

# FINANCIAL EXCLUSION: Can Mutuality Fill The Gap?

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NEW POLICY INSTITUTE AND THE UK SOCIAL  
INVESTMENT FORUM

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## **PREFACE**

**Andy Love M.P.**

British society, in the late 20th century, is being transformed in many ways. Whilst more affluent, Britain is also more unequal and more divided. Alongside record numbers of millionaires are an increasing number effectively excluded from the benefits of increasing affluence. The gap between the two is wider than at any time since records began.

The rise of a so-called “underclass” is widely discussed and hotly disputed. Recent research has highlighted growing social exclusion with women being particularly prone to poverty and isolation.

Concern about these trends and the increasing polarisation and fragmentation of society was central to the political debate at the General Election. So was a growing recognition that the market alone cannot adequately address these issues. Tony Blair has made clear his determination to tackle the problem of social exclusion.

One aspect of social exclusion is financial exclusion. In localities with higher concentrations of the poor and disadvantaged, market institutions have in recent years withdrawn from providing basic financial services. This is particularly true of high street banks and the larger building societies. The result has been to cut off whole communities from the provision of basic financial services. How can government help those individuals and communities?

As its title suggests, this pamphlet looks at the role of mutuality in achieving that aim. Since the formation of the early Friendly Societies and Building Societies in the 18th century, mutuality has offered a collective response to the needs of the less well-off. But can it deliver for the least well-off?

Even to pose this question now may seem ironic, as mutuality faces its greatest challenge with the conversion of largest Building Societies and Mutual Insurers. Yet there is also a strong belief that it can deliver, especially where it is a realistic response to local need. It is the great merit of this pamphlet that it attempts to describe practical ways in which this can happen.

If government is to make a tangible difference then it must engage with this process. It must ensure that other priorities, from individual savings accounts to the regulation of financial services, take the financially excluded into account. It must also go beyond the “top-down” approach of policies like Welfare-to Work, to find ways of giving real support to initiatives whose impetus originates within civil society.

For too long, society has ignored the plight of the excluded. Each year, the problems intensify and become more difficult to reverse. The pamphlet points the way to possible developments that may redress the alarming disappearance of basic financial services from our poorest neighborhoods. Well-written and thought-provoking, it should also encourage further research into how mutuality can be adapted to achieve in the next century the same objectives that it did in the last.

## INTRODUCTION

Jenny Rossiter and Peter Kenway

This set of papers is the result of a seminar organised in June 1997 by the New Policy Institute and the UK Social Investment Forum into the problems of low-income families in gaining access to financial services and whether mutual organisations can help meet their financial needs.

The conclusion is that mutuals *can* help fill this gap - but to do so they must work in partnership with conventional financial organisations.

### WHAT IS FINANCIAL EXCLUSION?

“Financial exclusion” refers to an absence of means for saving, for small-scale credit and for non-cash means of payment. Lack of a bank or building society account, or possession of an account with severe restrictions, are therefore the principal conditions for financial exclusion.

Financial exclusion can hit any household. In 1994, 1 in 5 adults lacked a current account. But it is concentrated among the poorer socio-economic groups where the ratio is 1 in 2 (National Consumer Council, 1997: 5-6). Such households tend to be concentrated in particular areas - “financial deserts”, as Andrew Leyshon and Nigel Thrift call them.

This problem has grown with deregulation and technological change in the financial services industry. Many households have been helped by these changes, with easier access to credit and a wider range of savings opportunities. But the market pressures that deluge better-off households with financial offers they rarely need also leave behind islands of exclusion where financial services for poor households are virtually non-existent and where those who need to borrow pay rates of 600 per cent or even more.

Using computerised mapping technology to show where profits are highest, banks and building societies have been pulling out of poorer areas. Pat Conaty records that all 24 building society branches have closed in Birmingham’s Aston ward since 1986, while Ed Mayo refers to a similar pattern in London. The effect of such withdrawal is made worse by the disappearance of gas and electricity showrooms from high streets, which makes cash payment much harder and access to a bank more important than in the past.

Access to a local branch might be thought less important now because of the rise of telephone-based financial services. However, although 95 per cent of households have a telephone, Leyshon and Thrift report that in some poorer communities the connection rates may be as low as 25 per cent.

### **MUTUALS AND MUTUALITY**

As financial exclusion is increasing, building societies, institutions which can help low-income households, are in decline. In 1775 Aston in Birmingham, today a financial desert, saw the launch of Britain's first building society by people who were unable to raise conventional housing finance. They decided that the best way to tackle the problem was to save and borrow amongst themselves.

Historically, the strength of the building society movement lay in the mutual principle. Societies had a strong local identity and put a premium on accessibility - they needed plenty of local branches to collect savings and hence invest in housing. They also directly linked savings and loans: originally only savers could borrow money.

These characteristics had eroded before the recent wave of demutualisation swept the bigger societies into the conventional banking sector. Nevertheless, they are worth recalling because the principles on which the societies were initially launched are relevant in tackling modern-day financial exclusion:

- The organisation is set up by those who need it, and will use its services. It is therefore naturally a “membership” organisation, “owned” by its users.
- There is a common bond among the members (e.g. locality, church, trade union, employer) and at least initially, direct personal ties hold it together.
- It will usually start life small and growth will not be its primary objective.

The “fundamental” mutual organisations are therefore credit unions, and savings and loans funds for micro-credit for business.

- **Credit Unions** meet personal borrowing needs, for example, to buy household goods or to ease financial problems during illness or unemployment. They have had much success both in the USA and elsewhere in Western Europe, but not so far in the UK. They work on the principle of financial co-operation, taking in regular small savings from members and lending out to those who want to borrow. Interest charges are lower than most credit card rates.
- **Saving and loan funds**, like credit unions, maintain a connection between the willingness to save and the right to borrow. In some schemes, the fund is backed by bank guarantees, to encourage suppliers to do business. In Andhra Pradesh in India, “micro-credit” of this kind has been used to help low-income families to build houses. Micro-credit schemes can also help finance small businesses with no other access to capital.

#### **MAKING MUTUALITY WORK AGAINST FINANCIAL EXCLUSION**

These papers show a number of possible answers to the problem of financial exclusion. Although mostly based on mutuality, self-help and strong local identity, there are considerable differences between them. These relate partly to the needs of the financial institutions’ users - for example, bill payment, personal loans or mortgage rescue - and partly to different ideas about appropriate forms of mutual and socially-based financial organisations.

A common theme is that while mutuals and mutuality have a central role to play, they cannot solve the problems on their own. Udo Reifner argues that money needs to circulate, and that the money of the poor is not enough: “circulating the money of the poor within the poor community means exclusion, ghettos”. Nigel Thrift points out that credit unions may lack the size, and hence the financial and technical scope, to have a significant impact on financial exclusion.

Most of our examples show how mutual organisations need partnerships with larger financial institutions:

- Richard Newcombe describes how a guarantee fund provided by a locally based housing association enables the Cambridge Building Society to run a saving and loan scheme for tenants. Pat Conaty describes a similar, guarantee-backed savings scheme for women entrepreneurs in Birmingham.

- Pat Conaty shows how the Aston Reinvestment Trust is designed to act as a lead agency which would combine with other organisations in areas such as mortgage rescue or bill payment. This is an example of a hybrid scheme aimed at bringing together a variety of funding sources depending on the problem being tackled.

### **WHAT CAN BE DONE WITH MAINSTREAM INSTITUTIONS?**

If mutuals must work with established financial institutions, what should be done to ensure that these institutions have incentives to help?

- Drawing on experience from continental Europe, Ed Mayo suggests that the recent disinvestment of banks in deprived areas could be counteracted by applying pressure on them, such as attaching new conditions on their right to hold a banking licence, to undertake a social audit of the impact of any planned branch closure.
- Udo Reifner argues that the problem should be presented to banks in a different way, as “adverse selection” rather than “exclusion” - a flaw in bank procedures rather than an inevitable outcome of them. This makes possible a quite different approach in which the emphasis is on developing products to meet the needs of those who are otherwise excluded.

### **CONCLUSION**

All the papers show the need for hybrid forms, or for partnerships, to tackle financial exclusion. There are, however, some key questions which this raises. In particular:

- What are the special contributions of the small local and large national, or international, organisations and what has to happen to make these partnerships a success?
- What balance should be drawn between encouraging traditional financial organisations to deal with exclusion (either alone or in partnership) and obliging them to do so?

Following the seminar, the New Policy Institute is launching a research project to examine these questions in order to identify the steps that could be taken, by local organisations, by established financial institutions, and by central government, to ensure that such partnership schemes develop and succeed.

## **FINANCIAL DESERTIFICATION**

**Nigel Thrift and Andrew Leyshon**

Our chief concern is that what is being produced is a retail financial system which promotes the “super-included” of certain financially attractive customers, the active exclusion of other less attractive customers (the so-called D list), and the increased isolation of those not in the system. Those who are excluded or isolated have an all too predictable composition - they include more women, more pensioners, more ethnic minorities.

### **THE GEOGRAPHY OF EXCLUSION**

Exclusion from financial provision has a matching geography of exclusion and isolation. This is the equivalent of the “food deserts” that some commentators have noted are being created by the supermarket chains as they concentrate their attentions on very specific sets of customers. In increasing numbers of areas there is no or very limited access to financial provision, fuelled by public housing policies that increasingly concentrate poorer people in one area.

This process of desertification is best seen in the decline of bank and building society branch provision since the late 1980s. As our map shows, bank branch closures have taken place across the country. But these closures have been very selective, forced by Geography Information Systems which are used to provide “reverse location” models. This is best shown by matching bank openings and closures with “lifestyle” areas. The areas which have seen the most dramatic declines in numbers of bank and building society branches are:

- Struggling multi-ethnic areas - pensioners and single parents, high unemployment . Local Authority rented flats.
- Struggling areas - Council tenants, blue collar families and single parents - LA rented terraces.
- Struggling areas- multi-ethnic, less prosperous private rented tenants, young blue collar families with children - privately rented terraced housing and bedsits.

Aspiring areas - academic centres and student areas - young educated white collar singles and couples - privately rented bedsits and flats.

Commentators have argued that three factors will ameliorate the process of desertification. One is that companies which have traditionally served poorer areas - weekly collection credit companies like Provident, and home collection companies like Prudential - will make up the weight. But even these companies are retreating from some housing estates which, often for good reasons, are seen as “no go” areas for collectors who are carrying cash.

Another factor is the spread of ATMs (automatic transfer machines or “holes-in-the wall”). But they are not being located in poorer areas. Finally, it is sometimes argued that telephone banking will come to the rescue. But, in fact, it is the inhabitants of the desert areas which are least likely to have access to telephones. For example, one 1992 study of a sink Newcastle Council estate found a household connection rate of only 26 per cent (Graham, S. and S. Marvin *Telecommunications and the City*, 1996).

#### **INFORMATION AND INFORMATION TECHNOLOGY**

This process of financial exclusion and isolation is mirrored by a process of information exclusion and isolation which, in certain senses, is just as serious. Some financial consumers are becoming very well informed. Increasingly, there is a sophisticated financial “audience” made up of consumers who are well-equipped to obtain information on what is happening in the financial sphere, to interpret that information and then to act upon it. This audience knows more about money and finance than formerly as a result of the explosive growth of financial media, and through the ability to act upon the information that comes from the media.

The enhanced ability to act is the result of an increased range of products which allow more choice, the growth of financial intermediaries and the expansion of new information technology which relays information, and allows a proactive stance to that information. 24 hour telephone banking is only the start of this process. Recent developments in information technologies, and the growing use of the internet by financial services firms, mean that people possessing a personal computer will soon be able to manage their personal finances in real time.

The other side of the development of more sophisticated financial audiences is the information shadow which falls over those who do not have the money or the skill to obtain access to growing financial infrastructures. They are reliant on fallback alternative infrastructures which may be effective - like family and friends or the Citizens Advice Bureau - but cannot lift them out of their circumstances.

The situation is the more serious because so much of what is the formal financial system is now concerned with information processed, even created, through information technology. The widespread use of Geographical Information System, behavioural credit scoring, and the like is evidence of the use of information to produce a world in which “information asymmetries” (the imbalance between what the borrower knows about the lender and the lender knows about the borrower), which have often been the only advantage which the consumer has, no longer exist. In these circumstances knowledge really is power, and the various campaigns for financial literacy seem increasingly important.

#### **POLICY: OUT OF THE ASHES?**

The only ethic behind the new structure of affairs that is coming into being, if ethic it can be called, is profit. Any notion of service to the community, often found enshrined in the old mutuals, is lost, dead and buried, gone. But we believe that this situation should be seen as an opportunity, rather than defeat. It seems to me that this structure of affairs signifies that we are at a cross roads in the provision of alternative finance in Britain.

On one model, what we see is what might be called a “small is beautiful” future, based on small-scale credit unions, LETS (Local Economic Transfer Systems) and the like. This is an alternative future with which, it has to be said, many of its proponents would be quite happy. Within it, it is possible to consider oneself as part of an alternative world, acting as a bulwark against capital values and as the vanguard of a new localism.

For various reasons, we think that this is a path that is not feasible. First, it is doubtful that it can ever reach most of the people who are in need of alternative financial provision. Second, research shows that these small-scale structures of provision are not necessarily more equitable; they can be as middle class as the structures they are attempting to forego. Third, these structures cannot reap the operational and technological economies of scale that are crucial in modern financial systems in order to produce low-cost finance. And fourth, they cannot take on the formal financial system, partly because they do not have the financial and informational clout to make their voices heard.

### **CONCLUSION**

These observations suggest that another model is needed, which, we believe, is to begin to rebuild a mutual sector. At this time, as building societies demutualise, this may seem a vain hope. We are not sure if this is the case, for a number of reasons:

- There are good examples of how to reach at least those who are excluded - and make them profitable - from the formal financial sector. For example, a number of companies are bundling less well off customers in such a way as to produce viable financial markets.
- There is a vast archive of knowledge from around the world which is concerned with attempts - some of them successful - to set up new forms of mutual organisations which are effectively hybrids - with both formal and informal financial attributes. For example, there are examples from India which forge coalitions of informal financial institutions into formal institutions in instructive ways.
- Advances in information technology and telecommunications do not all cut one way. The availability of cheap information technology, increasingly cheap telecommunications and, in some cases, cheap financial information, means that many financial operations that were expensive (e.g. back office functions, information storage) are now much cheaper. The technology can be used to produce considerable scale effects, by joining what were relatively isolated local operations together in a decentralised way, while still allowing considerable sharing of expertise and information.

## Financial Exclusion: Can Mutuality Fill The Gap

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A new mutuality, which seeks to achieve its ends by engaging with and linking too the mainstream financial institutions, is both necessary and possible. There are good examples to draw upon from other countries. While new technology is an important component of the problem of financial exclusion, it also opens up new possibilities which can help contribute to a solution.

## **POLICY RESPONSES TO FINANCIAL EXCLUSION**

**Ed Mayo**

It may not be a static or simple phenomenon, but financial exclusion exists and is an issue of increasing concern. What then could be a constructive policy response? The focus of this paper is on policy in relation to the financial services industry, using the issue of bank branch closure as an example of shifting from an agenda of disinvestment to one of reinvestment in Britain's deprived communities.

### **BANK BRANCH CLOSURE**

In *Financial Exclusion in London*, a study published this year by New Economics Foundation, we found that while there have been bank branch closures across wards of all levels of wealth or deprivation, the rate of bank branch closure has been highest among more deprived wards:

- Between 1990 and 1995, London lost one fifth of its bank branches (271 bank branch closures).
- In 1995, 126 out of 322 London wards had no local access to a bank branch, a 21 per cent increase on 1990.
- The distribution of local bank branches across London is highly inequitable. The wealthiest wards have on average five bank branches for every one branch in the most deprived wards. For example, in the poorest borough, Newham, there are 21 just bank branches: 10,750 people for each branch.

### **THE POLICY RESPONSE: A MULTI-LEVEL APPROACH**

There may be a single “magic bullet” policy which can address this, but I doubt it. A number have over the years been suggested. The *Caisses D'Epargne* in countries such as France, for example, were established with state funding to provide lifeline banking. The extent to which they do this now is questionable.

As elsewhere in the field of community development and consumer campaigns, such as in the field of energy, policy should steer clear of the grand flourishes and aim to strengthen the institutional capacity, particularly at the community level, of initiatives that offer appropriate and often diverse solutions to exclusion.

In the case of financial exclusion this means that policy needs to facilitate the practical mutual partnerships, public/private and voluntary sector, that can combat financial exclusion. There is already enough practical experience to indicate that such partnerships are built out of three steps: first, private sector voluntary action; second, community sector innovation, and third, public sector regulation.

***Level 1: Private Sector Voluntary Action***

This can include commercial banks assisting community initiatives with the use of premises when closing down the last bank in a poor area, assessment of the social impact of closing down bank branches in poor areas, setting up mini-bank branches within wider shopping sites (e.g. supermarkets).

At the least, banks have a broad responsibility to understand the social impact of major changes they undertake and to minimise costs and maximise benefits. Social audits provide a systematic assessment of the social impact of a business and involve key stakeholders. Social audits have been completed by a number of European banks and proved to be a practical way for banks to understand and report on the social impact of their actions.

***Level 2: Community Sector Innovation***

Policy support should be given to the innovative development of “community banks” in poorer areas, where commercial banks fear to go. There are two main strands of such banks in industrialised countries.

The first in the European tradition of “social banking” which has evolved to meet the particular needs of social economy initiatives such as co-operatives that face difficulties in obtaining finance from mainstream providers (for example, due to their unorthodox structure). European social banking initiatives are estimated to have financed around 5,000 social economy projects, invested \$1 billion and hold an overall equity capital base of \$34 million.

The second is the US tradition of community development banking. A more decentralised system of banking coupled with progressive legislation around community reinvestment has aided efforts to establish a wide range of locally-based banks which have financed over \$2.5 billion of community economic development and hold a capital and reserve base of \$800 million.

A wide range of such initiatives is now operating in the UK, including credit unions and community loan funds. There is scope for proactive policy change to support these, such as special status for community development credit unions.

***Level 3: Public Sector Regulation***

New legislation should enshrine the obligations of banks to society, in return for the profitable privilege of holding a bank licence, in terms of fair banking practices and providing banking services to the whole community. US legislation points to the ways in which light-touch legislation can do this, by ensuring that banks publish data on their record of “community reinvestment”.

The 1977 Community Reinvestment Act and associated legislation, establishing an obligation for banks to report on the distribution of their lending, has proved a touchstone for the success to date of community banking in the USA, providing a legislative framework for the mobilisation of public opinion, leverage on commercial banks and validation of community banking approaches. Around \$18 billion has been leveraged from commercial banks into reinvestment agreements.

The Act requires finance institutions to meet the credit needs of their entire communities and authorises the Federal Reserve and other federal regulatory authorities to determine compliance through periodic examination and reports filed by financial institutions. Using the Act local groups have been able to negotiate landmark community reinvestment agreements, involving either new money or the removal of restrictions that hamper reinvestment.

The fear of many lenders, that expanded lending in low and moderate income communities would have a negative impact on loan performance, has not typically been the case. Indeed, the Federal Reserve of Philadelphia has stated that many banks report that their low and moderate income loans are performing as well as, or better than, comparable loans to middle and higher income borrowers.

### **CONCLUSION**

The legislative model of the US does not directly transpose to the UK. However, the underlying principle of disclosure is the same. While “league tables” or the like could be published at national level with government backing, the most appropriate form for such legislation is at a European level to complement existing banking directives with a Social Disclosure Directive, focused on the social and geographical profile of key banking services.

## **NEW FINANCIAL PRODUCTS FOR INCLUSIVE BANKING**

**Udo Reifner**

The words “exclusion” or “discrimination” are normally not part of a banker’s language. If bankers want to describe the mechanisms of discrimination in economic language, they call it “selection”.

Financial institutions are not used to dealing with poverty, a task which is normally handed over to the state or not-for-profit institutions. But it could be useful to translate sociological notions into the language of financial management because solutions to exclusion may lie more in the hands of the banks than those normally supposed to deal with poverty. Banks already note the effect of “adverse selection”, the phenomenon whereby they often select the wrong clients. If we could partially define the exclusion of poor people as adverse selection, we could show it to be an internal banking problem.

### **THE NEED FOR FINANCIAL SERVICES**

What consumers need from financial services can be defined by the acronym SALIS - Security, Access, Liquidity, Interest and Social responsibility. Depending on the situation, any client - not only the poor - can be excluded from these functional banking areas. Of course, the weakest will usually be excluded from all of them. But middle and even upper income clients can be excluded from some. If an unsafe retirement plan is sold to middle class people who lose their savings, they are excluded from “security”.

Politically, this makes a big difference. In Germany, public awareness of the problems of the poor rose when it was shown that social injustice affected even the well-off. On the other hand, straightforward “inclusion” may not be the full answer to “exclusion”. Including poor people will not necessarily give them access to appropriate financial services. Indeed, inclusion may even damage some clients if the cost of the services involved increases their financial burden.

This shows the weakness of looking at financial exclusion only from the point of view of demand. Bankers will serve poor people if it is profitable business. But they need to develop products on the supply side more suited to needs of the poor, while still profitable. If there are good and bad products for people with moderate means, we should promote the good products. Profit could thus become a politically-correct means of allocating resources.

SALIS means identifying a secure product, with maximum liquidity, adapted to the personal life style of the poor, producing yields that can be satisfactorily attained with an appropriate social impact. 20 years ago, I started to focus on mainstream instead of alternative banking. The advantage of this approach is evident: if Deutsche Bank is one tenth of a per cent less selective, the impact will be greater than the work of all the social banks taken together.

But Deutsche Bank will not create such new products and approaches by itself, without new models from elsewhere. These come from “social laboratories of the real economy” (to use Osbourne’s description in *Laboratories of Democracy*, 1988) of the South Shore Bank experience in Chicago. Bankers have some awareness of the social impact of their activities. They also face pressure from the social investment sector, which, instead of reproaching them for “exclusion”, may ask why they are not able to sell a particular product or service. They may know about social reality but not how to incorporate it into their banking.

Two aspects of human activity, economic output and social responsibility, are thus linked. Public opinion forces the banking community to reflect on its policies and induces politically-minded citizens to apply pressure if apparently feasible projects are not taken up by the banks.

#### **THE NEED FOR MINIMUM STANDARDS**

There is, however, one element which is lacking in community reinvestment strategies in the USA: the question of minimum standards. The market can deal with demand but it cannot deal with minimum standards of living. Whatever is marketable is rewarded through profit. But not all that is marketable really helps people.

Therefore, there are three aspects to combating financial exclusion: supply and demand in the market place, and the state as a regulator. I am very interested in developments on the supply side, and it is important that some pressure for “including” poor people is exercised from a collective and responsibly-thinking demand side. But we also need minimum standards. This could be a specific European contribution to the American experiment in how to achieve a more socially responsible economy.

We want competition to start at a certain level. But we cannot allow a system of unbridled market forces which allows some people to fail completely in order to upgrade the overall economic position of society. The philosopher John Rawls' collective utilitarian approach (set out in his *A Theory of Justice*) wherein the general good in a democratic society can only be measured by the outcome for the poorest, is a valuable guideline towards minimum standards. These standards have to be imposed because they are not delivered by the market itself.

Such minimum standards include interest rate ceilings. Usury legislation is very important. We have achieved such limits in nearly all European states except Britain and Italy. If you do not cap interest rates, mainstream banking will always be able to cheat when forced into more socially-minded selection.

#### **CAN MUTUALS FILL THE GAP?**

We certainly have to reinvent institutions to achieve the goals of mutuality, but I do not think that mutuality itself will solve the problem of financial exclusion. One important new requirement in modern banking is that the maximum possible amount of money must be able to circulate at the maximum speed. Co-operatives may work effectively for social purposes, but the money does not circulate rapidly enough or through a sufficiently broad sector of the economy. Circulating the money of the poor within the poor community alone means exclusion, ghettos. You need to mobilise the money of the rich as well. Co-operatives should be integrated into larger financial networks.

In Germany, the integration of co-operatives into mainstream banking has led to co-operative members becoming shareholders. Bank customers become members for a 300 Mark fee when they open an account with a co-operative bank. When they close it the fee is returned. But they do not really participate in the affairs of the co-operative; they have no real influence. Today, co-operative banks in Germany are very large institutions. Their central bank has assets of 170 bn. Marks. Such banks cannot be organised on the basis of the co-operative ideals of the 19<sup>th</sup> century - they have essentially become mainstream clearing banks. It is therefore ridiculous that at the European level, Germany is viewed as having the biggest co-operative movement.

Instead of a mechanistic definition of a co-operative, we should look at the relationship between personal involvement and the circulation of money. At a very low level, there is the “LETS” system. However, the bigger the circle of activity becomes, the more productive and less personal it will be. So in order to create more socially responsible forms of financial services we must find ways of using larger entities.

An example is the ALSK Bank in Brussels. There, a big bank has created a small network with access to all the functions that are needed in a small group. The big bank services them and provides the chance of saving for clear goals. This combines the efficiencies of a large organisations with the ethics of a co-operative.

Germany also shows partnerships between small local banks and large central savings banks. Whatever specialised services are needed are provided by the central banks, while the savings banks in the villages serve the community and maintain personal communication.

### **EXAMPLES OF COLLECTIVE BANK PRODUCTS**

Banking in areas of poverty is not primarily a question of client selection. All clients are valuable if they promise a sufficient rate of return. But poor clients involve high transaction costs, are high risk, and individually create too little turnover. One major reason for this is the lack of appropriate products. There is, therefore, a need for new products where collective advantages compensate for individual disadvantages.

At the Institute for Financial Services we have developed a range of products of a mutual or co-operative nature which can be marketed by whoever wants to use them.

#### ***Real Estate Tenants' Fund***

In the north German city of Rostock, we developed a product whereby tenants acquire property rights in their house in the form of a real estate fund.

People think about their homes in two different ways: for living in, and as a capital investment. Share-holding companies and investment funds are designed for the capital side, whereas co-operatives and mutuals look at use. They tend to exclude each other. But both are needed: capital investment should go with people's identification with and participation in decisions about the funds. We therefore designed a closed investment fund with two kinds of shares or "stakes".

There are now two distinct stakeholders in the company. Both own shares which are legally designed for different purposes and can be used differently for tax deductions. A third of the shares are for investment only, and are tradable after ten years. The other two thirds can only be acquired by users of the property. Unlike conventional mutuals, "user" share can be sold to other users. This gives individuals the freedom to change their plans as well as the people with whom they choose to live.

These shares also give real property rights. They can be acquired with money or through working in the building. The financial benefits of these shares are passed on through rent reductions.

In addition, we developed a system for valuing work done on the building. If the cost of managing the property falls, then the value of the whole building goes up to the advantage of all stakeholders: those who use it then have shares which are worth more, while investors may sell their shares at a higher price after ten years. As the users are also potential buyers of the investors' shares, this system increases the potential demand and thereby improves the prospects of liquidity for those who want to invest, solving a major problem in the marketing of closed real estate funds.

After ten years, a user may leave and convert tenant shares into capital shares. The user thereby acquires property which can be sold or left to heirs in the conventional manner.

### ***Collective Bank Account***

For many poor households the most important banking need is access to funds. They have a cash flow problem, and it hardly matters to them from which institution they obtain the money. The funds must simply be there at the time they need them. We developed a collective bank account to meet this need.

Liquidity problems in a large joint account are lower because average liquidity is stable. If security problems can be solved and trust between account holders guaranteed, then an effective collective bank account is possible.

### ***Debt Adjustment For Over-Indebted People***

Another product was a scheme for over-indebted people developed with the Ministry of Justice. This product gain approval on the grounds that flexible out-of-court settlements and incentives to balance the power relationship between debtors and creditors would, in the end, be much cheaper for all parties than normal court discharge procedures. In this approach the bank acts as a type of collective agency which tries to apply specialised knowledge gleaned from a large number of similar cases. It thus becomes an experienced debt settlement agency. This is an example of a social policy approach to a recurring banking problem.

### **CONCLUSION**

Creating collective financial products is one way of drawing the financially excluded into the mainstream banking system. Not all banks will choose to offer these services. But if a real market develops in this field, the consequent demand will put pressure on banks to provide these products.

## **NEW MUTUALITY IN PRACTICE: THE EXAMPLE OF ART Pat Conaty**

The Aston Reinvestment Trust (ART) launched its SHARE fund for social investment in Birmingham on 27th June 1997, after three years of market research, business planning, seed capital raising, and operations development and six months of trial lending. ART SHARE – the first mutual community reinvestment fund in the UK - is now well on its way to raising a £1 million this year at a time when many mutual financial institutions have opted for banking status. ART might seem to be swimming against the tide of change - a tide which has seen building society outlets disappear completely in Aston (Birmingham's second poorest ward), along with mainstream banking services.

### **THE NEW MUTUALS**

The wholesale closure of bank and building society branches highlights the serious decline in traditional financial services. The launch of ART, however, is based on our conviction that mutuality has a key role to play in tackling the problem of financial exclusion. This confidence stems from the steady and largely unheralded growth of a new generation of mutuals at a local or regional level, where real member participation is still possible.

These “new mutuals” include credit unions in Britain and Community Development Loan Funds in the USA. There are now 27 credit unions - savings and loan co-operatives for personal credit in Birmingham, compared with only three a decade ago. Most provide services for low to moderate income communities in inner city areas like Newtown and Balsall Heath and on outlying housing estates like Druids Heath and Frankley. Their bad debt rate has been consistently under 2 per cent. Most importantly, credit union funds have been invested and reinvested again year after year, a cyclical benefit for on-going regeneration that grant aid alone cannot provide.

ART has been inspired by a new group of mutually-owned social investment funds and social banks both here in the UK and in the United States, in particular the successful USA Community Development Loan Funds, which lend to small businesses, social enterprises and affordable housing projects. Their investment can come from members of the public, small businesses, companies, government bodies, trusts and charities.

The number of Community Development Loan Funds in the USA has risen from just three in the early 1980s to almost 50 today. Like credit unions their loan loss rate has been very low (under 1 per cent). The Delaware Valley Community Reinvestment Fund (DVCRF) based in Philadelphia has been particularly inspirational to ART. From an initial fund of £240,000 in 1986, today DVCRF has grown to £20 million. From seven loans initially advanced by DVCRF in 1986/87, it is now making a sizeable loan every week.

In the past ten years, the 46 American funds together have invested over \$350 million, financed over 60,000 units of affordable housing, created over 12,000 jobs and attracted over \$3 billion (a 9:1 ratio) of additional investment from the private and public sector, for the benefit of disadvantaged urban areas and declining rural regions.

The basis of these “new mutuals” is a practical rediscovery of the ideas which inspired Robert Owen in 1821 to coin the phrase “co-operative society” in his journal “The Economist”. The term also reflects the experience of the 1820s, the decade when Britain achieved its largest number of local banks, when the success of a retail bank or local building society depended on the fortunes of local businesses.

We believe that similar local needs and opportunities exist to-day, created by the same processes that have led financial institutions to abandon poorer areas. Globalisation, downsizing and outsourcing has led to a segregation between large corporate and government purchasers on the one hand and small/ social business providers on the other. In this new environment about one in two employees now works in a small business, social enterprise or as a self-employed person.

### **WHAT NEW MUTUALS CAN DO: THE ART EXAMPLE**

ART’s initial lending to small inner-city job-creating businesses and to social enterprises has proved the need and demand for local social investment funds. ART backers believe mutuality is important since local reinvestment by members leads to local jobs, local housing, and local services appropriate to local needs.

ART's research and development has identified four areas where there is scope for a new type of mutual activity, which creatively combines the operation of socially-directed investment funds with mainstream financial institutions. These are:

***Credit Union bill payment system***

Poor people pay very high rates for basic banking services, a problem that has been exacerbated by the closure of bank outlets in low-income neighbourhoods.

Until the deregulation of financial services, low-income households were able to pay utility bills, rent and rate installments with a giro book at any bank or post office without charge. In the early 1980s banks began introducing counter charges to non-bank customers, initially at fifty pence or so; these soon escalated to £5 or more for each weekly payment.

Post office charges were introduced as well and have risen to over 80p per installment. While these charges could be avoided by becoming a bank customer and maintaining an account in credit, the closure of one in four bank branches since the late 1980s has made this option increasingly impractical.

Community-based credit unions could step into the gap created by the collapse of these local banking services, possibly working in conjunction with sub-post offices. A market feasibility study and business plan completed for Birmingham credit unions in 1994, which consulted senior utility business managers and local authority finance officers, indicated a willingness to pay subsidies to a credit union service on a commission basis. From April 1998 a small grant from the Single Regeneration Budget has been approved to test such a service through the Newtown South Aston Credit Union in Birmingham.

***Housing improvement finance for greener homes.***

With funding from Birmingham City Council, NatWest Bank and four Birmingham housing associations, ART has been investigating several niche areas for an ethical investment housing fund in Birmingham. One possibility is an expanded Home Energy Efficiency Scheme (HEES) grant which integrates both the basic HEES money (up to about £350) with additional regional electricity company grant funds available for "standards of performance" improvements for energy efficiency such as low-energy lighting.

This could produce a grant of up to £500 per household, which could then be matched by a local credit union loan of £500. The credit would be made available on the strength of the household's indicative ability to pay regularly over an initial three month period of savings contributions with the credit union.

***Micro-credit for self-employment and small business***

Self-employment has risen officially from about 6 per cent of the UK workforce to 14-15 percent today. Unofficially, the rate is far higher within the black economy, and as high as 25 percent in some ethnic minority communities. Many of the self-employed, however, have only limited access to working capital. They often lack security for loans, and can only raise money by expensive means, for example with the use of credit cards or through money lenders.

Drawing on the success of micro-credit organisations overseas, new schemes to finance women's start-up enterprises are presently under development in Norwich, Glasgow and Birmingham. The Birmingham work, which involves Birmingham Settlement, Birmingham Credit Union Development Agency and ART, is considering a credit union for women entrepreneurs. This would be supported by advisors from Birmingham Settlement and a guarantee fund managed by ART.

***Mortgage debt rescue***

Housing associations in Birmingham are interested in a possible local mortgage rescue service administered by ART. ART funds would provide loans for householders unable to maintain their mortgage payments. The scheme is based on successful experiments, by a few housing associations, which have allowed householders in financial difficulty to move from ownership into more affordable rental arrangements without suffering eviction or re-housing. ART would advance a secured loan on a subordinated basis from its own ethical investment fund to provide a 10-15 percent equity stake in the property for the first four to seven years of tenure change. Beyond this term, the stake would be purchased from ART by either a building society or housing association member; alternatively, the tenant might be able to opt to return to owner occupation.

**CONCLUSION**

The four programmes outlined above are just beginning in Birmingham. They have all been designed to reduce financial exclusion - in the city, it should be noted, which saw the launch of the first building society in 1775. Mutuality has in the past ensured financial inclusion. It has never been needed more than now.

## **SOCIAL BANKING: THE EXAMPLE OF NEW HORIZONS**

**Richard Newcombe**

Cambridge Housing Society (CHS), a 70 year old registered housing association with charitable status, has just launched an innovative savings and loans scheme in conjunction with the Cambridge Building Society (CBS). The aim is to give CHS tenants access to competitively - priced loans once they have established a satisfactory savings record indicating their ability to service their debt. The scheme also aims to encourage regular savings which will attract enhanced rates of interest.

CHS is a highly focused regional organisation which operates throughout Cambridgeshire and north Essex and which sees its local links as one of its main strengths. It owns a range of properties, including a large proportion of supported housing for diverse client groups. It has a total stock of 1,200 and has an on-going development programme.

### **A ROLE BEYOND HOUSING**

From its earliest days, the society has interpreted its role as stretching beyond the provision of housing alone. In the early war years, for example, it supplied tenants with seed potatoes and vouchers to purchase garden tools. In the 1950s it was a pioneer in building houses to provide accommodation for a local employer's key workers.

More recently it built and now runs, the Sunflower Children's Nursery where, with assistance from a bursary fund, children from low-income families are able to benefit from nursery education. In 1995 CHS launched its Home Care Service, offering care tailored to the needs of older people who wish to remain in their homes.

About 18 months ago, the Society began to examine the problems faced by its tenants in trying to obtain personal loans. It had been aware for some time of the high cost of credit for low income families, often without bank accounts, and with no access to mainstream financial institutions. Catalogue buying is expensive, and there are local examples of loan sharks charging interest rates of 300 percent a year.

An important element in CHS's research turned out to be the experience of savings and loans schemes in Andhra Pradesh in India. The Society has had links with these projects for some time through its support for the aid agency Homeless International (HI) and HI's relationship with the Youth Charitable Organisation (YCO) in Andhra Pradesh.

On a visit to YCO, CHS's director was particularly impressed by the saving and loans schemes operated by women in village communities. With the help of HI, these communities have been able to obtain loans to build permanent secure homes for themselves on the back of their regular savings record. The key to the willingness of commercial institutions to make these loans has been a guarantee fund which is held in a bank in India and acts as security against any default. In practice default rates have proved to be extremely low.

#### **THE NEW HORIZONS SCHEME**

CHS has now transferred and adapted the principles of the Indian examples to create a saving and loan scheme - the New Horizons scheme - which offers an attractive facility to tenants. This scheme has been developed in collaboration with the Cambridge Building Society (CBS), which for a number of years has worked with CHS as a provider of private finance for its building programme. CBS's contribution is crucial to the new saving and loan project because its systems back-up underpins the administration.

The saving and loan scheme runs as follows:

First of all, CHS deposits a lump sum with CBS to act as a guarantee fund. This attracts a standard rate of interest.

Second, all CHS's tenants, partners and children are eligible to open a savings account through the New Horizons Saving and Loan organisation, as it is called, with the money being deposited with CBS. There is no requirement for a minimum opening balance. The overall account acts as a sophisticated joint account, with individual savers obtaining the benefits of an enhanced savings interest rate. This is because all the savings are aggregated with the lump sum guarantee fund for the purposes of calculating the tiered interest rate due.

Third, once tenants have established a regular savings record they are able to apply for a loan, as a multiple of their savings up to a specified maximum amount. Individual tenants will have no need to offer any security, other than their regular savings record. CBS will be making the loans direct to tenants, secure in the knowledge that the guarantee fund is available.

Strict criteria have been agreed which will allow CBS to gain access to the guarantee fund in the event of default on loan repayments. The interest rate to be charged for loans, for the time being, is 1 per cent a month (APR 12.68%), equivalent to the standard credit union rate.

Fourth, a contribution towards the administrative cost of running the scheme will be made from the interest rate differential between the savings rate and the loan rates. This contribution will be apportioned between CBS and CHS. The significance of this element will clearly be dependent on the build up of a certain volume of transactions.

CHS believes there are four main advantages in the New Horizons Scheme over and above the model of the traditional credit union:

- **Accessibility:** CBS sees itself as providing a service to the local community with aims very compatible to those of CHS. It stresses the need for local branches and is planning to expand its current network of 18 outlets, whereas other financial institutions are “rationalising”. New Horizons’ savers will be able to deposit and withdraw money from any CBS branch as well as by post.
- **Visibility:** CBS, with its network of branches, has a credible and visible High Street presence which should enhance the success of the scheme.
- **Confidence:** The partnership inherent within the scheme between CHS and CBS, both long established and well respected institutions, operates within a clearly-defined community. This should encourage tenants to participate and take advantage of New Horizons.

- ***Sustainability:*** It is unlikely that CHS tenants on their own could ever represent a large enough market to sustain a traditional credit union over the long term. The numbers - approximately 4,000, which includes tenants and their families - are too low. New Horizons, however, has the operating advantage of the CHS funds and therefore does not need a large market to operate successfully. Moreover, the scheme is not dependent upon high levels of participation from committed volunteers to administer all the paper work and the accounting records. New Horizons will benefit from the existing experience, administration and systems operating within CBS. CBS will provide regular financial statements and reports.
- ***User/Tenant Participation:*** CHS has been able to use the scheme as an opportunity to encourage further tenant participation. A New Horizons Action Group has been set up which consists of tenants and members of staff from CHS and CBS. This group has been influential in advising on detailed operational issues and policies. It will receive loan applications and monitor loan repayments. Members of the group will be prepared to visit tenants who get behind with loan repayments, thereby replicating one of the strengths of a credit union, in which peer group pressure is an important factor in minimising arrears in loan repayments.

## **CONCLUSION**

CHS, which has received financial support for New Horizons from the Housing Corporation and Cambridge City Council, believes that this initiative shows what established local mutual organisations can achieve in working together for the benefit of the community. The New Horizons scheme could be replicated wherever a community based housing association and a local mutual building society share a common geographical area and complementary objectives.

New Horizons will offer real benefits to the tenants of CHS. It is an innovation in the field of social banking, tackling the financial exclusion experienced by housing association tenants and providing an incentive to regular savings and access to affordable loans.

## ABOUT THE CONTRIBUTORS

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**Richard Newcombe**, Chief Executive of the Cambridge Housing Society has worked in the Social Housing Movement for many years. As a Visiting Research Fellow at York University he is undertaking a project to establish how far social housing providers can extend their role into community-based initiatives.

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