1. Executive Summary

1.1 The Association of British Credit Unions Limited (ABCUL) welcomes much of the Final Report of the Independent Commission on Banking. Proposals to ring-fence retail banking from banks’ riskier investment activities should help protect ordinary consumers – and the taxpayer – from any future repeat of the recent banking crisis, and we welcome calls for increased competition and better deals for consumers.

1.2 However, ABCUL feels that in its Final Report, the Commission has missed an opportunity to address some of the fundamental failings in the commercial banking model and the potentially devastating instability of a financial services sector dominated by profit-driven banks which we have unfortunately seen in the last few years.

1.3 The banking system in the UK is one of the most concentrated in the developed world. As the Commission notes, the ‘Big Four’ banking groups account for 88% of retail banking business.

1.4 Because the plc banking model is driven by profits for external shareholders and rewards its staff (successful or not) with lucrative pay packages, it is at its core short-termist and encourages risk-taking in pursuit of maximum return. The interests of customers, therefore, will come second to the interests of profit.

1.5 The mutual model offers an alternative to this which is:
   - Small, dynamic and local, posing little or no systemic risk;
   - Price and service competitive lacking the profit pressures of the plc;
   - Driven by the interests of the member-owner;
   - Insulated from the excesses of investment banking and wholesale money markets.

1.6 ABCUL believes that a stronger credit union sector would provide true competition, genuine diversity and consumer choice, and greater structural stability in Scotland’s financial services industry. In countries such as the United States, Canada and Australia, credit unions are leading providers of alternative retail banking services. Through providing a strong alternative to the banks, credit unions are able to inject strong competition into retail banking and through their alternative member-led philosophy, are credited with “keeping the banks honest”. Replicating this success in Scotland would add much needed competition and diversity to the banking system.

1.7 British credit unions are legally constituted under the Credit Unions Act 1979. They are regulated deposit takers under the Financial Services and Markets Act (2000) with a specialist regulatory sourcebook in place which sets the prudential framework within which credit unions operate. Deposits held with a credit union are guaranteed up to £85,000 under the Financial Services Compensation Scheme and complainants have recourse to the Financial Ombudsman Service.

1.8 Scotland’s credit unions are currently a relatively small feature on our financial services landscape. However, this is not due to any failure of the credit union model or lack of interest from consumers. Credit unions across Britain operate within
legislation which has been described by the World Council of Credit Unions (WOCCU) as “amongst the most restrictive in the world”.

1.9 Despite this, Scotland’s credit union movement has continued to grow, and with the Legislative Reform (Industrial and Provident Societies and Credit Unions) Order now in front of the UK Parliament and firm proposals in place to create a back office facility for credit unions which would allow services to be made available through the Post Office network, there is now a real opportunity for credit unions to emulate the scale of other credit union movements around the world and provide real diversity and competition in the financial services market.

2. Introduction

2.1 The Association of British Credit Unions Limited (ABCUL) welcomes the opportunity to submit evidence to the Economy, Energy and Tourism Committee. ABCUL is the main trade association for credit unions in Scotland, England and Wales. As a co-operative itself, ABCUL is owned, funded and democratically controlled by its member credit unions. The majority of Scotland’s credit unions are ABCUL members, and they in turn serve the majority of Scotland’s individual credit union members.

2.2 Credit unions are not-for-profit financial co-operatives owned and controlled by their members for whom they provide safe savings and affordable loans. Credit unions provide inclusive services to the whole of their communities rather than simply the better-off. Increasingly, some credit unions can offer more sophisticated products such as pre-paid debit cards, current accounts, cash ISAs and mortgages.

2.3 There are currently 110 credit unions in Scotland serving around 250,000 members, holding £210 million in savings and lending £180 million.

2.4 The Credit Unions Act 1979 sets down in statute the objects of a credit union. These are four-fold:

- The promotion of thrift among members;
- The creation of sources of credit for the benefit of members at a fair and reasonable rate of interest;
- The use and control of their members’ savings for their mutual benefit; and
- The training and education of members in the wise use of money and in the management of their financial affairs.

2.5 ABCUL welcomes many of the recommendations of the Independent Commission on Banking. However, we would like to have seen a greater emphasis on the potential for mutuals to promote the diversity and competition which the financial services market so clearly needs as we believe the mutual model has been shown to be a robust alternative and a beacon of stability amongst the risk-taking of the profit-driven banks. This will therefore be the basis of our submission to the Committee.

3. The financial crisis, commercial banking and the role of mutuals

3.1 The Commission notes that the UK retail banking market is dominated by the commercial banking model, with the risk-taking and potential for instability which has become one of its features. ABCUL agrees that we must look to achieve greater stability in the financial system, and this should involve supporting the growth of more stable alternatives to commercial banking.
3.2 An increased role for alternative models would challenge the hegemony of plc, commercial banking and the integrated banking system. Mutual financial services providers – such as credit unions – offer an alternative which is insulated from the flaws which have resulted in near economic collapse, and their growth will therefore in turn increase stability within the system.

3.3 There is a growing body of economic theory which draws on the insights of the biological study of ecosystems and which shows that institutional diversity strengthens a financial system through reducing risk, and therefore mitigating the likelihood of failure and increasing stability overall – best articulated by Andrew Haldane, Executive Director for Financial Stability of the Bank of England. It has been proposed, too, that a more diverse financial system better promotes growth and tackles poverty.

3.4 As The Economist noted in August 2010: “Just as an ecosystem benefits from diversity so the world is better off with a multitude of corporate forms.”

3.5 In addition, credit unions and mutuals generally have advantages over their plc counterparts which can greatly benefit consumers, a greater role for which will raise standards of service and product offering from the commercial sector too, including:

- Credit unions and mutuals have been shown to have weathered the financial crisis better than their commercial counterparts – maintaining lending levels, increasing market share and experiencing many fewer failures than have been seen in the commercial sector.

- Credit unions and building societies in the UK are prevented by law and regulation from undertaking the kinds of investment banking activities undertaken by the commercial sector and which compromised their financial position. This insulates them from the financial turbulence seen in recent years and causes them to focus solely on the basic, retail needs of their members.

- Global research by the International Monetary Fund (IMF) has shown that the co-operative bank and mutual financial model is inherently more stable than that of the plc-banks.

- As member-owned organisations, mutuals are driven by the interests of their member-owners – evidence has shown how this results in improved customer service and product offering such as lower interest rates (as with credit unions in

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1 Andrew G. Haldane, *Rethinking the financial network*, April 2009: [http://www.bis.org/review/r090505e.pdf](http://www.bis.org/review/r090505e.pdf)
3 The Economist (2010), *The eclipse of the public company*, August 21st, p. 58
4 Deposits in ABCUL credit unions grew 15% in the financial year 08/09. Filene Research Institute in the US, has shown that credit union lending has been sustained throughout the last 3 recessions ([http://filene.org/publications/detail/firestorm](http://filene.org/publications/detail/firestorm)) – credit unions 75% less vulnerable to economic downturns. The Co-operative Financial Services has seen a 20% increase in deposits, 50% increase in current accounts, 24% increase in mortgage activity and 25% increase in corporate business. Dunfermline Building Society has been the only major mutual casualty of the crisis.
Scotland lending in competition with high-cost alternatives). Democratic, one-member-one-vote control gives customers a voice in the running of the organisation.

- Credit unions and mutuals – in the most part – operate on a local or regional basis. Credit unions, specifically, draw their membership from a restricted group (known as their common bond). In this way – in addition to their segregation from the wholesale financial markets – credit unions could never be classed as “too big to fail” and they spread wealth creation geographically where the profits and wealth creation of commercial banks was found to increasingly focus on London and the South East of England.

3.6 It is therefore our view that a credit union movement truly empowered to offer a competitive alternative to the commercial banks would be beneficial not only to Scottish consumers, but to the stability of the financial services industry itself.

4. Credit union development in Scotland

4.1 Scotland has a long history of co-operation and mutuality dating back to the eighteenth century with the Fenwick Weavers and New Lanark. In the modern era, Scotland’s first credit unions were formed around forty years ago, and there was a particular increase in their number and membership during the 1980s and 1990s, especially in the former Strathclyde Region.

4.2 In the decade since the turn of the century, credit unions in Scotland and across Britain have undergone a fundamental shift in their developmental philosophy and have earned significant recognition and support as a result.

4.3 Beginning with a seminal research project published in 1999 by Paul A Jones of Liverpool John Moores University, Towards Sustainable Development, British credit unions – led by ABCUL – began to implement a new model of development based around a recognition that credit unions needed to be professionally-run, financial businesses before they could be socially effective ethical financial services providers. Credit unions would need to have a broad-based membership, operate from visible, dedicated premises and provide a quality of service comparable with that of the mainstream financial services sector.

4.4 With almost everyone in Scotland able to join a credit union, the last decade has seen a consolidation of the number of credit unions in Scotland, but a continuing growth in the number of credit union members.

4.5 Increasingly credit unions began to employ trained staff, implement sound governance and provide services to a wider range of people – requiring a greater level of sophistication of product offering including cash ISAs, Child Trust Funds, insurances and mortgages.

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7 See: http://s.coop/towardssustainabledevelopment.

8 Only residents of Perth and Kinross are not currently covered by any credit union’s common bond, but an ABCUL-registered study group has been established there to hopefully transition to a full credit union in the near future.
4.6 In 2002, credit union regulation became the responsibility of the Financial Services Authority which meant, for the first time, credit unions were prudentially regulated and supervised. Furthermore, savings were guaranteed by the Financial Services Compensation Scheme and complainants had recourse to the Financial Ombudsman Service.

4.7 ABCUL successfully lobbied for various regulatory and legislative changes which have allowed for, amongst other things, an increase in the upper-rate of loan interest to allow credit unions to more sustainably serve people regarded as higher credit risks, greater flexibility around common bonds, and a package of UK legislative reforms which, when hopefully passed soon, will remove many of the restrictions under which Britain’s credit union movement has had to operate since its inception.

4.8 As a result of these and other initiatives, the decade to 2007 saw Britain’s credit union savings, loans and assets all grow by more than four-fold and membership almost treble.9

4.9 While there is an increasing professionalism in the credit union movement and its services become more sophisticated and more inclusive of a larger and wider membership, it is nonetheless important that the unique nature of credit unions is recognised by regulators and that a proportionate regulatory regime is followed. ABCUL recognises and welcomes that regulation is in the interests of individual depositors and consumers, but it is important that measures to better regulate the banks do not result in an unreasonable regulatory burden being placed on credit unions which could curtail their operations.

4.10 It is an important feature of Scotland’s credit union movement that they genuinely serve a diverse membership. Credit unions offer services to many people on lower incomes whom the commercial banks offer limited services to, but it would be wrong to regard this as credit unions’ sole membership or sole purpose. Many of Scotland’s credit unions provide an excellent service to people in full time employment and on good salaries, and it is this diverse membership which allows credit unions to sustainably provide a service to financially excluded members of the community.

4.11 Credit unions are therefore well placed to play a greater role in providing a wider range of services to a cross-section of consumers, and we believe this can play a beneficial role in promoting competition in the financial services industry.

5. Credit unions as a mutual alternative to commercial banking

5.1 Internationally, credit unions are established as a successful alternative to profit-driven financial services providers. In the United States, Canada, Australia and the Republic of Ireland, over a quarter of the population are members of a credit union.10

5.2 Credit unions in Scotland have not yet achieved their full, internationally proven potential – although there are pockets which exemplify what is possible with the right support, such as Glasgow, where around 1 in 5 residents belong to a credit union.11

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11 Figures from Glasgow City Council: [www.cucity.co.uk](http://www.cucity.co.uk)
Approximately 1 in 20 Scots is a credit union member, which compares favourably with the figure of around 1 in 65 for Britain (Scotland, England and Wales), but is nonetheless well short of the movement’s full potential.

5.3 However, Scotland’s credit unions have taken great developmental strides in the past decade, and the imminent passing of the Legislative Reform (Industrial and Provident Societies and Credit Unions) Order 2011 at Westminster will provide a modern, proportionate and flexible legislative framework for credit unions on a par with the best in the world, removing significant barriers to growth. Among other reforms, the new legislation will allow greater flexibility in determining credit unions’ common bonds, the option to pay interest on savings rather than a retrospective dividend, and for the first time allow credit unions to serve charities, small businesses and social enterprises as well as individuals.

5.4 The missing piece in the developmental jigsaw, based on international best-practice, is the development of a centralised, back-office system which would provide the economies of scale necessary to bring great efficiencies and consistency of service to the credit union sector, building capacity and resulting in a step-change in credit union development.

5.5 Such systems are commonplace in the most developed credit union sectors around the world as they address a natural tension which arises in the developmental process whereby the locally autonomous, democratic nature of each individual credit union begins to conflict with the need for sufficient scale to provide services which rival those of commercial counterparts. By pooling back-office resource, credit unions are able to tap into otherwise unattainable economies of scale whilst – crucially – retaining their local identity and ownership.

5.6 Those services which the back-office might provide include:

- A common accounting platform for credit unions enabling central treasury management;
- Central loan processing, credit control and marketing resource;
- Human resources, legal and compliance services provided centrally;
- Significant cost reductions in providing more sophisticated products, including current accounts, pre-paid debit cards, insurance, cash ISAs and mortgages;
- Centrally managed internet and telephone banking;
- A conduit through which full collaboration with the Post Office could be achieved, whereby all credit union accounts and services could be accessed at all Post Office branches, earning a transaction fee for the Post Office and greatly increasing the accessibility and visibility of credit unions. Pensioners, benefits claimants and small businesses are the main users of the Post Office’s services and credit unions have a strong role to play in serving these groups.

5.7 Even on conservative estimates, the potential for credit union growth with a back-office system in place is enormous. We anticipate total credit union membership in
Scotland, England and Wales could grow from around 900,000 today to 3 million in five years – and potentially by much more.

5.8 ABCUL is currently promoting the development of a centralised back-office system which could offer these considerable benefits to credit unions in Scotland and across Britain. While requiring a significant one-off investment to establish, this development would lead to a fast growth in scale and reach, introducing the credit union sector as a serious new player in the financial services market with the benefits for competition and stability that would bring.

5.9 More accessible credit union services – including through the Post Office network – would have the effect of drastically increasing the diversity, choice and competition in financial services as per the Commission’s recommendations. In a short timeframe, the credit union sector would be installed as a visible and accessible alternative to the high street banks, providing a consistency of service which they are unable to provide currently and providing a real alternative to millions of consumers. The financial system would be bolstered by the expansion of a movement which is concerned only with the financial wellbeing of its members and not with the profits of external shareholders and investors.

6. Conclusion

6.1 The plc, commercial banking model has been allowed to dominate the British financial services industry for many years. The result of the City’s excesses has been to bring the financial system close to total collapse and to force Government to expose the taxpayer to unthinkable losses in order to prevent absolute meltdown. The resultant recession – caused in large part by the banks’ need to rebuild their balance sheets and therefore to reduce their lending – has produced high unemployment and consequent social fallout across the country. The UK Government is embarking upon a period of fiscal retrenchment which will be painful for many.

6.2 In light of this political and social upheaval caused by the banking crisis, it is imperative that the option of returning to “business as usual” is not allowed. A new settlement in financial services must be reached which promotes alternative models of development.

6.3 While we welcome the Commission’s calls for greater competition in the financial services sector, we are somewhat disappointed that the “strong and effective new challenger” it calls for to be created from the Lloyds divestiture would seem to simply be another commercial bank. We believe the Commission should have taken its historic opportunity to call for greater support for diversity in the kind of financial services providers available to consumers and not just in the number.

6.4 Credit unions – and mutuals generally – are free of many of the key flaws in the commercial banking sector which have been identified by various commentators and economists as central to the crisis. A larger role for credit unions, therefore, will ensure more choice and competition in banking and will increase the stability of the system overall.

6.5 In the past decade, Scotland’s credit unions have undergone a reassessment of their development model leading to a great strengthening of the sector due to various
initiatives involving reform of the regulatory and legislative framework, strengthening governance and management, increasing the sector’s capacity and securing appropriate investment. The sector is now in a strong position to emulate its international counterparts.

6.6 A credit union back-office – as well as several other strengthening initiatives – and a full partnership with the Post Office network has the potential to transform the credit union movement and build upon the strong foundations laid over the past decade. This would create the conditions for a step-change in credit union development which would provide a new alternative to the high street banks for everyone, injecting diversity and competition into the financial system and contributing to its stabilisation following the unprecedented crisis.

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