# CP7/22 – Credit unions: changes to the regulatory regime Fair4All Finance response

December 2022

## Summary

We welcome the opportunity to respond to this consultation paper. Our response supports the vast majority of the proposals as a way to increase the resilience of the credit union sector.

However, in order to support sustainable growth, we believe expectations around capital requirements should

- Differentiate between deferred shares and subordinated debt
- Show more support for the valuable role of external investment in driving sustainable growth

## About Fair4All Finance

Fair4All Finance is a not for profit organisation founded in early 2019 to improve the financial wellbeing of people in vulnerable circumstances by increasing access to fair, affordable and appropriate financial products and services. We have three main priority areas:

- Expanding provision of affordable credit through a scaled community finance sector
- Partnering with banks and financial services providers to support the delivery of products and services for customers in vulnerable circumstances
- New product and market development – developing and scaling products and services to address market gaps

You can find our full strategy here.

## Our response

We agree with the principle of making sure that credit unions are safe and sound organisations for their members, and reducing the risk of failures. This is more important as some credit unions increase in size and complexity.

Fair4All Finance looks at regulation from both a sustainability and a growth perspective. One of our strategic priorities – developed with HM Treasury – is to grow the supply of affordable credit through a scaled community finance sector, including credit unions.

In recent years there has been a huge collapse in the provision of credit to customers excluded from mainstream finance. From 2019 to 2021 the home credit and high-cost short-term credit markets shrank by £1bn, issuing 3.25m fewer loans a year[1]. Over that same period credit union outstanding loans in Great Britain rose by £60m from £1.01bn to £1.07bn. We estimate the total gap in supply is around £2-3bn. While credit unions have grown admirably in recent years, it is not enough to meet the demand.

Without access to regulated and legal credit, there is a real risk that more people turn to dangerous illegal money lending. It's estimated that there could already be more than 1m people in debt to loan sharks[2].

Our work focuses on building resilience and enabling the right growth. Through our Covid-19 Resilience Fund, we supported 31 community finance organisations through the pandemic, helping to preserve an estimated 50% of affordable credit provision targeted to customers in vulnerable circumstances. And we've deployed £30m through our Affordable Credit Scale Up Programme, with investments backing business plans projected to triple affordable credit provision.

Our view on the consultation comes with a balance of these perspectives – we believe the regulatory regime should support the soundness of the credit union sector while not unnecessarily constraining growth. We supported the PRA's 2020 review of the credit union capital regime, which balanced these approaches and removed barriers to credit union growth.

On this basis we broadly agree with these proposals, including that

- Credit union legislation should be kept simple where possible, and smaller credit unions not taking advantage of new freedoms should continue to be regulated proportionately
- We support the principle that larger credit unions and those making use of new or more complex products will require stronger controls and higher expectations
- We're pleased to see proposals that extend the range of products a credit union can invest in, which we believe will support sustainable growth
- We agree that stronger liquidity testing, risk management and orderly winddown planning is

[1] Fair4All Finance analysis of FCA and firm data
[2] Swimming with Sharks (2022), Centre for Social Justice

important for the security of the sector. We believe that expectations on larger credit unions to have wind down plans are reasonable and believe this could also be extended to credit unions with assets of less than £100m, on a proportionate basis

However, we believe that proposals around capital requirements as currently drafted would not be proportionate and could hinder sustainable growth.

We disagree that subordinated debt and interest bearing deferred shares should be treated in the same way under these proposals. Due to the restrictions around the repayment of deferred shares[3], they should be regarded as higher quality capital.

We also believe that external investment can be an important tool to drive the growth and long term sustainability of credit unions.

Many credit unions seeking to grow are held back by high operating and customer acquisition costs. External finance can allow credit unions to meet their capital requirements while investing in technology, marketing or back office services – allowing them to increase retained earnings, sustainability and growth. Fair4All Finance has made investments on this basis – using subordinated debt to fund the sustainable growth plan of a credit union.

Using external investment to bolster regulatory capital can also be a way for a credit union to continue growing sustainably through temporary periods of economic downturn that make generating retained earnings more difficult.

We don't believe that any thresholds around this sort of capital should be seen as a hard cap and we note that where limits are exceeded, the PRA would only require a regularly updated plan to reduce reliance on these forms of capital over a reasonable timeframe. This is an important caveat.

These proposals should not discourage credit unions from temporarily using investor capital where it is part of a credible plan towards growth and sustainability. And we would not want investors to be discouraged from backing such plans by the perception that the PRA would disapprove or perceive this as a failure of compliance.

We would therefore like to see redrafted expectations that show more support for the important role of external capital in sustainable growth and that differentiate between subordinated debt and interest bearing deferred shares.

Finally, we would appreciate clarity that any restrictions or threshold would only apply up to a credit union's minimum capital requirements. After a credit union has reached its minimum CAR requirements, we believe any additional capital on top of that should be unrestricted in its makeup.

We'd be happy to discuss any elements of our response further with the PRA if helpful.

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[3] https://www.legislation.gov.uk/ukpga/1979/34/section/31A