Regulatory business plan

2009 – 2014

FIRST DRAFT 2nd April 2009

(without appendices)

Abbreviations used

ABCUL	Association of British Credit Unions Limited
CABx	Citizens Advice Bureaux
CBA	Community Budgeting Account
DWP	Department of Work and Pensions
KCC	Kent County Council
KCU	The Kent Credit Union (proposed)
KMFIP	Kent & Medway Financial Inclusion Partnership
RSL	Registered Social Landlord (e.g. Housing Associations)

Contents

List of tables

List of Appendices

1. Executive Summary

There is a real need for a credit union to cover the whole of Kent & Medway. Perhaps as many as 80,000 people may be relying on Home Credit with up to £19m leaving our poorest communities in excess interest payments, when compared to a credit union loan.[1] With the availability of credit becoming more restricted more residents may be making the move to high interest loans.

However a loan portfolio based disproportionately on high risk lending may act as a barrier to financial sustainability within a period that would be acceptable to Kent funders and investors. The Kent Credit Union (KCU) will balance its social and financial objectives by offering a 'product mix' attracting residents from all economic backgrounds.

There is an overview of products at Table 8.1. Tables 9.2.1 and 9.2.2 show the portfolio mix.

The KCU will offer a service to all residents in Kent and Medway, although local delivery will be dependent on funding arrangements and partnership working with the existing credit unions. Our partnership work with Registered Social Landlords (RSLs) will bring the service closer to social tenants, especially during the first three years of operation. Payroll Deduction schemes will be established with larger employers and support packages agreed with corporate sponsors.

An overview of principal partnerships is shown on diagram 12.1.

Our services are designed to meet a range of financial needs and will be offered in the context of a Community Finance Partnership (CFP) that delivers the **A**dvice, **B**anking, **C**redit and **D**eposits approach to financial inclusion. Key to this approach will be the Community Budgeting Account (CBA), enabling a full bill and debt management payment service to be offered to our members.

Details about the credit union's work to tackle financial exclusion can be found at section 4.

The credit union needs to raise up to £500k of revenue to run the organisation over a five year period. A further £150k of lending capital will help the organisation expand its business quickly and protect against the cost of delinquency during the critical first years of delivery. We aim for financial sustainability by October 2014 (assuming an October 2009 start) with ninety percent of costs being met by earned income during year five.

Table 1.1 : Summary facts and figures

	Year 1	Year 2	Year 3	Year 4	Year 5
Total members	400	1,100	2,000	3,000	4,200
Total shares	£250,000	£750,000	£1,125,000	£1,750,000	£2,500,000
Value of new loans	£365,000	£675,000	£890,000	£1,100,000	£1,400,000
Value of loan book	£265,000	£745,000	£1,135,000	£1,500,000	£2,000,000
Annual loan income	£30,000	£90,00	£125,000	£165,000	£195,000
Funding needed	£150,000	£100,000	£90,000	£70,000	£60,000
Cumulative reserves	£65,000	£70,000	£75,000	£90,000	£105,000

[1] There are 3m regular users of the alternative credit market country wide (HM Treasury 2004), up to 1.15m have no other credit options available to them according to the Competition Commission Home Credit Inquiry Final Report (2006). Using simple population data the proportion of home credit consumers in Kent may be 2.5% of this total. If a credit union loan costs £235 less than a similar loan from Provident Personal Credit the savings could be £18.8m.

2. Mission statement and overall objectives

***Our vision** is for the credit union to offer a high quality, community focused financial service for all residents of Kent*.

The Credit Union will combat financial exclusion by working in partnership to provide sustainable access to safe savings and affordable loans for all those living or working in Kent & Medway.

To help us achieve this mission, the Credit Union will:

- *Provide a range of financial products* for every income group, including a bill payment service, insurance, savings and loans accounts

  See table 8.1 for an overview of the loans products the KCU will offer.

- *Contribute to economic recovery* by encouraging financial prudence, incentivising borrowers to become regular savers and promoting financial capability in everything we do.

  See section 11 for details of the Community Budgeting Account (CBA).

- *Lend prudently* by offering loans only to those who can afford to repay them, working closely with other agencies to offer access to debt advice when needed.

  See section 8 for details of the loans products the KCU will offer.

- *Offer a social and financial return* for individual, community and corporate investors with a range of accounts that offer competitive rates of interest, using deposits for the benefit of local residents.

  See table 10.1 for an overview of the proposed savings products.

- *Work in partnership with local communities* and other statutory and non-statutory organisations to provide cohesive solutions to financial exclusion, combating poverty and improving financial wellbeing.

  See diagram 12.1 for an overview of our principal partnerships.

3. Membership and common bond

It is proposed that the qualification for admission to membership of the credit union shall be *"residing in, or being employed in, the Kent ceremonial areas as delineated in red on the map in appendix 1 so that in consequence thereof there shall be a common bond between all the members."*

The population of Kent plus Medway is 1.6m with almost one quarter of the population being under the age of 18 and therefore not eligible to take out loans with a credit union, but being able to save with one (and have a greater involvement in the organisation under the new regulations see section 18). Over 50,000 people travel into the county on a regular basis.[2] **The total of adults eligible to join a Kent Credit Union would be approximately 1.3m**. This common Bond would be sufficiently diverse to sustain a large membership across a range of low to middle income levels.

[2] Research and Intelligence Team (2007) *The Annual Business Inquiry* Kent County Council

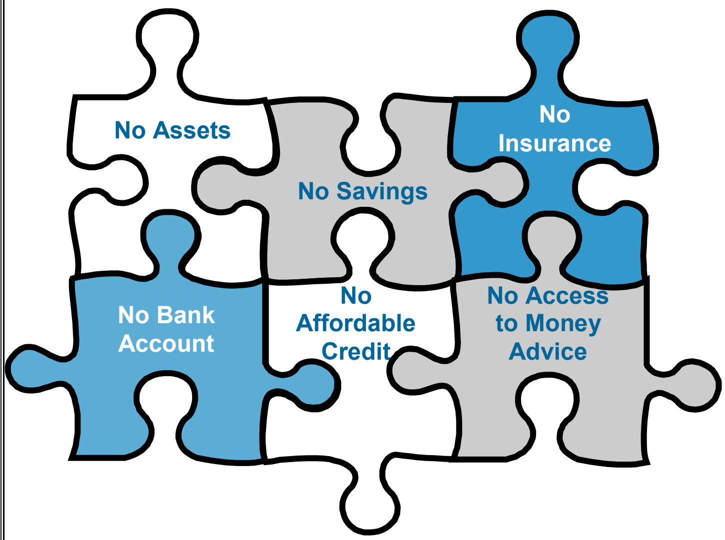
4. Assessment of need

The government's financial inclusion agenda has heavily influenced credit union direction, especially since December 2004. Delivering to this agenda will be an important way of ensuring that the credit union meets its social objectives and provides a number of funding opportunities. However developing a sustainable credit union requires a mixed membership and it will be important to assess the need for particular financial services in relation to the wider population. The aim is to generate sufficient surplus from more 'mainstream' lending (of £1,500 and above) to offer both a return to investors and to subsidise products offered to higher risk borrowers. The reality being that *we do not expect to generate an overall profit from lending members under £500.*

Tackling financial exclusion

We want the credit union to be part of a wider Community Finance Partnership (CFP) that delivers the **A**dvice, **B**anking, **C**redit and **D**eposits approach to tackle financial exclusion. The characteristics of financial exclusion have often been summarised as in diagram 4.1:

Diagram 4.1: Indicators of financial exclusion

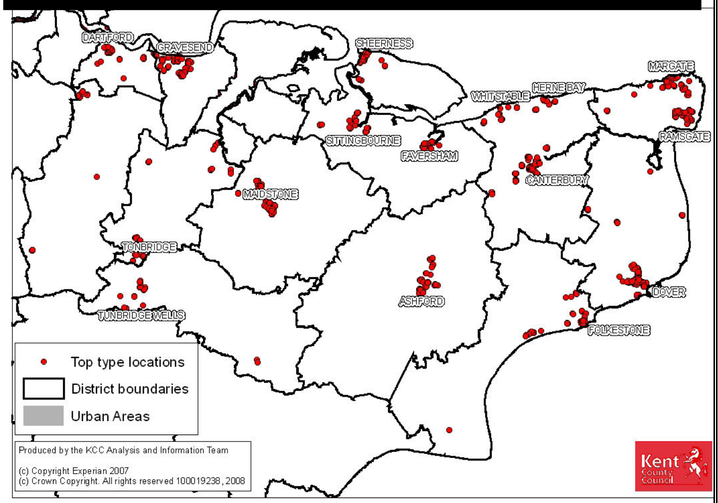


Advice. We expect that up to half of all 'subprime' loan applicants will be turned down because there is an underlying debt problem. With an economic downturn this proportion is likely to be significant for all medium and lower risk borrowers too. A tracking exercise at East Sussex Credit Union revealed that members who have their applications rejected find it difficult to access advice services, often borrowing from high cost lenders instead.[3] *Kent County Council (KCC) has committed £250k to fund Kent Citizens Advice Bureaux (CABx) to deliver money advice services.* Funding arrangements will include a commitment to refer to credit unions and consider the prioritisation of credit union debts. KCU will refer a number of unsuccessful applications to CABx.

Banking. Mosaic analysis by KCC has identified a number of household types that are likely to have poor access to banking and other financial services. The top nine household types to face such financial exclusion are detailed in appendix 2. There are approximately 40,000 such households and the map opposite shows their geographical distribution.

KCU will therefore offer a Community Budgeting Account with a bill payment facility to address this need. More detail is given in section 11.

Map 4.1: Lack of access to a bank account



[3] Pascoe Pleasence and Alexy Buck, Nigel Balmer, Aoife O'Grady, Hazel Genn, Marisol Smith (2001) *Causes of Action:Civil Law and Social Justice* Legal Services Research Centre

Deposits. Although recent evidence had suggested that UK households were saving the least for a generation, saving as a proportion of monthly income has recently jumped from 1.7 percent in July – September 2008 to 4.8% to December 2008.[4] This suggests that savings made, for example due to falling mortgage rates, are not being used to increase spending power but that more households are saving to mitigate against the financial risks they face during an economic downturn.

With interest rates so low borrowers are looking around for the best savings deals and this does create a very competitive market, but a marketing campaign which emphasises the ethical nature of a credit union investment and addresses concerns about the safety of financial institutions could assist the credit union's capitalization

If KCU is to promote financial inclusion it will do well to make good use of the partnerships that are being developed with RSLs, because up to 40% of social tenants may have no savings to fall back on.[5] Research has suggested that the **Savings Gateway** may provide an excellent opportunity to encourage asset based welfare, especially amongst social tenants.[6]

An Association of British Credit Unions Limited (ABCUL) **Feasibility Study** in July 2008 identified a clear need and strong demand for a credit union service - especially for lower income households. Consultation found nearly unanimous in-principle support from all those key individuals interviewed as part of the research. ABCUL also received many offers of practical support in setting up and running the credit union. The study carried out extensive consultation of potential service users and partner agencies and found widespread support for a credit union and identified several ways for it to fit in with other organisations services, for example:

- Gravesham Borough Council (Housing) would like to encourage members to join the credit union at tenancy sign up.
- Dover District Council would like to ensure that the credit union forms part of their wider financial inclusion strategy.
- Several CABx have identified a role for money advisers as 'credit union champions.'
- The existing credit unions offer local knowledge and an active existing membership and they recognise the funding opportunities a Kent-wide credit union could attract.

<u>The geography of financial exclusion in Kent</u>

Within Kent there are some real areas of deprivation, mainly located around the coast and including – but not limited to – The Isle of Thanet, and Dover. In fact, ten of the twelve local authorities in Kent moved up the deprivation ranking between 2004 and 2007.[7]

10 of the 12 local authorities in Kent have moved up the deprivation ranking since 2004

Research by the DWP has identified three 'amber' areas in the proposed common bond they are; (with DWP identifiers) **Gravesham** (52), **Swale** (76) and **Dover** (64).[8] These areas have

[4] Daniel Pimlott and Elaine Moore (2009) *Households rush to build up rainy day cash* <u>The Financial Times</u> March 27th
[5] Nick Powell (2008) *The Saving Gateway: operating a national scheme. Response to HM Treasury consultation* <u>National Housing Federation</u>
[6] Elaine Kempson, Stephen McKay and Sharon Collard (2005) *Incentives to save: Encouraging saving among low-income households: Final report on the Saving Gateway pilot project* <u>Personal Finance Research Centre, University of Bristol</u>
[7] Analysis & Information Team (2008) *The Pattern of Deprivation in Kent based on The Indices of Deprivation 2007* <u>Kent County Council</u>
[8] HM Treasury (2008) *Financial inclusion: the way forward*

been identified as a) having a high level of households living in financial distress and b) having no current credit union coverage.

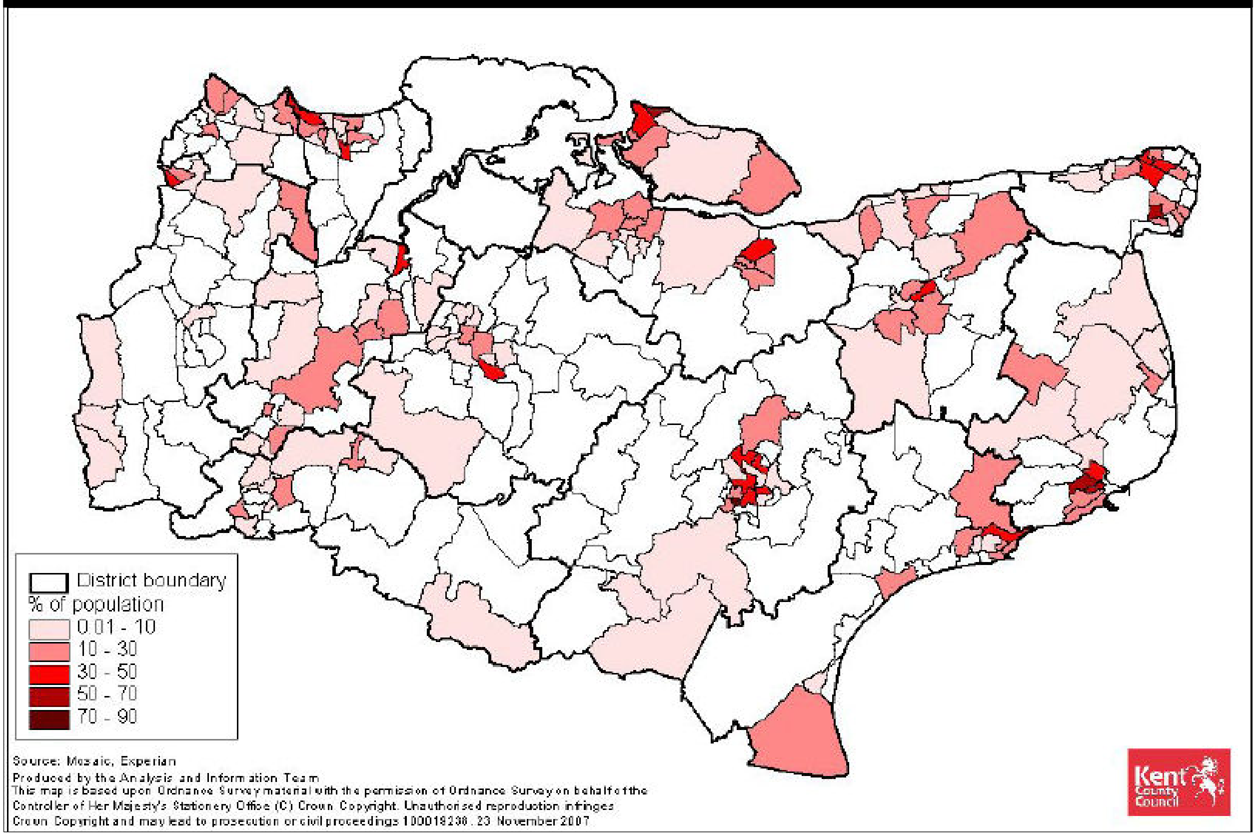
Given that up to eighty percent of households facing financial exclusion will be social tenants[9] a mapping exercise of Registered Social Landlords has taken place and a list of RSLs the KMFIP will negotiate with are given in table 16.1.2. Naturally the social tenancies overlap with the areas of deprivation and many of the Mosaic household types will be social tenants.

A wider need for financial services

At the heart of the business plan is the need to create a balanced mix of credit union members and the current drop in mainstream lending activity does present opportunities for a new credit union to lend to lower risk borrowers.

Research from the Bank of England shows that the availability of unsecured credit to households continues to contract with lenders suggesting that this trend will continue throughout 2009. Risk aversion, tougher credit scoring systems and higher rejection rates characterise the market and although demand for unsecured credit has fallen slightly, availability of credit has fallen at a much quicker rate, suggesting that there is a reasonable pool of medium risk borrowers for the credit union to lend to. [10]

Map 4.2: Mosaic analysis: densities of households facing financial distress



[9] Transact (2007) *Making the link: The business case for social landlords investing in financial inclusion* Toynbee Hall
[10] Bank of England (2008) *Credit Conditions Survey* Quarter 4 Annex 2

5.1 Operating environment – STEP analysis

Sociological

Kent is a prosperous county which makes a net contribution to the treasury and is home to a number of large employers. The county is ranked 104th out of 149 local authorities in England in terms of deprivation, but there is much urban and, in particular, coastal poverty. In Thanet, deprivation has increased significantly since 2004 and the area is ranked 65th out of 354 local authorities in England – up twenty places.[11]

The deprivation rank of Kent districts illustrates the extreme social and economic differences across the county. Thanet is within England's top 20% deprived and Sevenoaks is within England's least 20% deprived.

KCU's product mix will be offered at different intensities in different areas. The DWP has recognised a particular need to run a service in Gravesham, Swale and Dover and our initial geography could be characterised by this and similar funding, for example by locating services in areas where we are working with RSLs.

However, we also understand that the economy is shrinking and that means new groups of residents are coming under financial stress. Our marketing strategy and product structure will allow for these changes with a wide service offering for all socio-economic groups, although those in group 'A' may only be expected to contritute as part of our champions inititiave: see Diagram 12.1.

Technological

There are a range of recent developments from which the credit union could benefit. Moreover it is clear, given the potential funding constraints that we need to *keep back office costs as low as possible.*

In order to service such a large common bond we will be using an internet based platform called **Progress**. An initial project meeting with the software providers has demonstrated that there are a range of benefits including a document management system. Its integration with Sage Accounts will ensure better reporting and auditing. To facilitate payments-in we will be using standing order and the Pay Point network and we are exploring the use of a Kent County Council payment card. The Community Budgeting Account is explored in section 11.

Progress is fully integrated to the Co-operative Bank – our preferred banking supplier. The software offers a full case management approach to credit control and when integrated with a website can offer online account information, loan application and share withdrawal facilities.

If we are able to secure Growth Fund support the credit union may have early access to a new credit assessment tool being negotiated between ABCUL and Experian. This could present the credit union with very sophisticated credit assessment and fraud avoidance tools that will help Loans Officers better manage lending risk. Progress fully integrates with these 'shared system' credit assessment data enquiry tools.

Economic

Undoubtedly there are tough times ahead for the UK economy. With sub prime lending being a major contributory factor in the downturn, lending to higher risk borrowers must be only one part of the credit union offering. Our **portfolio mix** suggests that by year five we will have built enough capital to increase lending to the better off with higher value, lower risk loans offering an increased return. As a mutual these profits will be used for our member's benefit principally through a series of subsidies to fund higher risk lending.

[11] Analysis & Information Team (2008) *op.cit.*

A significant proportion of the credit union's initial membership will be social tenants. Although a reasonable proportion of such households will be economically inactive, many will be working in the service and construction industries which are being hit hard by the recession. For this reason we are looking to protect the interests of the wider credit union membership by *raising funding from RSLs so the costs and risks of such lending can be shared.*

The downturn does offer the credit union some opportunities. Insufficient liquidity means many consumers are being turned away even though under normal circumstances a bank would lend them money. KCU will need to ensure that these low and medium risk borrowers will find our offering attractive. *Critically many of these prospective members will have become net borrowers over the last decade and loan products designed for this segment will include an element of compulsory saving.*

In the run up to the April G20 meeting in London, Lord Malloch Brown warned that western consumers might have to get used to living "within their means". "You are just going to see... a recalibration of lifestyles - a whole vision in the future of a world driven less by consumerism".[12] Together with a more cautious approach to lending being taken by other financial service providers, it may be inevitability that consumer lending will fall – leading to a decrease in demand for a credit union loan.

Political

The change to regulations will offer a range of benefits to the KCU – in fact many of its basic presumptions are made on the basis of new services such as offering interest bearing and corporate deposit accounts.

Funding is another key concern. Whatever its merits the strategy of economic recovery through increased spending is not currently funded out of general taxation. Either taxes will need to increase or government expenditure reduced with the most likely outcome being a combination of both. On the one hand funding opportunities may flourish as part of the spending plans but on the other they could diminish should regeneration projects be scrapped.

Ongoing help will also depend on the political will of the government to continue to support credit unions. The Conservative spokesman for social inclusion, Iain Duncan Smith, has spoken of his party's enthusiasm for the credit union movement although he is last on record giving such assurances sometime before the current economic crisis.[13]

The **key to helping the credit union move from aspiration to reality has been KCC**. An initial investment of £100k development funding has been followed with a further £250k which provides a sound starting base both to trade and lever in other funding, including from the District Councils. Further in-kind support has been given through officer time, including development, legal, administrative and marketing assistance. An initial Supervisory Committee of three persons has been appointed. Two have relevant experience working as Trading Standards Officers at KCC, and one has experience working in internal audit at KCC. The credit union will also make use of the KCC contact centre. The council is the largest local authority in England covering an area of 3,500 square kilometers. It has an annual expenditure of over £2bn and a population of 1.3m. KCC is a CPA rated 'Excellent Authority.'

[12] Gaby Hinsliff & Zoe Wood (2009) *Alistair Darling to give budget cash boost to poorest* The Observer 29th March p. 1
[13] ABCUL (2008) *Credit Union News* September

5.2 Operating environment – SWOT analysis

Strengths

- A message of mutuality and prudent lending could work well given the causes of the current financial crisis.
- We have a strong level of support from KCC who have provided development funding, initial capital, lending capital and revenue funding.
- The credit union will offer a product mix of financial services that are attractive to all socio-economic groups.
- The credit union will launch with £60k of initial reserve capital.
- Strong ICT with Progress, text messaging, mobile outreach and the KCC contact centre
- A good working relationship with the existing credit unions which could lead to wider geographical access

Weaknesses

- The credit union 'brand' is a weak one with low levels of public awareness.
- A smaller organisation may seem financially vulnerable and potential investors may be reluctant to save with us.
- There is not enough funding in place – at this stage - to cover all the five year costs.
- The interest rate cap of 2% is not sufficient to cover operating and bad debt costs for smaller sized loans.
- The economic difficulty may make it harder to obtain funding from RSLs and District Councils.

Threats

- A recession increases bad debt, especially when jobs are at risk
- The Post Office could be rebranded as a 'People's Bank' lending to people on low incomes, moving into the credit union's natural market. But could the government afford to take on such a project?
- There is evidence that households are taking a more cautious approach to borrowing. This could reduce short-term demand for credit union loans.
- New regulations may not allow the credit union to offer interest on savings from day one of operation.
- New regulations may not be in force by October 2009
- Insufficient funding may lead to the FSA delaying authorisation

Opportunities

- New regulations offer a range of opportunities especially the ability to offer interest on savings and accept corporate deposits.
- The financial downturn creates an aversion to familiar financial institutions and a market opportunity for a new mutual.
- The Gateways and Progress software offer an excellent location and tool for outreach.
- Partnership working with the existing credit unions could bring an increased range of services to existing credit union members
- A partnership approach with Kent Citizens Advice and other money advice agencies offers a joined up solution to financial inclusion

6. Regulated activities

The financial downturn has shown how important it is to have a good capital base to lend from. The credit union will start trading with an immediate allocation of £60k to reserves. Over the following five years this will be increased by £45k. During the summer of 2009 the KMFIP may negotiate interest free subordinated loans to **improve our capital position**.

See table 1.1 for the growth in credit union capital.

Our aim is to compliment shareholding with corporate deposit taking and funded lending capital. This will allow us to retain good **liquidity** on individual investments. An offering of notice accounts, including a twelve month bond will also help us manage liquidity and interest rate risks.

Table 6.1: Liquidity

	Year 1	Year 2	Year 3	Year 4	Year 5
Liquidity	70%	74%	74%	74%	70%

We are aware of the concerns raised by the FSA in relation to **corporate governance** in credit unions. We will adapt the ABCUL good governance recommendations and recongise the importance that boards can share a common vision for the credit union and that directors receive adequate training and support to fulfill their roles. [14] We have appointed a shadow board and the proposed directors' CVs can be found in appendix 3. The board met for the first time at the beginning of April and has commenced a training and induction programme and will be leading on the credit union delivery plan whilst our application is with the FSA.

Staff will be trained on an annual basis in relation to the **prevention of money laundering**. Unlike many credit unions, the proposed Kent Credit Union will be largely cashless. Deposits will only be made by standing order, online banking, payroll deduction, Pay Point and the Community Budgeting Account. Of course money laundering is not a cash only process and we will use the Progress software system to create Know Your Customer records to identify and report unusual transactions.

We will go beyond the basic advice required when issuing loans to members. Our marketing and application materials will make the terms and conditions of credit union loans very clear – being the large, rather than small print, in our agreement. Some loans may only be granted where the member has received **independent and impartial advice**. We will receive support from KCC to develop an effective and robust complaints procedure and all staff will be trained, before the credit union opens, on the Treating Customers Fairly regulations.

Key to meeting our regulatory requirements will be the production of **effective management information.** In addition to reporting on regulatory areas such as solvency, liquidity ratio and the capital to assets ratio, directors and staff will review a range of performance indicators to track progress in meeting the objectives of this business plan. Our MI will use a traffic light system to highlight and report key facts and priority issues whilst recognising a need to report on more ad hoc issues. See appendix 7 for sample Management Information

To mitigate key person risk different staff and directors will be responsible for collating MI which will then be reviewed by the **supervisory committee.** The initial committee will include two people who have relevant experience working as Trading Standards Officers at KCC.

[14] FSA (2007) *Corporate governance in credit unions* Small Firms Team

7. Evaluating and managing key risks

Excessive loan delinquency leading to insolvency is the key risk the credit union faces as it launches during a recession in a country where a significant proportion of households are over indebted. The Consumer Credit Counselling Service has reported a significant decrease in the number of people who can offer anything but token repayments to the creditors.[15] Citizens Advice has recently reported than almost 60% of their money advice clients could offer no money to their non-priority creditors.[16]

We will launch the credit union with initial reserves of £60k. Over the initial five year trading period a further £45k will be allocated to reserves. We may also raise capital through interest free borrowing in the form of subordinated loans.

The credit union will use Progress software to manage its loan arrears and employ a **paid Loans Officer with a credit control function** (and administrative backup) to manage delinquency. Progress allows for text messaging reminders and the credit union will operate the Community Budgeting Account and payroll deduction services to ensure effective repayment of credit union loans, by receiving benefits and salaries direct into member accounts.

Offering interest to members offers real opportunities for credit union growth, but it is not without risk. KCU is proposing to offer loans of moderate value and it will need to raise lending capital to achieve this goal. Whilst the DWP and RSLs are other potential sources of lending capital, such funding arrangements can skew the business to the needs of lower income borrowers. Whilst we are aiming to offer a service to higher risk consumers, KCU's focus will remain medium risk borrowers and so **raising sufficient share capital is a key challenge**.

To help us manage demand for different savings accounts we will offer **limited issue bonds** and tracker accounts. Whilst fixed-term bonds that are offered at a time of rising interest rates have the potential to generate a small surplus for the credit union, the margin on a tracker account will be very small. Rising interest rates could begin to cost the credit union more than anticipated and we will need effective management information to monitor savings growth and projected returns required for investors.

We will also mitigate the expense of good returns for our savers by offering a dividend-only account. As the dividend will not be more than one percent (subject to the new regulations allowing for the credit union to offer interest on savings) this is an attractive way for a potential supporter to indirectly donate to the credit union. Similar **indirect donations will be sought from the corporate sector** with our corporate deposit account offering a financial return to local companies but this return would be shared with the credit union. See table 15.4 for an overview of how the corporate deposit account might work.

Disaster recovery

The Credit Union will have an emergency kit, stored off-site, which will include:

- Contingency plans
- Names, addresses and telephone numbers of credit union officers
- Insurance policy
- Tenancy agreement
- Credit union letterhead
- Up-to-date backup copy of computer software and files
- Details of alternative accommodation

[15] Consumer Credit Counselling Service (2007) *Statistical Yearbook* CCCS
[16] Citizens Advice (2009) *A life in debt: The profile of CAB debt clients in 2008* National Association of CABx.

Table 7.1: Summary of key risks			
Risk	**Mitigating action**	**Priority**	***Linked documents***
Adequate resources			
It is recognised that the credit union will require external funding for five years. *There is a risk that we will not be able to obtain sufficient funding to 'pump prime' the credit union's development.*	• Kent County Council have allocated £250k start-up funding to the credit union • We will use an investment prospectus to attract funding from Registered Social Landlords and corporations • A shortlist of other funders will be drawn up and we will agree in principle funding arrangements • A charitable company has been set up to increase the funding options available • Negotiations have opened with the Growth Fund	High	*See Supplementary document 1 for the prospectus* *See section 16 for the funding shortlist and details of confirmed supporters* *See table 16.1.1 for a potential DWP tender*
There will be a tapered approach to our funding, with 75% of external investment being spent within the first three years. *There is a risk that the credit union will not be able to generate sufficient income from its trading activities.*	• The credit union will have a balanced portfolio including a significant number of more profitable loans • We have triangulated the pricing of our loan products using two different costing models and a market analysis • External support for a professional marketing campaign is being sought • Interest rates are used to balance lending risk and reduce the cost of bad debt	High	*See table 8.1 for an overview of the loans products* *See section 9.1 for the pricing and interest rate modeling* *See section 13 for the marketing strategy*
The credit union can trade from a position of strength if it has sufficient reserve capital. Without this capital *there is a risk that the credit union will not be able to offer interest on savings.*	• Fundraising activities include requests to supporters for donations towards reserve capital • Financial plan aims to allocate a further £45k to reserves by the end of year five • Subject to changes in regulations the credit union will offer competitive rates of interest to its savers	Medium	*See table 14.1 for the financial overview* *See section 18 for an overview of proposed activities that require a change in legislation*

Risk	Mitigating action	Priority	*Linked documents*
In order to meet the earned income targets the credit union will need to grow its lending capital quickly. At a time of low interest rates *there is a risk that the credit union will not be able to attract sufficient savers.*	• Interest will be offered on all saving accounts • Fixed-term products to be offered to reduce the likelihood of early and unexpected withdrawal • Funding applications have been made for lending capital	Medium	*See section 16 for the fundraising strategy and successes to date*
Credit risk			
Establishing a credit union during a time of recession poses *significant risks in terms of ensuring that borrowers repay according to the terms of the loan agreement.*	• The credit union will use a full risk based scoring system to assess applicant's likelihood of repaying and fraudulent intent • Insight information will be used from a Credit Reference Agency information to confirm applicant's exposure to other debts and repayment record • The 'common bond' will be highlighted to encourage a moral response to demands for repayment • The credit union will employ a Loans Officer with a credit control function • Link repayments to the level of disposable income for that household as suggested by the ONS Family Expenditure and Food Survey	High	*See appendix 4 for an overview of the credit scoring system to be used* *See appendix 5 for loan affordability indicators* *See appendix 6 for the Loans Officer Job Description*
Economic uncertainty exposes the credit union to concentration risks. The credit union must spread its risk amongst different borrower types to avoid reliance on the behaviour of particular socio-economic types.	The credit union will develop a <u>product mix:</u> • Smaller sized Instant Loans for those on the lowest incomes • Save as You Borrow Loans for people on medium incomes or payroll deduction • Larger sized Flexi-loans for higher earners	Medium	*See table 8.1 for an overview of the loan products to be offered* *See graphs 9.1 and 9.2 for the proposed portfolio balance in years 1 - 5*

Risk	Mitigating action	Priority	*Linked documents*
A less predictable revenue expense is incurred each month as the credit union allocates money to provisions against the future cost of loan write offs. *There is a risk that the credit union will not be able to meet these obligations to provide for bad debt.*	• Lending capital for higher risk loans may be provided by the DWP and other funders, including Registered Social Landlords • The revenue cost of bad debt provision and the risk of delinquency will be shared by these funding arrangements • KCU will budget for bad debt provisions and allocate any surplus to the General Reserve	Medium	*See section 16 for the funding strategy and details of confirmed supporters* *See table 14.1 for the revenue and provisioning forecasts and models*
Compliance and regulatory risk			
Key to the credit union's development plan is the proposed changes to legislation. *There is a risk that the new regulations will not develop in line with the credit union's expectations*	• Seek views within the sector on the business plan's interpretations of the legislative changes • Maintain a dialogue with the FSA to ensure mutual understanding of KCU's application of the new regulations • Produce contingency plans especially with regard to dividend and interest rate policy	Medium	*See page 18 for the changes to legislation required to meet KCU business objectives*
Those involved in running the organisation will be the key to its success. *There is a risk that the skill sets of the Directors and staff will not match the needs of the credit union.*	• Agree a skills match for board membership and recruit accordingly • Work with these directors on a shadow - task orientated - board in the six months before the credit union launches • Recruit staff, especially the General Manager, some months before launch	Medium	*See appendix 3 for details of the 'shadow board'* *See appendix 6 for staff job descriptions*
Poor performance management systems and reporting will prevent Directors from taking informed decisions, leading to an increased risk of *financial non-compliance*	• Establish a robust management information system based on best practice and discussion with the FSA • Ensure the purchase of technology systems appropriate to the credit unions current and future needs	Medium	*See appendix 7 for a sample performance management reporting system* *See section 12 for details of ICT arrangements*

Risk	Mitigating action	Priority	*Linked documents*
Liquidity risk. The credit union must ensure that it has sufficient liquid assets to meet a cash demand for 10% of investors' funds within eight working days.	• Raise the capital required to be able to offer interest on savings • Introduce fixed rate bonds to keep deposits locked into the credit union • Encourage investment under Corporate Social Responsibility programmes.	Medium	*See table 10.1 for details of the savings products to be offered* *See section 16 for details of the KCU approach to corporate supporters*
In the event of a serious disruption to services *there is a risk that the credit union would not be able to ensure the continuity of its business operations.*	• Ensure appropriate data back up and negotiate ICT support contracts • Develop a disaster recovery plan and ensure all staff and directors review on a regular basis	Medium	*See section 7 for details of the disaster recovery plan*
External risks			
Interest rate risk. If there is a mismatch between the interest we offer savers and the charges we make for credit, investors may deposit their money elsewhere and borrowers may seek better deals	• Raise £55k launch capital to enable the credit union to offer interest on savings • Offer variable interest rate and fixed interest rate savings accounts • Raise deposits from the corporate, statutory and housing sectors	Medium	*See section 10 for details of the savings products to be offered* *See appendix 8 for list of potential corporate depositors*
There may be a lack of knowledge about credit unions leading to a *poor take-up of the service*	• Ensure widespread and professional use of all marketing opportunities, including those available to KCC • Work with corporate partners to find in-kind funding to support marketing • Use partner agencies, especially RSLs, to contact those tenants most likely to face financial exclusion	Medium	*See section 13 for the marketing strategy*
If the economy continues to be in recession there is an increased risk that *loans will become unaffordable reducing successful applications or increasing delinquency*	• Ensure a balanced lending portfolio with a product mix lending to diverse socio-economic groups	Medium	*See table 8.1 for an overview of the loan products to be offered*

8. Loans products

There is more detail on loan product pricing and income generation in section 9.1. Table 8.1 gives an overview of typical loans, their key features and the credit profile of potential customers.

Instant Loans will be attractive to people who may otherwise borrow from higher cost lenders, such as home credit companies, catalogues, pawn brokers and cheque cashers. The key to success with this type of loan product for the potential borrower is likely to be ease of application, convenience of repayment and availability of further credit in the future. The potential borrower is unlikely to be price sensitive and the cash amount of the loan repayment will matter more than the interest rate.

Experience from the Growth Fund credit unions suggests that whilst some borrowers will become savers, a majority of the users of this type of loan product will choose not to save in the short-term and continuing education about the benefits of saving will be necessary, perhaps making the Community Budgeting Account an option to manage repayments, but only on the condition that the member saves. *On this basis it is anticipated that few Instant Loan applicants will migrate to the discounted rate.*

Save as You Borrow loans will be purchased by those with some access to credit however the reduction in lending by mainstream institutions and the increase in acceptance cut offs have all created a market for this group. Although such borrowers will be more price sensitive, they are also keen to have an easy application process, and reasonable certainty around approval rather than the lowest rate possible.

Creating 'employee benefit' schemes with major employers, particularly local authorities and other public sector employers can make this a very attractive proposition for employees as the repayments and savings deposits can be made direct from pay. Other working borrowers can access the loan, but applicants whose income is defined by an hourly rate rather than annual salary wages are more likely to be offered an Instant Loan.

See appendix 8 for an overview of larger employers to be targeted for payroll deduction.

The **Flexi-Loan** is designed to appeal to 'prime' borrowers who may have many other credit options available. This group is likely to be far more rate sensitive than the other two borrower groups. It should be remembered though that mainstream financial institutions are engaged in a 'flight to quality' only accepting top quality applicants. This means that the credit union could find itself in the position of having a higher level of medium quality applications than it might expect, and must therefore be careful with the balance between making loans and minimising bad debt levels.

Borrowers in this category are likely to have high expectations of the service they will receive, and the credit union can put in place measures which can help to achieve this. For example accepting online applications and making payment by BACS will be essential.

Table 8.1: Overview of Proposed Loan Products

Loan type	Key features	Your credit profile	APR	Typical loan	Compare us to …*
Instant Loan: *new member*	• Weekly repayments • Smaller sized loans • Pay at your newsagent and Post Office • Payment holiday • Daily interest	**(Poor)** you may: • Not be working • Be on a low income • Be a council or housing association tenant • Have had a past difficulty repaying credit	26.8%	£400 repaid at £8 per week for 57 weeks. Total repaid = £455	**Provident Personal Credit** *and save over £230!* £400 repaid at £12 per week for 57 weeks. Total repaid = £684. Typical APR 189%
Instant Loan: *member's rate* *(To qualify you must be a regular saver and / or have had a loan from us before)*	• Special discounted savers rate • Weekly repayments • Fair sized loans • Pay at your newsagent and Post Office	**(Poor)** you may: • Not be working • Be on a low income • Be a council or housing association tenant • Have had a past difficulty repaying credit	20.7%	£750 repaid at £16 per week for 52 weeks. Total repaid = £825	**Real Personal Finance** *and save almost £145!* £750 repaid at £18.60 per week for 52 weeks. Total repaid = £968. Typical APR 63%
Save as You Borrow Loan	• Save as you borrow • Monthly • Medium sized loans • Pay via your pay packet or standing order	**(Fair)** you may: • Be working • Be a tenant • Have had a past difficulty repaying credit • Have other loans	17.9%	£2,000 repaid at £98 per month for 24 months Total repaid = £2,335	**Welcome Finance** *and save nearly £1,000!* £2,000 repaid at £138 per month for two years. Total repaid = £3,312 Typical APR 69.6%
Flexi-loan	• Unsecured loan • Interest charged daily • No early repayment penalties • Payment holiday • Ability to overpay	**(Good)** you will: • Own your home on a mortgage or outright • Have an income of more than £20,000 • Have other loans, including credit cards • Have missed few or no payments on your other credit commitments	10.9% Variable	£4,000 repaid at £102 per month for 48 months Total repaid = £4,875	**The Co-operative Bank** *and save up to £625!* £4,000 repaid at £115 per month for four years. Total repaid = £5,500 Typical APR 17.9%

*Source: www.moneysupermarket.com accessed 18th January 2009

9.1 Loan book income

Critical to the credit union's success will be its ability to meet all its running costs, pay a competitive return to investors and build capital. Its main source of income will be the interest from its loan product range:

Table 9.1.1: Typical loans

	Instant Loan: New member	Instant Loan: Members' rate	Save as You Borrow	Flexi Loan
Typical APR	**26.8%**	**20.7%**	**17.9%**	**10.9%**
Credit score	*Very poor*	*Poor*	*Fair*	*Good*
Typical value	£400	£750	£2,000	£4,000
Repayment period[17]	57 weeks	52 weeks	24 months	48 months
Loan payment	£8	£16	£98	£102
Recommended savings payment	£2	£4	£11	£13
Year 1 income[18]	£54	£65	£240	£345
Total income	£55	£75	£335	£875
Bad debt	*9%*	*7%*	*3.5%*	*2.0%*

The typical APR may be increased to compensate for additional risk, but generally will be fixed according to the borrower's credit profile. APR for those with 'fair' or 'good' credit ratings is set largely according to market conditions. Smaller sized loan rates are far less than competitors are charging. Partly this is due to a legal maximum interest rate (2% per month) being applicable, but the credit union is also committed to tackling financial exclusion and reducing poverty and will therefore continue to offer loans at a comparatively low rate of interest.

Table 9.1.2: Income per loan versus cost per loan analysis

	Instant Loan: New member	Instant Loan: Members' rate	Save as You Borrow	Flexi Loan
Income	**£55**	**£75**	**£335**	**£875**
Application (45 mins)[19]	£45	£45	£45	£45
Disbursement (15 mins)	£15	£15	£15	£15
Repayment and admin	£10	£7	£5	£10
Insurance	£2	£4	£22	£65
Credit control	£60	£30	£15	£15
Write offs	£36	£53	£70	£80
Total costs	*£168*	*£154*	*£172*	*£230*
c) Profit / loss	***-£113***	***-£79***	***£163***	***£645***
Number of loans for £1,000 'profit'	0	0	6	2

[17] The higher risk Instant Loans are designed for members with a weekly income cycle and are repaid weekly. Save as You Borrow and Flexi Loans are designed for salaried members and the repayments would, normally, be monthly.
[18] This is the income for year one of each new loan issued.
[19] Analysis for higher risk loans could be through interview and for lower risk (but higher value) loans it is presumed that Credit Reference Agency Insight data and scoring are used to assess loans to ensure a quick turnaround in 45 minutes.

Notes to table 9.1.2: *The costs for application and disbursements are based on £60 per hour staff time. Repayment and admin are largely based on the term of the loan, but there will be higher transaction costs for the smaller loans which are more likely to be repaid via Pay Point or the Community Budgeting Account. Credit control intervention is based on an average of one hour per loan for the highest risk borrowers and 15 minutes for the lowest risk loans.*

Table 9.1.3: Interest based cost analysis

	Instant Loan: New member	Instant Loan: Members' rate	Save as You Borrow	Flexi Loan
a) Interest rate	**26.8%**	**20.7%**	**17.9%**	**10.9%**
b) Variable costs	33.0%	13.5%	5.1%	3.2%
c) Risk charge	9.0%	7.0%	3.5%	2.0%
d) Capital charge	1%	1%	1%	1%
e) Total charges	43%	21%	9.6%	6.2%
f) Profit / loss	-16%	-1%	8.3%	4.7%
Net income per loan	-£65	-£6	£166	£188
Number of loans for £1,000 'profit'	0	0	6.0	5.3

Notes to table 9.1.3: *In this pricing model we set an interest rate (a) and work out what the variable costs are – from table 9.1.2 - (b), write offs (c) and a capital charge – how much we would lose if we took the cash off deposit - (d) are as a percentage of the balance. This gives a total percentage charge (e) and a percentage profit or loss (f).*

Analysis

As the costing models above show, borrowers with credit scores that are 'very poor' or 'poor' are unlikely to generate a profit for the credit union. The interest charge costing model shows a smaller loss than the cost per loan approach for the Instant Loans mainly because of the costs of credit control. A reduction in the risk charge in table 9.1.3 (write off cost in table 9.1.2) may turn these loans into profit making ventures and this could be achieved if we are to receive assistance with lending capital so funders share the cost of bad debt. With no prospect of a further lifting of the interest rate cap of 2% per month, it is clear than even with a reduction of variable costs, these **'social objective' loans will have to be subsidised from a mix of credit union profits and external funding** arrangements with the former become a larger part of this mix as the organisation grows.

As there is an explicit commitment to offer subsidised loans for members on lower incomes, the credit union will need to ensure an effective **'product mix'** and that although there may be a greater number of smaller sized loans, overall the portfolio will be made up of a greater proportion of lower risk, more profitable loans.

The tables show that the Save as You Borrow and Flexi Loans offer a much better return. As the average size of the Flexi Loan is larger the impact of one or two borrowers failing to repay their loans would be much greater as the credit union has to provide for delinquency at a higher rate. Although the return may be greater, a much smaller number of these loans will be made during the initial period of trading.

Although the return per loan is broadly similar in both costing models for the Save as You Borrow product, there is a significant variance in the projected return for the Flexi Loan and this will require careful monitoring. We will, therefore, operate a variable rate of interest rate for the Flexi-loan so we can adjust according to the returns we make and the prevailing rate charged elsewhere in the marketplace.

9.2 Portfolio mix

Attempting to attract and serve very diverse groups of borrowers can be difficult, and the new credit union should work hard to ensure that it is not seen as a 'poor person's bank' or a lender of last resort, but rather as a positive choice for a wide spectrum of different socio-economic groups.

For this reason the credit union will offer a range of different loan products and these will form part of a wider portfolio mix: although we will offer a greater number of higher risk – Instant Loans, these will form a much smaller proportion of the overall portfolio in terms of their value.

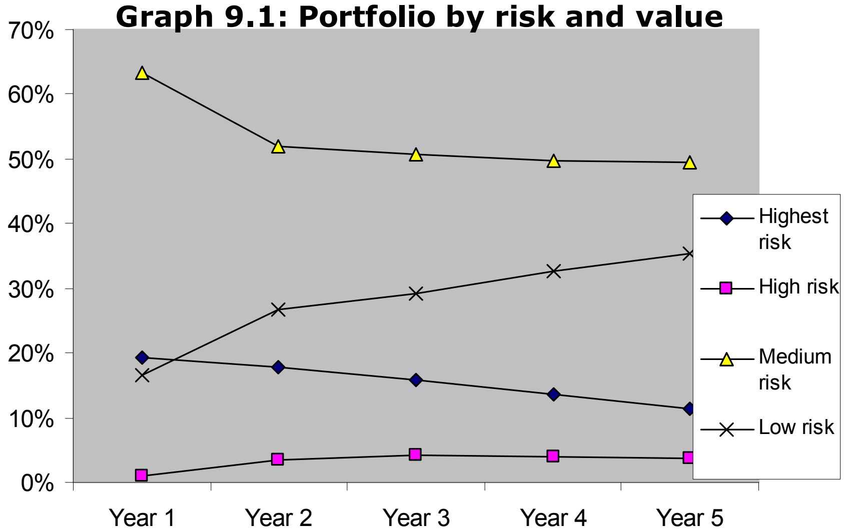
Table 9.2.1 : Loan type by number (issued each year)

	Year 1	Year 2	Year 3	Year 4	Year 5
Instant loan	175	300	350	375	400
Instant loan discounted	5	30	50	60	70
Save as you borrow	115	175	225	275	350
Flexi loan	15	45	65	90	125

Table 9.2.2 : Loan type by value (issued each year)

	Year 1	Year 2	Year 3	Year 4	Year 5
Instant loan	£70,000	£120,000	£140,000	£150,000	£160,000
Instant loan discounted	£3,750	£22,500	£37,500	£45,000	£52,500
Save as you borrow	£230,000	£350,000	£450,000	£550,000	£700,000
Flexi loan	£60,000	£180,000	£260,000	£360,000	£500,000

Graph 9.1: Portfolio by risk and value



Graph 9.2: Portfolio by risk and number of loans

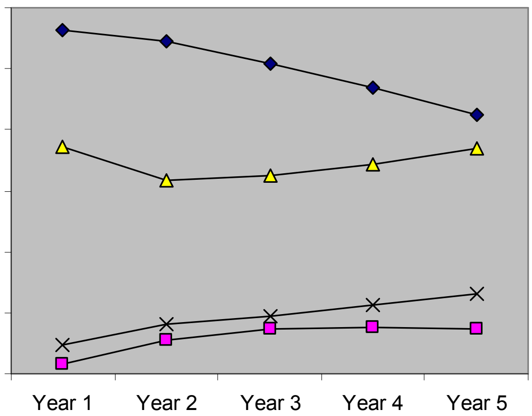


Table 9.2.3: Overall net income from loans

	Year 1	Year 2	Year 3	Year 4	Year 5
Loan income	£29,034	£87,101	£125,824	£164,262	£195,299
Write offs	£5,386	£10,773	£20,665	£28,615	£36,350
Other provisions	£2,693	£5,386	£10,333	£14,308	£18,175
Net loan income	***£20,955***	***£70,942***	***£94,826***	***£121,339***	***£140,774***

10. Savings products

Our ability to offer interest on savings is critical to achieving the goals set out in this business plan. Whilst we could predict future dividend rates – and we seek to retain a dividend account – the credit union will need to be able to make a positive offer to give depositors a return on the capital they invest with the credit union.

The ability to offer interest on savings will be **dependent on a change to regulations.** At this stage it is not clear whether the regulations will change in time for the credit union's launch in October 2009 and consideration will need to be given to whether the organisation 'soft launches' and then markets its loan products when the regulations do change, probably by January 2010.

Some of the proposed legislation remains unclear and the proposals will have to be studied in greater detail before the application is submitted to the FSA.

Our **instant access account** will hold at least 70% of all our shares. Members can withdraw their savings without notice, but the interest rate is lower, representing 25% of the current Bank of England base rate. This will be an attractive account for those seeking to build up their savings over time, especially those who have no history of saving.

We will offer a **tracker account** which follows the BoE base rate minus 0.25%. It is an attractive rate of return. Although there are better deals elsewhere on the market the credit union would be taking risks offer such a guaranteed return at a time of interest rate uncertainty, so we may rely on savers ethical consciousness to choose the credit union and / or their suspicion of the mainstream banking sector.

In order to help the credit union better manage liquidity and interest rate risks we will offer a limited issue **fixed rate twelve month bond.** We would be looking to attract lump sum savers, perhaps with an ethical approach to investment.

In addition to the accounts shown below, consideration can be given to offering Instant Access Savings Accounts, Junior savers accounts and Christmas / holiday savings clubs.

Table 10.1: Overview of proposed savings accounts

	Year 1	Year 2	Year 3	Year 4	Year 5
BoE Base Rate	0.5%	1.0%	1.5%	2.0%	4.0%
Instant access account	0.1%	0.3%	0.4%	0.5%	1.0%
Three month tracker	0.3%	0.8%	1.3%	1.8%	3.8%
Twelve month bond	0.5%	0.8%	1.1%	1.5%	3.0%
Dividend	0.0%	0.5%	1.0%	1.0%	1.0%
Instant access account – cumulative	£175,000	£525,000	£875,000	£1,225,000	£1,750,000
Three month tracker – cumulative	£25,000	£75,000	£125,000	£175,000	£250,000
Twelve month bond – cumulative	£25,000	£75,000	£125,000	£175,000	£250,000
Dividend only – cumulative	£25,000	£75,000	£125,000	£175,000	£250,000
Interest due to savers	£406	£2,438	£6,250	£11,813	£34,375
Dividend due to investors	£0	£375	£1,250	£1,750	£2,500
Total returns to investors	**£406**	**£2,813**	**£7,500**	**£13,563**	**£36,875**

11. The Community Budgeting Account

The CBA is part of Progress and works by receiving the member's benefits or wages which are then used to electronically pay the member's bills, including any creditors and a sum into their credit union savings account and loan (if applicable). Before the budgeting plan is put into practice the member sees an adviser (e.g. from a CAB) who helps them draw up a financial statement and explore ways of maximising income and minimising indebtedness.

Surplus income is then paid electronically into a Basic Bank Account which is negotiated with a national financial services provider. In the future the credit union may decide to send the surplus money to a **Credit Union Current Account,** thus keeping the member's money within one financial institution.

Current access to **Debt Management Plans** is largely limited to those with disposable income and many debtors on the lowest incomes cannot access repayment systems such as those offered by the Consumer Credit Counselling Service. DMPs ensure timely and affordable repayments to creditors, preventing enforcement action and the 'exported costs' to public services such action can have (e.g. re-housing evicted families). *The CBA will enable the credit union to offer DMPs to those excluded from the service at present.*

Critically the CBA can help reduce **re-referral to advice agencies** of those clients who have missed payments or whose creditors have requested a review. This can keep resources free to serve the needs of those new clients who are much more likely to present for advice with a serious priority (e.g. repossession notice, bailiff letter).

The CBA also presents the credit union with **further funding opportunities.** The CBA can be the glue that binds together an advice service and the local credit union and this is an attractive proposition for funders and it is worth exploring joint funding initiatives with money advice providers on this basis. Repayment of utility and other debts may warrant subsidy from creditors, including RSLs.

12. Delivery structure

Although initial funding arrangements are likely to characterise our early geography, it will be important to ensure that all residents within the common bond can access the credit union from day one of trading. To achieve this goal the credit union will use an **internet based platform** to deliver its service. The Progress system can accept online loan and membership applications. Our website will allow 24 hour access to account balances, use loan calculators, withdraw shares and change address.[20]

The credit union will also benefit from use of the **KCC contact centre** which will be used to filter telephone enquiries about the services we would offer.

Part of the Progress package is the 'credit union in a bag' – which allows for an effective and interactive outreach service. The credit union will employ an outreach worker to run **Community Service Points**, with support from local volunteers. Local residents will be able to access all the credit union services, including applying for and receiving payment of a loan.

We would also deploy **'trusted intermediaries'** to allow widespread access to credit union services. Such persons may include Housing Officers and staff in advice agencies.

Payroll deduction services will be offered for employed members where an organisation has agreed e.g. the County and District Councils. These types of scheme will be essential to keep transaction costs low and to minimise delinquency.

See appendix 8 for a list of larger employers that may be willing to operate payroll schemes.

The existing credit unions may operate as local branches in Canterbury, Margate and Chatham. As part of the consultation process behind this business plan the KMFIP has been meeting the existing credit unions on a regular basis. We have agreed a memorandum of understanding which can be found at appendix 9. No decision has been made about how the credit unions may work together but the memo offers an early insight into a potential branch or localised delivery partnership.

The Gateways are new public service delivery vehicles across Kent which will include a range of front line services. It is intended that footfall per annum will grow to 1.4m. They pull a range of agencies together and will have strong customer service focus using very engaged 'meet and greeters'. They also include third sector services. The aim of Gateways is to address a fragmented solution to all issues e.g. advice, housing, benefits, public health, skills, self help and Social needs. This can include a credit union.

Paid staff will be responsible for running our central office and would support the trusted intermediaries and volunteers working in any branches that are established. We will also work with a team of **volunteer champions** whose role it will be to promote the credit union at a local and regional level. Champions may include housing association staff, community activists, chairs of resident associations and the Kent Ambassadors. They will be supported by our Outreach Development Worker.

In addition to our loans and savings products the credit union will offer the **Community Budgeting Account** and this is explained further in section 11.

[20] See www.progress.ie for more information.

Diagram 12.1: Kent Credit Union Delivery Model

Community Budgeting Account

- Money & budgeting advice
- Income maximisation
- Bill payment
- Debt Management Plans

Gateways

- Account opening
- Receipt of loan applications
- Referral for other services

Champions

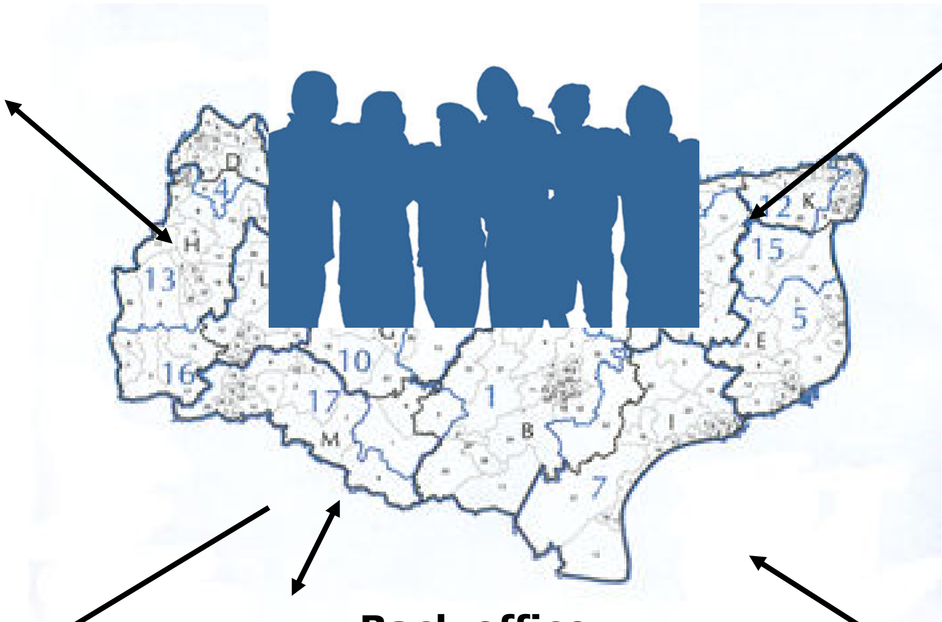
- Promoting the credit union
- Fundraising
- Receiving member feedback

Local authorities

- Payroll deduction
- Economic regeneration
- Supporting tenancies
- Supporting financial inclusion

Internet presence

- Virtual private network
- Online balance checking
- Online applications



Social landlords

- Supporting tenancies
- Supporting financial inclusion
- Promotional support

Payments in

- Payroll deduction
- Standing order
- Pay Point
- Salary and benefits

Back office

- KCC contact centre
- Email and website
- Loan applications
- Marketing
- Finances

Diagram 12.2: Historical delivery structure

Phase 1 – establishing the credit union

(Focus in: areas as agreed with funders)

Date: Oct 2009 – March 2011

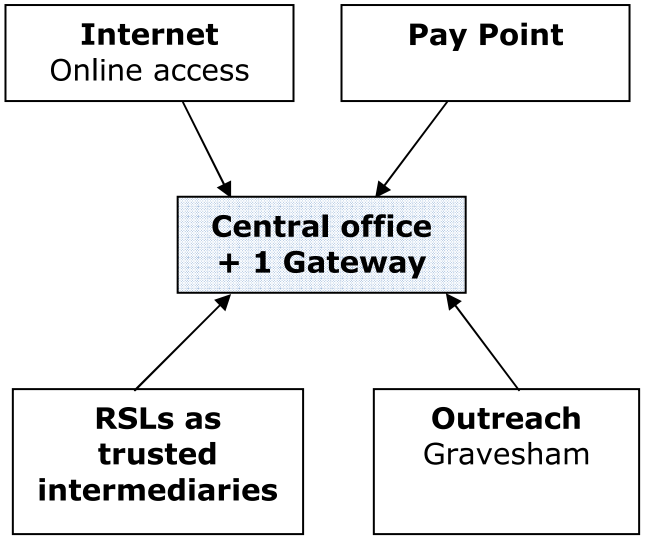
Members: 900

Product focus: Instant Loan

Member focus: Financially excluded

Loans at end of period: £500k (£500k pa)

Shares at end of period: £500k



Phase 2 – embedding the credit union

(Focus in: areas suffering financial distress)

Date: April 2011 – March 2013

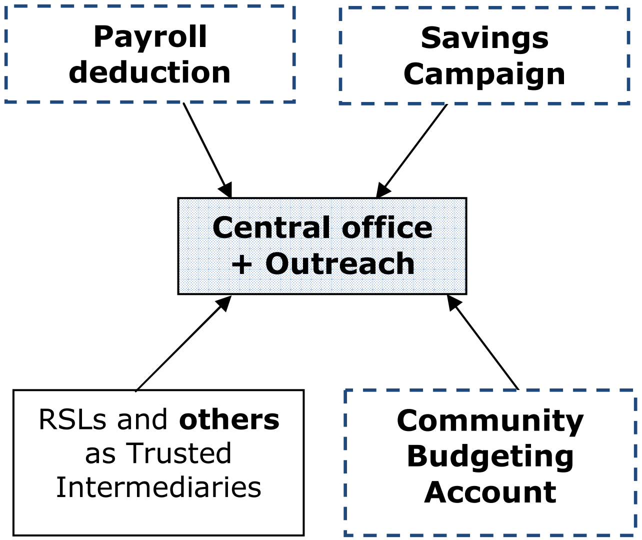
Members: 2,500

Product focus: Save as You Borrow Loan

Member focus: Payroll deduction

Loans: £1.2m (£800k pa)

Shares: £1.5m



Phase 3 – Sustaining the credit union

(Focus in: areas with higher disposable income)

Date: April 2013 on

Members: 4,200

Product focus: Flexi Loan

Member focus: Mainstream borrowers

Loans: £2m (£1.4m pa)

Shares: £2.5m

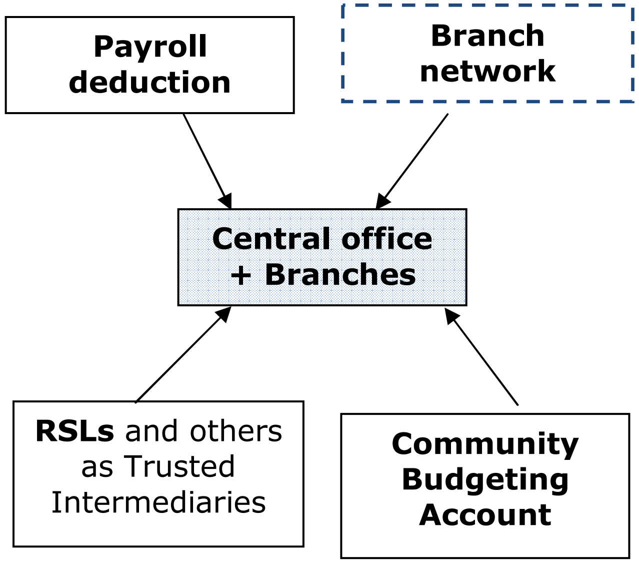
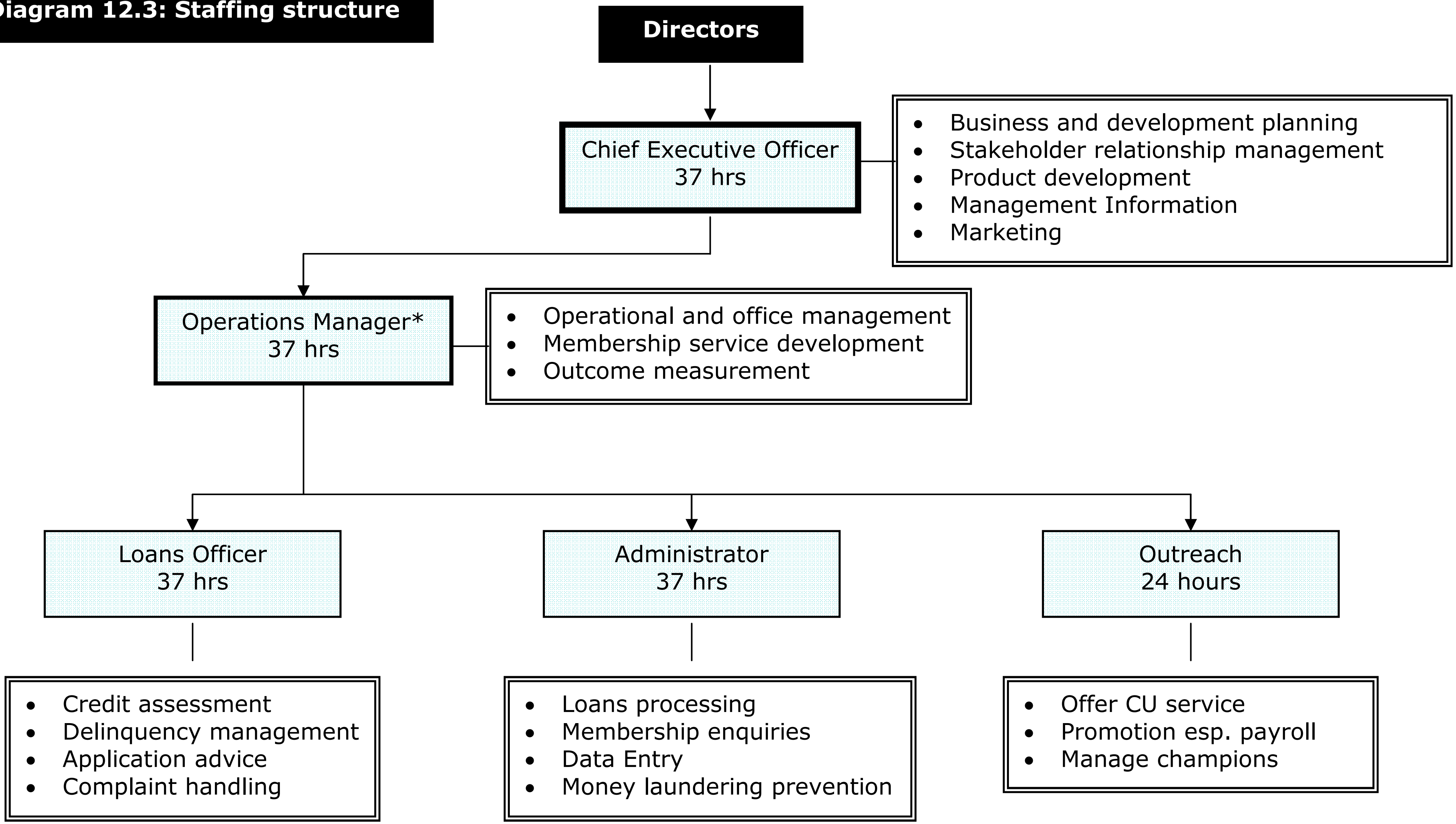


Diagram 12.3: Staffing structure



* The operations manager is an aspirational post. Whilst not absolutely essential to running the credit union (and is therefore not in the current budget), such a role would free the CEO to work more strategically leading to greater expansion of the credit union and improved product development.

13. Marketing

Our loans products are aimed at three key market segments – the financially excluded 'subprime' borrower, lower and middle income workers and the homeowner on an average salary. Savings products offer a reasonable rate of return to attract investors but the credit union does not expect to compete on savings rates alone, it will have to engender a message of ethical and community based services as well.

The financially excluded

The alternative for most people refused credit from a conventional source is to borrow from a doorstep lender or unlicensed lender. According to the OFT, some 5% of adults have taken out a home credit loan in the last 12 months. The total amount of debt outstanding to such firms, most of which deal with specific areas or regions, is currently valued at £2bn.[21]

The largest provider of 'home credit' is Provident Financial. This is also the UK's biggest doorstep credit lender, holding over 33% of the annual £2bn market. The company offer short term, unsecured loans with weekly payments collected by its agents. A simple loan of £100 from would require weekly payments of £3 over 57 weeks. On the face of it this would seem easily manageable to a low-income family. However, the cost of borrowing that £100 is £171, equivalent to an APR of 189.2%[22]. Other companies offer loans with much higher interest rates are common and routinely reach 500% APR or more.

The majority of KCU's work will be with members who require the low cost services it can offer when compared to the sub-prime lenders operating in the area. Here the message will be based on effective low-cost financial services and support for members, along with the security offered by the Financial Services Compensation Scheme (FSCS) and the benefits of free Life Savings and Loan Protection Insurance. These are all tangible and quantifiable benefits for members, as is the annual dividend payable on their savings.

Market Segment	**Value Statement(s)**
Credit union responders	• Low-cost loans • Safe savings • Ease of service e.g. Pay Point, via the telephone • Free Life Savings and Loan Protection insurances • Access to other agencies e.g. CAB, etc. • Community-based

Low and middle income workers

An immediate direct benefit, especially for lower income members will be the affordable cost of a credit union loan. With restrictions on mainstream lending the credit union may also be a popular choice for middle income earners. Even where lenders may be prepared to offer a loan - smaller sums borrowed over the short term from a credit union can be far more cost effective than borrowing from a bank or building society. There are no loan set-up costs, early redemption fees or compulsory insurances to add costs to a credit union loan and interest is calculated daily on the reducing balance.

This market segment will be targeted with the message that credit union membership can produce real financial benefits and savings.

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21 Office of Fair Trading (2004) Press release: OFT consults on reference of home credit market to Competition Commission
22 Source: www.providentpersonalcredit.com accessed 7th April 2009

Market Segment	Value Statement(s)
Low and middle earners	• Low interest rates on short-term loans • Safe savings • Payroll saving facility • Community support • Fair-trade ethos • Dividend • Non-profit making

Homeowners on average salaries

Although property prices have fallen more than 16% in the last 12 months, pushing many into negative equity most homeowners who have lived at their current address are likely to have some collateral in their property.[23] This market segment will be very price and service sensitive and a variable rate product emphasising its redemption penalty free nature may be very attractive.

There is evidence that this target group are using the general reduction in mortgage rates to save for the future and so demand for these loans will not be as great as it once was but there are cross selling opportunities with savings accounts.

Market Segment	Value Statement(s)
Homeowners on average salaries	• Competitive interest rates • Daily interest charged • No early repayment penalties • Draw down facility with a flexible credit limit • Online account access • Linked to savings accounts • Payroll saving facility • Community support • Fair-trade ethos • Dividend • Non-profit making

High net worth individuals

High net worth individuals will be encouraged to deposit significant savings with the credit union as a form of community benefit, i.e. their money will be used to help reduce individual debt and promote financial inclusion in Kent. The charitable company, the Kent & Medway Financial Inclusion Partnership, can also be used to receive Gift Aid donations. The major difference between making a significant deposit with the credit union or a similar donation to a charity is that, while in both cases there is a tangible and identifiable benefit, the credit union is able to produce a financial return on the deposit and the individual can of course have their money back whenever they wish, possibly for beneficial use elsewhere. This is an important and specific value statement that the credit union will use for this targeted market.

[23] Hilary Osborne (2009) *House prices fall by 16.5%* The Guardian 27th March

The deposits of these individuals will be used to develop the 'loan pool' of Kent Credit Union and if this lending capital is made available to people using doorstep loan companies for every £1,000 invested the credit union could save an average household £500 in interest each year.[24] As well as having an attractive range of savings accounts that offer a reasonable return, there will be opportunities to forego interest payment as a way of indirectly donating to the credit union. KCU will use the 'Kent Ambassadors' group to network with such individuals and persuade them to support the credit union.

Market Segment	**Value Statement(s)**
High net worth individuals	• Local community benefit • Financial inclusion • Safe savings • Anti-poverty strategy • Reducing debt in Kent • Fair-trade ethos • Money re-available for further good works • All profits returned to members for re-investment in local economy • Non-profit making • Option to receive a return on the investment

Further market segmentation will be used to target individuals within these broad groups. This segmentation will include, but not be limited to, the following:

- **Location** – defining members by where they live, work, shop or go for other reasons.
- **Life style** – hobbies, recreation can influence saving and borrowing choices
- **Occupation** – can influence tastes and attitudes.
- **Family status** – this may include responsibilities for children and/or elderly relatives.
- **Age** – people at different ages have different needs.
- **Gender** – men and women may have different saving and borrowing needs.
- **Usage** – different segments of the membership are likely to use the credit union for different purposes.

The credit union will market its services in a number of different ways:

- **Word of mouth**. By phase two of the operation most people will contact the credit union following a word of mouth recommendation.
- **Referral** from partner agencies will be the main source of knowledge of the credit union during phase one of the operation with referrals coming from RSLs in particular.
- **Internet and web based marketing** will be used to appeal to middle and higher income members
- **Launch related publicity** will provide the initial boost for recognition
- **Sponsorship and advocacy** from other Kent institutions and companies

[24] Provident Personal Credit charge £325 to borrow £500, which is £255 more than the credit union. For every £1,000 invested we can offer two such loans saving poorer households up to £500 in interest each year. Source: www.providentpersonalcredit.com accessed 7th April 2009

14. Five year profit and loss account

Table 14.1: Five year profit and loss						
	Year 1	**Year 2**	**Year 3**	**Year 4**	**Year 5**	***Total***
Income						
Loan income	£29,034	£87,101	£125,824	£164,262	£195,299	***£601,520***
Investment income	£699	£3,195	£7,497	£14,935	£51,344	***£77,670***
Entrance fees	£400	£710	£890	£1,000	£1,200	***£4,200***
Total income	**£30,133**	**£91,006**	**£134,211**	**£180,197**	**£247,843**	***£683,390***
Revenue spend						
Staff [25]	£106,033	£108,154	£110,317	£112,524	£114,774	***£551,802***
Training	£3,000	£2,000	£1,000	£750	£500	***£7,250***
Travel	£500	£1,000	£1,100	£1,200	£1,300	***£5,100***
Premises [26]	£15,000	£13,000	£13,000	£13,000	£13,000	***£50,000***
Office costs [27]	£3,300	£3,300	£3,300	£3,300	£3,300	***£16,500***
Banking costs [28]	£20,000	£12,000	£7,000	£8,000	£9,000	***£73,000***
Marketing	£5,000	£4,000	£3,000	£3,000	£3,000	***£18,000***
Insurance	£15,394	£23,085	£30,284	£37,476	£47,104	***£153,343***
Legal and professional	£2,500	£3,000	£3,500	£4,000	£4,500	***£17,500***
Total revenue spend	**£170,727**	**£169,539**	**£172,501**	**£183,250**	**£196,478**	***£892,495***
Other spend						
Transfer to reserves	£2,000	£4,500	£9,000	£13,000	£17,000	***£45,500***
Return to investors	£406	£2,813	£7,500	£13,563	£36,875	***£61,157***
Bad debt provision	£2,693	£5,386	£10,333	£14,308	£18,175	***£50,895***
Write offs	£5,386	£10,773	£20,665	£28,615	£36,350	***£101,789***
Total other spend	**£10,485**	**£23,472**	**£47,498**	**£69,486**	**£108,400**	***£259,341***

15. Funding shortfall

Taking the total projected spends against earned income, creates a revenue funding requirement of £470k over the initial five year period.

Table 15.1: Overall funding requirements						
	Year 1	**Year 2**	**Year 3**	**Year 4**	**Year 5**	***Total***
Total income	£30,133	£91,006	£134,211	£180,197	£247,843	***£683,390***
Total expenditure	£181,212	£193,011	£219,999	£252,736	£304,878	***£1,151,836***
Funding shortfall	**£151,079**	**£102,005**	**£85,788**	**£72,539**	**£57,035**	***£468,445***

[25] See diagram 12.3 for details of the staffing mix
[26] It is presumed that the premises will be donated and that we will obtain discretionary relief for business rates
[27] It is presumed that the FSA will allow for electronic provision of statements and announcements of AGMs to reduce the cost of contacting members directly. Some mailing costs would be met by external corporate sponsors.
[28] Banking costs are higher in the initial period to account for the cost of setting up systems and linked training. Costs then rise according to growth in the portfolio. We are anticipating mostly free banking and most of these costs relate to the Community Budgeting Account transaction costs, Finance Director fees, Pay Point fees and licences for Progress.

Table 15.2: Five Year Balance Sheet

	Year 1		Year 2		Year 3		Year 4		Year 5	
Assets										
Loans to Members (after write off)	£267,437		£747,310		£1,135,943		£1,523,359		£2,000,654	
Less Provision for Doubtful Debt	-£2,693		-£8,079		-£18,412		-£32,719		-£50,984	
		£264,743		**£741,923**		**£1,125,611**		**£1,509,051**		**£1,982,479**
Current Assets										
Debtors & Prepayments	£2,000		£3,000		£4,000		£4,000		£4,000	
Cash at Bank	£114,737		£259,710		£382,849		£515,181		£816,311	
	£116,737		£262,710		£386,849		£519,181		£820,311	
Less Current Liabilities										
Creditors and Accruals	£2,000		£3,000		£4,000		£4,000		£4,000	
	-£2,000		-£3,000		-£4,000		-£4,000		-£4,000	
Net Current Assets		£114,737		£257,017		£374,770		£496,769		£783,592
		£379,480		**£998,940**		**£1,500,380**		**£2,005,820**		**£2,766,070**
Represented by:										
Share Capital		£250,000		£750,000		£1,250,000		£1,750,000		£2,500,000
Other lending capital		£67,480		£182,440		£174,880		£167,320		£160,570
Reserves		£62,000		£66,500		£75,500		£88,500		£105,500
		£379,480		**£998,940**		**£1,500,380**		**£2,005,820**		**£2,766,070**

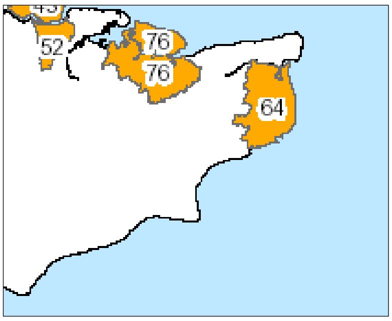
16.1 Raising the funding - strategy

Leverage and pump priming

The key to the funding strategy will be to use funding resources from one area to 'lever in' funding from elsewhere on a match funded basis. For example Southern and Hyde Housing Associations have both agreed to fund the credit union and this enables us to negotiate with other Registered Social Landlords with a much greater degree of confidence. Kent County Council has made a donation of £250,000 and this should help us persuade a range of other funders, including the District Councils.

A credit union is an attractive funding option because it will eventually generate an income which will be sufficient to cover all of its running costs.

Department of Work and Pensions (DWP).



DWP is responsible for delivering the government's Growth Fund. Three priority areas have been identified for investment: **Gravesham** (52), **Swale** (76) and **Dover** (64).

Funding is in the form of lending capital plus revenue support to the granting of loans. Additional set-up support may be available and the interest earned on loans can be set aside in a reserve for later business development activities.

Lending capital of £50k with revenue support of £15k would enable the credit union to deliver 175 loans to people facing financial exclusion living in these priority areas. This would enable the credit union to develop a performing loan book of £43k, generating a gross income of around £8k per annum. The cost of delinquency would be fully funded for the duration of the contract and can be expected to run at 9%.

Table 16.1.1: Potential Growth Fund Tender

	Year 1	**Year 2**	***Total***
No of loans	100	75	***175***
Average value	£400	£400	***£400***
Total value	£40,000	£30,000	***£70,000***
Capital repaid	£14,000	£20,000	***£34,000***
Write offs	£3,500	£3,500	***£7,000***
Capital needed	£30,000	£20,000	***£50,000***
Loan book c/f	**£23,000**	**£29,000**	

Table 16.1.2: List of Priority RSLs and Stock Level

Hyde	2,178
Southern	1,925
Russet	6,069
Town & Country	5,475
Moat	2,329
Orbit	3,348
Swale	5,652
West Kent	4,469
Maidstone Housing Trust	5,040
MHS Homes (ALMO)	7,700
Local Authority retained stock	34,746

Registered Social Landlords

Around 65% of people facing financial exclusion are likely to live in **Social Housing.** By promoting take-up of affordable credit and encouraging saving, tenants are less likely to experience rent arrears.

A potential model would be based on Social Landlords direct mailing their tenants. The credit union could presume a 3% return (2.5% for loans, 0.5% for savings), generating demand for an average £400 loan with a successful application rate of 50%.

If half of the 80,000 properties in Kent participate, the credit union could attract 400 savers and 1,000 loan applicants. This would generate a demand for loan capital of £200k.

Service Level Agreements for the Community Budgeting Account
The Community Budgeting Account (which is explored further in section 11) would enable more members to pay for their fuel by direct debit which attracts a greater reduction in fuel costs than many of the social tariffs. Local energy providers may be interested in supporting the CBA as it will assist them in achieving fuel poverty targets. The repayment of Debt Management Plans may attract support from creditors and grant funding bodies. RSLs may be interested in assisting the credit union in meeting the costs of the CBA on a per tenant basis.

Corporate Social Responsibility
There has been some initial support of credit unions through the South East England Development Agency (SEEDA) Corporate Cabinet. Direct support for marketing has already been achieved in other areas and companies have already indicated their interest in supporting the credit union's ICT infrastructure. There is further potential for support which also comes in the form of **in-kind** funding, such as premises and expertise.

The proposed changes in regulation could allow KCU to encourage corporations to make a deposit with the credit union, with the depositor foregoing interest as an indirect contribution to the organisation's running costs:

Table 16.1.3: Corporate investment account

	Year 1	Year 2	Year 3	Year 4	Year 5
Value of deposits	£100,000	£250,000	£500,000	£1,000,000	£2,000,000
BOE Base Rate	0.5%	1.0%	1.5%	2.0%	4.0%
Credit union rate of return on deposit	0.4%	0.8%	1.1%	1.5%	3.0%
Credit union return	£375	£1,875	£5,625	£15,000	£60,000
Corporate rate	0.3%	0.5%	0.8%	1.0%	2.0%
Corporate return	£250	£1,250	£3,750	£10,000	£40,000
Net profit to credit union	**£125**	**£625**	**£1,875**	**£5,000**	**£20,000**

Charging for ancillary services
Currently credit unions can only recover the actual charge for providing a service and are prevented from cross subsidising activities. Current reform proposals include the ability to make a surplus from certain activities and this is most likely to benefit the credit union if it were to charge for a **banking product.** A current account may be an additional developmental add-on to the Community Budgeting Account.

We could also offer a Visa debit card and affiliate schemes such as home contents and car insurance.

16.2 Raising the funding – action to date

The KMFIP has developed an **Investment Prospectus** which is enclosed with this business plan. The prospectus targets RSLs, local authorities, corporate investors and also offers a general appeal to individual supporters. The document has been sent to each of the District Councils and ten RSLs. Negotiations have been opened with a range of potential funders.

The Partnership has also **opened negotiations with the DWP** with a view to obtaining a Growth Fund contract. Funding allocations have yet to be finalised, but supportive messages have been received. The three amber areas within the proposed common bond present an opportunity to deliver on a range of fronts in Kent and negotiations are ongoing. It is recognised that the Growth Fund has the potential to skew the credit union's loan book and as such the funding request has been reduced, although the profile in table 16.1.1 would require prioritising two out of the three amber areas.

It will also be worth exploring **grant making bodies** for support and a shortlist of these opportunities is being drawn up which includes the Coalfields Regeneration Trust, Big Lottery Fund and a range of utility trust funds.

At the end of March the following funding has been committed:

Kent County Council: £250k for general running costs although £60k will be used as initial capital and a further amount *may* be used as lending capital.

Hyde Charitable Trust: An initial £10k has been donated to the development fund, all of which will be used to meet revenue costs. Negotiations for ongoing support continue.

Southern Housing Foundation: £20k has been donated with a 50/50 split for revenue and lending capital.

West Kent Housing Association: £2k for general running expenses with a commitment to longer term support post FSA application.

With £60k initial capital and £20k for the initial lending capital, the remaining £212k is sufficient funding for the first 18 months of operation.

In addition to the KCC support we have opened negotiations to raise £700k. However given the economic downturn and pressures on local authority budgets we do not anticipate being able to raise all this additional revenue. A sixty percent success rate would meet our revenue requirement for the full five year business plan.

There are a range of significant funding negotiations which are ongoing and it is anticipated that **by summer of 2009 we will have secured sufficient funding to pay for the first three years of operation.** Discussions are also taking place about supporting the credit union indirectly for example by offering free premises, using the KCC contact centre and support for marketing from a large insurance company.

17. Some factors influencing income generation performance

A full risk assessment and action plan is outlined in section 7. However, for the purposes of financial planning it is worth exploring 'what if' scenarios and assess what the impact on the credit union might be if growth is slower than expected.

Demand for loans is 15% poorer than anticipated.
The business plan suggests that over a five year period the credit union will make 3,300 loans with a total value of almost £4.5m which will generate just over £600k.

The impact of a reduction in demand for loans will be greater if the credit union is unable to offer enough of its members higher value loans. Smaller sized, higher risk loans would generally make a loss - so a reduction in demand on that side of the business would have less of an impact.

Table 17.1: Income from new loans (Year 3)

	Number	Value	Income from new loans
Instant loan	350	£140,000	£17,199
Instant loan: discounted	50	£37,500	£3,023
Save as you borrow	225	£450,000	£52,110
Flexi loan	65	£260,000	£21,977
	690		**£94,309**

If there was an across the board reduction in loans of 15% (or 100 loans) total income would fall by £14k. If 100 fewer 'Instant Loans' were granted, income would fall by £5k. If 100 fewer 'Save as Your Borrow' loans were issued, income would fall by more than £22k.

Sufficient market segmentation would help mitigate such a decline in demand and the credit union will need to monitor take up by loan product to ensure that the portfolio remains focussed on achieving our income goals.

Share deposits are 15% smaller than anticipated.
Smaller value share deposits would mean fewer loans, which in turn would reduce income earned. Sufficient liquidity is maintained to offset some of the impact with an average liquidity of 70-75% being maintained during the first five years of operation. Although it would be necessary to manage the risks associated with tighter liquidity, we could expect a fall of in income of around £5k (five percent of £94,000).

The credit union would spend less on the return it gives its savers if the shareholding was reduced, although it would also have less cash in the bank earning interest. The credit union would end up with a net saving of around £200.

Funded lending capital is 15% less than anticipated.
In order to reduce lending risk and achieve social objectives the credit union will meet some of the demand for its loans using capital funded by RSLs, local authorities and, potentially the DWP. The business plan envisages £185k of lending capital being utilised and this is used to offset almost £30k of bad debt costs over the five year period.

A 15% reduction in funded lending capital would add a further £4,500 of write off costs to the revenue account. In addition if this led to a 15% reduction in lending for higher risk borrowers a further £5k would be lost in year three.

In sum a 15% shortfall on our anticipated loan, shares and funded lending capital targets could lead to a loss, over the five years, of around £60k

18. Future opportunities

A legislative reform order is currently laid before parliament and it I anticipated that a range of changes to credit union regulation will take force from 1st October 2009, including:

Replacing the membership qualification requirements. This would allow a combination of any two membership qualifications e.g. – KCU could have a 'common bond' which would allow people living or working in Kent *and* tenants of a national housing association to join the credit union (as long as the housing association has a presence in the common bond).

Allow credit unions to admit bodies corporate, unincorporated associations or partnerships to membership. This would allow the credit union to offer a deposit account to corporations as well as local charities. The value of the investment would have limits.

Allow credit unions to offer interest on deposits, provided certain requirements are met. Provided the credit union has sufficient capital and risk controls in place it could offer members interest on their savings in addition to the normal profit sharing dividend.

At this stage we do not presume to have sufficient funding to introduce the ABCUL **Credit Union Current Account**. It will also be important to see how those credit unions introducing this new banking product adapt to its use and can verify the costing models. The KMFIP very much sees the Community Budgeting Account as an initial banking product and rather than surplus income leaving the credit union entirely it makes commercial sense to retain that cash within the organisation using the current account.

There are many opportunities to be realized through closer partnership working with the **existing credit unions** in Cantebury, the Isle of Thanet and Medway. We have benefited from their local knowledge and experience and local delivery in those existing common bonds could be supported by KCU, perhaps through a branch related structure. No decision has been made as to how the credit unions would work together in future, but a dialogue remains open and we would be looking to begin to firm up proposals once KCU has been trading for a period of six months.

See appendix 9 for the memorandum of understanding between the Kent credit unions.

Table 19.1: Project plan

	Apr	Sep	Jan	Apr	Sep	Jan	Apr	Sep	Jan	Priority	*Key issues*
Business planning											
Submit and review business plan											*The business plan will be submitted in May 2009 and in the six months prior to trading we will need to raise the funding and ensure we have the right marketing messages.*
Review marketing strategy											
Review risk strategy and financials											
Develop the fundraising strategy											
Governance and staffing											
Recruit, induct and train shadow board											*We have recruited a shadow board and need to begin the process of training to ensure the credit union has appropriate governance systems in place.*
Recruit paid staff and volunteers											
Review member involvement											
Delivery											
Identify premises											*There is still work to be done in relation to the delivery structure. Premises need to be found and local delivery systems agreed. We need to ensure that the regulations allow for the payment of interest on savings – this may require a 'soft launch' followed by full launch in January 2010*
Negotiate local delivery systems											
Implement and review ICT											
Run member feedback sessions											
Negotiate delivery with other CUs.											
Launch the credit union											