Creating Credit, Not Debt
Towards a personal microloan scheme in Ireland
By Georges Gloukoviezoff, UCD Geary Institute

September 2014
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Any opinions expressed here are those of the author and not those of UCD Geary Institute, the Central Bank of Ireland or the Social Finance Foundation.
Contents

EXECUTIVE SUMMARY .......................................................................................................................................................... VII

RECOMMENDATIONS ........................................................................................................................................................................... VIII
Role of credit unions ........................................................................................................................................................................ viii
Outreach ......................................................................................................................................................................................... viii
Financial Inclusion Fund ................................................................................................................................................................... viii
Independent body ........................................................................................................................................................................... viii
The personal microloan ................................................................................................................................................................ ix
A complementary alternative: the consolidation microloan .......................................................................................................... ix
Costs .................................................................................................................................................................................................... ix
Repayments ................................................................................................................................................................................... ix
Subsequent borrowing ...................................................................................................................................................................... x
Application process ........................................................................................................................................................................ x
  ❖ Application process: The main option ......................................................................................................................................... x
  ❖ First fast track option ................................................................................................................................................................ x
  ❖ Second fast track option ........................................................................................................................................................ xi
  ❖ The alternative option .......................................................................................................................................................... xii

INTRODUCTION .............................................................................................................................................................................1

METHODOLOGY ......................................................................................................................................................................................... 2
Understanding needs and scale of need ............................................................................................................................................... 2
Analysis of good practice models .................................................................................................................................................... 3
Defining the implementation strategy ............................................................................................................................................. 3

1. HOUSEHOLDS IN NEED OF AN AFFORDABLE LOAN ........................................................................................................... 5

1.1 WHY IS A PERSONAL MICROLOAN SCHEME NEEDED IN IRELAND? .................................................................................. 5
Strong increase in poverty and unemployment since 2008 .......................................................................................................... 5
Assessing the potential demand for personal microloans ........................................................................................................... 7

1.2 UNDERSTANDING THE NEEDS OF POTENTIAL BORROWERS .......................................................................................... 9
Managing cash on a weekly basis .................................................................................................................................................... 9
Juggling financial commitments on an inadequate income ........................................................................................................ 10
Credit and budgeting in low-income households ....................................................................................................................... 11

1.3 BORROWING PATTERNS .............................................................................................................................................................. 12
Main sources of credit .................................................................................................................................................................. 12
A portfolio of lenders ..................................................................................................................................................................... 14

1.4 CHARACTERISTICS OF AFFORDABLE LOAN PROVIDERS .................................................................................................. 15
Application process ........................................................................................................................................................................ 15
Loan characteristics and repayment methods ............................................................................................................................. 16
Handling difficulties ..................................................................................................................................................................... 18

1.5 WHY NO LENDER MANAGES TO TICK ALL THE BOXES ..................................................................................................... 20
2. OBSERVATIONS AND LESSONS FROM OTHER JURISDICTIONS ........................................... 24

2.1 PROVIDING AN ALTERNATIVE TO MONEYLENDERS ......................................................... 24

   The importance of defining clear aims ........................................................................... 24
   Key points in developing clear aims ............................................................................... 25
   ‘Affordable’ or ‘appropriate’ loans? .................................................................................. 25
   Key points regarding affordability .................................................................................... 26
   Developing a suitable application process ........................................................................ 26
   Key points regarding the application process .................................................................... 27
   Strategic issues .................................................................................................................. 27
   Key strategic points .......................................................................................................... 28

2.2 MODELS OF GOOD PRACTICE IN OTHER JURISDICTIONS ........................................... 28

   Standalone lenders .......................................................................................................... 28
     ❖ Scotcash (Scotland) ......................................................................................................... 28
     Key insights from Scotcash ............................................................................................... 30
     ❖ The CUOK scheme, London Mutual Credit Union (England) ........................................ 31
     Key insights on CUOK ....................................................................................................... 33
     ❖ The No Interest Loans Scheme (NILS) (Australia) ......................................................... 34
     Key insights on the NILS programme .............................................................................. 36
   Lenders linked to a mainstream financial institution ...................................................... 36
     ❖ MicroBank – CaixaBank (Spain) .................................................................................... 36
     Key insights on MicroBank .............................................................................................. 38
     ❖ Parcours Confiance, savings banks (France) ................................................................. 38
     Key insights on Parcours Confiance .............................................................................. 39
     ❖ StepUP Loans – National Australian Bank (Australia) ................................................... 40
     Key insights on StepUP loans ......................................................................................... 43
   Public funds ....................................................................................................................... 47
     ❖ The discretionary Social Fund (UK) ............................................................................... 47
     Key insights on the Social Fund ..................................................................................... 49
     ❖ The Social Cohesion Fund (France) .............................................................................. 49
     Key insights on the Social Cohesion Fund (France) ....................................................... 52
     Key insights on the Growth Fund (UK) .......................................................................... 54

3. KEY RECOMMENDATIONS: A ROADMAP FOR IRELAND ................................................... 55

3.1 AIMS OF THE PERSONAL MICROLLOAN SCHEME .......................................................... 55

3.2 A NEW PRODUCT OR A NEW LENDER? ........................................................................... 55

3.3 DEFINING A SUSTAINABLE BUSINESS MODEL: THE NEED FOR A FINANCIAL INCLUSION FUND ............................................................................................................................... 57

3.4 MANAGEMENT OF THE PERSONAL MICROLLOAN SCHEME ......................................... 59

   A managing body ............................................................................................................. 59
   Contracting stakeholders ................................................................................................. 60
   Training stakeholders ...................................................................................................... 61
   Coordinating stakeholders ............................................................................................... 61
   Monitoring activity and results ....................................................................................... 62
   Advocating for financial inclusion .................................................................................. 63

3.5 CHARACTERISTICS OF PERSONAL MICROLLOANS ...................................................... 64

   Eligibility criteria .............................................................................................................. 64
     ❖ Profile of borrowers and their income ........................................................................... 64
     ❖ Borrowing purposes, debts and making ends meet ....................................................... 65
Amount lent .................................................................................................................. 67
Cost for the borrower .................................................................................................... 68
   The business model: Should it break even or does it need to be subsidised? .......... 68
   Views of partner organisations .............................................................................. 68
   The regulatory framework .................................................................................... 68
Fees and collateral ........................................................................................................ 69
Repayment: Avoiding the 'one size fits all' approach .................................................. 69
   Amount repaid and length of the repayment period ............................................ 69
   Frequency of repayments .................................................................................... 69
   Repayment methods ............................................................................................ 69
    Allowing credit unions to receive repayments by direct deduction .................... 70
    Extending the Household Budget Scheme to personal microloan repayments ....... 71
Dealing with arrears ...................................................................................................... 72
Subsequent borrowing .................................................................................................. 73
3.6 CHARACTERISTICS OF THE LENDING PROCESS .................................................. 74
Outreach ......................................................................................................................... 74
Assessment and decision ............................................................................................... 75
Broader financial inclusion and refusal ......................................................................... 77
Providing support and managing the relationship ....................................................... 77
3.7 NEXT STEP: PILOTING PHASE .............................................................................. 78

CONCLUSION ............................................................................................................... 79

RECOMMENDATIONS ................................................................................................... 80
Role of credit unions ...................................................................................................... 80
Outreach ......................................................................................................................... 80
Financial Inclusion Fund ............................................................................................... 80
Independent body ........................................................................................................... 80
The personal microloan ................................................................................................. 81
A complementary alternative: the consolidation microloan ......................................... 81
Costs ............................................................................................................................... 81
Repayments ..................................................................................................................... 81
Subsequent borrowing .................................................................................................. 82
Application process ........................................................................................................ 82
   Application process: The main option .................................................................. 82
   First fast track option ............................................................................................. 82
   Second fast track option ....................................................................................... 83
   The alternative option ......................................................................................... 84

BIBLIOGRAPHY ............................................................................................................. 85
### List of acronyms

<table>
<thead>
<tr>
<th>Acronym</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>ABCUL</td>
<td>Association of British Credit Unions Limited</td>
</tr>
<tr>
<td>APR</td>
<td>Annual percentage rate</td>
</tr>
<tr>
<td>CDFI</td>
<td>Community development financial institution</td>
</tr>
<tr>
<td>CEDB</td>
<td>Council of European Development Bank</td>
</tr>
<tr>
<td>CIB</td>
<td>Citizen Information Board</td>
</tr>
<tr>
<td>COSEF</td>
<td>Comité d'orientation et de suivi de l'emploi des fonds</td>
</tr>
<tr>
<td>CSO</td>
<td>Central Statistics Office</td>
</tr>
<tr>
<td>CUDA</td>
<td>Credit Union Development Association</td>
</tr>
<tr>
<td>DSS</td>
<td>Australian Government Department of Social Services</td>
</tr>
<tr>
<td>DWP</td>
<td>Department for Work and Pensions</td>
</tr>
<tr>
<td>EIB</td>
<td>European Investment Bank</td>
</tr>
<tr>
<td>ESRI</td>
<td>Economic and Social Research Institute</td>
</tr>
<tr>
<td>FLAC</td>
<td>Free legal advice centres</td>
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<tr>
<td>FTE</td>
<td>Full-time equivalent</td>
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<tr>
<td>GHA</td>
<td>Glasgow Housing Association</td>
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<tr>
<td>GSM</td>
<td>Good Shepherd Microfinance</td>
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<tr>
<td>IBF</td>
<td>Irish Banking Federation</td>
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<tr>
<td>ILCU</td>
<td>Irish League of Credit Unions</td>
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<tr>
<td>LMCU</td>
<td>London Mutual Credit Union</td>
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<tr>
<td>NAB</td>
<td>National Australian Bank</td>
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<tr>
<td>NESC</td>
<td>National Economic and Social Council</td>
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<tr>
<td>NGO</td>
<td>Non-government organisation</td>
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<tr>
<td>NILS</td>
<td>No Interest Loans Scheme</td>
</tr>
<tr>
<td>SGEI</td>
<td>Service of general economic interest</td>
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<tr>
<td>TASC</td>
<td>Think-tank for action on social change</td>
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Executive summary

Borrowing money is often unavoidable when living on low or moderate income. Having to deal with a stagnant level of income while the costs of essentials (such as rent and electricity) are constantly rising puts household budgets under pressure. Making ends meet and dealing with unexpected expenses become a real challenge. In these situations, some people might borrow money from a credit union, their relatives or a moneylender, or they might accumulate arrears. As the interviews have shown and as Salter (2014) observed, different debts impact the lives of those experiencing them in different ways. Therefore, as long as adequacy of income is not achieved, it is a social policy requirement to ensure that appropriate sources of credit are available for those who are most in need.

The aim of this report was to assess the feasibility of a personal microloan scheme providing access to affordable loans for households excluded from mainstream or credit unions loans. In that respect, particular attention has been paid to the needs of these households, as well as to insights from existing schemes abroad.

Before summarising what could be the main characteristics of such a personal microloan scheme, three key guidelines have to be underlined.

First, the scheme’s aim – or aims – has to be clearly defined. As set out in this report, these aims are: to provide affordable loans to low and moderate income households; to deter them from moneylenders; to prevent or tackle excessive indebtedness; and to contribute to borrowers’ broader financial inclusion. Having a clear understanding of what the scheme is trying to achieve is key to choosing the right characteristics of the scheme, such as lending through the credit union movement, as well the microloans themselves, such as almost no eligibility restrictions except being able to repay the loan. It also plays a key role in how the scheme’s activities will be monitored and its continuous improvement achieved.

Second, it is of paramount importance to put borrower needs at the heart of the scheme’s design. Providing affordable loans to low-income households is a real challenge. It is risky. It is costly. It is complex. Therefore, it is tempting to give more weight to others stakeholders’ constraints when designing the scheme. Letting lenders’ constraints lead the design of such a scheme, however, is likely to lead to it underperforming or failing, as the rationale for a personal microloan scheme is grounded precisely in the current lenders’ inability to serve these borrowers due to their constraints or unwillingness. While realistic choices have to be made in order to ensure that the scheme is sustainable, it has to meet the needs of its target audience in order to be successful. To do so, particular attention should be paid to the budgeting habits of potential borrowers – managing money in cash on a weekly basis – as well as to the emotional dimension of borrowing – the financial stress people are experiencing as well as the stigma attached to debt.

Finally, the third guideline involves considering the personal microloan scheme as a learning process. It is unlikely that its design will be perfect from the start. Therefore, it is
necessary to have flexibility in place, with the ability to adjust the scheme to meet unanticipated needs of borrowers, as well as the ability to identify such needs, through the continuous evaluation of the scheme.

**Recommendations**

On the basis of these guidelines, the following recommendations are made.

**Role of credit unions**

The personal microloans should be provided by the credit union movement as they already have the necessary infrastructure, as well as the ability and willingness, to provide such loans. Credit unions would also allow broader financial inclusion through their other financial services.

Lending through the credit union movement would prove more efficient than setting up a new type of lender or public loan fund. The following are some features of this approach.

- Lending requirements would be simplified to suit the target audience profile.
- Each participating credit union would set up its own loan fund.
- A cap would apply to the amount that each credit union can lend through the scheme (a percentage of their assets).
- The definition of the ‘common bond’ might need to be extended in order to ensure appropriate geographic coverage.

**Outreach**

Outreach should be achieved by: working in partnership with trusted organisations (such as An Post, MABS, Saint Vincent de Paul); advertising the scheme in relevant media; and setting up a customer-friendly national website.

**Financial Inclusion Fund**

A Financial Inclusion Fund should be set up with the aims of:

- guaranteeing 50% of the personal microloans;
- providing capital to improve stakeholders’ infrastructure and human resources;
- providing revenue to cover part of the administrative costs of running the programme; and
- funding an ongoing evaluation that measures impact and efficiency.

**Independent body**

An independent body should be set up, in charge of:

- managing the Financial Inclusion Fund;
- managing the scheme by: contracting stakeholders; training them and coordinating them at local and national level; monitoring stakeholder activity; and promoting financial inclusion at local and national level.
The personal microloan

The ‘personal microloan’ would range from €50 to €2,000 and would have an APR between 12.68% and 26.8%. No profile eligibility criteria would apply except the ability to repay the microloan and being excluded from mainstream or credit union loans. People in arrears or anticipating to be in arrears would be eligible. All purposes would be eligible including debts. However, when the amount of debts funded would be over €1,000, MABS support should be requested. In order to increase the relevance of the response provided to the borrower a second complementary type of loan should be envisaged: the ‘consolidation microloans’.

A complementary alternative: the consolidation microloan

The complementary type of loan would be the ‘consolidation microloan’. This would deal with debt between €1,000 and €25,000. People could apply regardless if they are in arrears or not. The consolidation microloans would be an early step to avoid the borrowers’ financial situation deteriorating further with the risk of ultimately having to apply to the Insolvency Service. Both debtors and creditors would benefit from this early response.

The assessment of the situation of these borrowers would be carried out by MABS on a mandatory basis and the microloan would be granted only if significant write-off could be negotiated with creditors (at least 40% of the debt). The interest rate would be as low as possible and the 50% guarantee from the Financial Inclusion Fund would apply.

Costs

Both types of loan would come with no cost to the borrower except the interest rate. No collateral and no savings requirements would apply. Similarly, no fees would be charged in the case of a missed payment. A large range of financial responses would be available to ensure that the repayments remain sustainable for the borrowers (such as reducing the repayments and implementing a moratorium). In the case of a borrower being unable to continue to reimburse the microloan, the remaining amount to be paid should be written off. Court procedures would apply only when clearly dishonest behaviour has been established.

Repayments

The frequency and nature of repayments should meet the needs of borrowers.

- Repayments could be made on a weekly, fortnightly or monthly basis, depending on the borrower’s budgeting cycle.
- Repayments could be made in cash (for example, at the lender’s office or the post office), by direct debit or by direct deduction. Regarding direct deduction, it should only be made possible through a borrower’s explicit request and if protective
procedures are in place (such as the possibility of having the repayment paid back in case of financial hardship).

Subsequent borrowing

Subsequent borrowing should be possible but only one personal microloan should be active at a time. Early repayment should be possible at no cost.

Application process

Considering that the profiles and needs of borrowers will potentially vary and in order to ensure that the personal microloan scheme proves efficient and generates a high level of take-up, several options have been considered regarding the application process. These options are complementary. They provide appropriate responses to the potentially heterogeneous demand for personal microloans.

❖ Application process: The main option

Under the main option, borrowers would apply for a personal microloan to their local credit union. The assessment would take place during a face-to-face meeting. If debt issues are detected but the microloan amount is under €1,000, the lender would make the decision to lend themselves. However, they would be entitled to request MABS’s expertise. Whatever the purpose of the loan, the support from a third party (such as an NGO or MABS) would be possible at each stage of the procedure.

❖ First fast track option

Borrowers in receipt of social benefit and who are willing to borrow less than €1,000 would be eligible to manage their repayments by direct deduction through the Household Budget Scheme provided by An Post. No assessment would be required by the credit union, which would grant the loan as all direct deduction taking place through this scheme cannot exceed 25% of the amount of social benefits paid.
Second fast track option

Borrowers with a higher level of income and with a current account might not have access to mainstream or credit union loans due to lack of or poor credit history. Others with the same level of income and of financial inclusion might feel uncomfortable applying for a loan at a credit union. In order to help these borrowers access the personal microloan scheme and avoid borrowing from a moneylender, an online channel would be available. Potential borrowers would be able to apply online through a customer-friendly national website. Successful applicants would have no contact with the credit union while unsuccessful ones would be provided with all relevant information to meet with either their local credit union or their local post office if they are eligible for the Household Budget Scheme.
The alternative option

Borrowers looking for a loan of more than €1,000 in order to fund debts should not have access to the personal microloan scheme. They would be channelled to the consolidation microloan process, which requires a detailed assessment of their situation by MABS workers and negotiations with their creditors in order to reduce their debt.

*Household Budget Scheme
Introduction

For many people, borrowing money is the only way they can fund a project, make ends meet or pay for unexpected expenses. However, borrowing is not necessarily a straightforward response.

Because they are considered too risky or insufficiently profitable, some people cannot access any lenders. As a result, they may find themselves having to give up a higher education course, or may lose their job because they cannot afford the cost of fixing their car. Others will find themselves in multiple arrears as they try to juggle creditors and keep up with the bills that they think have to be paid first.

Other people will have access to a loan but its terms and conditions will prove inappropriate to their situation. Such a loan will worsen the borrower’s situation, either because the interest rate, fees or repayment amount of the loan are too high or because the person’s solvency assessment was superficial.

Having access to some sort of credit is necessary but being accessible is not enough. A loan has also to prove appropriate to the needs of borrowers. This is a challenge; one that has yet to be met.

Following the financial crisis and the burst of the property bubble, most households in Ireland experienced a fall in their disposable income. A high level of unemployment, cuts in public spending, increased tax pressure have all made this experience particularly painful for those on a low and moderate income level. Symptoms of the financial pressure many households are under include high level of arrears in mortgage, rent or utility bills.

While this has taken place, and converse to their pre-crisis lending practices, mainstream lenders have become increasingly reluctant to lend, while credit unions are less and less accessible to low-income borrowers. Many households are therefore in a situation where they are in greater need of short-term loans while having a higher risk borrowing profile, which denies them access to more cautious mainstream lenders and less accessible credit unions. Such a situation benefits moneylenders, whose number of customers has increased from 300,000 in 2005 to 360,000 in 2013. However their loans come at a cost, which can prove detrimental to the well being of borrowers.

There is an urgent need in Ireland for an easily accessible source of appropriate credit for individuals who are excluded from mainstream sources of credit and unable to access credit union loans. The aim of this report is to assess the feasibility of an Irish personal microloan scheme that would address this need. In order to do so, a three-step process has been taken.

First, the report presents an analysis of unmet needs. This is a prerequisite to setting up a successful scheme. The demand for an alternative provider of affordable loans is assessed and the nature of borrower needs regarding credit is analysed in detailed. This
analysis takes into account budgeting and borrowing patterns and identifies key characteristics that personal microloans should have in order to be appropriate.

Second, an international assessment of good practice is carried out. Good practice models that have been identified as learning opportunities fall into three categories: standalone lenders that manage their own loan fund; lenders linked to a mainstream financial institution that underwrites loans; and public funds that can be used to provide loans, guarantee funds and provide financial support to third sector lenders. Within each category, three examples of good practice were analysed. This assessment led to insights about how to meet borrower needs and to overcome key challenges in establishing a sustainable and appropriate loan provider.

Finally, based on the two previous steps, recommendations are made in order to contribute to the implementation of a successful Irish personal microloan scheme. These recommendations look at the scheme’s aims, organisation, business model and management, and provide a detailed description of the characteristics of loans and the process of accessing one.

Methodology

This feasibility study has been funded by the Central Bank of Ireland and the Social Finance Foundation. It has been hosted at the Geary Institute (University College Dublin). It is part of a three year international research programme (2012–2015), mainly funded by the Aquitaine Region (France) and involving the Comprasec (Bordeaux University) alongside the Geary Institute. This broader research programme aims at assessing qualitatively and quantitatively the impact of personal microcredit in France and comparing the situation regarding access to small loans both in France and in Ireland.

Understanding needs and scale of need

The first stage of the research involved a systematic analysis of available qualitative and quantitative research reports regarding the financial needs of low-income households facing difficulties in accessing mainstream credit. The focus was on publications dealing with the Irish or British credit market as the similarities are extremely strong. However, studies exploring borrower needs in France, Australia and Canada were also considered.

The literature review was complemented by in-depth qualitative interviews with potential personal microloan borrowers. It was decided to interview unemployed people, as their professional situation would prevent them from accessing mainstream sources of credit and would therefore qualify them for borrowing from a personal microloan scheme.

The recruitment of interviewees was done through local employment services as well as an NGO providing services for women. In order to include a variety of situations, interviews took place in Dublin and in a rural area. In addition, particular attention was
paid to gender, age, marital and family status as well as the professional status of the partners of interviewees, if applicable.

Interviews were carried out in September and October 2013. All of them were recorded, fully transcribed and analysed.

While initially 25 interviews were planned, data saturation was reached sooner than expected: the rate at which new information emerged from the interviews quickly declined. This was not the case regarding the literature review. It was therefore decided, after 18 interviews, to allocate more resources towards the analysis of good practice models than initially planned. Specifically, it was decided to extend the geographic coverage of the good practice models as well as the depth of the analysis carried out.

**Analysis of good practice models**

While it was initially planned to focus on good practice models in France and Britain, it was later decided to extend the geographic coverage of the analysis. Therefore, models from Spain and Australia were included and the total number of detailed assessments was increased from six to nine.

Before analysing these models, it was necessary to identify them. This was accomplished through the literature review and direct contact with key informants in the fields of personal microfinance and financial inclusion.

Once the good practice models were identified, their detailed assessment was based on three elements:

- a systematic analysis of available qualitative and quantitative research reports regarding their distribution model, business model and the results (impact and efficiency) obtained;
- a questionnaire, partly completed through information gleaned from online and literature sources, provided to representatives of the good practice models; and
- interviews with representatives of these models following on from their responses to the questionnaire, in order to gather more detail on specific points.

**Defining the implementation strategy**

Based on a systematic analysis of policy documents and regulations, and insights from the two first steps of the research project, an implementation strategy was designed. In order to enhance its relevance to the Irish context, interviews were carried out with key stakeholders regarding: their understanding of the issue, their actual role and strategy as well as their views on the provisional recommendations.

These interviews were carried out with representatives from the following bodies:

- The project funders, who were met on several occasions –
  - Department of Consumer Protection, Central Bank of Ireland
  - Social Finance Foundation.
- Traveller MABS (met on 13 June 2014)
• Registry of Credit Union, Central Bank of Ireland (met on 25 June 2014)
• Irish League of Credit Unions (ILCU) (met on 25 June 2014)
• Money Advice Budgeting Service (MABS) (met on 07 July 2014)
• Saint Vincent de Paul (met on 07 July 2014)
• Irish Banking Federation (IBF) (met on 11 July 2014)
• Credit Union Development Association (CUDA) (met on 18 August 2014)
• An Post (met on 20 August 2014).
1. Households in need of an affordable loan

Establishing a personal microloan scheme in Ireland is not an aim *per se*. It is a means of meeting unsatisfied needs. The first step in a feasibility study is therefore to assess and understand the nature and extent of such needs. The questions that need to be answered relate to: the need for an alternative provider of affordable loans; the nature of the borrowers’ needs regarding credit; and the key characteristics the personal microloans should have in order to meet these needs.

1.1 Why is a personal microloan scheme needed in Ireland?

The first step that needs to be taken before setting up a personal microloan scheme is establishing the potential demand. However, this presents two challenges. First, it requires detailed up-to-date figures, which are not always available. Second, and more importantly, such ‘demand’ varies depending on the characteristics of such a scheme. For example, demand would be considerably lower if eligibility criteria excluded making ends meet and repaying debts as reasons for taking out a loan.

Therefore, it is more realistic to provide evidence about why a personal microloan scheme is needed and the scale of the population experiencing credit-related difficulties in Ireland, even if not all those affected might become personal microloans borrowers.

**Strong increase in poverty and unemployment since 2008**

Being in need of a loan and not being able to access one through mainstream lenders is often triggered by the same factors: low income and unemployment.

Since the Great Recession started in 2008, poverty has increased in Ireland, according to its three main indicators. According to the latest figures available, between 2008 and 2012:

- The proportion of those at risk of poverty grew from 14.4% to 16.5%;
- The proportion experiencing deprivation grew from 13.3% to 26.9%; and
- The proportion experiencing consistent poverty grew from 4.2% to 7.7%.
The increase of the at-risk-of-poverty rate is even more remarkable considering that during the same period, the at-risk-of-poverty threshold dropped from €12,409 to €10,621 (real income), while the cost of daily living rose.

Such trends reflect the fact that a growing number of people are experiencing hardship. In that context, access to affordable credit becomes a real difficulty, while the need for it might often be pressing. It is interesting to note that the main type of deprivation experienced over recent years has been the inability to replace worn-out furniture; a form of deprivation that could be resolved by a personal microloan.

Unemployment is another reason why people face difficulties accessing affordable loans. Affordable lenders might prove reluctant to lend to someone not in employment. In addition, many people who are out of work close their current bank account, reducing their ability to access mainstream credit sources.

The observed trend regarding unemployment is not as negative as those regarding poverty. The situation has slightly improved since 2012: while the unemployment rate reached 15.1% in February 2012, it is now at 11.6% (June 2014). However, unemployment remains very high: 131,000 people were unemployed in 2008 but 300,700 are unemployed in 2014. During the same period, the population considered as not being in the labour force increased by 9.8%.

Another reason to consider unemployment in Ireland as a very serious issue is provided by a recent report published by the National Economic and Social Council. According to this report, 23% of households in Ireland are considered as jobless households (National Economic & Social Council (NESC), 2014). The term 'jobless households' refers to those household where no working-age adult is at work, or where their total working time over the past year was less than 20% of total working time.
Assessing the potential demand for personal microloans

In order to assess the potential demand for personal microcredit, the Citizens Information Board considered both the population experiencing poverty while unemployed and the population in employment but experiencing poverty. Drawing from 2009 figures, the report estimated that potential demand would comprise approximately 232,700 borrowers (Citizen Information Board (CIB), 2013). If the same calculation is made with 2012 figures, the potential market would consist of 293,300 borrowers.

However, these two assessments of potential demand are significantly below the number of customers of moneylenders1, which is estimated at 360,000 (Central Bank of Ireland, 2013b). Estimates of the number of potential borrowers might be too conservative.

The assessments provided above rely on an evaluation of poverty based on the at-risk-of-poverty threshold: having an annual income of less than 60% of the median income. However, as the evolution of the deprivation rate shows, income-based poverty indicators do not tell the full story. This is particularly true when the median income is decreasing, as is the case here.

Not all households were affected by this decrease in income to the same degree. Looking at the evolution of disposable income between 2008 and 2011, an ESRI report shows that the bottom and top deciles experienced the strongest reduction (Callan et al., 2014).

*Figure 2: Change in average real disposable income by decile, 2008–2011 (%)*

The fact that the vast majority of households saw their income reduced over the last few years means that, even without being under the poverty line, they might experience some form of hardship. In a recent technical paper for the Department of Social

1 This also includes catalogue companies and retail firms involved in the provision of goods on credit.
Protection, Maître, Russell and Whelan (2014) provide some examples of such difficulties. By 2011:

- 17% of households were going into debt for ordinary living expenses, up from 9% in 2004;
- 54.4% of households were unable to afford an unexpected expense, compared to only 21% in 2004\(^2\);
- 65% of households were unable to save, compared to 56% in 2004; inability to save is a problem when trying to access a credit union loan.

However, these consequences are not equally shared by all households. Despite having their disposable income significantly reduced, it is unlikely that households in the top decile, for example, will have to rely on a personal microloan scheme to fund some of their needs.

Maître, Russell and Whelan (2014) allow us to identify who is facing these difficulties. In order to better capture the level of economic stress within households, they developed a composite indicator, which takes into account:

- inability to make ends meet;
- inability to avoid arrears;
- the fact that total housing costs pose a financial burden;
- needing to go into debt to meet ordinary living expenses; and
- inability to save.

Based on this composite indicator, it appears that the mean level of economic stress among the Irish population remained stable between 2004 and 2007 before increasing by 53% between 2007 and 2011. As with developments regarding disposable income, all social classes are affected. However, two key elements have to be underlined. First, the lower the social class, the higher the level of economic stress. However, and this is the second key element, in contrast to the evolution of disposable income, ‘the affluent income class group remained relatively insulated from stress. The stress levels of the precarious income and lower middle class have not reached the high level of the income poor group; however, the gap did narrow and these groups also experienced a deterioration of their situation relative to the affluent class. So there is clear evidence of a squeeze for the precarious and lower middle income class group’ (Maître, Russell and Whelan, 2014, p. 44).

Their work validates the ‘middle class squeeze thesis’ and invites consideration of personal microloan borrowers above the poverty line. Among them are mortgage holders. As outlined by the authors, this population has ‘seen a substantially higher increase in economic stress than those in other forms of housing tenure, which narrows but does not reverse the advantage this group had prior to the recession’ (Maître, Russell and Whelan, 2014, p. 45). As a sub-group, distressed mortgage holders are even more in need of a personal microloan scheme. This is because they may struggle

\(^2\) In 2004 and 2005 no amount for the expense was mentioned in the question while from 2006 onwards a specific amount was given as an indication. The amounts ranged from €875 in 2006 to €1,145 in 2011.
to access funds to meet their needs due to the prudent lending circular from the Central Bank, which excludes them from access to credit due to their arrears (Central Bank of Ireland, 2013a).

This population regroups a significant number of households. According to the Central Bank:

- 132,217 mortgage accounts for principal dwelling houses (17.3%) were in arrears at the end of Q1 2014;
- 93,106 of these accounts were in arrears of more than 90 days (12.2%);
- The observed decline relative to Q4 2013, of 3.2%, masks ongoing increases in very long-term arrears (over 720 days), which occurred for 35,314 mortgage accounts;
- In addition, 92,442 mortgage accounts were classified as restructured (Central Bank of Ireland, 2014a).

While it is a challenging task to assess the potential demand for personal microloans, it appears that this demand is clearly growing. It is growing due to the increased financial pressure experienced by numerous households. It is also growing due to increased difficulties in accessing credit. In February 2014, lending for consumption and other purposes decreased by 6.3% over the last year (Central Bank of Ireland, 2014b).

There is a clear need for a personal microloan scheme. However, in order to be successful, such a scheme has to meet borrowers’ needs.

1.2 Understanding the needs of potential borrowers

Research for this report involved a literature review and complementary in-depth qualitative interviews with potential borrowers. Together, these two sources provide a detailed picture of the needs that must be met by a successful personal microloan scheme.

Managing cash on a weekly basis

Research in Ireland has shown that cash is the preferred way of managing a budget among low-income households (Corr, 2006, 2011; Daly and Leonard, 2002). As underlined by Corr (2011), O’Reilly (2006) explains the prevalence of cash management by the fact that this method meets the four main requirements for low-income households:

- **Control**: Cash allows households to have instant and as frequent as needed access to their money at no cost.
- **Visibility**: It is possible to have physical contact with cash, which helps people to know better what money they spend and what money they still have. Cash therefore seems to be more appropriate in order to keep track of spending.
- **Flexibility**: Cash can be easily redeployed from one payment to another, while a household juggles bills. Such flexibility is not as available with direct debit for example.
- **Certainty**: There are no hidden costs when using cash, which helps to avoid debt.
These qualities are important for many low-income households, due to the constraints they experience while managing their budget. In managing a budget, the lower the income, the higher the level of control should be in order to make ends meet (Corr, 2011; Daly and Leonard, 2002). For example, one way of maintaining control of a budget is by earmarking money, for example by assigning amounts of cash to specific expenses (Corr, 2011; Daly and Leonard, 2002; Hohne, 2007; Pahl, 1999, 2008). While use of cash easily enables this, mainstream financial services are less appropriate for such a way of budgeting. They also score poorly regarding the four qualities identified by O'Reilly (2006) as essential for these households. Along with being refused by financial institutions, these qualities of cash use largely explain why a lower level of access to, as well as use of, mainstream financial products is observed among low-income households (Corr, 2006, 2011; Russell, Maître and Donnelly, 2011).

The budgeting techniques implemented by low-income households reveal real ability to budget even if a lack of income means being rarely able to plan ahead. This is confirmed by a report of the Financial Regulator, on financial capability in Ireland, which states, ‘People with higher incomes are more likely to score higher at planning ahead than those on a lower income. However, low scores for those on the lowest incomes may indicate affordability rather than capability issues’ (Financial Regulator, 2009).

Therefore, as explained by Corr (2011), ‘the main goal of managing a low income is to make the money last until the next income payment’. Such a goal is achieved by managing a budget on a weekly basis in line with the payment of the main source of income of the households concerned: social welfare payment (Corr, 2006, 2011; Daly and Leonard, 2002). These households tend to pay their bills on such a basis, in cash, using community facilities (i.e. Post Billpay Service) (Corr, 2011).

**Juggling financial commitments on an inadequate income**

If the preference for budget management through cash is one of the consequences of having a low level of income, another consequence is the fact that these households are often unable to face an unexpected expense. Daly and Leonard (2002) state that low-income households often struggle to keep up with their financial commitments. Corr (2011) explains that they are mainly ‘coping’ or ‘managing’ their financial difficulties, to various degrees, rather than ‘overcoming’ them. The financial pressure experienced by low-income households (see Section 1.1) leads to two important outcomes.

The first outcome is that access to affordable credit is a real need for low-income households. However, and this is the second outcome, this need is the consequence of a broader issue: the inadequacy of their income. Even if this report does not aim to explore this question, it is essential to keep in mind the link between the need for credit and inadequate income. Kempson and Collard (2012) argue that, ‘realising our vision for financial inclusion requires that the state, through general taxation, ensures that everyone has an adequate income whatever their circumstances’. So far, this is not the case in Ireland. Research on minimum essential budget standards, carried out by the Vincentian Partnership, shows that most households that depend on social welfare and
some of those above the at-risk-of-poverty thresholds have an income that is inadequate to meeting their essential needs. While already insufficient in 2013, the income of social welfare dependent households was predicted to be even less able to meet the cost of minimum essential budget standards in 2014 (Vincentian Partnership for Social Justice, 2013). As mentioned by TASC (2013), a report by MABS also notes that the need for small-scale credit exists ‘in the absence of a basic protected income’ (MABS, 2011).

This report focuses on how to provide such small-scale loans in an appropriate way. In order to do so, it is necessary to understand how low-income households use credit.

Credit and budgeting in low-income households

Research in Ireland (Corr, 2006), the UK (Collard and Kempson, 2005) and France (Gloukoviezoff, 2010) shows that low-income households do not consider credit as a right and have a responsible attitude towards debt, with most of such households reluctant to get into debt in the first place. However credit is a need that increases or decreases, depending on factors such as a household’s income, attitude toward debt and overall situation.

Using credit has two main purposes. First, it can help low-income households deal with unexpected expenses or changes in their income. Second, it can help them to improve their situation as it allows them to spread the cost of planned and recurring expenses (such as Christmas) or to finance projects, such as training or purchasing equipment. Research in Ireland shows that the main purposes for borrowing among low-income households relate to essential or ongoing living costs, emergencies, basic consumer durables and child-related expenses (Conroy and O’Leary, 2005; Corr, 2006, 2011; Daly and Leonard, 2002).

However, if credit can have a positive impact, it also involves risk. Considering that low-income households often have access to mainly costlier forms of credit, it appears that these short-term responses prove damaging on a longer term basis. Gibbons, Vaid and Gardiner (2011) assessed that high-cost credit leads to cutting back on food expenditure, reducing expenditure on social activities and not taking holidays, rationing fuel use, arrears on credit repayments, arrears on household bills and forgoing or losing out on other life opportunities; examples here might include not taking driving lessons, or struggling to continue with education. Corr (2006) explains that borrowers would be more likely to end their relationship with a moneylender if their situation improved. A report of the Central Bank of Ireland (2013b) states that 14% of borrowers feel trapped by their use of moneylenders. Finally, Buckland and Martin (2005) observe that borrowers of credit at a high interest rate sometimes feel that such borrowing is ‘deepening [their] debt load and aggravating a cycle of poverty’.

Moneylenders are accused of getting low-income households into a cycle of debt. There are two main causes for this outcome. First, there is the practice of step-up loans, which sees the amount lent increasing each time the borrower repays a former loan and gets a new one (Corr, 2006). Second, there is the more damaging practice of ‘reloaning’. Despite being illegal, reloaning means that a borrower will be offered another loan while
still reimbursing a previous one, with part of the new loan being used to repay the former one.\(^3\) Qualitative studies have shown that such a practice is common amongst low-income borrowers (Byrne, McCarthy and Ward, 2005; Corr, 2006, 2011). A recent report from the Central Bank states that one-quarter of borrowers were offered an additional credit before the balance of a previous loan had been fully repaid and one out of five took another loan before the existing loan was repaid (Central Bank of Ireland, 2013b). Among the second group, 27% used the new loan to reduce an existing loan.

There is a clear need for short-term credit among low-income households. As this need is a result of inadequate income, accessing short-term credit is a risky solution as its high cost reduces the income available for necessary spending. Therefore, it is essential that these households get access to a form of credit that meets their budgeting requirements while also proving affordable in order to contribute to the financial autonomy of the borrowers.

1.3 Borrowing patterns

Having analysed how low-income households manage their budget, it is useful to take a closer look at borrowing patterns.

Main sources of credit

If low-income households are not totally excluded from borrowing from banks, they face a number of barriers that make them less likely to use that source of credit (Corr, 2006). These barriers relate to: a bad credit history or a lack of credit history; lack of a bank account; identification requirements; and a fear among borrowers of losing control over their finances (especially regarding credit card use) (Collard and Kempson, 2005; Corr, 2006). Therefore, their main sources of credit are: family and friends; credit unions; moneylenders; and other types of subprime lenders (Corr, 2011; Daly and Leonard, 2002).

Research by Collard and Kempson (2005) reinforces the statement that the socioeconomic situation of borrowers has a direct impact on the availability or use of these different sources. They distinguish between households in the UK with a full-time wage, those with a part-time wage and those dependent on state benefits. For the first group, there is a high level of use of mainstream credit sources (credit cards, personal loan and store cards) and borrowing from friends and family, while use of moneylenders is low. For the second group, the level of use of mainstream borrowing is lower, though it still takes place, while there is a higher level of borrowing from moneylenders. The third

\(^3\) Section 99 of the Consumer Credit Act 1995, as amended, states that where credit is made available to a borrower by means of a moneylending agreement, that credit shall not be reduced by the moneylender or a person acting on his behalf by any amount in respect of: a) Repayment of the credit or any charges related thereto, or b) Repayment of a previous credit or any charge related thereto, and no payment in respect of the credit shall be required of the borrower by the moneylender or a person acting on his behalf before the due date of the first repayment instalment (Central Bank of Ireland, 2013b).
group rely mainly on moneylenders, mail order catalogues and the Social Fund Budgeting Loan Scheme. Interestingly, borrowing from friends and family was significantly lower among the two last groups.

These trends were also observed among long-term unemployed people who were interviewed for this study. The longer their unemployment history and the more critical their financial situation, the more likely they were to move from mainstream credit towards non-mainstream credit (including illegal lending).

Choosing one lender over another is related not only to the financial situation of the borrower; the ‘conditions’ attached to different types of loans are also relevant. For example, despite being part of the non-mainstream lending sector, ‘payday loans’ are not as accessible as it might seem. They require that borrowers have a bank account, a cheque book as well as a regular income; these criteria essentially define the target customers of this type of loan as those on a higher level of income (Buckland and Martin, 2005; Collard and Kempson, 2005). Corr (2011) gives evidence of strengths and weaknesses of various lenders, which might influence borrowers’ choice, if indeed they can make such a choice, which is not necessarily the case:

- Credit unions are seen as accessible and easy to use but the savings prerequisite acts as a barrier, as does, for younger borrowers, the absence of a facility to transfer repayment electronically;
- Family and friends represent a safe and accessible solution in case of a ‘critical’ emergency, though asking them for a loan is also seen as awkward and embarrassing;
- Moneylenders are quick and easy to access but they were found to leave borrowers short of money for basic expenses.

When considering the motives of borrowers that use moneylenders as opposed to other lenders, Corr (2006, p. xxi) explains: ‘the main push factor towards moneylenders was the denial of credit from mainstream financial institutions; pull factors included accessibility, reduced bureaucracy, convenience, transparency, simplicity, [that] no credit history is needed and repayments are collected in cash on a weekly basis.’ A report of the Central Bank provides similar results; here, 70% of those who borrowed from a moneylender explained their choice by the ease of availability and the convenience of this form of credit. However, only 5% of the respondents explained it by the fact that they had been refused credit somewhere else; this is despite almost one-quarter of moneylender borrowers reporting there were refused a credit union or bank loan (Central Bank of Ireland, 2013b).

Finally, another element that influences borrowers’ choice is the reputation of the lender. Such a reputation is based on different elements, like word of mouth and family tradition (Byrne, McCarthy and Ward, 2005; Collard and Kempson, 2005; Corr, 2006 ; Kempson and al., 2009). According to the Central Bank report, 50% of borrowers were introduced

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4 A payday loan is a relatively small loan provided on the understanding that the recipient will repay the loan once they receive their next wages. Currently such loans are not available in Ireland.
to their moneylender by referrals from family or friends (Central Bank of Ireland, 2013b). The fact that people they trust (family or friends) have had a good experience with a lender is a key decisive factor.

Once a relationship is established with a moneylender, it is very difficult to end it. This is because the amount of money available to borrow increases over time, as does the satisfaction level of borrowers: 83% of moneylender borrowers are satisfied with their lenders and 38% of customers hold longer-standing loan arrangements of at least five years with their moneylenders (Central Bank of Ireland, 2013b).

A portfolio of lenders

If it is interesting to learn why low-income borrowers choose one lender over another, it has to be highlighted that borrowers do not necessarily contact only one credit provider at a time. Some moneylender borrowers are multiple lender borrowers. In Ireland, one-fifth of moneylender borrowers take out loans from more than one moneylender, while one-third borrow from another type of credit provider – typically a bank, building society or credit union (Central Bank of Ireland, 2013b). The same observations have been made by other research studies in Ireland (Byrne, McCarthy and Ward, 2005; Corr, 2006, 2011) and in the UK (Collard and Kempson, 2005; Kempson et al., 2009) as well as by the interviews carried out for this report. This is interesting because it means that some people do not borrow from moneylenders because they have no access to mainstream lenders, but because they choose to do so.

One of the main reasons behind this use of multiple sources of credit (formal and informal, commercial and non-commercial) is that borrowers consider these providers as part of a portfolio of credit options, which as a whole gives certainty regarding future access to a loan in case of an emergency (Kempson and al., 2009). This portfolio can include mainstream lenders, which means that some high-cost credit borrowers are not facing real access difficulties, or can include only non-mainstream lenders, showing that despite the fact that these borrowers have access to lenders like credit unions, which would be considered to be more appropriate, they continue to borrow from high-cost lenders.

Such an observation is important as it shows that the target audience of a personal microloan scheme might not be limited to people who can only access moneylenders for a loan. It therefore might not lead to a complete end to the use of moneylenders.

If it appears that some borrowers ‘mix’ lenders, getting as much as they can from one source and approaching another to make up the balance of their requirements (Byrne, McCarthy and Ward, 2005), it is also important to highlight that different lenders are used for different purposes. Corr (2011) explains that:

- Banks and finance companies are used for long-term purposes (e.g. motor vehicles, house purchase, equipment);
• Credit unions are also used for home improvement and motor vehicles but they are used as an additional source, for once-off events like Christmas, First Communion or holidays;
• Moneylenders are also used for such once-off events, as well as for emergencies (i.e. falling into arrears and bill payment);
• Family and friends are used for small loans to make ends meet and for emergencies.

This breakdown of loan providers according to the purpose of the loan should be kept in mind while setting up a personal microloan scheme that aims to help these borrowers escape from high-cost credit. Marston and Shevellar (2014, p. 167) explain that, in Australia, ‘microfinancing schemes therefore operate in a complementary market space in the mixed economy of credit, compared to the payday lending industry’. In order to be successful, it is essential to pay attention to the conditions attached to these loans.

1.4 Characteristics of affordable loan providers

Not all high-cost credit borrowers are low-income households. There are many socioeconomic profiles among moneylenders’ clientele. However, borrowers who have the least choice and who are the most in need of access to affordable credit are on a low income. Therefore, even if an appropriate form of credit should accommodate the needs of various potential borrowers, it must primarily meet the budgeting needs of the low-income households.

Application process

In order to meet the needs of low-income borrowers, an affordable loans provider should implement an application process, taking into account the important features for its potential clientele, as shown by the research literature.

As Collard and Kempson (2005) state, ‘first and foremost, people on low incomes want to be able to access credit quickly and easily’. An essential feature of moneylenders is that they can grant a loan over a single phone call, while credit unions or local not-for-profit loan schemes involve more complex application procedures, which are seen as bureaucratic by borrowers (Collard and Kempson, 2005; Corr, 2006). Getting a quick answer is particularly important in times of an emergency or an immediate need. The failure of more mainstream schemes to answer quickly enough may lead these borrowers to contact moneylenders (Byrne, McCarthy and Ward, 2005). Access criteria therefore need to be simple and transparent; this means that potential borrowers should be able to have, in advance, a fair idea of the likelihood of their application being successful (Collard and Kempson, 2005).

Borrowers accept that they need to demonstrate their ability to repay their loan but such an assessment should take into consideration that most of them do not have a bank account and do not have a credit history. Therefore, personal assessment techniques should be favoured over credit scoring ones. This approach would also meet the need of these borrowers for personal contact, as low-income households value the relationship they build with their lenders and tend to favour one-to-one contact over remote
transactions (Byrne, McCarthy and Ward, 2005; Collard and Kempson, 2005; Jones and Barnes, 2005; Kempson, Bryson and Rowlingson, 1994; Whyley and Brooker, 2004). Such contact is essential in building a relationship based on trust.

Such trust is reinforced if the application assessment is non-judgemental. What low-income borrowers ‘dislike is having to justify their wish to borrow for a particular purpose (as used to be the case with the Social Fund) or making their case to a committee of local people (as happens for larger loans from many credit unions)’ (Collard and Kempson, 2005). Low-income households borrow to buy essentials, to pay bills or to face unexpected costs. More specifically, loans are used to pay for child-related expenses, consumer goods, transport, changes in personal circumstances or to meet the costs associated with annual events (Corr, 2006, 2011). A recent study of the Central Bank reflected these findings; it found that moneylender borrowers use their loans mainly to buy goods (30%); for family events (23%); for sports club membership (14%); for paying bills or addressing debts (9%); for travel and holidays (9%); for car-related expenses (7%); and home improvements (4%) (Central Bank of Ireland, 2013b).

Among these borrowing purposes, some could be seen to relate to non-essential spending (i.e. sports club membership) or to represent an unhealthy way of budgeting (i.e. paying for bills or addressing debts). Byrne, McCarthy and Ward (2005) give the example of a woman who wanted to borrow money for her child’s Holy Communion but whose application was refused by her credit union on the grounds that it was a waste of money. This experience was made even more unpleasant for her by the fact that friends of hers who borrowed for the same purpose but gave ‘home improvements’ as the reason for their loan request on the application form were successful. In order to reach high-cost credit borrowers and help them move towards a more affordable source of credit, it is necessary to take into consideration their real funding needs, needs that are largely defined by aspects of their socioeconomic situation (e.g. income inadequacy).

Overall, what matters to low-income borrowers is that lenders ‘are perceived to understand the needs of people on low incomes and be able to understand their circumstances without judging them. This combination is necessary for customers to feel comfortable asking for loans and being honest about their ability to repay. It also enables them to assess, with a reasonable degree of confidence, their likelihood of getting a loan’ (Kempson, Ellison, Whley, and Jones, 2009, p.14).

The moneylender has these qualities. This explains why customers of moneylenders can prove reluctant to switch to other credit providers, even when the latter are significantly cheaper (Collard and Kempson, 2005).

**Loan characteristics and repayment methods**

Along with the characteristics of the application process, it is essential that the loans provided meet the needs of potential borrowers. Three aspects have to be taken into account: the total amount that can be borrowed, the price paid and the amount of the repayments.
In Ireland, the most common loan amount borrowed from moneylenders is between €200 and €500 (Central Bank of Ireland, 2013b). Similar amounts are borrowed in the UK (Collard and Kempson, 2005). This need for small loans is not satisfied by banks, which offer larger loans, especially for people without a bank account who cannot enjoy overdraft facilities (Adams, 2009; Collard and Kempson, 2005). Providing affordable credit means that very small loans also have to be available. Such a provision might prove difficult given that credit union themselves are moving away from such loans (Byrne, McCarthy and Ward, 2005).

The second element relevant here is the price paid by the borrowers. The most common rate of APR for moneylenders in Ireland is 125%, and it can be even higher. This is one of the reasons why the feasibility of a personal microloan scheme is assessed in this report. However, this is clearly not a key issue for borrowers. People do not shop around for the best price (Jones and Barnes, 2005). Despite being aware of the high price they are paying, greater importance is given to the convenience and ease of availability (Central Bank of Ireland, 2013b). Valuable features for borrowers include the cost being easy to understand and fixed over the repayment period, as they often struggle to understand terms and conditions, of credit cards for example (Adams, 2009; Byrne, McCarthy and Ward, 2005; Collard and Kempson, 2005; Corr, 2006).

Along with the simplicity of the pricing (fixed and transparent) what really matter to low-income borrowers is the affordability of the weekly or monthly repayments (Collard and Kempson, 2005; Kempson and al., 2009). Byrne, McCarthy and Ward (2005), interviewing moneylender borrowers, found that despite being aware that credit unions were cheaper and easy to access, these borrowers would continue to get loans from moneylenders. As stated by Collard and Kempson (2005, p. 16), ‘in other words, people were looking for weekly repayments and amounts that they could easily accommodate in their household budget’. The authors give the example of the Social Fund Budgeting Loans, which were interest free but highly criticised by borrowers due to the high level of the repayments.

In order to ensure that repayment terms are as affordable as possible, attention should be paid to at least two distinct factors. The first is the involvement of borrowers when setting the repayment amount. In the UK, credit unions are implementing such a practice, and this is particularly appreciated by borrowers (Collard and Kempson, 2005). The second element is related to the frequency of repayments. As seen previously, low-income households tend to manage their budget on a weekly basis. Therefore it makes sense to allow them to repay their loan on the same basis. Collard and Kempson (2005) and Corr (2011) both state that borrowers think that they would not be able to keep up with a repayment scheme, if it was not on a weekly basis.

Along with the level and frequency of repayments, which have to fit with money management strategies of low-income households, a final factor must be taken into account: the way repayments are made.

Regarding moneylenders in Ireland, a study for the Central Bank found that borrowers repay their loans by:
• Payment made at customer’s residence (39%);
• Direct debit (21%);
• Post office (20%);
• Online (8%); and
• At the moneylender’s premises (5%) (Central Bank of Ireland, 2013b).

It appears that not all high-cost credit borrowers share the same preference regarding the way they repay their loan. Some prefer to repay their loan on a monthly basis through direct debit. These borrowers are usually financially included and are looking for bigger loans (Kempson and al., 2009). Others would also appreciate the convenience of direct debit; however, they would use this method only if they had a higher income. On their lower income, they worry about the charges they would owe the bank if not enough money was in their account at the time a payment was claimed (Collard and Kempson, 2005).

Corr (2011) shows that as well as the borrowers’ situation, the type of loan taken out influences the way loans are repaid by low-income households:

• Moneylender loans are paid in cash, on a weekly basis, at the person’s doorstep;
• Catalogues are paid on a monthly basis at the post office;
• Credit union loans are paid via weekly visits at the credit union or through a standing order or direct debit if the borrower has a bank account;
• Car loans and mortgages are mainly paid by direct debit.

Even if low-income households use a variety of payment methods, it appears that home collection remains at the top of the list. This results from a large proportion of low-income household not having a bank account and seeing home collection as a convenient approach that also minimises the risk of falling behind on payments. However, it is also seen by some borrowers as embarrassing and stigmatising as neighbour can see the agent calling at the door; having a debt collection agency at the door can mean being associated with financial difficulty (Collard and Kempson, 2005 ; Corr, 2006, 2011).

Exploring alternatives to home collection that would suit the needs of low-income households, Collard and Kempson (2005) found that direct deduction from income is far more popular than direct debit. This option has its downsides but it seems that borrowers who used this in the UK while borrowing from the Social Fund found it both reliable (e.g. they knew where they were in terms of income and repayments) and convenient.

Offering various methods of repaying a loan is a key feature in attracting potential borrowers. Alongside this, it is also necessary to take into account the various ways of handling difficulties that can occur while an individual is repaying a loan.

**Handling difficulties**

Repayment difficulties are unavoidable. Their frequency is such that in the UK:

• only between 2% and 10% of home credit loans are repaid on time and to contract terms;
• home credit companies typically expect a 26 week loan to be repaid within 30 weeks;
• one-third of repayments are missed each week; and
• a ‘quality’ customer is someone who makes six out of 10 of their repayments on time
  (Collard and Kempson, 2005; Kempson and al., 2009).

In Ireland, 25% of moneylender customers experienced difficulty in meeting repayment
requirements over an 18 month period and 29% felt under pressure to make a
repayment on time (Central Bank of Ireland, 2013b). Even when borrowers are in theory
carefully selected and supported, as should be the case with the French personal
microcredit scheme, 45.5% of borrowers will miss at least one repayment over the
course of the total repayment of their loan (Gloukoviezoff and Rebière, 2013).

These problems are mainly the result of income inadequacy and its potential irregularity
rather than a lack of money management skills or will to repay a loan. Therefore, low-
income borrowers particularly value lenders who recognise the challenges of maintaining
regular payment over time on a low income (Collard and Kempson, 2005). In order to
appeal to low-income borrowers, a credit product should incorporate flexibility in the
form of ‘payment holidays’, ‘reduced payment for longer periods’ or ‘product which can
be scaled down to a minimum during times of hardship’ (Byrne, McCarthy and Ward,
2005; Kempson and Whyley, 1999). But most of all, low-income borrowers value the fact
that their repayment difficulties do not lead to additional charges at a time when
they are the least able to afford them (Collard and Kempson, 2005).

Such features are shared by moneylenders and most credit unions. However, there are
significant differences. First, the cost of arrears for the lenders is built into the high price
of moneylender loans, while this is not the case for credit unions. Second, while
moneylenders do not take people to court as it is usually cheaper to write off the debt,
credit unions take their indebted members to court (Byrne, McCarthy and Ward, 2005).
Borrowers seem to prefer the combination of high cost and no court than low cost with
the risk of being taken to court (Collard and Kempson, 2005).

However, despite the fact that moneylenders seem to provide a response to repayment
difficulties that meets the needs of low-income borrowers, Corr (2011) explains that
borrowers experiencing hardship are going through severe deprivation in order to repay
their loan, such as going without food or spending money saved for children on a loan,
etc. Gloukoviezoff and Rebière (2013) make the same observations in a very different
context – the French guaranteed personal microcredit scheme, where people deprive
themselves in order to honour their repayments.

Trying to find a solution without seeking help, through measures that include self-
imposed deprivation, is a common trait among low-income households, which can be
explained by the desire to protect their self-esteem by showing they do not need any
support (Gloukoviezoff, 2010). A consequence of this behaviour observed by Corr
(2011) is the reluctance among low-income households to seek advice or support
around financial difficulties. In that respect, credit unions seem to try to offer borrowers

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5 Some credit unions and CDFI in the UK consider that a fixed price and no penalty for default
encourages irresponsibility (Kempson et al., 2009)
the opportunity to renegotiate the terms of the loan in case of difficulty and to encourage the person to go to the Money Advice and Budgeting Service (MABS).

1.5 Why no lender manages to tick all the boxes

There is a wide variety of lenders in Ireland, from banks to moneylenders. However none of them succeeds in meeting all the needs of low-income borrowers, as shown on the following table.
**Table 1: Summary of characteristics of lenders**

<table>
<thead>
<tr>
<th>Feature</th>
<th>Banks</th>
<th>Credit unions</th>
<th>Moneylenders</th>
</tr>
</thead>
<tbody>
<tr>
<td>Perceived quality of relationship between borrower and lender</td>
<td>- Often seen as not welcoming for low-income borrowers.</td>
<td>- Staffs are seen as accommodating but sometimes judgemental; - Self-exclusion is present among Travellers, lone parents and welfare recipients as credit unions are seen to be moving to a more middle-class clientele and ignoring low-income needs.</td>
<td>- Close relationship with agent, family tradition, not judgmental.</td>
</tr>
<tr>
<td>Score</td>
<td>-</td>
<td>+</td>
<td>++</td>
</tr>
<tr>
<td>Application process</td>
<td>- Seen as slow and bureaucratic.</td>
<td>- Fast but not fast enough for an emergency; - Considered to be becoming more lengthy and complicated.</td>
<td>Fast, consistent and simple; No credit history, no bureaucracy.</td>
</tr>
<tr>
<td>Score</td>
<td>-</td>
<td>+</td>
<td>++</td>
</tr>
<tr>
<td>Accessible (risk assessment methods)</td>
<td>- Unlikely to get a loan (low income, bad or no credit history).</td>
<td>- Appropriate for low income but it seems that some credit unions require a good credit history.</td>
<td>Appropriate for those on a low income, no credit history needed.</td>
</tr>
<tr>
<td>Score</td>
<td>-</td>
<td>+</td>
<td>++</td>
</tr>
<tr>
<td>Minimum amount borrowed</td>
<td>- Minimum amount is too high.</td>
<td>- No minimum but seem to be moving towards larger loans due to regulation.</td>
<td>No minimum.</td>
</tr>
<tr>
<td>Score</td>
<td>-</td>
<td>+</td>
<td>++</td>
</tr>
<tr>
<td>Simple product</td>
<td>- Worried about losing control over budget with credit card.</td>
<td>- Simple.</td>
<td>Simple however some borrowers disagree.</td>
</tr>
<tr>
<td>Score</td>
<td>-</td>
<td>+</td>
<td>++</td>
</tr>
<tr>
<td>Costs (direct and indirect)</td>
<td>- Interest rate is considered too high.</td>
<td>- Low interest rate; - Automatically insured at no extra cost.</td>
<td>Very high cost; Re-loaning is also an issue.</td>
</tr>
<tr>
<td>Score</td>
<td>-</td>
<td>+</td>
<td>++</td>
</tr>
<tr>
<td>Repayment methods and frequency</td>
<td>- Monthly repayment, need to have a bank account.</td>
<td>- Repayment terms chosen to suit members.</td>
<td>No need to have a current account; In cash, on a weekly basis, at home.</td>
</tr>
<tr>
<td>Difficulties</td>
<td>- Little flexibility over missed payment.</td>
<td>- Flexible and no cost; - Risk of being brought to court.</td>
<td>Flexible and no cost.</td>
</tr>
<tr>
<td>Score</td>
<td>-</td>
<td>+</td>
<td>++</td>
</tr>
<tr>
<td>Securities/collaterals</td>
<td>- None.</td>
<td>- Saving history required.</td>
<td>None.</td>
</tr>
<tr>
<td>Score</td>
<td>++</td>
<td>-</td>
<td>++</td>
</tr>
</tbody>
</table>
It clearly appears that moneylenders and credit unions both come close to meeting all the needs of low-income borrowers while banks target a more middle-class clientele. However, neither moneylenders nor credit unions meet all the needs of low-income borrowers; both lenders fail in different areas. These ‘failures’ and their differences can be explained by two interrelated elements: costs and ethos.

Serving low-income borrowers is costly. They have a higher risk of default. Their repayments are more frequent (weekly) and based on a costlier method (cash often collected at home). They borrow small sums of money while the costs of processing their applications are quite similar to the application costs for a higher amount. The most appropriate risk assessment method is a face-to-face one, which is also costlier than using credit scoring methods. Credit unions and moneylenders make different choices in order to adapt to these constraints and still lend to this population. These variations are explained by ethos.

Moneylenders are commercial companies whose only aim is to be profitable while a credit union is a ‘group of people who save together and lend to each other at a fair and reasonable rate of interest’; such a cooperative ‘exists only to serve its members – not to profit from their needs’. Therefore, moneylenders and credit unions do not reach the same solutions in serving low-income customers.

Moneylenders satisfy almost all the needs of borrowers, which explains why convenience is the most cited quality regarding them. However, such a service has a cost and borrowers pay for it. They pay through the very high interest rate charged but also by the way good borrowers are retained. Knowing that establishing a new relationship with a potential borrower is costly, moneylenders assess them by the way of a ‘trial run’ or ‘step up’ loan, where the amount lent increases with good repayment. Borrowers have a reason not to switch to another credit provider: they would have to go through the whole process again. Home collection is part of this strategy. While it is a convenient way for most borrowers to repay a loan, it is also a way for moneylenders to manage these repayments, to constantly assess the borrowers and to identify other credit needs that would be a sale opportunity (Collard and Kempson, 2005). A final way of making a profit, despite being illegal, is by offering rollover loans, which make borrowers constantly reimburse a loan. The apparent appropriateness of moneylender loans comes with a very high price, which does not limit itself to the level of the interest rate.

Credit unions adopt a different approach because they intend to lend at a fair and reasonable rate of interest (which is capped) and to continue a tradition of co-operative self-help. Therefore, they have adapted their services to the price they can charge in order to make this approach financially sustainable. Some of these choices appear to be contradictory regarding the needs of low-income borrowers, despite having a rationale. The saving requirement is a way to have collateral for the lender as well as to assess the budgeting behaviour of the potential borrower. The lengthier application process is also

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due to the desire of the credit union to lend wisely both for the organisation itself and for the borrowers. Finally, the fact that they bring borrowers in difficulty to court can be seen as a way of encouraging responsibility (in line with the self-help ethos), whereas the moneylenders’ attitude to missed payments is seen as encouraging dependence (Kempson and al., 2009).

These two attitudes to lending to low-income households reflect a tension between difficulties in access and difficulties in use. Moneylenders guarantee access to a large loan, but at a cost that can lead to serious use issues, while credit unions offer narrower access but, in theory, with a far lower likelihood of use difficulties. The setting up of a personal microloan scheme must be informed by these choices in order to be able to be sustainable and to meet the needs of low-income borrowers.
2. Observations and lessons from other jurisdictions

‘There have been a number of attempts to develop low-cost credit products for people on low incomes, including credit unions; savings and loans schemes set up by housing associations; and community-based loan schemes. Take-up of these credit services has so far been modest and none of them has made significant inroads into the customer base at the lower end of the sub-prime credit market. Although the reasons for this are not well understood, it is clear that cost is not always the main consideration when people on low incomes decide where to borrow money.’

Collard and Kempson, 2005, p. 1

Such a statement, made by leading researchers on financial inclusion in the UK, highlights the importance of being realistic about what a personal microloan scheme can achieve in Ireland. It also reminds us that particular attention should be paid to the needs of borrowers in order to make such an offer attractive to them.

This chapter identifies the key issues that should be addressed by a programme that aims to provide an alternative to moneylenders (Section 2.1) and presents good practice in dealing with these key issues (Section 2.2).

2.1 Providing an alternative to moneylenders

The importance of defining clear aims

The aim of this report is to examine the feasibility of introducing personal microloans to respond to the needs of people facing difficulties in accessing mainstream consumer credit in Ireland. Implicit in this objective is a desire to provide a practical alternative to moneylenders, thus reducing the costs of small personal loans. However, such an aim needs to be clarified.

Is the aim of this alternative to move borrowers from moneylenders towards more appropriate, existing sources of credit (i.e. credit unions) or is it to set up a new lender that offers access to appropriate loans to moneylender borrowers, thereby potentially keeping them as customers?

Answering this question is of paramount importance as it will shape most of the decisions that will have to be made in order to define a successful scheme.

- It will have an impact on the nature of this scheme, by determining whether it involve a new lender offering appropriate loans or a new appropriate loan offered by existing lenders.
- It will influence the potential role of partners as well as their willingness and ability to be involved.
It will also have an impact on the business model. If the personal microcredit is a gateway to financial services already provided by existing lenders, the cost of the programme can be spread over the entire activity. However, a standalone lender will have to find a way to build a business model that relies exclusively on its micro-lending activity.

As well as clarifying the aim of this alternative to moneylenders (keeping or moving borrowers), it is also necessary to clarify the anticipated contribution of such a scheme to financial inclusion more generally. Should it focus on providing access to affordable loans or should it also contribute to helping people overcome their potential financial difficulties through debt advice and improve their access to financial services, such as a current account and debit card? The role of potential stakeholders will depend on the answer. For example, in assessing the best options for providing affordable credit in the Scottish Highlands, Adams (2009) considers that an affordable credit provider must combine lending with money advice in order to ensure people understand the implication of their commitment.

Finally, it is essential to be able to assess the results obtained by the personal microloan scheme. Such assessment should cover:

- the scheme’s activity, such as the number of loans granted, the number of applications received and the default rate;
- the scheme’s impact on borrowers, in terms of factors such as their financial situation and financial inclusion;
- the scheme’s impact on stakeholders, for example regarding the quality of their lending decision and procedures; and
- the scheme’s broader impact on society: the social return on investment.

**Key points in developing clear aims**

The key issues for consideration are whether the microloan scheme should:

- keep moneylender borrowers or move them towards existing appropriate lenders;
- focus on affordable loans or improve financial inclusion more generally; and
- how to monitor results and the impact evaluation process.

**‘Affordable’ or ‘appropriate’ loans?**

While the global cost of a loan can be a burden for borrowers, the key driver when choosing a lender is not necessarily the cost. As Kempson and al. (2009, p. 12) explain, ‘for people on low incomes affordability is more important than cost when it comes to repayments. Affordability, in this context, is delivered by an expensive and, from the perspective of a new lender, potentially risky combination of weekly repayments, home collection and flexibility regarding payment problems’. In this statement, the authors point out the main difficulty of creating an alternative to moneylenders: how to offer relatively low-cost loans that would be affordable, with repayments fitting within the borrowers’ budget; and appropriate regarding for example the extent to which the
repayment method and frequency of repayments fits with borrowers’ budgeting strategies.

Along with the cost, it is therefore important to pay attention to the fact that the minimal amount, if any, that can be borrowed must reflect some of the borrowers’ needs. Regarding repayments, the amount, frequencies and the methods available should work with the budgeting strategies of borrowers in order to maximise the likelihood of reimbursement. Flexibility is also a key element when it comes to dealing with missed payments.

**Key points regarding affordability**

The key issues for consideration here are:

- the cost of the loan (i.e. interest rate, potential fees, etc.);
- the minimum sum it is possible to borrow;
- setting the repayment level;
- the frequency of repayments;
- the accepted methods of repayment; and
- implications (including costs) of missed payments.

**Developing a suitable application process**

When low-income borrowers apply for a loan they are often under time pressure. Therefore, they will contact the providers that they think will be the most able to give them a positive answer quickly. Too often, they get in touch with a moneylender. Meeting this need of speed is a particular challenge for an alternative lender.

The core competency of an alternative lender should be its ability to assess a borrower’s level of risk (e.g. the likelihood of the loan being reimbursed), but it should also be able to assess the adequacy of such a loan regarding the situation of the borrower (e.g. the usefulness of the loan). This assessment cannot rely on automated techniques and requires meeting the borrower to discuss their situation.

In order to reduce the time required for this assessment, it is necessary to limit as much as possible any factors that could act as barriers for potential borrowers. These factors include:

- the accessibility of the place where the assessment takes place;
- identification documents required;
- the scope of eligible reasons for borrowing – repaying debts and holidays, for example, are sometimes excluded by alternative lenders though they are real needs for borrowers; and
- whether or not repeated borrowing is permitted – whether these kinds of loans should be accessible only once or several times.

It is also very important that the staff are understanding of the situation of the borrowers, non-judgemental, welcoming and professional.
Finally, the criteria that support the decision of whether or not to lend have to be easily understandable for potential borrowers in order for them to be able to assess their likelihood of success prior to their application.

**Key points regarding the application process**

- These access barriers should be reduced:
  - physical barriers (e.g. opening hours and location);
  - administrative requirements (i.e. identification document);
  - profile requirement (i.e. it should not exclude people with existing debts);
  - eligibility criteria (i.e. these should include reducing existing debts and making ends meet).
- Staff should be welcoming and understanding.
- The application process should be quick and simple.
- Lending decision drivers should be simple and transparent, based on a face-to-face assessment.

**Strategic issues**

As mentioned in the introduction of this chapter, Collard and Kempson (2005, p. 1) outline many attempts to develop low-cost credit for low-income borrowers in the UK but this has proved a challenging task. Even with clear aims, good product design and an appropriate application process, an alternative lending scheme can fail if strategic issues are not sufficiently taken into account. Four strategic issues are critical.

The first is deciding the nature of the **business model**. Even if it is a not-for-profit scheme, there are still questions about the way the costs of providing appropriate credit should be shared between stakeholders (e.g. borrowers, the credit industry and the State) as well as how the default costs will be covered (e.g. via a guarantee fund). These questions are complex ones because lending to low-income households is risky and therefore costly, either for the customers or those in charge of subsidising the scheme.

The second issue is identifying an effective **organisation model**. It could be a stand-alone lender working independently or in partnership with other agencies, or it could be a new product that would be offered by existing stakeholders. The answer to this question should be influenced by numerous other decisions, one of which relates to the geographic coverage of the scheme.

The third issue concerns the **capacity** of the scheme to reach potential borrowers. In Ireland, as in the UK, such a lender will have to compete with well-established moneylenders and it might prove difficult to make borrowers switch.

The fourth issue is often underestimated but generally proves to be essential. Setting up an alternative lender often requires working with **partners** from different backgrounds, such as NGOs, social worker and bankers. Such partnership work cannot succeed if two conditions are not simultaneously present: the ability to develop a cross-cultural dialogue and the full commitment of at least one key person in each participating organisation.
Key strategic points

Key strategic points includes:

- the business model;
- the organisation of service delivery;
- the scheme’s capacity to reach borrowers; and
- ensuring the cooperation and commitment of all the partners.

2.2 Models of good practice in other jurisdictions

Already excluded from mainstream lenders, borrowers unable or unwilling to access a loan from their local credit union are left with few alternatives to moneylenders. The main alternative is the Loan Guarantee Fund provided by MABS. This enables people in need of a small loan (around €300) on an emergency basis to access a credit union loan. This loan is fully guaranteed by MABS. However, this fund cannot deal with the extent of demand for it.

Therefore, if this scheme is a source of inspiration, it is necessary to look abroad in order to get some insights about the best way to establish an Irish personal microloan scheme. Good practice models that have been identified as learning opportunities fall into three categories. First, there are standalone lenders, which manage their own loan fund. Second, there are lenders linked to a mainstream financial institution that underwrites loans. Third, there are the public funds that can act as loan providers, guarantee funds or provide financial support to third sector lenders.

Standalone lenders

- Scotcash (Scotland)

Table 3 presents some background information on Scotcash in Scotland.

<table>
<thead>
<tr>
<th>Starting date</th>
<th>Number of employees (FTE)</th>
<th>Number of loans 2013</th>
<th>Missed payment rate</th>
<th>Default rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>18</td>
<td>1,522</td>
<td>7.72% (60 days with no payment)</td>
<td>3.97%</td>
</tr>
</tbody>
</table>

Scotcash opened its doors in 2007. It has 18 employees and six offices in Glasgow (four of them open one day a week). It was developed as a result of a strategic review of advice services in Glasgow, which found that a significant proportion of the local population had no bank account and few options in relation to borrowing. Despite a high number of credit unions in the city, many were unable (or unwilling) to save before borrowing and Scotcash was a way of filling that gap.
The aim of Scotcash is to provide affordable loans to borrowers and to move as many of these borrowers as possible either to credit unions or to mainstream banks. In order to do so, it encourages borrowers to save with a credit union in order to access their lower interest rate loans (lower than loans from Scotcash) and to develop a saving habit.

Scotcash has been set up as a gateway to financial services. Along with loans, it provides:

- basic bank accounts in partnership with the Royal Bank of Scotland and Barclays – 279 were opened in 2012–2013;
- saving accounts in partnership with Glasgow credit union – 55 were opened in 2012–2013;
- money advice in partnership with the Citizens Advice Bureau, which provides two senior advisers – 756 clients were helped in 2012–2013;
- domestic white goods packages in partnership with Scottish Hydro Electric;
- access to food vouchers for any of the local food banks in partnership with Trussell Trust; and
- access to energy advice.

However, the provision of loans forms the heart of Scotcash’s work. Only one type is available but all purposes are eligible. The amount varies between £50 and £1,000; a higher amount can be considered on a case-by-case basis. A loan should be reimbursed within 13 to 52 weeks. On average, the amount borrowed is £531, repaid over 42 weeks with a weekly repayment of £17.44. In 2012–2013, a total of 1,522 loans were provided, at a total value of £807,623. Two-fifths (40%) of these loans were for new borrowers and 60% for repeat customers. The loans’ interest rate varies between 82.9% (£1,000 over 52 weeks) and 159.05% (£50 over 13 weeks). An administration fee of 6% applies but no collateral is required.

In order to apply, borrowers meet a loan officer, fill in a form at the counter and wait to be contacted (‘fast track application’) or apply online. The latter is extremely popular with a 230% increase since it started in October 2013. The decision to grant the loan is made by a loan officer based on the information provided by the borrower, within 48 hours on average. There is no automated process.

The repayment amount is negotiated with the loan officer after an exhaustive budget analysis has been carried out. Payments can be made on a weekly, fortnightly or monthly basis but only by direct debit. It is a requirement of the scheme that borrowers have a bank account allowing direct debit; therefore, potential borrowers without a bank account are helped by Scotcash to open one (including a basic bank account).

The delinquency rate is 7.72% of all its loans (60 days without a payment). When a missed payment occurs, the loan officer gets in contact with the debtor through letters and phone calls and tries to reach a solution (previously a debt recovery company carried out that task). No fees are applied at this stage. If no solution is found, direct deductions to social welfare benefits or wage arrestment are implemented and fees apply (related to the legal costs). So far, 3.97% of the total volume of loans has been written off.
In order to reach potential borrowers, Scotcash has opened six offices and is willing to open more in Glasgow’s deprived areas. It has also made a particular effort to design a client-friendly website, which complements the face-to-face interactions. Alongside direct channels to accessing its services, Scotcash developed a strong communication strategy with various targeted printed media, as well as with trusted partners within the targeted communities. Referral via these sources is considered very effective as a new lender can face difficulties in establishing trust within the local community.

In order to provide services alongside loans as well as to reach borrowers, Scotcash works in partnership with a broad range of organisations. Partnerships are also key to its business model. In 2010, Scotcash had a 37% ratio of operating loss to portfolio, which was an understatement of the true level of subsidy dependence according to Mosley (2010, p. 18). Even if Scotcash hopes to be able to break even by 2018–2019, its income from loan interest, administration fees and consultancy fees is not sufficient and subsidies are essential to its development. Among the main funders are: Glasgow City Council, Glasgow Housing Association (GHA), Royal Bank of Scotland and a housing association called ng homes (formerly North Glasgow Housing Association). For these funders, their investment is not at a loss as Scotcash’s activities have outcomes.

There are outcomes for the borrowers themselves. First, there is the savings made on the difference in borrowing the same amount from a moneylender. Scotcash provides the following example: if a loan of £400 is made by the moneylender organisation Provident over a 32-week period, it would cost the borrower £153.32 more than if it was made by Scotcash. Along with this impact, a positive association is observed regarding personal income (19% increase), personal saving and the ability to exit from ‘home’ or ‘doorstep’ credit (Mosley, 2010). There is also an impact for the funders as these loans can improve tenant sustainability, help reduce rent arrears and support community cohesion (Scotcash, 2013).

**Key insights from Scotcash**

- Scotcash was set up partly due to the inability of many households to meet credit unions’ saving requirements.
- Scotcash is a gateway to financial inclusion based on partnership work among agencies such as credit unions, banks and citizen advice bureaus.
- Scotcash provides the option of online access but all applications are dealt with manually, and the online option complements face-to-face interactions.
- There is flexibility regarding the frequency of repayments but these are only accepted by direct debit; access to a basic bank account is made easier through the scheme.
- The scheme switched from using a debt recovery agency to in-house recovery.
- Despite being heavily subsidised, its APR is still high (83% to 160%) even if lower than that of moneylenders.
- Housing association are key funders.
Table 3: Information on CUOK

<table>
<thead>
<tr>
<th>Starting date</th>
<th>Number of employees (FTE)</th>
<th>Number of loans 2013</th>
<th>Missed payment rate</th>
<th>Default rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>33 (all LMCUs)</td>
<td>2,923</td>
<td>5.2% (of total amount)</td>
<td>n.a.</td>
</tr>
</tbody>
</table>

London Mutual Credit Union (LMCU), one of the largest credit unions in the UK, launched a payday loan pilot scheme called CUOK in 2012. It is a comprehensive online application and assessment platform that provides the ability for 24/7 loan applications, decision making, approval and loan payment. Its aim is to divert borrowers (including LMCU members) from high-cost lenders and to move them or keep them as LMCU customers. This favours financial inclusion on a broader level, as LMUC provides members with a credit union current account, a bills payment account, online transactional banking, a savings account and insurance products.

CUOK payday loans range from £100 to £1,000, though first-time borrowers can only access a maximum loan of £400. The interest rate is the same as that which applies to all credit union loans: 3% per month or 42.6% per year (it was 2% per month or 26.8% per year during the pilot phase). In addition, as only LMCU members are eligible for CUOK, the first loan potentially includes a one-off, non-refundable membership fee of £2 and a deposit of £5 on a savings account (both deducted from the first loan). Finally, an optional same day payment fee of £11 is applicable if the borrower does not want to wait three working days for the money to be transferred. Over a year, 6,087 fully completed applications were submitted and 2,923 payday loans were granted (at a total value of £687,757) to 1,219 successful borrowers, 73% of whom were already members of LMCU.

The whole process takes place online; however, borrowers can contact LMCU staff and meet them in one of their five offices. The borrower applies on the dedicated website by selecting the amount needed and the period of time (between one and three months) over which they will reimburse the loan, and by providing the requested information regarding their financial situation as well as answers to five psychometric questions. The decision is instantaneous and based on an automated process, including a credit check. However, unsuccessful applications are referred for checking and a manual decision by LMCU staff.

All purposes are eligible for CUOK payday loans. However, there are strict eligibility conditions for the borrower. First, they must be a member of LMCU and therefore be living, studying or working in its catchment area. In addition to their LMCU membership (or eligibility for membership), borrowers must also be employed and earn more than £12,000 a year. They must have a current account allowing direct debit facilities where
their salary is paid, as well as a debit card. Considering these conditions, it appears that CUOK is not targeting people facing the most severe difficulties (i.e. those in financial exclusion and who are unemployed), even if 18% of their borrowers are unemployed (these borrowers were mainly already members of LMCU and their credit history had a positive impact for them). Interestingly, existing members borrowed more than new members as they took out 2.62 loans in average (£231.66) versus 1.79 loans for new members (£249.55).

Regarding arrears, 6.3% of all CUOK payday loans are at least one month in arrears (£36,000, 5.2% of total amount) compared to 28% of all payday loans across the industry. This rate is lower for existing members (4.8%) than for new members (12%). However, when considering loans in arrears by two months or more, the delinquency rate drop to 2.7% (£15,000, 2.2%) (Evans and McAteer, 2013). There is no cost for a missed payment but interest continues to be charged until the loan is fully repaid. LMCU deals with arrears for CUOK loans in the same way as it deals with its longer term loans. No information is available about the default rate but only 1.3% of payday loans were in arrears for more than three months.

The pilot is considered a success due to the number of loans granted (more than 14 time the amount anticipated), the low level of missed payments and the impact observed. Evans and McAteer (2013) explain that borrowers have saved £119 in average (£50 per loan, £144,966 in total) compared to the standard rate charged by payday lenders. They therefore consider that if all payday loans in one year had been taken from a credit union, it would have saved the UK payday loans borrowers between £676 million and £749 million. Evans and McAteer also found that 68% of borrowers would be fairly unlikely or very unlikely to use other payday lenders once they had borrowed from CUOK (Evans and McAteer, 2013).

Such behavioural changes are positive for LMCU as they lead to new customers. It appears that 26% of new members used longer term loans with LMCU and that such a take up increases with time; in total, 8% of new members (less than three months) accessed longer term loans, compared to17% of those who were members for 4–6 months, 33% of members for 7–9 months, and 52% for members of more than 10 months. It also appears that on average, new members have saved £53 in borrowing from CUOK (ranging from £13 for members of less than three months to £95 for members for more than 10 months). Finally, one-quarter of new members have opened a credit union current account (Evans and McAteer, 2013).

The fact that LMCU new members are using its services is a key element of the business model. The ‘loss leader approach’ relies on the fact that the deficit linked to the CUOK activities will be more than compensated by the profit made on these new customers, as explained by Evans and McAteer (2013).

The main cost has been the establishment of the pilot scheme (infrastructure development, marketing and management). The cost of this (£112,387) was covered by two grants: one from the Friends Provident Foundation (£62,500) and one from the Barclays Community Finance Fund (£50,000).
Costs of running the project are as follow:

- costs relating to approved applications: £35,058;
- costs relating to unsuccessful applications: £4,616;
- costs relating to delinquent loans: £15,483.

The streams of income generated by the project are as follows:

- new membership fees (2%, £662);
- interest paid (77%, £26,974); and
- income from the optional transfer fees (21%, £7,506 – net income).

The pilot generated a loss of £20,015 (£6.84 on every loan). With the new interest rate, assuming that activity would have remained the same, the loss generated would have been £4,112 (£1.4 on every loan).

However, the pilot also generated indirect incomes. Evans and McActeer (2013) listed ‘taking out additional products’ or ‘productively using the saving assets accumulated’, but they only took into account the income coming from interest charged for longer term loans, which would be £13,291 (Evans and McAteer, 2013). When this income is included the loss was still at £6,275 (£2.15 on every loan).

However, two important elements must be considered.

- When only considering the costs of CUOK loans to new members, their borrowing from LMCU leads to a profit of £9.20 per loan.
- If the use of longer term loans from ‘older’ new members (of at least nine months) is replicated for all new members, the overall pilot (including exiting members) would make a profit of £8,950 (£3.06 for every payday loan, £7.34 for every members) (Evans and McAteer, 2013).

These results, obtained using a lower interest rate than the one currently in place, are important as the motivation of LMCU to develop this product was first and foremost business orientated. LMCU sees payday lending as an important loan market where they can offer a better product at a significantly lower cost for the borrower. The result should be a new stream of employed people becoming long-term members of LMCU. As of April 2014, it is estimated that CUOK had attracted 1,040 new members.

**Key insights on CUOK**

- The scheme is 100% online.
- It targets a very specific audience: employed borrowers earning more than £12,000 per year and who are financially included.
- Although it involves an highly automated process, refusals are manually checked.
- A large proportion of new members move on to use other LMCU products.
- The programme is profitable when return from future consumption of borrowers is taken into account.
The No Interest Loans Scheme (NILS) (Australia)

Table 5 presents some background information on the No Interest Loans Scheme (NILS) provided by Good Shepherd Microfinance in Australia.

Table 4: Information on the No Interest Loans Scheme (NILS)

<table>
<thead>
<tr>
<th>Starting date</th>
<th>Number of employees (FTE)</th>
<th>Number of loans 2013</th>
<th>Missed payment rate</th>
<th>Default rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1981</td>
<td>155 (across the NILS network)</td>
<td>22,349</td>
<td>7%</td>
<td>4%</td>
</tr>
</tbody>
</table>

The Good Shepherd Sisters started the first NILS programme through the Good Shepherd Youth and Family Service in Victoria in 1981. It aimed to offer access to affordable credit for people unable to replace essential household items when they broke. Today, Good Shepherd Microfinance (GSM) maintains the national NILS network in partnership with the National Australian Bank (NAB), the Australian Government Department of Social Services (DSS), the Victorian Government, the Queensland Government and more than 257 accredited providers at over 609 locations around Australia.

NILS’s loans are provided and managed by accredited providers, which are community organisations. While approximately 77,000 enquiries were made in 2013 regarding the scheme, 22,350 NILS loans were granted. Each provider manages its own loan fund. These funds are community funds. This means that repayments are returned to the fund in order to be lent again. Initially, the loan capital is provided by NAB, though some providers have access to capital from other sources. Currently, €15 million is allocated to the NILS programme. Around 300 employees (155 full time equivalent) and more than 1,000 volunteers are involved in the NILS programme. Their role involves:

- informing potential borrowers;
- interviewing them and establishing a monthly budget;
- helping them to complete the application form;
- presenting the application to the local loans assessment committee;
- managing the credit contract and payment of the loan; and
- managing the repayments and handling potential arrears.

GSM coordinates the programme. It accredits NILS providers, monitors their performance against accreditation standards and the programme’s principles, and provides them with supports when appropriate. In addition, GSM provides grants to providers to fund the operational costs of running the programme. This funding varies depending on the availability of government funding, which is decreasing. Additionally, not all providers are funded as some of them get their own stream of funding from local government and philanthropies.

NILS has two types of programmes. The main one is a general NILS programme offering loans from €210 to €830. These loans are typically used to purchase household items and the main eligibility criteria is to be living on a low income (mainly being in receipt of
social benefits). The second type of NILS programmes, called ‘specialist NILS programmes’, target specific needs, like catering for women leaving a violent partner or providing loans for people living in remote areas where the delivery cost of items can be as high as the price of the item itself. The eligibility criteria are slightly different and the maximum amount is higher (€1,380). The loan amounts were determined based on the cost of typical products, affordability for client group and limitations of capital available.

The NILS loans come with no interest, no fees and no collateral. Therefore, there is no cost for the borrower. In addition there are no fees when missed payments occur or when a loan is written-off (after 365 days unpaid) or due to legal procedures. Despite all these features, which could be seen as encouraging adverse selection and moral hazard, the delinquency rate is only 7% and the default rate is 4%. In seeking to explain such results, an evaluation of NILS’s providers states that:

‘The practices most closely correlated with low rates of arrears were found to be: using a casual approach with clients, being flexible, and having a good relationship with local retailers. The practices more closely correlated with low rates of write-offs were the provision of material supports (e.g. food, clothing, etc. to clients who need it either through the NILS agency or a referral), varying the conditions of the loan if a client’s circumstances changed, and having strong governance structures around the program.’ (Cowling and al., 2013, p. 5)

Treating clients with respect and dignity and lending in a professional manner when assessing demand and dealing with arrears are the two key factors that explain these results. This approach influences the assessment of the demand, which is carried out on a face-to-face basis with no credit check involved. However, it should also be underlined that the majority of borrowers repay their loan by direct deduction from social benefits, a payment method that reduces the risk of arrears.

The NILS programme does not generate any direct income. It is 100% subsidised by national and local government as well as third parties. However, the money invested is not invested at a loss. For every euro invested in a NILS loan, €1.59 of value is created; this value is both economic, relating to asset building, cost saving and employment, and social, relating to reduction in stress and anxiety, improvement in self-confidence and increased independence (Centre for Social Impact, 2014). Purchasing a fridge or a washing machine has the highest social and economic return, with €2.45 and €2.35 per €1 invested.

Even if improving financial inclusion in general is not the first aim of the NILS programmes, GSM provides NILS borrowers with products like ‘StepUP loans’ (low interest loans to people on low incomes) or the ‘AddsUP matched savings plan’ (up to €350 accessible when the loan is repaid). It also provides financial counselling through its pilot ‘Good Money community finance stores’ in Victoria, which offer financial services and advice to those excluded from mainstream financial services, targeting potential borrowers that would not contact community organisations. Receiving a NILS loan does not lead to a higher level of financial services detention; however, 42% of borrowers who had used high-cost lenders in the past either stopped using them or reduced their use of
them as a result of receiving a NILS loan and 47% of borrowers experienced a net improvement in their financial capabilities (Centre for Social Impact, 2014).

**Key insights on the NILS programme**

- A borrower-focused approach, professional lending practices and direct deduction from social benefits are key reasons behind low levels of arrears and loan write-offs.
- Local loan funds seem to be an efficient way of managing the programme.
- A coordinating body is needed in charge of accrediting lenders, monitoring them, providing them with support and funding them.
- A contract-based approach with lenders and close monitoring are needed.
- Both the economic and social returns on investment should be taken into account when considering the level of subsidies.

**Lenders linked to a mainstream financial institution**

- **MicroBank – CaixaBank (Spain)**

Table 6 presents some background information on MicroBank provided by CaixaBank in Spain.

<table>
<thead>
<tr>
<th>Starting date</th>
<th>Number of employees (FTE)</th>
<th>Number of loans 2013</th>
<th>Missed payment rate</th>
<th>Default rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>14</td>
<td>40,000</td>
<td>1.17% (over 90 days)</td>
<td>1.57%</td>
</tr>
</tbody>
</table>

MicroBank was founded in 2007 to channel the microcredit activity that ‘la Caixa’ – its sole shareholder – had up to then been operating through its welfare projects. Previously a ‘social microcredit programme’ had also been run by the Caixa Foundation since the early 1990s. The aim of the creation of MicroBank was to enhance the impact and efficiency of these social activities within a rigorous and sustainable framework appropriate to a bank.

MicroBank has only one office where 14 people are employed. However, it has an agreement with ‘la Caixa’, which establishes that MicroBank operates with the support of CaixaBank’s infrastructure (MicroBank pays a fixed amount for each operation – microloans or accounts). This means that CaixaBank supports MicroBank through its 5,700 branches (the largest network in Spain) as well as its full range of back office services (commercialisation, processing and monitoring MicroBank’s payment, IT system, etc.). Regarding the borrowers, the agreement stipulates that they deal with CaixaBank’s employees when applying (via face-to-face evaluation and scoring methods carried out by the branch employee) and repaying their microloan.

The main focus of MicroBank is to provide microcredit to businesses and households; however it also provides other services specifically tailored to the needs of its customers: a basic savings account, a basic current account and a debit card.
Regarding households’ microloans, three types are available.

- ‘Personal and family microcredit’ is available to people with an income below €18,000 per year and is aimed at financing projects associated with personal and family development, as well as needs arising from specific and unforeseen situations. For example, these might relate to health, education, requirements of people with disability, family reunification or the purchase of necessary transport.

- ‘Eco-microcredit’ is available to the same profile of borrowers with the aim of financing the purchase of environment-friendly products (electrical domestic appliances with the class A or above energy label) or ecological vehicles (cars, motor-bikes, electric bicycles and business vehicles), or to improve energy efficiency in the home (to finance solar panels, waste-water treatment, etc.).

- ‘Club Ahora microcredit’ is available to people over 65 years and with a net annual income of less than €18,000. It is intended to help the health and wellbeing of older people by providing funding for technical support, adaptations to the house, and accessing health and welfare services.

The personal and family microloans have no minimum amount and a maximum one of €25,000 (based on the EU definition of microcredit). The interest rate is 13% (fixed) with fees between 0% and 3%. No collateral is required. These loans mainly fund family needs (32.9%), housing (31.4%) and transport (18.5%).

The repayments are made by direct debit on a monthly basis, with the amount negotiated by the loan officer with the borrower. There is a maximum length of six years for full reimbursement with a possible ‘grace period’ of 12 months.

The delinquency rate of MicroBank’s microloans is 1.17% (of those in arrears for more than 90 days) and the default rate is 1.57%. When missed payments occur, the usual CaixaBank’s process applies: the branch’s employee tries to contact the debtor and if unsuccessful in securing repayment, an external recovery company is commissioned. Such a company assesses the financial situation of the borrower and if they are found solvent, legal action is taken while if not solvent, the operation is considered a loss.

MicroBank works in partnership with social bodies such as public institutions, NGOs and universities, which provide information and support to potential borrowers. Such partnerships help to increase the coverage of the distribution network and to reach groups that would not be reached by traditional channels (i.e. through media campaigns). However, these partnerships are not formalised and MicroBank does not provide any funding, as the microloans are a financial response to partners’ clients’ needs.

Microbank is profitable. Its income is generated by its commercial activity: interest and fees paid by borrowers, fees on other services, etc. Its main cost relates to the fees paid to CaixaBank to operate through its banking system.

The funds for lending are available from different sources:

- MicroBank’s own fund (company equity and accumulated reserves and yearly profit);
- customers’ fund obtained through saving products; and
• funding from credit institutions: CaixaBank, loans from the Council of European Development Bank (CEB) and from the European Investment Bank (EIB).

MicroBank has commissioned a business school and a consultancy firm to assess the impact of its activity; however these evaluations either focus on professional microcredit or were ongoing at time of writing.

**Key insights on MicroBank**

- MicroBank uses the infrastructure of a mainstream bank (CaixaBank).
- It works in partnership with social entities in order to increase its outreach.
- It manages arrears in a way that is very similar way to how a bank manages arrears.
- Repayments are made by direct debit (as is usual in Spain).
- The number of loans per year is very high (40,000).
- It is a profitable activity with a 13% APR.

❖ **Parcours Confiance, savings banks (France)**

Table 7 presents some background information on Parcours Confiance.

<table>
<thead>
<tr>
<th>Starting date</th>
<th>Number of employees (FTE)</th>
<th>Number of loans 2013</th>
<th>Missed payment rate</th>
<th>Default rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006</td>
<td>67</td>
<td>4,500</td>
<td>10% (of total amount)</td>
<td>6% (of total amount)</td>
</tr>
</tbody>
</table>

Parcours Confiance, a comprehensive financial inclusion programme targeting low-income households, was launched by the savings banks in France in 2006 as part of their legal obligation (suppressed in 2008) to promote general interest including financial inclusion. It provides access to personal microloans to people who are excluded from mainstream credit, and personal advice as well as basic banking services. Its aim is to move borrowers towards mainstream financial institutions. There are 50 Parcours Confiance branches located across the 17 regional savings banks and 67 employees (full time equivalent) are providing this service.

Parcours Confiance works in partnership with each regional savings bank. These banks provide the microloans as well as basic banking services while financial education can be provided by a NGO called Finances and Pedagogy, which is supported by the saving banks. The role of Parcours Confiance is to assess the application of each potential borrower (through a face-to-face assessment), to provide advice before a loan is granted and to provide support once a loan has been granted. NGOs or social services work in partnership with Parcours Confiance in order to detect potential borrowers and to provide support once a microloan has been granted. Parcours Confiance provides training to its partners but there is no financial relationship.

The vast majority of the loans provided are personal microloans guaranteed by the Social Cohesion Fund. Parcours Confiance and the savings banks comprise the first
personal microloans lender in France, providing more than one-third of all guaranteed microloans granted since 2006.

The amount of these loans varies from €300 to €3,000 (in exceptional circumstances reaching €5,000), and are reimbursed over 36 months. Loans can be paid into the account of the borrower or directly to the providers of the relevant good or service. They are repaid on a monthly basis and mainly by direct debit through an account sometimes specifically opened for that purpose at a regional savings bank. The interest rate is 2% on average and fees apply in cases of missed payment (between €8 and more than €20). No collateral is required.

There are conditions in addition to the ability of the borrower to repay the loan: creating a business and reimbursing debts are not eligible purposes. However, Parcours Confiance also provides professional microloans for entrepreneurs.

The delinquency rate (in arrears for more than three months) is 10% of the global amount lent and the default rate is 6% (before deducting the 50% guarantee of the Social Cohesion Fund). When missed payments occur, the Parcours Confiance adviser tries to contact the borrower and to find a solution within the standard banking solutions. If after six months no solution is found, the guarantee is called and no legal procedure is implemented.

Regarding the impact of Parcours Confiance on borrowers:
- 70% of borrowers are ‘very satisfied’ to have borrowed from Parcours Confiance;
- 50% of unemployed borrowers got a job;
- 80% of borrowers feel that Parcours Confiance helped them to access or to keep a job; and
- two-thirds of borrowers feel that Parcours Confiance helped them to improve their budgetary skills (Fédération Nationale des Caisses d’Epargne (FNCE), 2010).

However, only 20% of borrowers with missed payments feel that the responses provided were appropriate and only 19% became customers of savings banks.

The business model of Parcours Confiance is based on a high level of subsidiaries by the savings banks as part of their corporate social responsibility budget. However, it is estimated that the cost of a borrower is compensated over four to six years if they become a good customer (e.g. having their main banking relationship with the savings bank).

**Key insights on Parcours Confiance**
- Parcours Confiance was set up at a time when the savings banks had a legal obligation to invest to promote financial inclusion.
- It works with partners in order to increase its outreach.
- Partners are trained by Parcours Confiance staff.
- It deals with arrears in the same way as a bank would and borrowers are not satisfied with this.
- The loan is provided by the savings banks.
The cost of the scheme can be covered when the borrower become a customer of the savings banks, despite a very low APR (2% on average).

- StepUP Loans – National Australian Bank (Australia)

Table 8 presents some background information on ‘StepUP loans’ introduced by Good Shepherd Microfinance in Australia.

<table>
<thead>
<tr>
<th>Starting date</th>
<th>Number of employees (FTE)</th>
<th>Number of loans 2013</th>
<th>Missed payment rate</th>
<th>Default rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004</td>
<td>Four dedicated within GSM and 51 in partner’s organisations.</td>
<td>2,900</td>
<td>16% of loans in arrears at least for one day and 6% over 60 days.</td>
<td>1% (of total amount)</td>
</tr>
</tbody>
</table>

Informed by its long-term, successful programme NILS, Good Shepherd Microfinance introduced StepUP loans in 2004 as an intermediary type of credit between NILS and mainstream credit. The aim was to provide alternative loans to people who would otherwise have had to borrow from high-cost lenders or who would have had no access to credit at all.

This scheme is based on the hope that appropriate access to credit will lead to future access to mainstream credit providers. However, if a borrower’s financial situation does not improve, subsequent borrowing from the StepUP scheme is possible. Good Shepherd Microfinance also encourages saving through the AddsUP matched savings plan. When borrowers successfully finish paying a NILS or a StepUP loan, they can open an AddsUP savings account and have their savings matched by up to €340 once in a 12 month period.

The StepUP programme is the result of a partnership between: Good Shepherd Microfinance, which manages it; the National Australian Bank (NAB), which provides operational funding and the loans; the Australian Government Department of Social Services (DSS), which also contributes to operational funding; and the numerous community organisations that form part of the providers network, which supports customers in preparing their application form, managing arrears and promoting the programme.

Overall, Good Shepherd Microfinance has 56 staff and no volunteers. Among them, one dedicated national manager and three dedicated state coordinators manage the StepUP programme. In addition, 51 StepUP microfinance workers in the community agencies (positions funded by Good Shepherd Microfinance, which also provides training and monitoring) and some dedicated staff in NAB ensure the delivery of the loans.

The StepUP programme remains a relatively small one and its presence is still not widely recognised in the community. Therefore, it relies on the partner providers to undertake regular local promotions. In addition, Good Shepherd Microfinance funds – at
very small scale – local media coverage; for example, radio advertisements, newspapers and signs notices on public transport.

StepUP loans range from €540 to €2,000 (€1,850 on average) with a fixed interest rate of 5.99% and no other fees or collateral required. They can be repaid over six months to three years. The repayment can be made on a weekly, fortnightly or monthly basis in cash, by direct debit, scheduled transfer or internet banking.

Between 2006 and 2013, 9,537 loans were granted with 2,110 made in 2012–2013 and 1,250 in July–December 2013. However, if the StepUP programme capacity to deliver loans is limited by the resources available, the restrictions regarding eligible purposes also play a significant role.

The loans have to be used in a ‘productive’ manner by funding what would be considered as ‘essentials’ (white goods, medical and dental expenses, second-hand car, vocational educational costs, etc.). Ineligible expenses are: debt consolidations; second-hand furniture and household items; fines and bills; everyday household items (DVDs, gaming consoles, etc.); Christmas and other holiday expenses; and ‘make-ends-meet costs’.

Existing debts can prevent access to a StepUP loan as it is not intended for people who are financially overcommitted, with existing difficulties repaying a loan, or who already have more than two forms of mainstream credit. When the application is assessed and the credit history is checked, outstanding debts must be under €340 and a payment plan must be in place.

In order to respond to the needs of people facing debt difficulties, Good Shepherds Microfinance is currently piloting a new programme called ‘debt deduct’. Five sites in Victoria provide no-interest consolidation loans up to €1,370, alongside the support of a financial counsellor with the aim of achieving debt relief.

Potential borrowers with debt difficulties can also be directed to ‘good money community finance stores’, which provide financial services and support. These are run under a joint community partnership between Good Shepherd Microfinance, NAB and the State Government of Victoria. Three shops are currently in place.

Prior to a StepUP loan being granted, microfinance workers meet with clients in order to assess their situation. Based on partnerships with community organisations, the evaluation can be carried out in 38 sites across all states in Australia. A pilot has also recently been launched to develop phone and internet access as some clients found it difficult to travel to the dedicated sites.

It should be noticed that the eligibility requirements (which include being in receipt of social benefits and residing at an address for more than three months) are guidelines only, and flexibility is allowed. When a client is found to be a good fit with the StepUP loan, the microfinance worker helps collate all the required documents and prepare a budget. Then the application is transferred to the NAB personal loans department, which makes the assessment including a credit report check. Once the application is sent to NAB, it takes one to two weeks for a decision to be reached. If an application is
successful, the loan is granted by NAB and it is registered on its loans book the same way as any other loan provided by the bank. When the application is successful, the loan is paid by cheque to the goods or service provider.

The delinquency rate is 16% of all loans being in arrears by one day or more and 6% of all in arrears by more than 60 days. When a borrower misses a payment, no fees are charged. In order to deal with arrears, every week the microfinance worker receives an arrears report from NAB and Good Shepherd Microfinance and contacts borrowers who are between one and 21 days in arrears. If a borrower is over 21 days in arrears, the management of the account is handed over to a dedicated StepUP person in the NAB collection team. However, the collection process is constantly shared between both partners to ensure maximum community sector support. Various actions can be implemented to try to find a solution: referrals to other support services, explaining payment methods, reminding clients of their due date, negotiating repayment plans, pausing payments and making settlement offers.

When arrears extend over 180 days, NAB can decide to write off the loan. So far, 1% of the total volume of current loans has been written off. Such an outcome impacts the credit history of the borrower.

StepUP loans have positive impacts for borrowers:

- 75% of borrowers claimed that they were better off as a result of the StepUP loan;
- 66% who had been previously using payday lenders stopped using them or significantly decreased their use;
- 50% experienced positive changes regarding financial management.

However, if 22% of borrowers have seen their financial inclusion improved, 10% have seen it deteriorate (Centre for Social Impact, 2013).

Regarding its business model, the StepUP loan programme relies on public and private subsidies. The total cost of the programme for a value of 1,000 loans is €716,480.

The cost of Good Shepherd Microfinance for managing the programme and employing microfinance workers is equally shared by NAB and DSS. On top of that, NAB also assumes the costs of defaulted loans, administration and forgone interest and fees on the loaned capital. The interest paid by borrowers covers part of NAB's administration costs.

The high level of subsidies is legitimate when compared to the social return of the programme (Centre for Social Impact, 2013). Benefits are economic and social.

- Economic benefits include saving on welfare payments, reduction in use of emergency credit and payday lending and saving on fringe credit for item(s), totalling €1.02 million.
- Social benefits include reduction in anxiety and stress, improvement in confidence and self-esteem and improvement in living conditions, totalling €920,000.
For each €1 invested in a StepUP loan, there is a social return of €2.68. The programme generates a net benefit of €1.22 million for every 1,000 loans granted.

**Key insights on StepUP loans**

- Good Shepherd Microfinance funds microfinance workers within partner organisations.
- It also monitors their activity and provides training.
- Good Shepherd Microfinance acts as a coordinator between the microfinance workers and their organisations in contact with the borrowers and NAB, which provides the loans.
- The focus on ‘productive’ purposes reduces the number of loans granted.
- People in arrears are eligible to a StepUP loan if the amount of their arrears is lower than €340 and if a repayment plan is in place.
- Only social benefits recipients are eligible.
- Arrears are dealt with by the microfinance workers for the first 21 days, after which a NAB collection team becomes involved.
- StepUP Loans deliver a strong social return on investment with a net benefit of €1.22 million for every 1,000 loans granted.
<table>
<thead>
<tr>
<th>Lender</th>
<th>Recruitment</th>
<th>Application assessment</th>
<th>Decision</th>
<th>Loan provider</th>
<th>Payment</th>
<th>Repayment</th>
<th>Missed payment</th>
<th>Subsequent borrowing</th>
</tr>
</thead>
<tbody>
<tr>
<td>CUOK – LMCU</td>
<td>Communication with members, website.</td>
<td>Online application (with credit check).</td>
<td>Automated (manual if credit check unsuccessful).</td>
<td>LMCU</td>
<td>EFT on current account.</td>
<td>In one go or monthly; Direct debit.</td>
<td>No cost but interest continues to be charged.</td>
<td>62% of borrowers are repeat borrowers but not a goal.</td>
</tr>
<tr>
<td>ScotCash</td>
<td>Branches, media, partners.</td>
<td>Face-to-face (with credit check).</td>
<td>Loan officer</td>
<td>ScotCash</td>
<td>EFT on current account.</td>
<td>Weekly; Direct debit.</td>
<td>No cost except if legal action is taken.</td>
<td>60%</td>
</tr>
<tr>
<td>NILS</td>
<td>Word of mouth, partners, media.</td>
<td>Face-to-face; Flexible approach.</td>
<td>Loan assessment committee</td>
<td>Good Shepherd (community loan fund).</td>
<td>Paid through the same channel as social benefits (centrepay).</td>
<td>Fortnightly; Direct deduction from social benefits, cash or EFT.</td>
<td>No cost, no legal action.</td>
<td>Possible but not a goal.</td>
</tr>
<tr>
<td>Parcours Confiance</td>
<td>NGOs, social services, saving banks branches.</td>
<td>Face-to-face; Flexible approach.</td>
<td>Parcours Confiance adviser</td>
<td>Regional savings bank</td>
<td>EFT on current or saving account, payment to service provider.</td>
<td>Monthly; Direct debit.</td>
<td>Dealt by adviser; Fees (€8 to more than €20).</td>
<td>Possible but not a goal.</td>
</tr>
<tr>
<td>StepUP</td>
<td>Word-of-mouth, partners, media.</td>
<td>Face-to-face; Flexible approach.</td>
<td>National Australian Bank</td>
<td>National Australian Bank</td>
<td>Cheque to the supplier.</td>
<td>Weekly, fortnightly or monthly; Cash deposit, direct debit.</td>
<td>Dealt by microfinance worker until 21 days then by dedicated person in NAB.</td>
<td>Possible but not a goal.</td>
</tr>
<tr>
<td>MicroBank</td>
<td>CaixaBank’s branches and partners (NGOs).</td>
<td>Face-to-face and scoring system.</td>
<td>Caixa branch employee</td>
<td>MicroBank</td>
<td>EFT on current account.</td>
<td>Monthly; Direct debit.</td>
<td>Default commission and interests for late payment.</td>
<td>Possible as long as borrower complies with MicroBank’s target profile.</td>
</tr>
</tbody>
</table>
Table 9: Loan characteristics by scheme

<table>
<thead>
<tr>
<th>Lenders</th>
<th>Amount</th>
<th>Length</th>
<th>Interest rate</th>
<th>Fees</th>
<th>Collateral</th>
<th>Purposes</th>
<th>Eligibility requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td>CUOK – LMCU</td>
<td>£100 to £1,000 (£400 for first time borrower).</td>
<td>1 to 3 months</td>
<td>42.6% (26.8% during the pilot).</td>
<td>£2 membership; £5 saving deposit.</td>
<td>No</td>
<td>All purposes</td>
<td>LMCU membership; Employed and earning more than £12,000 a year; Current account, direct debit and debit card.</td>
</tr>
<tr>
<td>ScotCash</td>
<td>£50 to £1,000</td>
<td>13 to 52 weeks</td>
<td>82.9% – 159.05%</td>
<td>Administration fees from £3 to £60.</td>
<td>No</td>
<td>All purposes</td>
<td>Being over 18 years; Having a bank account; Living in the Glasgow area.</td>
</tr>
<tr>
<td>NILS</td>
<td>€210 to €830 (£1,380 for specific purposes).</td>
<td>12 to 18 months</td>
<td>0%</td>
<td>No</td>
<td>No</td>
<td>Productive only (essential goods like household items, medical services, etc.).</td>
<td>In receipt of social benefits; Living in the same address for three months at least.</td>
</tr>
<tr>
<td>Parcours Confiance</td>
<td>€300 to €5,000</td>
<td>12 to 48 months</td>
<td>2%</td>
<td>No</td>
<td>No</td>
<td>Productive purposes (repaying debts and make-ends-meet are excluded).</td>
<td>Being excluded from mainstream credit.</td>
</tr>
<tr>
<td>StepUP</td>
<td>€540 to €2,020</td>
<td>6 months to 3 years</td>
<td>5.99%</td>
<td>No</td>
<td>No</td>
<td>Productive only (holidays, Christmas, debts and make-ends-meet are excluded).</td>
<td>In receipt of social benefit; Living in the same address for three months at least; Not having more than one bank loan.</td>
</tr>
<tr>
<td>MicroBank</td>
<td>Maximum £25,000</td>
<td>Maximum 6 years</td>
<td>13%</td>
<td>Maximum 3%</td>
<td>No</td>
<td>All purposes</td>
<td>Annual income below €18,000</td>
</tr>
</tbody>
</table>
Table 10: Broader financial inclusion by scheme

<table>
<thead>
<tr>
<th>Lenders</th>
<th>Basic banking services</th>
<th>Savings account</th>
<th>Loans</th>
<th>Financial education</th>
<th>Other</th>
</tr>
</thead>
<tbody>
<tr>
<td>CUOK – LMCU</td>
<td>Yes; Credit union current account (CUCA) and bill payments account.</td>
<td>Yes</td>
<td>Yes; Credit unions loans.</td>
<td>No</td>
<td>Yes; Insurance products.</td>
</tr>
<tr>
<td>ScotCash</td>
<td>Yes; Basic bank account in partnership with Barclays and Royal Bank of Scotland.</td>
<td>Yes</td>
<td>No</td>
<td>Yes; Financial advice provided by Glasgow Central Citizens Advice Bureau (within ScotCAsh Branch).</td>
<td>'domestic white good packages'; Food bank vouchers (Trussell Trust); Project: provision of fuel poverty advice and debt and benefits advice.</td>
</tr>
<tr>
<td>NILS</td>
<td>No</td>
<td>Yes (Good Shepherd)</td>
<td>Yes; StepUP, Debt deduct pilot.</td>
<td>Yes; Advice from the 'good money community finance store'</td>
<td>Yes; Home energy saver scheme.</td>
</tr>
<tr>
<td>Parcours Confiance</td>
<td>Yes; Current account and basic banking service with savings banks.</td>
<td>Yes (Savings Banks)</td>
<td>Yes (savings banks)</td>
<td>Yes; Advice from Parcours Confiance's advisors; Financial education from NGO Finances &amp; Pedagogy.</td>
<td>Yes; Insurance products (saving banks).</td>
</tr>
<tr>
<td>StepUP</td>
<td>No</td>
<td>Yes; AddsUP Match Savings Plan.</td>
<td>Yes; NILS, debt deduct pilot.</td>
<td>Yes; Advice from the 'good money community finance store'.</td>
<td>Yes; Home energy saver scheme.</td>
</tr>
<tr>
<td>MicroBank</td>
<td>Yes; Basic current account; Basic savings account; Debit card.</td>
<td>Yes; Basic savings account.</td>
<td>Yes; Eco-microcredit.</td>
<td>No</td>
<td>Yes; Ethical fund and ecological fund.</td>
</tr>
</tbody>
</table>
Public funds

The discretionary Social Fund (UK)

The Social Fund was introduced in 1986 by the Social Security Act, replacing community care grants and budgeting and crisis loans. Over one million loans were granted each year, on average. Potential borrowers applied to Jobcentre Plus and, if granted, these loans were to be mostly repaid from social security benefit incomes. Two types of loans provided by the Social Fund were relevant regarding an Irish microloan scheme.7

- Budgeting loans (from £100 to £1,500) were for those in receipt of social assistance for 26 weeks and who needed to purchase items that are difficult to budget for through social assistance benefits.
- Crisis loans (up to £1,500) aimed to avoid risk and damage to the health and safety of the applicants. These loans could also cover living expenses when there was an interruption to the usual flow of benefit incomes (called ‘alignment’ crisis loans). Applicants did not need to be in receipt of income support or income-based jobseeker’s allowance.

In 2011–2012, over half of the applications for crisis loans (596,000) were made by people who had spent their benefits and needed money to meet living expenses. Almost four-fifths (78%) of them were successful and were awarded on average just under £50 (Gibbons, 2013).

Budgeting and crisis loans had positive features. They were interest free. The application process was considered straightforward and the decision was made quickly. Borrowers also appreciated the fact that the loan repayments were deducted directly from their benefit payments, which meant they avoided falling into arrears (Collard and Kempson, 2005). However some limitations were also pointed out. The main ones were: limited funds available led to a large proportion of applications being turned down or only partially funded; the repayment rates were often considered too high by borrowers (maximum period of repayment being 104 weeks); and the fact that repayments were deducted from benefits meant that people had to survive on a lower income (Legge et al., 2006).

The discretionary Social Fund was abolished by the coalition government following the Welfare Reform Act 2012. This Act has been effective since April 2013. Under it, the following changes are occurring.

- Budgeting loans will continue to be provided until they are transferred to the new Universal Credit scheme, and will be abolished once Universal Credit has been fully rolled out.
- Alignment crisis loans are being replaced with a new approach, whereby people whose social benefits are temporarily stopped will receive an advance payment to cover the intervening period. Once their social benefit payment is resumed, instead

7 A third type is the community care loan scheme.
of receiving a back payment they will simply begin receiving their normal monthly payment again, the back payment no longer being necessary as this has already been covered by the advance payment.

- Crisis loans for items and general expenses have been replaced by a new localised service.

Regarding the new localised service, England, Scotland and Wales are implementing these changes in different ways. Both Scotland and Wales decided to implement a centralised fund (the Scottish Welfare Fund and the Welsh Social Fund) while England opted for a decentralised approach whereby local authorities would be in charge of responding to these needs.

Despite this difference, there are many commonalities.

- Both the Scottish Welfare Fund and the Welsh Social Fund will provide grants rather than loans as loans are considered too costly and complex to manage. This rejection of loans is also observed in England: more than half of the local authorities in charge of implementing the scheme favour a grants scheme. This choice will decrease the funding available to applicants, as around 50% of crisis loans were funded through the recycling of loans repayments (Gibbons, 2013).
- Another common point is a limitation of cash payments. Even if the decision has not yet been made in Scotland, it seems that the direct provision of goods and services or the issuing of vouchers appears to be favoured.
- Finally, a common concern comes from ‘the fact that DWP allocations are lower than existing Community Care Grant and Crisis Loan expenditure, we also find that a number of local schemes will involve further restrictions on the eligibility for, and level of assistance that will be provided’ (Gibbons, 2013, p. 37). Such a situation is alarming as the funds provided by DWP are not ring-fenced.

An interesting part of the debates regarding this transformation of the discretionary Social Fund relates to the role of the credit union movement. In Scotland as well as in England, local authorities are encouraged to link with credit unions so people can receive a loan instead of a grant or avoid borrowing from a high-cost lender. However, such an involvement raises important questions.

First, there is the tension between the need for credit unions to develop a sustainable business model and their role regarding the provision of loans as an alternative to high-cost lenders. Based on the experience of the Growth Fund, credit unions are worried about the level of bad debts that might arise if they provided a local loan scheme. They expect that local authorities will need to provide additional capital for lending and also to under-write potential losses through a loan guarantee fund.

There are also questions about their role regarding payment processing. It could be an opportunity for both the local authorities and for the credit unions as:

- it would be more secure and cheaper than cash;
- it would generate new members for the credit unions; and
- it would give access to financial services and affordable credit to applicants.
However, if most credit unions are able and willing to play this role, they also want to be compensated for it.

Finally, they could play a role by providing basic banking services that are appropriate to applicants’ needs (such as a ‘jam jar account’) and potentially useful for other stakeholders like social lenders, for example through an account where the rent amount is ring-fenced. Such provision could also help to connect with people with financial difficulties and help them address their situation. However such a role requires coordination between the main stakeholders as well as the ability of credit unions to provide such services.

Despite explaining that it was too early to provide a clear, costed, preferred model of delivery, Gibbons identifies a basic good practice model whereby:

- third sector financial services providers would be commissioned to administer both grants and small loans designed to meet immediate needs;
- this provision would be followed up with the offer of account services to receive payments of benefits and wages (including the option of budgeting accounts for people in need of help with managing their money); and
- there would be a potential for consolidation loans to be made to replace high cost commercial credit borrowing with more affordable loans (Gibbons, 2013, p. 105).

**Key insights on the Social Fund**

- An indirect weakness of the crisis loans, is that, in Ireland, the needs they cover are already covered by supplementary welfare emergency needs payments (Citizen Information Board (CIB), 2013).
- Repayments were made by direct deduction with positive and negative consequences for the borrowers.
- The new system promotes grants and non-cash payments over loans.
- Credit unions are seen as a natural partner in managing grants payments as well as providing alternative access to loans (including potential consolidation loans).
- Credit unions are willing to play this role but need financial compensation, additional capital for lending as well as the under-writing of potential losses.

**The Social Cohesion Fund (France)**

The Social Cohesion Fund (*Fonds de Cohesion Sociale*) was introduced in 2005 by the social cohesion law. It is overseen by a committee (*Comité d’orientation et de suivi de l’emploi des fonds – COSEF*) made up of representatives of the government department providing the funds, the Banque de France, several lenders and one NGO. It was granted €75 million by the State over five years to guarantee 50% of professional and personal microloans. Its purpose is to reduce the cost of the risk for lenders and to encourage banks to become involved in the provision of microcredit.

In 2006, the Social Cohesion Fund’s mission was extended to subsidise the support provided to borrowers by partner organisations of the personal microcredit scheme.
(mainly NGOs and social services). These organisations have to identify potential borrowers and support them all throughout the process.

Personal microloans are loans whose amount ranges from €300 to €5,000, and which should be repaid over one to four years at a moderate interest rate (usually at 5% APR). In theory, they should serve a ‘productive’ purpose or help the borrower face an unexpected change in their situation. They cannot be used to fund debts, to make ends meet or to set up a business. In reality, the goods and services funded are related to mobility (73.8% of all microloans), housing conditions (22.8%), professional issues (10.9%), debts (6.7%), training (3.7%) and health (1.7%). Their purpose can relate to professional inclusion, for example getting a job or keeping in employment (71.8%), social inclusion (20.5%), housing (15.2%), family cohesion (10.1%), budget issues (3.3%) and health (2.5%) (Gloukoviezoff and Rebière, 2013). A single microloan can be used for more than one good or service and can serve more than one purpose.

Alongside providing its guarantee, the Social Cohesion Fund, or more specifically COSEF, is in charge of approving lenders and organisations (such as NGOs and social services) that support potential borrowers.

At the end of 2012, 26 lenders had received its approval. However, these lenders were not contributing to the scheme to an equal extent: four of them provide 75% of the personal microloans (Saving banks, 33.7%; Crédit coopératif, 14.9%; ADIE, 14.2%; Crédit Mutuel, 11.1%). Regarding the organisations in charge of supporting borrowers, eight national networks were approved in 2012 (including French Red Cross and Caritas France), as were 496 local organisations (mainly NGOs) (Fonds de Cohésion Sociale, 2013).

Overall, it is difficult to assess the activity of the Social Cohesion Fund, for two reasons. First, there is a lack of documentation and evaluation of its activity. Second, its activity is partly assumed by COSEF and partly assumed by the Caisse des Dépôts, a public long-term investor at the service of public interest and economic development, which manages the Fund on a daily basis.

At national level, the role of the Caisse des Dépôts involves ensuring an administrative and financial supervision of the scheme, managing the national website, organising working groups with stakeholders, assessing the scheme and organising conferences. At local level, it involves supporting the development of the scheme in each region, helping lenders and NGOs or social services to work together and organising local forums to favour exchanges between stakeholders.

Under the supervision of COSEF, the Caisse des Dépôts provides financial support to the NGOs in order to help them be more effective, while promoting personal microcredit. Such financial support is provided as follows.

- The first year, the organisation is awarded €7,500 to fund structural costs (such as staff costs and IT costs) and €50 per application submitted to the lender (within the limit of €2,500 or 50 applications).
• The second year, the organisation is awarded €5,000 to fund structural costs and €50 per application submitted to the lender (within the limit of €5,000 or 100 applications).
• The following years, there is no more funding for structural purposes, but the organisation is still awarded €50 per application submitted to the lender (within the limit of €7,500 or 150 applications).

This funding scheme has been in place for the last seven years. However, it might evolve during the coming years as the Caisse des Dépôts is trying to promote a more centralised process, whereby there would be only one organisation per region in charge of assessing applications and supporting borrowers. These organisations would be NGOs or social services that have succeeded in their role regarding personal microcredit over the last few years and that would be willing to take on such responsibility. So far, only just over 10 such organisations exist.

While there is no assessment of the efficiency of the French personal microloan scheme, it has been criticised for its low level of lending. Between the end of 2006 and the end of 2013, 54,080 personal microloans were granted for a global amount of €121 million while it seems that the potential demand would range from 600,000 to 1.6 million households.

This partly disappointing result does not condemn the microloans themselves as they have proved very useful. A national impact assessment study (Gloukoviezoff and Rebière, 2013) shows the following.

• 80% of borrowers have seen their global situation improve or be protected due to the personal microloans.
• 66% of borrowers who borrow to improve or protect their professional situation consider that the personal microloan had a positive impact, an impact that proves stronger for people who were already in employment when applying for a microloan.
• The proportion of borrowers at risk of poverty decreases from 79% at the time of their application for a microloan to 68% when interviewed (six months to five years after getting the microloan).
• On average, the standard of living of borrowers increases from €756 when they apply for a microloans to €859 when interviewed (having professional inclusion as a loan purpose is the most likely purpose to produce a standard of living increase, from €771 to €881).
• However, only 16.8% of borrowers stated that the personal microloans had a positive impact on their financial inclusion, understood as access to basic banking products, cost of this access and access to affordable mainstream loans, while 7.8% stated a negative impact.

Despite these numerous positive results, 45% of all borrowers miss at least one payment over the lifetime of their microloan. Such difficulties largely explain the poor results regarding financial inclusion as the responses provided by lenders are largely inappropriate. The high level of borrowers experiencing at least one missed payment does not lead, however, to a high level of default. Considering the supposed high risk of
these borrowers, the default rate of the scheme remains relatively low, at 6.46% of all the microloans granted between the end of 2006 and the end of 2013. It represents €4.09 million, of which 50% is paid by the Social Cohesion Fund to the lenders (Fonds de Cohésion Sociale, 2014).

The impact of the personal microloan scheme on society has not been assessed. Even the cost of the overall scheme is not known. Only one element of this evaluation can be provided: the money saved for society by allowing unemployed people to get back to work. According to the Finance General Inspection, such a saving is valued at €2,500 per individual (Brabant et al., 2009). As 8,250 unemployed borrowers at the time of their application got back to work due to their microloan, the global saving can be estimated to be around €20.65 million.

**Key insights on the Social Cohesion Fund (France)**

- Caisse des Dépôts provides:
  - administrative (approval) and financial supervision of the scheme;
  - management of a national website for borrowers and stakeholders;
  - assessment of the scheme; and
  - advocacy work.

- The Social Cohesion Fund is used for:
  - Guaranteeing 50% of microloans; and
  - Funding stakeholders to help them to structure their activity.

- Difficulties occurred in ensuring an equal geographic availability and ensuring the full commitment of all lenders.


The Growth Fund was a sub-fund of the Financial Inclusion Fund, which was run by the Department for Work and Pensions (DWP) from 2005 to 2011. The Financial Inclusion Fund provided £250 million to improve financial inclusion including funding the Growth Fund. While the Growth Fund was £42 million in 2007, in December 2007 a further £38 million was allocated, and in Budget 2009 the Chancellor announced an extra £18.75 million, bringing the total to almost £100 million.

The aim of the Growth Fund was to raise the level of access to affordable credit. In order to achieve this, it provided support to third sector lenders in three different ways.

- It provided loan capital to third sector lenders, mainly credit unions and community finance development institutions (CDFIs) to lend to financially excluded households.
- It provided revenue to Growth Fund lenders to support the delivery of loans, for example to help cover administrative and staff costs.
- It provided funding to develop the capacity of third sector lenders, by addressing costs such as IT equipment and new premises.

Between July 2006 and October 2010, 330,000 Growth Fund loans were provided, with a total value of over £137 million, by over 150 lenders serving about 400 towns, cities and rural areas (Financial Inclusion Taskforce, 2011). These loans did not require
borrowers to have any prior history of savings. The application process was considered quick and straightforward. Repayments were made by various channels including direct debit and direct deduction and no fees were charged in the case of a missed payment (Whyley, 2010).

Between 2006 and 2007, £59.3 million in loan capital was employed for a total value of loans distributed of £137.2 million (excluding interest) and an average value of £478. Interest rate charged varied between lenders (CDFI charging more than credit unions) and between loans (subsequent loans granted at a lower rate knowing that 68% of Growth Fund borrowers borrowed repeatedly), but on average Growth Fund loans were associated with a 26.8% APR. The default rate over the period was 4.5% (Collard, Hale and Day, 2010).

Regarding costs, Collard, Hale and Day (2010) assessed the social costs of this lending activity (mainly ‘opportunity costs’ as resources could have been invested elsewhere and ‘cost of default on loans’) and administrative costs. Social costs were estimated for the period 2006–2010 at £14.3 million and administrative costs at £40.8 million (£4.6 million for DWP and £36.2 million for Growth Fund Lenders).

Among the benefits of the Growth Fund are the interest rate savings for borrowers due to the lower level of interest rate and the shortening of the period of repayments. Such savings are estimated to fall between £377 and £425 per borrower, which would translate into a total saving over the lifetime of their current credit commitment of between £119.8 million and £135.1 million (Collard, Hale and Day, 2010). It can also be added that as 30% of borrowers would have had no other credit alternative, this group is estimated to earn an additional welfare benefit of up to £1.2 million. As these loans were accessed by lower income groups there is a further distributional effect of between £89.9 million and £101.3 million as their marginal utility for consumption is higher (Collard, Hale and Day, 2010, p. 56).

The report also assessed what interest rate should be charged in order ‘to put Growth Fund Lending on a more stable commercial platform’ (Collard, Hale and Day, 2010, p. 57). It is estimated that an APR of 71.2% would be required to cover operational costs and financial risks associated with lending, and an APR of 108.2% would be required to reach a commercial rate of profit of 12.7% on loan capital. However, based on the average operating costs of 2010, the APR required to break even would be between 39.6% and 48.1% and it would be between 72% and 80.1% to make a 12.7% profit (Collard, Hale and Day, 2010; Whyley, 2010).

The evaluation (Collard, Hale and Day, 2010) also shows that the Growth Fund reached its targets as 79% of its borrowers were in the two lowest income quintiles. Growth Fund lenders served a new market as only 4% of applicants were already credit union members or CDFI customers at the time of their Growth Fund application. However, these borrowers were not fully excluded from credit as lenders only provided loans to those who would have otherwise obtained credit but at a higher cost. Half of the borrowers had other loan commitments at the time of their application but often at no cost (sources included the Social Fund and family and friends). Accessing the Growth
Fund did not stop them from borrowing from these various sources, including costly ones, but it seems to have encouraged 32% of borrowers to borrow less (Collard, Hale and Day, 2010).

Regarding wider financial inclusion impacts, Collard, Hale and Day (2010) make the following conclusions.

- ‘13 per cent of all Growth Fund applicants with a bank account had this account as a result of their contact with their Growth Fund lender (equivalent to 10 per cent of all applicants). This figure was higher among successful Growth Fund applicants than unsuccessful applicants’ (Collard, Hale and Day, 2010, p. 62).
- ‘As a result of the Growth Fund, three in ten applicants (29 per cent) now had savings in saving account, whereas they previously had none’ (Collard, Hale and Day, 2010, p. 63).
- Even if 84% of applicants were not offered any kind of advice on money matters and, when offered, it was more likely than not to be turned down, ‘39 per cent of successful applicants felt their money management skills were better. Similar proportion said they felt more in control of their finance (41 per cent); more financially secure (39 per cent) and less worried about money generally (37 per cent)’ (Collard, Hale and Day, 2010, p. 63).

The Growth Fund also involves positive impacts for participating lenders (Collard, Hale and Day, 2010; Financial Inclusion Taskforce, 2011). These include:

- a changed customer profile (i.e. reaching younger customers);
- operating in a more business-like way, using a combination of methods to reach a decision about lending or not – 80% had a dedicated credit controller on their staff and 90% monitored missed payments at least weekly and often daily, practices that were fairly less common among non-Growth Fund lenders; and
- a strong increase in volume lent (200%), while the number of paid staff (FTE) increased by 1.5 and the number of service points by two.

Despite these positive results, the majority of Growth Fund lenders were still dependent on grants to fund their activity.

**Key insights on the Growth Fund (UK)**

- Growth Fund provides loan capital, revenue to support the delivery of the loans and funding to develop the capacity of the lenders.
- Direct deduction had positive (avoiding arrears) and negative (struggling with cutbacks) consequences.
- These loans did not deter people from borrowing from other sources but one-third of the borrowers did borrow less.
- The framework that was applied to third sector lenders helped them to structure their activity and to be more aware of the best way to handle borrowers’ needs;
- In 2010, Growth Fund APR should have been between 39.6% and 48.1% to break even.
3. Key recommendations: A roadmap for Ireland

Based on the insights from the literature review, interviews with potential borrowers and Irish stakeholders and the analysis of good practice, key recommendations for an Irish personal microloan scheme have been formulated and are presented here.

3.1 Aims of the personal microloan scheme

The first aim of the personal microloan scheme is to provide affordable and appropriate loans to its borrowers. This means that its key indicators of success are: level of take-up; delinquency and write-off rates; and its impact on borrowers. However, complementary aims should also be pursued.

Alongside the provision of an affordable loan, the scheme should try to deter borrowers from using moneylenders or, more realistically, to reduce their borrowing from high-cost sources of credit. In that respect, the scheme must necessarily allow repeated borrowing and link with other types of affordable loans (e.g. credit union loans).

Another complementary aim is to improve borrowers’ financial inclusion more broadly. The provision of personal microloans can also be an opportunity to promote access to basic banking services (in particular the basic payment account), saving products and insurance.

Finally, the personal microloan scheme can provide an opportunity to prevent or to tackle households’ excessive debts and over-indebtedness. In that respect, linking the scheme with MABS or other relevant organisations (such as FLAC) is essential, as is the development of a specific loan product to restructure debts.

3.2 A new product or a new lender?

There are three main options for developing access to affordable loans for low-income households.

The first one is to set up a new public lender inspired by the Social Fund in the UK, the Caisse d’allocations familiales (body in charge of child benefit) in France or the advance payment option from Centrelink in Australia. Only the Social Fund has been assessed as a model of good practice in this report and it has recently been dismantled. Interviews with Irish stakeholders have shown that there was no appetite for such a solution. This would prove difficult to establish as it would require public funds to cover the costs of setting up and running the fund, as well as capital for providing loans. Therefore, establishing a new public lender does not seem to be a realistic option.

The second option is to set up a not-for-profit lender, which could be a community development financial institution (CDFI), a microfinance organisation or a community-based loan scheme. Here again, the barriers to setting this up seem to be too high to consider this as the main option. It would:
• prove particularly costly;
• face difficulties reaching its targeted audience both for geographic coverage reasons as well as reputational ones; and
• require potential candidate organisations, which are yet to be identified.

However, when a personal microloan scheme is in place, the possibility for new lenders to take part should be explored.

The third option is to provide a new type of loan through existing lenders. This approach is inspired by the Growth Fund in the UK, the Social Cohesion Fund in France and the MABS Loan Guarantee Fund, which guarantees credit union loans to people referred by MABS. Such an option would have several advantages, summarised in Box 3.1 overleaf.

**Box 1: Advantages of providing a new loan through existing lenders**

1. The credit union movement is already well established in Ireland and offers a good geographic coverage even if some remote or deprived areas are not covered.
2. The credit unions are positively perceived by the vast majority of the population, while banks have seen their image deteriorate. This good reputation would prove helpful when establishing relationships with potential borrowers, even if some of them might still be reluctant to engage with a credit union.
3. Considering that its lending activity has been decreasing over the last few years due either to a lack of demand or to increased prudential lending requirements, the credit union movement is willing to lend more and has funds available to do so.
4. Credit unions are able to move borrowers from personal microloans to their other types of loans. Many of them are also in the position to promote borrowers’ global financial inclusion, for example via access to a basic payment account.
5. As a movement, credit unions seem to welcome such an initiative even if the participation of all individual credit unions is not guaranteed.

Despite these positive qualities, a challenge might lie ahead for the credit union movement. Based on its cycle of risk assessments and on-site engagement with credit unions, the Central Bank of Ireland recently stated its concerns about weaknesses identified in governance, lending, operations and risk management for most credit unions they visited (Central Bank of Ireland, 2014c). However, these weaknesses do not condemn this option to failure. A small number of credit unions are seen as having sound procedures and the vast majority of those concerned have shown willingness to improve. In that respect, the personal microloan scheme could be a real opportunity for the credit union movement, benefitting from it as did the lenders who took part in the Growth Fund in the UK, thereby learning ways to professionalise their practices (Collard, Hale and Day, 2010; Financial Inclusion Taskforce, 2011).

The fact that credit unions should be favoured for this scheme does not mean that other types of lenders should be excluded, despite the lack of obvious candidates. The credit union movement will not be able to cover the entire country; not all areas have a credit union and some credit unions may be unwilling to participate. Local solutions might
include the establishment of a community loan fund inspired by NILS, or of a community
development financial institution similar to Scotcash. Such responses could also prove
effective as a gateway to financial inclusion if they involve working in partnership with
other organisations, including credit unions, like Scotcash is doing.

3.3 Defining a sustainable business model: The need for a financial inclusion fund

Designing a sustainable business model is vital. However, being sustainable does not
necessarily mean that the programme needs to break even.

A sustainable business model for this scheme could also include services consumed by
borrowers, which generate a profit for the lender. For example, LMCU engaged in the
payday loan sector with a business model that proved successful despite the
programme itself losing money, while MicroBank is a profitable institution as it benefits
from CaixaBank’s low-cost back-office services.

Sustainability can also include the social return on investment that would legitimate
public and/or private subsidies. As previously shown, one euro invested in the NILS
programme creates €1.59 of economic and social value, while one euro invested in the
StepUP programme generates a social return on investment of €2.68.

Defining a sustainable business model is a challenging task when providing loans to
supposedly high-risk borrowers at a cost that does not reflect the level of risk or the
costs related to most steps taken to reduce this risk, such as a detailed budget
assessment and provision of support.8

The level of interest that should be charged of borrowers is discussed in more detail in
Section 3.5.3. Here, it is sufficient to state that this level will not be high enough to cover
all the costs involved in such a scheme. Therefore, it is crucial to pay particular attention
to factors that can help reduce the costs of the scheme and that favour a sustainable
business model.

The first factor is reducing the costs associated with risk. While mainstream banks
transfer this cost to customers by charging them fees when payments are missed, high-
cost lenders spread these costs over all their borrowers; borrowers with a lower level of
risk (e.g. who repay with no difficulties) subsidise borrowers with a higher level of risk
(e.g. those who miss payments). In the case of the personal microloan scheme, none of
these options would provide a satisfactory solution. The required response is to set up a
guarantee fund inspired by the Growth Fund in the UK or the Social Cohesion Fund in
France. Such a fund would provide a 50% guarantee to the lenders, thus halving the
cost of the risk. This would mean that when a borrower defaults, half of the amount left

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8 Among the methods that could be implemented to reduce the risk of missed payment is that of
making these payment by direct deduction. This option and its implications are discussed further at a
later stage in this report.
to repay would be reimbursed to the lender by the Fund. The remaining 50% would be assumed by the lender, thus ensuring that lending decisions are made responsibly.

The cost of risk can also be reduced by adopting efficient procedures when assessing potential borrowers and when dealing with arrears. Good practice models have shown that such efficiency relies largely on labour-intensive procedures and on accurate information management.

Therefore, the second factor is to adopt a cost efficient delivery model. Choosing to provide a new type of loan through an existing network of lenders instead of establishing a new lender is in itself a cost-saving decision. An infrastructure would already be in place; there would be a network of provider and an IT system for example. Additionally, potential synergies with the main activity of the providers would allow cross-subsidies. Such a virtuous circle is illustrated by the example of CUOK, though it was facilitated by its focus on the higher end of low-income borrowers.

In addition, collaborations between lenders and organisations trusted in the community could help reduce the running cost of the scheme, while improving its efficiency. Organisations like An Post, Saint Vincent de Paul or MABS would have a real added value by referring potential borrowers as well as supporting them during the application process and once the loan is granted, if needed.

However, it is unlikely that guaranteeing the microloans and working with an existing network of lenders will ensure the sustainability of the business model. Some challenges lie ahead, including the fact that room for improvement has been identified regarding the lending practices of the credit unions. The experiences of the Growth Fund, the Social Cohesion Fund and Good Shepherd Microfinance all show that subsidies are needed both for lenders and their partners regarding:

- capital to improve infrastructure and human resources (including training); and
- revenue to cover the administrative costs of running the programme.

This leads to the third key factor, which is that the guarantee fund should subsidise the stakeholders involved.

The guarantee fund could be financed by stakeholders that are neither directly nor strongly involved in the personal microloan lending activity. This includes mainstream banks, moneylenders, energy providers, local housing authorities, the State as well as European funds; for example the Progress Microfinance programme.

The classification of the guarantee fund as a service of general economic interest (SGEI) – as was the case with the Growth Fund – would also facilitate its subsidisation of stakeholders. Such a fund, which could be called the ‘Financial Inclusion Fund’ should also finance evaluation and research activities in order to ensure that the scheme is efficiently run and has the intended impact.

Finally, if the credit union movement is to be the main lender within the scheme, the fund does not need to provide capital for lending. Each credit union would set up its own lending fund. Such a fund should be capped at a certain percentage of each credit
union’s assets. However, the inclusion of lending-related capital in the fund could be envisaged if a new type of lender was to take part in the scheme; examples here might include the CDFI or a community-based loan scheme.

Therefore the Financial Inclusion Fund would be a key element of the personal microloan scheme by playing four main roles:

- guaranteeing 50% of the microloans;
- providing capital to improve infrastructure and human resources;
- providing revenue to cover part of the programme’s running costs; and
- funding the ongoing evaluation of the programme.

However, it is unlikely to be used as a loan fund unless new types of lenders get involved and need to access lending capital.

3.4 Management of the personal microloan scheme

Most of the good practice identified involved a key actor managing the provision of affordable loans. This role was played by the Growth Fund in the UK, by the Social Cohesion Fund through the Caisse des Dépôts in France and by Good Shepherd Microfinance in Australia. The establishment of such a body was also the key recommendation of a recent report by the Institute for Public Policy Research (Lawrence and Cooke, 2014), which looked at ways to increase access to affordable credit in the UK.

While this might be overlooked or considered as a relatively easy task, the management of the scheme is a key element of its success and ability to deliver outcomes for all stakeholders.

A managing body

Based on the insights drawn from the good practice models, the implementation and development of an Irish personal microloan scheme requires a body in charge of managing both the project and the guarantee fund. Such a body should display characteristics that ensure its independence from any party involved as well as legitimacy to act as manager of the project and of the guarantee fund through its aims, governance structure and internal competencies. These characteristics could involve:

- being a non-state or financial industry body;
- aiming at improving access to affordable loans and improving financial inclusion;
- having a board involving the main stakeholders or their representative bodies; and
- having expertise regarding microlending, managing guarantee fund and promoting financial inclusion.

Among existing bodies, the Social Finance Foundation is one possibility. It could set up a subsidiary agency similar to Microfinance Ireland regarding professional microcredit in order to manage the personal microloan scheme in general and the Financial Inclusion Fund in particular. As this fund would guarantee the loans provided by the lenders
involved in the personal microloan scheme and support all stakeholders (including by providing operational funding), the dedicated body should have a relevant board regarding personal microlending. This is because it would play a key role in the ability of the scheme to adapt well to the needs and constraints of both borrowers and stakeholders.

The aim of this dedicated body should be to improve access to affordable small loans and help people avoid debt difficulties. It should have five key tasks:

- contracting stakeholders;
- training stakeholders;
- coordinating stakeholders;
- monitoring activity; and
- advocating for financial inclusion.

**Contracting stakeholders**

The first task of the body in charge of managing the personal microloan scheme would be to identify eligible stakeholders. In that respect, a set of requirements for lenders and other stakeholders (in charge of reaching out to potential borrowers and/or supporting them) should be defined. This would include not-for-profit lenders and NGOs with appropriate resources. This would protect borrowers from receiving a poor quality service. Once organisations willing to participate are chartered, a contract should be established, setting out the responsibilities and commitment of the ‘chartered’ organisations and the managing body. Eligibility to the Financial Inclusion Fund would only be open to stakeholders complying fully with their contractual obligations.

The evaluation of the Growth Fund (Financial Inclusion Taskforce, 2011) shows that a robust contract management approach has been vital in order to incentivise lenders to reach the objectives of lending to the target population while also keeping down the level of defaulted loans. Establishing contracts with lenders led to them making regular and detailed management information reports, which helped them to have a better understanding of their performance and to improve their professional standard when required. Such increased self-assessment ability is a valuable outcome for the stakeholders as it might lead to other improvements in the delivery of their core services. In the context of the evaluation of credit unions’ lending practices by the Central Bank of Ireland, such an outcomes could be valuable (Central Bank of Ireland, 2014c).

But more than the establishment of a contract itself, the way it is managed is what matters. Incorporating clear targets, regular monitoring and active, ongoing contract management, the ‘model of intensive relationship-based contract management is key to the impact that the Growth Fund has achieved’ (Whyley, 2010, p. 24).

Good Shepherd Microfinance also sets up contracts with its providers in order to ensure that they perform their tasks (for example, regarding preparing clients’ applications and arrears management) in line with the programme guidelines. Conversely, the French personal microloan scheme shows clear signs of a lack of clarity regarding the task each
stakeholder should perform. In that respect, a more robust contracting approach would have prevented partners from overlap for some tasks (assessment of the potential debtor) while not delivering for others (lack of support in case of missed payment) (Gloukoviezoff and Rebière, 2013).

Alongside the establishment of contracts, the coordinating body should also facilitate the development of definitions of clear procedures and related forms and documents in order to make the collaboration between various stakeholders as efficient as possible. This process should involve all the stakeholders in order to make sure that their own procedures and constraints are taken into account.

**Training stakeholders**

Another key element of success identified by the good practice stage of the research is the training of the stakeholders. The provision of personal microloans will either be a totally new activity or an activity targeting a new segment of borrowers. Therefore, all stakeholders are in need of some form of training.

Good Shepherd Microfinance trained the microfinance workers in charge of supporting potential borrowers during the application process, while the Caisse des Dépôts contracted training out to various organisations targeting volunteers or employees of NGOs and social services. However, lenders can also be in need of training.

From the early stages of the Growth Fund programme, training needs were identified for lenders’ staff. The Department of Work and Pension (DWP) and the Association of British Credit Unions Limited (ABCUL), in conjunction with research carried out by Paul Jones, developed and designed the Delta Project. Delivered by the ABCUL’s development, education and learning team, this programme aimed at empowering staff to deal with these new borrowers.

Such a training service should be provided to all stakeholders and should be adapted to their specific roles and needs. In that respect, consultation with stakeholders’ representative associations should be organised, from the early stages of the project, in order to ensure access to good information from staff on the ground.

**Coordinating stakeholders**

The ability of the personal microloan scheme to reach potential borrowers will depend on the quality of the stakeholders’ network. If the involvement of representative organisations at national level is essential, the ability to build a strong network of trusted stakeholders at local level is paramount.

Wide variety in terms of local potential stakeholders means that a local level coordination could be required. This need is increased by the fact that organisations with potential cultural differences will have to collaborate. In that respect, the Growth Fund appointed ‘financial inclusion champions’, whose role was to coordinate action and best practice in tackling financial inclusion across local authority areas, social landlords and other frontline agencies. These champions were to liaise with strategic partners, support
stakeholders in order to secure external funding and to raise awareness about the Growth Fund loans.

Both the French personal microloan scheme and the StepUP programme have shown the essential role of supporting stakeholders at local level. While Good Shepherd Microfinance itself provides support to partners, the Caisse des Dépôts delegates responsibility to one stakeholder per region to act as a local coordinator.

Such a local coordination role should be provided directly by the national coordinating body or indirectly by chartered partners. Therefore, in collaboration with local stakeholders, the coordinating body should:

- provide a framework to help build or strengthen a local stakeholders’ network;
- provide assistance in order to secure external funding; and
- organise a stakeholders’ forum where views, ideas, insights and issues could be shared.

Additionally, the coordination role should include linking the personal microloan scheme with any other existing lending initiatives. When successful initiatives exist it is better to support them (even by providing a guarantee if they meet the eligibility criteria) rather than to compete with them. Channelling borrowers to such initiatives to access a loan when it proves more appropriate to do so would enable the scheme to focus on areas where there is an inadequate supply of affordable loans.

**Monitoring activity and results**

Managing the personal microloan scheme requires having access to relevant data. Such data are even more important when a body is managing a fund that guarantees part of the loans as well as funding stakeholders.

The French personal microloan scheme suffers from unreliable data provided by stakeholders. While the data related to the loans granted are of good quality, they are often poor regarding the purpose(s) of loans, the characteristics of loans and missed payments and write-offs. Conversely, the Growth Fund had a data requirement addressing all these factors built into the contract established with stakeholders. Lenders had to make regular and detailed management information reports, which provided the DWP with a useful monitoring tool and means of assessing the organisation’s systems (Financial Inclusion Taskforce, 2011).

Three main types of information should be gathered by the coordinating body, with the collaboration of the stakeholders, summarised below.

- Information related to the loans themselves:
  - financial information (such as number of loans, value of each loan, interest rate, missed payments occurrence, arrears, write-offs);
  - activity information (such as main characteristics of the borrowers, main characteristics of refused potential borrowers, purpose of the loans)

- Information related to the lending activity:
- various costs of running the activity for the stakeholder;
- various incomes (direct and indirect) generated by the lending activity.

- Information related to the results achieved:
  - impact on borrowers;
  - impact on organisation.

All of this information should be collected by the stakeholders themselves. However, it should be kept in mind that this data collection, while essential, should require as little time as possible. For example, regarding information on the potential impact on borrowers, it should be as simple as possible, with the aim of providing feedback to stakeholders about the best way to help potential borrowers. More detailed data should be provided by external evaluation.

In order to make this information collection process cost efficient, its parameters should be defined in order to meet existing reporting activities. For example, the credit unions are already reporting to the Central Bank. Therefore, the following options should be considered.

- The quarterly financial return to the Central Bank should include the value and outstanding value of personal microloans.
- PRISM as well as the annual audit carried out by the Central Bank should include the personal microloans within their remit.
- The compliance statement by the board of each credit union should take into consideration the personal microloans.

An indirect result of this effort to collect data should be the stakeholders’ empowerment in relation with self-assessment. Such ability is usually valuable as illustrated by the fact that two thirds of the French personal microloan scheme’s stakeholders have been learning from their involvement in the scheme (Gloukoviezoff and Rebière, 2013).

**Advocating for financial inclusion**

Providing affordable loans to low-income households is the aim of the personal microloan scheme. However, in order to tackle problems related to borrowing from high-cost lenders effectively, insights from the programme should be shared with stakeholders, policy makers and the general public at local and national level.

The aim of Good Shepherd Microfinance is, together with their community partners, to enable people to define and then realise their own economic wellbeing through appropriate financial services. It states that this aim is also achieved by:

- measuring, evaluating and communicating how its programmes are contributing to economic mobility and wellbeing through partnerships with research institute; and
- sharing their learning, and engaging with and influencing key actors from all sectors including the media.

Such statements could be applied to the role of the coordinating body regarding advocacy. By engaging at national and local level with key stakeholders, it could
contribute to building more financially resilient communities and a more financially inclusive Ireland.

3.5 Characteristics of personal microloans

Eligibility criteria

Criteria are seen as a way of ensuring that the scheme is only used by its targeted audience. They usually deal with the profile of the borrower and the purpose of the loan.

❖ Profile of borrowers and their income

There are many types of criteria regarding a profile of eligible borrowers. The most common ones focus on the level of income – setting maximum (i.e. StepUP loans, MicroBank’s loans) or minimum (i.e. CUOK) thresholds – and on the nature of the income (i.e. whether or not the borrower receives benefits). Such criteria aim to avoid a situation by which borrowers who could access mainstream loans or credit unions loans take advantage of the personal microloan scheme, or conversely, one where people considered unable to repay a loan would try access to it.

What the above criteria really try to achieve is to make the eligibility decision quick and easy by excluding, ex ante, people who do not meet the requirements. By doing so, they sometimes exclude people in complex situations who need a personal microloan and who could repay it but who would be considered as earning too much or too little. For example, a person not in receipt of social benefits might experience a situation that should qualify them for the scheme (i.e. the working poor).

However, such aims can be achieved in a more accurate way by carefully assessing the financial situation of potential borrowers. In that respect, it seems that the profile criteria should be limited as much as possible and, if there are any, that they should be seen as flexible guidelines, as is the case for the two programmes run by Good Shepherd Microfinance (NILS and StepUP Loan). Overall, the main eligibility criteria should be the ability to repay the loan and exclusion from mainstream loans and credit union loans; this is the case for Parcours Confiance and the Social Cohesion Fund in France. However, borrower profiles could enable providers to channel some clients towards relevant application or payment options within the scheme itself. For example, people with a current account and who are in employment could apply online as is the case for CUOK’s borrowers.

In the Irish context, at least two criteria require specific attention. The first is the issue of the required ‘common bond’ to be able to borrow from a credit union. Such a requirement might limit the ability of potential borrowers to access personal microloan in at least two situations:

- when no credit union or other lender provides such loans in their area;
- when a local credit union has reached its lending cap regarding personal microloans.
In order to avoid such situations, an expansion of the ‘common bond’ definition should be considered. Currently, it focuses on geographic (living, working or studying within a precise area) or professional (working in a specific organisation) factors, but it could be expanded to include exclusion from mainstream financial services and credit union loans. Such extension would allow people:

- to join a community credit union of their choice while they are living, working or studying in an area where no credit union is providing personal microloans; and
- to access a personal microloan from a community or industrial credit union while being an existing member of a credit union that either has reached its lending cap regarding these loans or is not providing them.

In the latter case, such an extension of the common bond definition creates a kind of solidarity between credit unions in their efforts to meet the potential demand for personal microloans without being restricted by their own lending capacity.

The second criteria relates to the situation of people with mortgage arrears or who have been through the insolvency procedure. According to the prudent lending circular (Central Bank of Ireland, 2013a), borrowers in these situations should not have access to an additional loan. However, for some of them, it might be essential to access some form of credit and they would have the ability to repay a small amount on a regular basis. Therefore, the personal microloan scheme should be open to such borrowers on a case-by-case basis. The French personal microloans were made available, on a pilot basis, to people who had been through the Banque de France procedure to deal with over-indebtedness. Its evaluation showed that the delinquency and write off rates for this group were no higher than they were for other borrowers (Gloukoviezoff and Rebière, 2013).

**Borrowing purposes, debts and making ends meet**

There are two schools of thought regarding borrowing purposes. The first one considers that microloans should only be used in a productive way (as is the case with NILS, StepUP Loans and Parcours Confiance). Therefore, the purpose of borrowing needs to be seen as essential to the wellbeing of the borrower and is often linked to employment (such as vocational training or buying a car) or housing conditions. However, defining ‘essentials’ can be difficult and often reflects moral judgments rather than careful evaluation of the impact on the borrower. For example, funding holidays for a family or repaying debts at a lower interest rate than would have been possible with a moneylender would usually not be considered as essential.

The second school of thought does not apply any restrictions on the purpose of a loan (examples here include Scotcash, CUOK and MicroBank). The only condition imposed regards the borrower’s capacity to sustain the loan repayments. This approach makes sense when the aim of a personal microloan scheme is to deter borrowers from high-cost lenders. The scheme has to meet the same needs as the high-cost lenders would, but in a more appropriate manner.
Some learning from the first school of thought should be taken on board. Setting eligibility criteria regarding the reasons for taking out a loan might lead some of the potential borrowers to lie about the real reason they are applying for a loan in order to increase their likelihood of success. Such ‘lies’ are also made in France by the NGO volunteers or social services employees who support the borrowers during the application process when they think that the loan would have a positive impact on the applicant (Gloukoviezoff and Rebière, 2013). More importantly, these ‘lies’ often aim at hiding the fact that the microloan will be used to make ends meet and to repay other debts – purposes that are often excluded from personal microloan schemes. A key decision to be made, therefore, is whether debt repayment and making ends meet are eligible reasons for taking out a loan.

These are the main questions to be addressed here.

- Is it financially sound to grant a loan to help someone to make ends meet?
- Will people who are already in arrears be able to repay an additional loan?
- Will it create an incentive for creditors to channel some of their debtors in difficulty to get a personal microloan in order to be repaid?

The answer to the first two questions should be provided by an in-depth assessment of the borrower’s financial situation. However, and this is particularly true when debts are involved, such assessment requires time and skills, sufficient levels of which the lender might not have.

In France, almost 7% of borrowers used their microloan to repay debts, despite such a purpose being excluded from criteria (Gloukoviezoff and Rebière, 2013). This has led to a planned, pilot-based expansion of the personal microloan scheme to debt consolidation, but only for debts falling below a certain level, yet to be defined. Alongside StepUP loans and NILS, Good Shepherd Microfinance set up a pilot called ‘Debt Deduct’, which provides consolidation loans with an assessment carried out by debt advisers.

These two options – limiting the amount of debt that is eligible and involving a professional debt adviser at the assessment stage – could play a role in responding to borrowers’ needs in the Irish context.

Below a €1,000 threshold, the appropriateness of funding existing debts and making ends meet could be assessed by the lenders themselves within the personal microloan scheme’s standard procedure. If the lenders are unsure about the relevance of the microloan, they could ask MABS to carry out an in-depth financial assessment. While not compulsory, the lender would be entitled to decline the microloan if the borrowers refused to meet with MABS when this has been requested.

For a loan over €1,000 and when its purpose is to repay debts, the same process could be followed with MABS support strongly recommended. However, it would be better if the borrower had access to a different type of microloan in terms of branding and characteristics. This loan could be called a ‘consolidation microloan’ and its features
could be influenced by the Finnish experience regarding guaranteed consolidation loans (Gloukoviezoff, 2013). Its features would be as follows.

- The amount would range from €1,000 to €25,000\(^9\).
- The interest rate would be significantly lower than the rate for personal microloans.
- The maximum repayment period would be eight years;
- The loan would be made by a credit union or other lender with the 50% guarantee from the Financial Inclusion Fund.
- The existing creditors would have to agree to write off at least 40% of the debt (depending on its nature).
- Mortgage arrears could be included within the ‘consolidation microloan’.
- Negotiations with creditors would be carried out by MABS workers on behalf of the debtor.

Making a partial write-off compulsory should respond to a third challenge: creditors having an excessive incentive to channel their debtors in difficulties to the microloan scheme. In such cases, debtors would get a significant rebate on their debt while creditors would get the remaining debt risk free in one payment rather than having to wait for several years before being repaid.

Pending the availability of such a consolidation loan or other responses (such as a systematic referral to MABS), making ends meet and repaying debts should not be excluded from the eligibility criteria for accessing personal microloans. These needs are frequent among the target audience for the personal microloan scheme and it would be a key pull factor in helping these potential borrowers to get in touch with the scheme’s stakeholders. Even if the personal microloan is not granted, this approach could help the scheme reach people in need of financial help and therefore contribute to their broader financial inclusion by providing alternative solutions.

**Amount lent**

Most of the good practice models identified have a minimum and a maximum amount that can be borrowed. The minimum is usually around €100 while the maximum is between €1,000 and €2,000. This is in line with the most common loan amount borrowed from moneylenders in Ireland, which is between €200 and €500 (Central Bank of Ireland, 2013b).

It seems that a sensible bracket would be €50 and €2,000 with the possibility, in exceptional circumstances, of going below or beyond these limits. A higher limit for loans specifically targeting restructuring debts would need to be considered, as described previously.

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\(^9\) In the Finnish example, the maximum amount was €35,000. However considering that the microcredit definition at European level sets a maximum of €25,000, the more conservative option was chosen.
Cost for the borrower

Defining the cost for the borrower is influenced by several factors.

- **The business model: Should it break even or does it need to be subsidised?**
  
  If the programme has to break even it seems it would be difficult to provide the loans at a lower APR than 40% according to insights from the Growth Fund (Collard, Hale and Day, 2010). If the programme is subsidised, a lower interest rate could be charged. Indirect incomes for stakeholders, such as cross-selling by the lenders and social return on investment, should be taken on board to define a level of APR that would be suitable.

  If it is decided to go with a different option than lending through the credit union movement, the cost would be even higher. A not-for-profit home credit company, for example, would not be able to break even if they charged less than 120% APR (Kempson et al., 2009). Subsidies and a guarantee would allow the cost to be reduced significantly. However, a standalone lender like Scotcash still lend with an APR of between 80% and 160%, even though they are heavily subsidised.

- **Views of partner organisations**
  
  Partnerships are likely to be a key element in the success of the scheme. However, as interview data and the literature review have shown, organisations that are trusted by the community might prove reluctant to commit themselves to channel and support borrowers if the APR of the loan is high. The impact evaluation of the French personal microloan scheme showed that NGOs' volunteers and social workers were reluctant to take part in a loan scheme that would charge more than 6% APR (Gloukoviezoff and Rebière, 2013) while this reaction would occur with a higher APR in the UK (Kempson et al., 2009). In an Irish context, such a threshold is likely to be lower than the 40% required for the programme to break even.

- **The regulatory framework**
  
  The option of operating the personal microloan scheme through credit unions might mean that their interest rate cap will apply (1% per month, or 12.68% per year). Considering the different factors that influence the pricing of personal microloans, two facts are relevant: that CUOK managed to make a profit with an APR of 26.8% when the subsequent consumption of new borrowers was taken into account; and that the UK raised the credit union interest rate cap to 3% per month (42.6% per year). This suggests a possible maximum interest rate of between 26.8% and 42.6% per year. This would involve the lending by credit unions being made under specific regulations and the capital for lending being ring-fenced.

  However, setting the APR at a level that exceeds the current cap applying to credit union loans should result from a request from the credit union movement itself and should be made by taking into consideration all stakeholders’ views. Considering the highly sensitive nature of this question, the credit union’s APR cap might be reviewed at a later stage, once the scheme has already proved effective.
Fees and collateral

While CUOK, Scotcash and MicroBank charge their borrowers with fees, such an approach should not be taken by the personal microloan scheme in order to compete with moneylenders. The only cost should be the interest paid; this would make the cost of the loan for the borrower transparent and easy to understand.

Similarly, there should be no collateral or saving period requirements in order to access personal microloans. Such requirements act as barriers for low-income potential borrowers.

Repayment: Avoiding the ‘one size fits all’ approach

While repayment is a key element for the borrower, it is also a crucial factor from the lender’s point of view in order to reduce the risk of missed payment. Three components have to be taken into consideration.

- **Amount repaid and length of the repayment period**
  The repayment amount for the borrower has to fit into an often extremely tight budget. Therefore, it must be possible for this to be customised to the needs of individual customers. The evaluation of the CUOK pilot showed that even payday borrowers appreciated having the option of repaying their small loan over the longer period of three months (Evans and McAteer, 2013).

  Considering the need to meet the repayment capacity of borrowers, no minimum amount should be set. However, when it leads to a repayment taking place over several years, it would be beneficial to review the situation after one year, in order to establish whether or not the repayment amount can be increased, thereby shortening the repayment period.

- **Frequency of repayments**
  The frequency of repayments should be based on borrowers’ budgeting habits. As most low-income borrowers budget on a weekly basis, repayment should generally also be made every week. However, not all low-income borrowers budget this way so it should also be possible to make repayments on a fortnightly or monthly basis. This is the approach taken by the StepUP loan programme in order to suit the needs of its various borrowers.

- **Repayment methods**
  Key elements of the success of moneylenders are that borrowers can make repayments in cash and that repayments are collected on the borrower’s doorstep. Recruiting a network of agents for home collection would lead to numerous difficulties: attracting a good agent will prove difficult considering the limited interest rate potentially applied to borrowers. This makes this approach an unsustainable option for a personal microloan scheme (Kempson et al., 2009).
However, as cash is the main way low-income households manage their budget, this should remain the main repayment option for a personal microloan, alongside others. Such cash repayments should be possible at the office of the lender but also through local post offices or PostPoint as well as through PayPoint, PayZone and equivalent, as is the case for bills.

Direct debit should also be considered, as some borrowers may have a bank account – this is a cost effective way of collecting repayments. It is a requirement of CUOK’s borrowers to have such an account and Scotcash helps its borrowers to open a basic bank account if they are financially excluded. In the same way, credit unions could encourage and support personal microloan borrowers to open a basic payment account.

However, such an approach could be costly for borrowers if a situation arose whereby the amount to be repaid was not in their account when a repayment was due. A procedure should therefore be in place whereby borrowers can phone the lender to postpone a payment or ask for a smaller amount to be taken, and at no extra cost (Collard and Kempson, 2005, p. 20). If the account is managed by the lender, no fee should apply.

Finally, a third repayment method should be considered: direct deduction from benefits or wages. This method is cost effective and reduces risk for lenders (at least as long as the borrower is in receipt of benefits or in employment). However, there is mixed evidence from the Social Fund assessment about the suitability of this method for borrowers (Collard, Hale and Day, 2010; Collard and Kempson, 2005; Whyley, 2010). On the one hand, it is perceived positively as it is very convenient, and there is no risk of the borrower forgetting. On the other hand, it shows a lack of flexibility during times of hardship, leading to borrowers having to cut back on essentials. As with direct debit, procedures should be in place to protect borrowers’ standard of living.

Two complementary options should be implemented: expanding the direct deduction option to credit unions and building on the Household Budget Scheme provided by An Post.

Allowing credit unions to receive repayments by direct deduction

Having made sure that the repayment amount is suitable and that the borrower’s preferred repayment method is by direct deduction, credit unions should be allowed to be repaid through this channel. This would significantly reduce the cost of these loans and almost remove risks. In return, borrowers experiencing difficulties should be allowed to contact their credit union either in advance or once the deduction has happened to explain their situation and be partly or fully refunded. This procedure would have a positive effect for the lender as it would create an opportunity to get in touch with borrowers in difficulty and discuss their financial situation. It might lead to a potential solution, thus ensuring the loan repayments remain sustainable.

While such refunds by the lender should be compulsory, once a borrower has made use of this option three times over a period of three months, a detailed assessment of the borrower’s financial situation should be carried out. In the absence of an assessment,
the option of having the amount directly deducted from social benefits or wages being repaid by the lenders would be suspended. Such an assessment would provide detail on the difficulties faced by the borrower and allow the lender and the borrower to look for a sustainable solution.

**Extending the Household Budget Scheme to personal microloan repayments**

An Post is already providing a direct deduction facility to social benefit recipients: the Household Budget Scheme. It allows social benefit recipients to pay regular amounts towards various household bills by direct deduction from certain social welfare payments. Two of its characteristics deserve specific attention: eligibility of creditors and the maximum repayment allowed.

Currently, the eligible creditors are limited to: local authorities, ESB, Bord Gáis, Airtricity and Eircom. This list should also be expanded to include credit unions regarding the personal repayment of microloans. This would be a partial return to what was in place up until recently: before the Social Welfare Act 2012, which reduced the suppliers that can be paid through the Household Budget Scheme, more suppliers were able to access the scheme. Among them were some credit unions working in partnership with MABS and National Traveller MABS. Known as the ‘Lough Payment Scheme’, this scheme has allowed borrowers supported by MABS to repay a loan to their local credit union by direct deduction. Around 400 MABS clients are using this facility (National Traveller Money Advice and Budgeting Service, 2014). However, as of March 2014, the Department of Social Protection has notified MABS that the Household Budget deductions will be discontinued for any MABS client using the Lough Payment Scheme. Re-opening the Household Budget Scheme to credit unions providing personal microloans would therefore prove particularly relevant.

This relevance is linked to the second characteristic of the Household Budget Scheme: the payment limitation to 25% of the social welfare payment. All payments made by direct deduction – including those potentially relating to the personal microloan scheme – cannot exceed one quarter of the social benefits paid to the individual. This requirement should ensure that a direct deduction does not lead to excessive budget constraints for people whose income is already low.

Therefore, characteristics of the Household Budget Scheme already address sustainability regarding the microloan repayments. This has two main implications for the personal microloan scheme.

Firstly, involvement of the Household Budget Scheme could **greatly simplify the assessment phase**. As repayments are being directly deducted from social benefit payments, there is almost no risk for the lender. And as the repayment should fit alongside other payments, within the 25% limit, the borrower should be able to afford to repay the loan. Assuming that the same procedures are in place to protect borrowers when unexpected events occur (the option of having the repayment amount paid back), the Household Budget Scheme appears to be a safe way to manage the provision of the personal microloan and could replace the detailed assessment of a potential borrower’s
situation by the lender. The post master would be in charge of assessing whether borrowers are eligible for the scheme before sending the form to the local credit union, which would grant the loan.

Secondly, considering that the repayment should fit within the 25% limit, the maximum amount that could be borrowed should be limited to €1,000. This would allow the duration of the repayment period to be kept to a maximum of two years, which is already a long time for borrowers living on a low income. However, in order to make such loans as appealing as those of moneylenders, all purposes should eligible, including debts.

Building on the Household Budget Scheme would open a cost effective, fast-track channel for borrowers on social benefits to access personal microloans. It would also build on the close relationship that An Post has developed with these potential borrowers. As these potential borrowers are already receiving social benefits from the Post Office, they are more likely to be made aware of the personal microloan scheme, and to feel more confident in applying for it through An Post. However, it would be beneficial to borrowers if they could be made aware that getting in contact with MABS could allow them to reduce the debt amount that would be repaid by the microloan.

If there is a sufficient degree of flexibility is in place and other challenges are considered carefully (such as the need to deal with people when they stop receiving benefits or when they change job or lose their job), direct deduction would be an efficient system. It is illustrated by the fact that Good Shepherd Microfinance and the National Australian Bank are advocating this approach in order to make Centrepay (the Australian direct deduction from benefit scheme) available for StepUP borrowers (Corrie, 2011).

**Dealing with arrears**

Arrears are unavoidable when lending to low-income borrowers. Except Parcours Confiance and MicroBank, which apply mainstream banking methods, none of the good practice models identified charges fees for missed payment. The absence of costs to the borrower in case of missed payment should be retained as a key feature of the personal microloan scheme.

Not charging borrowers is necessary but alone it is not sufficient. Appropriate responses should be provided to borrowers in order to help them manage their debt in a sustainable manner. Such responses include:

- making sure that the due date for repayment as well as the payment method continue to suit the borrower;
- referring the borrower to a debt adviser or to other support services depending on the causes of their difficulty; and
- offering financial solutions such as negotiating a repayment plan, pausing payments and making settlement offers.
When looking for solutions, it would be more effective for borrowers to deal with the person who was in charge of their application, as shown by the identified models of good practice.

- The debt recovery activity was implemented on behalf of Scotcash by a debt recovery company before being brought back in-house, with better results.
- StepUP borrowers remain in contact with the microfinance workers who helped them to apply, even after being 21 days in arrears, when the NAB collection team intervenes.
- An evaluation of NILS also demonstrates that the partner organisations that were experiencing the lower level of arrears and write-offs were organisations with a flexible approach to borrowers’ difficulties (avoiding a ‘one size fits all’ approach) and which had staff with the right personality and skills, enabling them to adopt an informal approach with the borrower (Cowling et al., 2013)

When a borrower is supported by an organisation during the borrowing process, this organisation should also be contacted by the lender when a missed payment occurs in order to make sure that it can provide assistance to the borrower while looking for a sustainable solution.

Key factors in finding a sustainable solution for the borrower, where possible, are: absence of fees; appropriate responses; and good relationships. However, these ingredients lose their power when they are implemented too late. A Growth Fund evaluation showed that Growth Fund lenders consider that it is key to ‘be seen to follow-up missed payments quickly and effectively’ (Collard, Hale and Day, 2010, p. 37). Such a conclusion reflects the procedure implemented within the StepUP programme, where microfinance workers receive an arrear report every week from National Australian Bank and Good Shepherd Microfinance. Therefore, lenders involved in the personal microloan scheme should put in place procedures that allow them to deal with arrears in a responsive and efficient manner. When necessary, the implementation of such procedures should be supported by the Financial Inclusion Fund. This would allow replication of the results obtained by the Growth Fund, whose lenders’ arrears management and debt recovery process appear to have been better organised and more effective than those of the non-Growth Fund lenders (Collard, Hale and Day, 2010).

**Subsequent borrowing**

While repeat borrowing from moneylenders (also called re-loaning or rollover loans) can be harmful for borrowers, it seems sensible to allow borrowers to access subsequent loans. As long as such practice is not the result of a severe income inadequacy and does not negatively contribute to it, this could help borrowers avoid turning to high-cost credit. All good practice models identified allow repeat borrowing, even if the level of such borrowing varies by scheme.

However, only one personal microloan should be active at a time. This means that if a borrower with a personal microloan needs to access another loan, the previous one has
to be repaid in full. This might involve an early repayment, which should come at no cost and could be included in the subsequent microloan. This option should only be offered to borrowers who are not experiencing repayment difficulties at the time of their application and following an in-depth assessment of their financial situation.

3.6 Characteristics of the lending process

Outreach

Being able to reach potential borrowers when they are in need of a loan is a key driver of success. The difficulty for a new product is related to its targeted audience’s borrowing habits. It is a challenging task to divert borrowers from credit sources that have proven successful previously, even at a high cost.

Various research reports, as well as the good practice models studied here, state that word of mouth is the best way to get people to engage with a new lender or product. However, such a reputational effect takes time to develop and requires successful experiences among a scheme’s first borrowers.

In order to overcome this difficulty, it is necessary to establish trust between personal microloan providers and potential borrowers. This can be accomplished through locally trusted third parties. Working with well-known partners, such as An Post, MABS, Saint Vincent de Paul or other community stakeholders, is one approach common among the good practice models in order to get in contact with borrowers. Referrals from such organisations helps establish trust, on both sides, between the lender and the borrower.

Alongside reaching out to potential borrowers and building trust, the role of third parties will also involve providing support for borrowers who have the least experience with accessing credit. Some members of the targeted population will need guidance in adapting their budgeting techniques to the requirements of repaying a loan. Such support will be needed prior, during and, if successful, after the assessment phase. As this might prove time consuming and therefore costly for the partners in charge, funding should be made available by the Financial Inclusion Fund in order to make sure that support is provided in an appropriate way.

Other stakeholders should also be involved, such as local housing authorities, housing associations, energy providers and trade unions. Their role would be not only to establish trust but also to reach out to potential borrowers. This could also prove very effective in providing information about the personal microloan scheme when people are experiencing difficulties in accessing funding. For example, when refused a loan from a mainstream bank or a credit union, when denied a grant from social services, or when having difficulty in paying an energy provider, an insurance company, or a mechanic, people could get a leaflet with information regarding the personal microloan scheme.

Another important issue is geographic coverage. Credit unions, which are established in most communities in Ireland, appear to be the best solution. However some disadvantaged or remote areas do not have a local credit union. Partnerships with local
stakeholders could help to partly overcome this difficulty but other alternatives, such as mobile delivery or temporary presence (i.e. for a few hours per week within the building of a local partner) should be explored, bearing in mind the common bond requirement (and its potential development as suggested previously).

Therefore, developing a variety of partnerships will help establish trust, allow people to be reached when they are in need of a loan, and offer better coverage of the population. In that respect, developing a strong partnership with An Post, including through the Household Budget Scheme but not limited to it, would prove extremely beneficial for the personal microloan scheme outreach capacity.

Alongside these various physical channels for reaching potential borrowers, two other channels should be considered. The first one is communicating about the personal microloan scheme through various media, such as advertisements and interviews in local and free newspapers, radio shows and TV shows. The limitation of this strategy is that it can be costly and needs to be repeated to avoid the message fading out. Nevertheless, experience from various good practice models identified shows that it is a communication tool that cannot be excluded.

The second channel for reaching potential borrowers is by establishing a customer-friendly website. Not all moneylender borrowers have access to the internet but many of them do, as shown by the CUOK pilot. All major moneylenders have a website, as the internet is a quick and easy way to look for a loan in case of an emergency. The personal microloan scheme should be accessible this way, at least to provide clear information about how to get such a loan. It would also help to reach borrowers who would not consider credit unions, MABS or Saint Vincent de Paul as their natural interlocutors. In that respect, the possibility of an online application process should also be considered (see below).

Assessment and decision

Assessing potential borrowers is both the most difficult task of the process and the most important one. Assessment is a difficult task as it needs to bring together:

- **speed**, as the need for a loan is often related to an emergency;
- **accuracy**, as a poor assessment is a problem both for the lender and the borrower;
- **clarity**, as potential borrowers need to be able to broadly anticipate the outcome of their application;
- **flexibility**, as rigid eligibility rules might exclude people who would have had the ability to repay a loan;
- **quality relationships**, as the nature of the contact established with potential borrowers will influence their repayment patterns.

In order to satisfy all these criteria, the personal microloan scheme would offer three complementary access channels.
The first channel would be through An Post and the Household Budget Scheme. While accessible only to borrowers in receipt of social benefits and with a borrowing need of less than €1,000, this channel would prove quick and simple as:

- it does not require numerous documents;
- it involves a trusted body;
- the eligibility criteria are clear and easy to understand; and
- the outcome is easy to anticipate as the assessment is mainly related to the ability to fit the repayments within the limit of 25% of a social benefits payment.

The second channel would be through the credit union network. Based on the insights of most of the good practice models identified, the most effective way of assessing a potential borrower’s situation involves:

- having a professional expert carry out the assessment;
- carrying out this assessment during a single face-to-face meeting; and
- requiring only a limited number of essential documents.

The assessment experts should be able to make the decision to lend, based on general guidelines rather than strict criteria, as is the case for the StepUP programme. When making their decision, the assessment experts should be able to take into account the borrower’s character along with solvency indicators. In particular, if a credit check is required, flexible rules should apply with the agreement of the Financial Regulator.

The assessment experts should be an employee or volunteer of the lender, in order to avoid multiple and fragmented assessments by various parties involved in the lending process, as seen in the French personal microloan scheme (Gloukoviezoff and Rebière, 2013). Therefore, lenders’ partners should focus on channelling people towards the personal microloan scheme and informing them about the application process requirements (such as documents needed) rather than providing an initial budget assessment.

However, when such an assessment is part of the normal relationship between the potential borrower and a partner, as it is for MABS or for a lender (i.e. mainstream banks), and pending the agreement of the potential borrower, the personal microloan lender should be provided with the information already collected and the analysis already carried out in order to be able to build on this previous assessment.

The third channel to accessing a personal microloan would be through a national website. In order to accelerate the decision-making process without overloading lenders’ employees with extra work, the possibility of an online application option should be seriously considered. The example of CUOK, where higher income borrowers can get their loan online as they meet all the required criteria while other potential borrowers are manually assessed, is particularly interesting in that respect.

The possibility of implementing several application channels depending on the borrowers’ profile should also be seriously considered, as the outcomes of this approach are promising.
Broader financial inclusion and refusal

While the assessment focuses on the potential borrower’s ability to repay a loan, it is also an opportunity to identify financial inclusion needs additional to the loan itself.

Needs that could be addressed by the assessment expert are those related to access to a product such as a current account, a savings account, debit cards and insurance products. In that respect, the credit union movement is most likely to be able to meet borrowers’ needs directly by providing them with their own financial products, or indirectly by helping them to open a basic payment account, if they cannot offer this themselves.

There are other needs that the assessment expert is unlikely to be able to address. They include the need for financial advice and help regarding social benefit payments. Therefore, it should be possible for the lenders to refer these borrowers to relevant partners – for example, MABS, social services and NGOs. In that respect, the lenders, partners and borrowers’ roles and responsibilities within these procedures should be precisely defined.

In some cases, the assessment will lead the lender to deny access to a microloan. Knowing that the aim of the personal microloan scheme is to deter borrowers from high-cost lenders, particular attention should be paid to these refusals. Such a decision, and more importantly its rationale, should be carefully explained in order for refused borrowers to understand the likely consequences involved in borrowing money in their situation. The assessment expert should also, as much as possible, look at alternative solutions, involving partners like MABS, NGOs and social services, in order to avoid a situation where refused borrowers would be left by themselves to find a solution to their financial problems.

Providing support and managing the relationship

While some good practice models had a support system, put in place by partners of the lenders, being supported is not a requirement for all borrowers. It also creates some difficulties, as partners in charge of the support are not necessarily able to provide it. In addition, it leads to a dilution of responsibility between the different stakeholders. Therefore, support should be structured following four guidelines.

First, support should be provided for borrowers who need it. This mainly includes borrowers unfamiliar with accessing credit and its budgeting requirements and those experiencing a complex financial situation. Support should be in place from the early stage of the application process. Its role would be to assist borrowers in managing their budget while repaying their microloan and, if a missed payment occurs, to assist them while dealing with the lender. In order to ensure the quality of this support, it should be provided by an organisation that is trusted by the borrower and funding should be made available by the Financial Inclusion Fund to support organisations if required.
Second, the nature of the support, regarding for example the frequency of contact, should be **personalised** regarding borrowers’ needs and their preferences. Support should be tailored in order to favour borrowers’ autonomy and to avoid unnecessary action that would prove costly for all parties.

Third, lenders should also support borrowers by providing an appropriate and timely way of dealing with **missed payments**. Each time a missed payment occurs, contact should be made with the borrower (and the organisation providing support if appropriate) in order to assess the reason for it and the potential need to look for a solution. Not all missed payments are a sign of real difficulty. Contact with borrowers will however show that the lender is paying attention to their repayments. When missed payments are the consequence of a serious budget issue, a solution should be sought in collaboration with the borrower as detailed in the previous section.

Finally, when it appears that a borrower is willing to repay but cannot afford to do so and will not be able to do so in the future, the loan should be considered a loss. The **limits** of what can be achieved through support should be acknowledged, while bringing borrowers to court should be restricted to situations where dishonest behaviour has been established.

### 3.7 Next step: piloting phase

The above recommendations are evidence based. However, they provide large scope for adaptation to the constraints of the various stakeholders. Therefore, in order to reach a detailed plan for a Irish personal microloan scheme, it is highly desirable to pilot such a scheme.

Such a pilot should take place in a variety of areas, including a rural area, a middle-sized town, suburbs and a big town, where access to a moneylender is high or where a significant part of the population is at risk of poverty. Such variety should allow understanding of existing local barriers and specific factors that should be taken into account before a national rollout of the scheme.

Crucially, such a pilot should also involve an evaluation process, from its beginning, in order to make sure that all valuable insights are gathered and taken into account.
Conclusion

Borrowing money is often unavoidable when living on low or moderate income. Having to deal with a stagnant level of income while the costs of essentials (such as rent and electricity) are constantly rising puts household budgets under pressure. Making ends meet and dealing with unexpected expenses become a real challenge. In these situations, some people might borrow money from a credit union, their relatives or a moneylender, or they might accumulate arrears. As the interviews have shown and as Salter (2014) observed, different debts impact the lives of those experiencing them in different ways. Therefore, as long as adequacy of income is not achieved, it is a social policy requirement to ensure that appropriate sources of credit are available for those who are most in need.

The aim of this report was to assess the feasibility of a personal microloan scheme providing access to affordable loans for households excluded from mainstream or credit unions loans. In that respect, particular attention has been paid to the needs of these households, as well as to insights from existing schemes abroad.

Before summarising what could be the main characteristics of such a personal microloan scheme, three key guidelines have to be underlined.

First, the scheme’s aim – or aims – has to be clearly defined. As set out in this report, these aims are: to provide affordable loans to low and moderate income households; to deter them from moneylenders; to prevent or tackle excessive indebtedness; and to contribute to borrowers’ broader financial inclusion. Having a clear understanding of what the scheme is trying to achieve is key to choosing the right characteristics of the scheme, such as lending through the credit union movement, as well the microloans themselves, such as almost no eligibility restrictions except being able to repay the loan. It also plays a key role in how the scheme’s activities will be monitored and its continuous improvement achieved.

Second, it is of paramount importance to put borrower needs at the heart of the scheme’s design. Providing affordable loans to low-income households is a real challenge. It is risky. It is costly. It is complex. Therefore, it is tempting to give more weight to others stakeholders’ constraints when designing the scheme. Letting lenders’ constraints lead the design of such a scheme, however, is likely to lead to it underperforming or failing, as the rationale for a personal microloan scheme is grounded precisely in the current lenders’ inability to serve these borrowers due to their constraints or unwillingness. While realistic choices have to be made in order to ensure that the scheme is sustainable, it has to meet the needs of its target audience in order to be successful. To do so, particular attention should be paid to the budgeting habits of potential borrowers – managing money in cash on a weekly basis – as well as to the emotional dimension of borrowing – the financial stress people are experiencing as well as the stigma attached to debt.

Finally, the third guideline involves considering the personal microloan scheme as a learning process. It is unlikely that its design will be perfect from the start. Therefore, it is
necessary to have flexibility in place, with the ability to adjust the scheme to meet unanticipated needs of borrowers, as well as the ability to identify such needs, through the continuous evaluation of the scheme.

Recommendations

On the basis of these guidelines, the following recommendations are made.

Role of credit unions

The personal microloans should be provided by the credit union movement as they already have the necessary infrastructure, as well as the ability and willingness, to provide such loans. Credit unions would also allow broader financial inclusion through their other financial services.

Lending through the credit union movement would prove more efficient than setting up a new type of lender or public loan fund. The following are some features of this approach.

- Lending requirements would be simplified to suit the target audience profile.
- Each participating credit union would set up its own loan fund.
- A cap would apply to the amount that each credit union can lend through the scheme (a percentage of their assets).
- The definition of the ‘common bond’ might need to be extended in order to ensure appropriate geographic coverage.

Outreach

Outreach should be achieved by: working in partnership with trusted organisations (such as An Post, MABS, Saint Vincent de Paul); advertising the scheme in relevant media; and setting up a customer-friendly national website.

Financial Inclusion Fund

A Financial Inclusion Fund should be set up with the aims of:
- guaranteeing 50% of the personal microloans;
- providing capital to improve stakeholders’ infrastructure and human resources;
- providing revenue to cover part of the administrative costs of running the programme; and
- funding an ongoing evaluation that measures impact and efficiency.

Independent body

An independent body should be set up, in charge of:
- managing the Financial Inclusion Fund;
- managing the scheme by: contracting stakeholders; training them and coordinating them at local and national level; monitoring stakeholder activity; and promoting financial inclusion at local and national level.
The personal microloan

The ‘personal microloan’ would range from €50 to €2,000 and would have an APR between 12.68% and 26.8%. No profile eligibility criteria would apply except the ability to repay the microloan and being excluded from mainstream or credit union loans. People in arrears or anticipating to be in arrears would be eligible.

All purposes would be eligible including debts. However, when the amount of debts funded would be over €1,000, MABS support should be requested. In order to increase the relevance of the response provided to the borrower a second complementary type of loan should be envisaged: the ‘consolidation microloans’.

A complementary alternative: the consolidation microloan

The complementary type of loan would be the ‘consolidation microloan’. This would deal with debt between €1,000 and €25,000. People could apply regardless if they are in arrears or not. The consolidation microloans would be an early step to avoid the borrowers’ financial situation deteriorating further with the risk of ultimately having to apply to the Insolvency Service. Both debtors and creditors would benefit from this early response.

The assessment of the situation of these borrowers would be carried out by MABS on a mandatory basis and the microloan would be granted only if significant write-off could be negotiated with creditors (at least 40% of the debt). The interest rate would be as low as possible and the 50% guarantee from the Financial Inclusion Fund would apply.

Costs

Both types of loan would come with no cost to the borrower except the interest rate. No collateral and no savings requirements would apply. Similarly, no fees would be charged in the case of a missed payment. A large range of financial responses would be available to ensure that the repayments remain sustainable for the borrowers (such as reducing the repayments and implementing a moratorium). In the case of a borrower being unable to continue to reimburse the microloan, the remaining amount to be paid should be written off. Court procedures would apply only when clearly dishonest behaviour has been established.

Repayments

The frequency and nature of repayments should meet the needs of borrowers.

- Repayments could be made on a weekly, fortnightly or monthly basis, depending on the borrower’s budgeting cycle.
- Repayments could be made in cash (for example, at the lender’s office or the post office), by direct debit or by direct deduction. Regarding direct deduction, it should only be made possible through a borrower’s explicit request and if protective
procedures are in place (such as the possibility of having the repayment paid back in case of financial hardship).

**Subsequent borrowing**

Subsequent borrowing should be possible but only one personal microloan should be active at a time. Early repayment should be possible at no cost.

**Application process**

Considering that the profiles and needs of borrowers will potentially vary and in order to ensure that the personal microloan scheme proves efficient and generates a high level of take-up, several options have been considered regarding the application process. These options are complementary. They provide appropriate responses to the potentially heterogeneous demand for personal microloans.

- **Application process: The main option**

  Under the main option, borrowers would apply for a personal microloan to their local credit union. The assessment would take place during a face-to-face meeting. If debt issues are detected but the microloan amount is under €1,000, the lender would make the decision to lend themselves. However, they would be entitled to request MABS’s expertise. Whatever the purpose of the loan, the support from a third party (such as an NGO or MABS) would be possible at each stage of the procedure.

- **First fast track option**

  Borrowers in receipt of social benefit and who are willing to borrow less than €1,000 would be eligible to manage their repayments by direct deduction through the Household Budget Scheme provided by An Post. No assessment would be required by the credit union, which would grant the loan as all direct deduction taking place through this scheme cannot exceed 25% of the amount of social benefits paid.
**First fast track option**

- Fast track option 1: If in receipt of social benefits and loan $\leq 1,000$
- HBS* An Post
- Personal microloan

**Second fast track option**

Borrowers with a higher level of income and with a current account might not have access to mainstream or credit union loans due to lack of or poor credit history. Others with the same level of income and of financial inclusion might feel uncomfortable applying for a loan at a credit union. In order to help these borrowers access the personal microloan scheme and avoid borrowing from a moneylender, an online channel would be available. Potential borrowers would be able to apply online through a customer-friendly national website. Successful applicants would have no contact with the credit union while unsuccessful ones would be provided with all relevant information to meet with either their local credit union or their local post office if they are eligible for the Household Budget Scheme.

*Household Budget Scheme*
The alternative option

Borrowers looking for a loan of more than €1,000 in order to fund debts should not have access to the personal microloan scheme. They would be channelled to the consolidation microloan process, which requires a detailed assessment of their situation by MABS workers and negotiations with their creditors in order to reduce their debt.

*Household Budget Scheme
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With the support of the Aquitaine Region