Introduction:
Bringing community finance under a sharper spotlight

Noyan Nihat
Chief Operating Officer
Privat3 Money
Inclusion Working Group Mentor
The Payments Association

Community finance traces its origins back to the Victorian era when these kinds of institutions were the trusted heart of communities nationwide. This need hasn't gone away, but society has changed, and technology has evolved exponentially, so how can we bring these options into the modern age?

6.7 million people in Britain are now in **severe financial difficulty**

More than **9 million** adults across the UK were **declined for credit** in just 12 months

The Financial Conduct Authority (FCA) estimates that 12.9 million adults in the UK have low financial resilience – one in four of the country's adult population – and research by Debt Justice shows that a record 6.7 million people in Britain are now in severe financial difficulty.

These figures highlight the financial fragility of millions, and the lack of access to affordable credit options only exacerbates the situation for this group. If an individual has a low credit score or a thin file, accessing credit from mainstream, affordable options can be difficult, and they may feel they have nowhere else to turn other than to high-cost credit from predatory lenders.

Money and Pensions Service estimates that more than nine million adults across the UK were declined for credit in just 12 months between April 2022 and 2023. Against this backdrop, community finance organisations, such as Credit Unions and CDFIs, are doing their best to step in and provide more responsible sources of credit and savings products.

In short, they serve the unserved. Unfortunately, they often lack adequate resources and support to effectively carry out their mission and offer a wider suite of financial services.

With the cost-of-living crisis prompting a significant increase in the number of people considered to be 'non-standard' in the credit market, how can we change the perception of community finance to bring it more into the mainstream, attract investment, and drive financial inclusion?

It is our hope that the ideas and recommendations explored in this paper will be used as a tool to help shape and drive long-term, meaningful reform, with the goal of unlocking access to financial services for underserved individuals and boosting inclusion nationwide.

12.9 million
adults in the UK have low financial resilience –

– one in four of the country's adult population

Chapter One:
Community finance: From then to now

The concept of a Credit Union was first established in the early 1800s when families, villages, and communities would convene to form financial cooperatives. This idea spread to other parts of the world and led to the emergence of a CDFI sector in the US in the early 1970s, which was initially set up to combat 'red lining' by banks - the practice of denying people access to credit because of where they live. This was quickly followed by the establishment of the UK's Industrial Common Ownership Finance Ltd., founded in 1973 and still trading as Co-operative and Community Finance.

Personal lending by CDFIs **increased by**
23%
in 2023 to a total of
£66 million,
and CDFIs helped households **save a total of**
£29 million
in interest compared with borrowing from a high-cost lender.

In the 1980s and 1990s, a growing number of CDFIs and so-called 'lenders of last resort' were established in the UK. In 1998, increased political recognition of the role of CDFIs in enterprise promotion, regeneration and financial inclusion emerged through the Policy Action Teams established by the Prime Minister's Office. In the 2000s, a new wave of UK CDFIs started with help from the government's Phoenix Fund and Growth Fund.

CDFIs and Credit Unions play a crucial role in supporting small businesses and individuals both to access credit and save. For the purpose of this report - and given the remit of The Payments Association's Financial Inclusion Working Group - the focus is on consumers. Together with Credit Unions, CDFIs comprise the bulk of the community finance sector.

In the UK today, there are around 500 Credit Unions with an estimated 1.8 million members that are spread across the country. They primarily promote financial well-being within a local area by providing access to affordable savings and loan products.

CDFIs, meanwhile, have been attempting to scale up and unlock sustainable and inclusive economic growth, supporting the increasing numbers of people in financial difficulty following the 2008 global financial crisis and amidst the current cost-of-living struggles. Indeed, despite limited resources, the UK's CDFIs are now operating at 31 times the scale they did in 2003.

According to Responsible Finance's 2024 Impact Report, personal lending by CDFIs increased by 23% in 2023 to a total of £66 million, and CDFIs helped households save a total of £29 million in interest compared with borrowing from a high-cost lender.

However, given the sector's origins in serving those excluded from mainstream financial services due to income and social background, and perhaps because other financial institutions have been able to embrace technology at a quicker pace, community finance organisations have gained a reputation for serving only the financially vulnerable and excluded, bringing with it a stigma that makes some people reluctant to consider it an option.

In our in-depth conversations with payments industry professionals, the third sector and regulators, many expressed a view that the current negative perception and stigma associated with being financially vulnerable could be one of the reasons why UK Credit Unions continue to have a comparatively small member base than in other markets.

> **"Unfortunately, society can stigmatise the financially vulnerable, and not many people will put their hand up and say they're in that group."**
>
> *Matt Woodcock, Membership Support Manager, Responsible Finance.*

more than a quarter

(27%)

of UK adults have been **forced to turn to high-cost providers**

with **more than a third**

(35%)

saying they subsequently **struggled to repay** the money borrowed

London Mutual Credit Union, for example, only has about 40,000 members in a city of nearly nine million people. In comparison, nearly 140 million Americans were members of a federally insured Credit Union in 2023. In the UK, the stigma around Credit Unions has seemingly strengthened, and they're often grouped alongside food banks and welfare benefits, whilst in the US they are seen as a key pillar of community investment.

These types of financial institutions play a vital role in UK society, meeting the financial needs of people who might otherwise be unable to access financial products and services, particularly credit. For UK consumers, the cost-of-living challenges continue to place a strain on finances, and many are now reliant on credit to get by. A report by insurer LV shows that 62% of all UK adults have debt, with 16% taking on at least £20,000 of debt, excluding mortgages.

For those struggling to make ends meet, mainstream, affordable credit is becoming increasingly harder to access. Research by responsible lender Creditspring shows that more than a quarter (27%) of UK adults have been forced to turn to high-cost providers after being rejected by mainstream lenders, with more than a third (35%) saying they subsequently struggled to repay the money borrowed.

This situation is not sustainable and, if left unchecked, will contribute to long-term financial instability for millions of people, which will have knock-on implications for growth and productivity across the UK economy. Community finance providers are a viable solution to this. They are well placed to provide access to important financial services for these individuals, for example, and provide credit in a safe and affordable way. They also support consumers with more holistic, wraparound services that will be critical to helping these individuals rebuild their financial stability.

Yet as our research found, there are systemic barriers – beyond just stigma – preventing these organisations from reaching and supporting individuals most in need, and these must be overcome if we are to boost financial inclusion and create a safer, fairer, and more accessible financial system for all.

> **"We decline 19 out of every 20 applications that are likely to fall into the hands of the growing number of illegal money lenders.**
> Some of these customers could be served if more data was captured by credit reference agencies to support those who don't own their own homes if this was offered on a real-time basis. Examples of this could be rental payments and bill payments."
>
> *Rachael Magowan, Chief Technology Officer, Moneyline*

Chapter Two:
Facing up to the barriers

The UK's CDFIs and other institutions that serve the financially vulnerable or excluded are doing valuable work driven by a clear ethos, passion, and purpose. They are also contributing to wider economic growth by boosting financial inclusion and bringing more people into the financial ecosystem.

Total of gross loan books in the community finance sector stood at around

£167 million

in Q1 2023.

Total gross lending in the UK hit

£17.2 billion

in December 2023.

However, the fact remains that the sector is very small - Fair4all Finance figures show that the accumulated total of gross loan books in the community finance sector stood at around £167 million in Q1 2023. To put this into context, total gross lending in the UK hit £17.2 billion in December 2023.

To scale the sector and reach more people, we must first acknowledge the barriers that stand in the way of progress. Following discussion with experts from across the industry, third sector and regulators, these issues have emerged consistently as the main barriers to scaling community finance solutions and unlocking pathways to financial inclusion:

Language choices and unpacking what it means to be a 'community':

The first step towards prompting greater private and public sector buy-in, attracting investment to the sector, and reaching more consumers is to reassess and redefine the 'brand' of community finance.

This starts with the language used. The term 'finance' is all-encompassing but can also be restrictive - many associate the term with the 'nuts and bolts' of transactions, and it misses the idea of the holistic wraparound financial care that community providers are working hard to provide or could provide. Additionally, there needs to be distinction between credit and debt. There is a tendency to talk about finances as 'debt' for subprime borrowers, whilst it is 'credit' for those classed as prime borrowers. These nuances matter. They reinforce stereotypes.

> ***Rachael Magowan, Chief Technology Officer, Moneyline:*** *"To redefine community finance, there's a societal perception we must change. So much of the discourse around lower-income individuals is focused on improving financial education, which feeds a narrative that this is a group more prone to financial distress due to an inability to budget and poor spending habits. This is unfair – more often than not, these are individuals who are doing their best to meticulously balance income and outgoings while living off a tight budget."*

We also need to rethink what a community means in this context. Historically, it has referred more to geographical areas, but it's now expanding more into religion or other value-based groups with a common tie.

In this respect, we also need to consider how broadening the concept of community could help community finance institutions serve consumers across the UK, as well as help catalyse investment across different regions if a larger customer base helps them be more attractive to this investment.

"We need to think about the definition of community as well because we tend to think of it very much in a geographical sense, whereas that's no longer the case," ***says Lorraine Brady, Chair, Pay. UK Industry Advice Council.*** *"People connect with people in all sorts of different ways now."*

This can also include groups with a shared mental or physical medical condition, with community finance solutions created by people with first-hand experience of the problems faced. One example of this is Sibstar, the UK's first debit card and app designed specifically for people living with dementia. The company was founded by Jayne Sibley, and the product was informed by her experience of caring for her parents.

"We need to stop thinking about community finance as a niche.
It's not a niche – it's one in four people with low financial resilience. The language currently used immediately pigeonholes people into a small group, which makes them harder to reach. We can do projects here, there and everywhere – but it's going to take a top-down approach of someone understanding there's a huge number of people that need services like this."

Jayne Sibley, Founder, Sibstar

Community finance providers can help a larger number of consumers access financial services and help create more inclusive growth across the UK by further tapping into community ties through financial solutions. For example, working with the UK's Islamic Finance Council to provide products that better align with the values of the country's Muslim population.

The common bond

Closely linked to the community element is the 'common bond', which is a criterion that dictates who can join a Credit Union, usually based on geography, employer, or sector. This can restrict scalability and standardisation of services – you may have a great solution that could help many people, but it's confined to Leeds or the police force, for example.

"From our perspective, there's obviously lots of overlap between community finance and financial inclusion, but as it stands today, they're not synonymous with one another. Our aspiration is very much to serve the whole community, rather than just a narrow segment of it that's dictated by geography." ***Ben West, Head of Business Development, London Mutual Credit Union***

Regulatory pressures – a misbalance of fairness

Despite having significantly less investment and fewer resources to draw on, community finance organisations are still subject to the same regulatory requirements as their mainstream counterparts, such as the Irresponsible Lending Rule and Consumer Duty.

One expert in the space describes community finance as being 'handcuffed to a particular ethical policy' and whilst providers are proud to fly that flag, they still have the same overheads as those who can charge more. There's a distinct misbalance of fairness here'.

Meanwhile, ongoing Know Your Customer (KYC) and Anti-Money Laundering (AML) demands and costs are adding to an already heavy burden and are piling pressure on many organisations looking to provide for underserved customers.

A lack of investment

Perhaps the most significant barrier is that community finance organisations are penalised for making a profit, which limits their ability to invest in growth themselves or attract external investment. This, in turn, prevents them from investing in innovation and technology to improve their product offerings and reach more people. Compounding this issue is the continued lack of investment from both government and private venture capitalists. This explains why Credit Unions and CDFIs often struggle to find the required liquidity to lend. Recognising these issues, in March 2024, Lloyds Bank became one of the first mainstream lenders to invest in the UK's CDFI sector, putting forward a £62 million investment fund.

Capitalising on innovation

The lack of funding also hamstrings the UK's community finance organisations, preventing them from procuring the latest technology to boost their propositions, improve their decisions, and help them reach more users. They are often being sold outdated technology through their networks rather than having a coordinated and strategic approach to incorporating new technology within the business or investing in innovation themselves.

Research shows that 80% of members in the US believe their Credit Unions innovate "somewhat" or "very" well. While many US Credit Unions offer a wide range of digitally focused products that attract customers from across the country, Credit Unions in the UK still face challenges in this area.

> *"When the Credit Unions get technology, it's kind of like the wrong trousers from Wallace and Gromit,"* ***observes Karen Elliott, Chair and Professor of Practice in Finance and Fintech, Birmingham University.*** *"It's not fit for purpose, it doesn't work, and that then breaks trust in the technology – which means they're already a step behind."*

Trying to standardise propositions across the sector is also a challenge, as different providers are at different points of their tech journey. Some already have advanced apps and are technologically mature, but others are at the start of their journey and are building infrastructure from the ground up.

Case Study - Credit Union

Gurminder Bhagrath
Chief Operating Officer
Plane Saver Credit Union

"As a sector, there's a huge opportunity for us to be more technologically savvy and capitalise on the innovation in the payments space to cut costs, streamline operations and increase efficiencies. But this must be done in a balanced way that ensures we don't lose the human touch that's so important in this industry – often, we are dealing with vulnerable people in complicated financial situations.

"There also needs to be a shift in how we view ourselves. If we were able to change our mindset to both look at and market ourselves as commercial financial institutions, then I think it would help us to reach a wider audience.

"Lastly, we cannot underestimate the immense power of collaboration. All too often, organisations in the sector view each other as competitors and work in siloes, and this is hampering the pace of progress. Credit Unions are meant to be cooperatives – that means working together to support members and improve financial inclusion rates at a national level. In practice, this means knowledge sharing, referring members, sharing technology, and coming together to lobby for meaningful reform."

Plane Saver provide a range of flexible savings and affordable loans to their colleagues. They were founded in 1993 by a group of British Airways Engineers and now have over 25,500 members, making it one of the largest Credit Unions in the UK.

"Credit Unions play a vital role in the world of responsible lending. The interest rates are affordable and competitive, and they regularly top polls for good customer service.
Yet far too many people aren't aware of their existence, and others wrongly believe that they are geographically bound, so if you live outside of a certain area, you won't qualify for a loan. I'd like to see the entire financial services industry focus on highlighting and promoting the work of these vital yet overlooked sectors."

Martyn James, Consumer Rights Expert

Chapter Three:

Forging a path to commercially sustainable, scalable, and mainstream community finance

As outlined, there are a multitude of barriers facing the sector, including the language used, constraints of the common bond, unfair regulatory expectations, and a lack of investment that prevents organisations from capitalising on the latest innovations. So, what are the solutions?

Redefining community finance

Clearly, there is a requirement to remarket community finance to position it as an appealing alternative to what's already in the market, rather than something for those who can't afford the more 'desirable' alternatives.

This will require a culture and mindset shift across society in the long term, and in the short term, investment in a concerted and united communications effort from the industry but also from policymakers and third-sector agencies that often signpost people to community finance organisations.

We can look to Germany as an example of what this could look like. People don't talk about Credit Unions or community finance there; rather, they have local banks named Volksbanken ('People's Banks'), which bypasses negative connotations and effectively rebrands organisations that provide affordable loans and other inclusive financial services. This helps to avoid perception problems in the German market.

Similarly, in the US market, where there are nearly 1,500 CDFIs managing a total that exceeds $450 billion, the community finance sector is lauded for its capacity to tackle systemic issues whilst also expanding into new areas, such as mortgages and down payment assistance.

Incentivising investment

There is an urgent need for more commercial investment into the sector, however many investors and mainstream banks are limited in their ability to get involved while managing risk in a highly regulated industry. By working in collaboration with partners like Fair4AllFinance, Responsible Finance, community finance institutions and regulators, investors and mainstream banks can be better equipped to overcome these limitations.

Case Study - Retail and Commercial Bank

Shaun May
Strategy and
Innovation Manager
NatWest

"Community finance offers an ethical and safe way to bridge that resource gap and develop financial inclusion. In 2023 we recognised at NatWest Group that households and families across the UK were experiencing challenges and anxieties in relation to their finances. We wanted to deepen our support for those impacted by the rising cost of living and as part of a package of support measures and provided £900k grant funding distributed via Responsible Finance to CDFIs across the UK.

The funding had two purposes: providing small value hardship grants to individual consumers who needed help to make things easier; and to increase access to affordable credit through business development funding, building resilience and capacity within CDFIs.

It's key to financial inclusion that people feel comfortable engaging within their community, whatever that community may be, and know that there is support there from the industry whenever they may need it."

NatWest Group is the largest business and commercial bank in the UK, with a leading retail business. NatWest serves over 19 million customers, with business operations stretching across retail, commercial and private banking markets.

The Government must consider how to make the community finance sector more attractive to investors from inside and outside the financial services sector, as well as outside the UK. The government could, for example, encourage tie-ups between German or US-based Credit Unions and those in specific regions of the UK through focussed trade missions or tax incentives. As well as being the right thing to do on an ethical level, encouraging investment in this area will support broader economic growth in the UK with a focus on regions outside London.

For some CDFIs, working with a first-loss funding partner to access initial investment to help absorb bad debt can be a valuable way to kickstart a growth journey and serve more customers. There are existing initiatives that could be impactful, for example, if greater apportionment were given to CDFI expansion from the £350 million Dormant Assets Scheme, which provides funding for social and environmental initiatives across the UK.

Fundamentally, serving financially vulnerable customers is a high-cost, low-revenue market. It's not a lucrative venture, and so the way to make it sustainable is by helping community lenders to serve a higher volume of consumers.

Harnessing the power of technology

Whilst raising awareness of the products and services they provide is important, Credit Unions and CDFIs could also become more accessible – and extend their services – by harnessing current and emerging payment technologies, including improvements in data capture and open banking, for example.

Case Study - Not-for-profit loan provider

Moneyline

Rachael Magowan
Chief Technology Officer
Moneyline

As a financial services industry, we have seen limited progress in mass market payment solutions to improve financial inclusion. Flexible payment options continue to be a barrier to our customers, letting them retain control and giving them a choice of when and how they pay, which is still driven by organisational needs. This may be driven by a lack of investment in technology transformation for older systems, and the payment providers' costs may mean reduced profits."

There is also an opportunity to leverage more fintech innovation, especially open banking. Some community finance organisations are already engaging with open banking to enhance their proposition. One is Salad Money, a social enterprise and CDFI that has harnessed open banking to offer employed workers with thin credit files short-term loans of up to £1,000.

Moneyline is a not-for-profit loan provider that facilitates access to credit for customers that need small cash loans and flexibility with their payments. Moneyline's products are designed to support our customers by offering flexibility on how and when they pay.

Case Study - FinTech

incuto

Jon Stevens
Chief Administration Officer and Head of Strategic Initiatives
incuto

"There is so much potential when it comes to leveraging the innovations that are available to us – be that technology or open banking itself – to address financial exclusion, but the overall impact to date has been relatively limited.

"The application of open banking will be key in the journey to redefining community finance to make it more inclusive, accessible, and fit for purpose. But this will only succeed if we have trust and buy-in from consumers, and this requires greater transparency regarding how open banking is used and the associated outcomes it can bring.

"The resultant benefits should be lowering the cost of lending, increasing the ability for those in the sub-prime and near-prime categories to access more affordable credit, enable smarter decision making and ultimately drive better outcomes."

incuto provides a cloud-based technology platform allowing lenders to enhance their customer experience and automate back-end processes. incuto offer a wide range of off-the-shelf services, allowing community lenders to access new channels to market.

Widely-used kitemarks.

The link between open banking, financial digitalisation, and enhancing inclusion is clear. The crucial question lies in whether providers can now effectively harness the latest technological advancements and professional collaborations to transform challenges into opportunities. The Global Financial Inclusion Index emphasises the importance of collaboration between financial providers and government entities in driving market maturity. We echo that call.

Again, we can look to other markets for inspiration. In the US, for example, the National Community Reinvestment Coalition uses advanced data analytics to track the progress of its lending and other activities. The Volksbanken in Germany, meanwhile, works closely with fintech partners to both fund growth and enhance products and services. For example, Volksbanken und Raiffeisenbanken, a brand of cooperative banks in Germany, has developed a prominent API portal to leverage new open banking opportunities.

Building trust and growing the customer base

When it comes to building trust and credibility among consumers, a point of consideration is the introduction of a kitemark for companies operating in the community finance space. Originally known as the British Standard Mark, the BSI Kitemark was first registered as a trademark in 1903 and is now recognised as a symbol of outstanding quality, safety, and trust across a wide range of products and services.

There is a potential for this to be extended to community finance providers who are making a real effort to support the underserved. By meeting agreed criteria – such as improved data collection and reporting - organisations could receive a kitemark which would drive customer acquisition. This could also be effectively signposted from both financial institutions and support organisations, such as Citizens Advice and debt charities.

We should also consider how the restrictive rules imposed on Credit Unions by the common bond can be loosened. For example, putting measures in place so that Credit Unions no longer have to prove that new members have something in common. This would mean that as well as serving people who live or work in the same area, Credit Unions would also be able to open up to new customer groups.

Letter from America: The need for a regulatory rethink

A more pragmatic, nimble and fair regulatory approach to community finance organisations is sorely needed. The government and the UK's regulatory bodies need to consider special business rates for community finance organisations, as well as more manageable regulatory requirements.

Building on the Affordable Credit Challenge that HM Treasury ran with Challenge Works to connect fintechs and Credit Unions, a logical next step could be the creation of a sandbox for Credit Unions and CDFIs to demonstrate how, and where, they can extend their services and the value this would bring to society.

Here, we could learn lessons from the US. There is a network of Credit Union Service Organizations (CUSOs) throughout the country, which are corporate entities owned by federally insured Credit Unions. They allow Credit Unions to pool resources to access finance and scale technology solutions, and they are a big part of why so many US credit unions are financially viable and successful in their own right.

In the UK, there is only one such entity – Credit Union Solutions. The Centre for Social Justice has previously called for HM Treasury to create a Credit Union Strategic Mergers Fund, which would support the creation of larger, more sustainable Credit Unions, and has also lobbied for Credit Unions to be allowed to provide a greater variety of services.

It should be noted the US also has the Community Reinvestment Act, imposing a minimum service obligation on mainstream financial institutions, which means if those institutions don't serve the underserved, they must fund others to do so. Whilst we wouldn't suggest the need for a similar levy, we could swap the 'stick' for the 'carrot' and introduce incentives for the UK's biggest banks to further fund Credit Unions and CDFIs.

Appropriately incentivising mainstream financial institutions would prompt them to become more involved in the space. "Fundamentally, it's about giving the mainstream a broader view of the base they need to serve and how they need to serve it," said ***Lorraine Brady from Pay.UK's Industry Advice Council***.

Dr Pål Vik
Senior Research Fellow, Community Finance Solutions
University of Salford

Improving data collection

"We currently lack comparable and standardised data on community finance customers to determine which groups are already well served by the community sector and where there are gaps in provision.

"Community finance providers should be required to report standardised data on customer characteristics to government – or a central industry body - as part of an accreditation or certification process in exchange for access to a suite of funding and support. There are existing schemes on which this certification could be modelled, including the accreditation of UK community finance institutions for Community Investment Tax Relief and the certification of US community lenders to receive support from the federal CDFI fund.

"The resulting evidence base could be used by government and partners to improve access to community finance by strengthening existing models where these work well and stimulate innovation where traditional approaches fail."

Community Finance Solutions (CFS) is an independent research and development unit specialising in financial inclusion and community finance.

Conclusion:
Making community finance fit for purpose in the digital age and a viable solution to financial exclusion

Community finance isn't a niche – it's something needed by many people in today's uncertain economy. We need to take the good work being done by Credit Unions and CDFIs, reduce the cost of delivering it, and scale it. Technological innovations, such as open banking, have a huge role to play, with fintechs introducing a host of new solutions to the market. However, we also need the government and policymakers to create an environment in which these services and the CF sector can flourish.

"Last year Responsible Finance helped to influence legislative change on Community Investment Tax Relief (CITR), which has been hugely successful in unlocking more funding for SME and social enterprise lending CDFIs.

Expanding this to personal lending CDFIs would incentivise investment and unlock access to vital credit for thousands more people."

Matt Woodcock, Membership Support Manager, Responsible Finance – the UK's trade body for CDFIs

This paper has highlighted the need for the government to incubate and support the sector in a better, more targeted way, and we need to widen its appeal and reach, getting mainstream financial institutions and investors more involved. By focusing on the areas below, the incoming government can work with the payments industry to unlock the full potential of the UK's community finance sector, helping to create more scalable community finance solutions that can be adopted nationally rather than just in certain pockets across the UK.

Policy recommendations

Policy recommendations from The Payments Association's Financial Inclusion Working Group for the government, regulators, and wider financial services sector to consider:

Build a community finance sandbox.

Initiatives such as HM Treasury's Affordable Credit Challenge from 2021 are evidence of how impactful schemes that connect community lenders and tech providers can be, but we need to regain momentum. The creation of a dedicated sandbox environment where Credit Unions, CDFIs, and other community finance stakeholders can come together with the fintechs that are innovating in this space to find new solutions that can help them widen their services and grow their customer base would be a positive step towards the development of technological solutions to advance the efficacy and efficiency of community finance organisations.

Adopt learnings from other markets.

The government and regulators should engage with other markets, such as the US and Germany, to learn more about their successful initiatives and what could be introduced to the UK market. For example, Credit Union Service Organizations (CUSOs) - central bodies that allows Credit Unions to pool resources to access finance and scale technology solutions - have been a big success in the US. How can this be replicated in the UK?

Rethink the regulatory framework and business rates.

Address the current 'misbalance of fairness' restricting the growth of the community finance sector by implementing a more agile regulatory framework for the sector that recognises its purpose, ethos, and mission. This should be combined with the extension of business rates relief for community finance organisations.

Introduce a kitemark.

Having an easily recognisable symbol of outstanding quality, safety, and trust for organisations working to support underserved consumers would help to drive trust among the public and support customer acquisition, as people in need of help would know exactly where to turn. Such a kitemark would rely on appropriate signposting measures from both central and local government.

Incentivise and legislate greater engagement with the community finance sector.

Incentivise greater engagement with the community finance sector. This could include targeted investment incentives for community finance institutions to draw upon and forms of support such as mentorship programmes and better signposting initiatives.

Relax the common bond.

Community finance providers should work with regulators to explore how they can navigate the challenges created by the common bond to standardise successful initiatives across the wider sector.

Contributors

Gurminder Bhagrath
Chief Operating Officer
Plane Saver

Martyn James
Independent expert

Rachael Magowan
Chief Technology Officer
Moneyline

Jayne Sibley
Founder and CEO
Sibstar

Jon Stevens
CAO & Head of Strategic Initiatives
incuto

Dr Pål M. Vik
Senior Research Fellow - Community Finance Solutions,
University of Salford

Matt Woodcock
Membership Support Manager
Responsible Finance

Financial Inclusion Working Group

The Inclusion Working Group has the specific purpose to inform and collaborate with government, regulators and third sector bodies, providing clarity on innovations and solutions in payments that can reduce financial exclusion and the poverty premium. It seeks to achieve this by collaborating with industry bodies, developing thought-leadership campaigns, and informing regulatory and legislative decisions.

Financial Inclusion Working Group Committee Members

David Bailey
Head of Payment Strategy
Santander

Pooja Bhachu
Director Public Policy UK & Ireland
Mastercard

Tribh Grewal
Head of Alt Pay
Discover Financial Services

Jos Henson Gric
Co-Founder
Flex

Neil Harris
Chair of the Advisory Board
The Payments Association Board

Andrew Martin
SMEB

Shaun May
Strategy and Innovation Manager
NatWest

Noyan Nihat
COO
Privat3 Money

Simon Thomas
Senior Product Manager
allpay

Kit Yarker
Chief Operating Officer, PFSL
EML Payments

About The Payments Association

The Payments Association is the largest community in payments. Founded in the UK in 2008, the association now operates communities in the UK, EU and Asia, helping almost 300 companies enhance their commercial interests, solve societal problems such as financial exclusion and evaluate new opportunities for innovation in payments.

Our purpose is to empower the most influential community in payments, where the connections, collaboration and learning shape an industry that works for all.

We operate as an independent representative for the industry and its interests, and drive collaboration within the payments sector in order to bring about meaningful change and innovation. We work closely with industry stakeholders such as the Bank of England, the FCA, HM Treasury, the Payment Systems Regulator, Pay.UK, UK Finance and Innovate Finance.

Through our comprehensive programme of activities for members and with guidance from an independent Advisory Board of leading payments CEOs, we facilitate the connections and build the bridges that join the ecosystem together and make it stronger.

These activities include a programme of monthly digital and face-to-face events including our annual conference PAY360 and awards dinner, CEO round tables and training activities.

We run six stakeholder working Project groups: Inclusion, Regulator, Financial Crime, International Trade, Digital Currencies and Open Banking. The volunteers within these groups represent the collective view of The Payments Association members at industry-critical moments and work together to drive innovation in these areas.

We conduct exclusive industry research. This research is not legal advice. It is made available to our members through our Insights knowledge base to challenge and support their understanding of industry issues. This include monthly whitepapers, insightful interviews and tips from the industry's most successful CEOs.

---

the payments association

St Clement's House, 27-28 Clement's Lane, London EC4N 7AE
Tel: +44 20 3540 9760
Web: www.thepaymentsassociation.org
Email: info@thepaymentsassociation.org
@ThePAssoc
The Payments Association