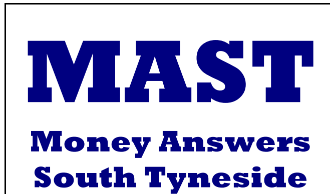
Money Answers South Tyneside



Borrowing your way out of debt

South Tyneside
Credit Union Ltd

A research report into the operation of the Money Answers South Tyneside debt consolidation programme

March 2006 – December 2007

Paul A Jones
Research Unit for Financial Inclusion
Liverpool John Moores University
September 2008

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The Money Answers South Tyneside Debt Consolidation Programme

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Executive Summary

The MAST debt consolidation programme

Money Answers South Tyneside (MAST) is an independent community development finance institution established to promote economic regeneration.

The MAST debt consolidation programme enables over-indebted individuals, many of whom are customers of sub prime lenders, to access a loan at a reasonable rate of interest in order to consolidate and repay high-cost debts. It operates mainly in low-income communities and is designed to combat financial exclusion.

Following a financial consultation with a South Tyneside Citizens Advice Bureau (STCAB) adviser, MAST will grant a consolidation loan if it is judged that this would be in the long-term financial and personal interest of the borrower. With high-cost debts cleared and links to previous creditors broken, MAST offers an individual a new start and an opportunity to move on to greater financial inclusion and security.

Established in March 2006, the programme is managed by MAST in partnership with STCAB and South Tyneside Credit Union (STCU). The debt consolidation fund was established with a £200,000 grant from the Northern Rock Foundation.

Research into the effectiveness of the programme

The Research Unit for Financial Inclusion at Liverpool John Moores University was engaged by MAST at the request of the Northern Rock Foundation to undertake a research enquiry into the effectiveness of the programme and to generate learning outcomes that would enable improvements in practice and performance.

The research project took place over a 21-month period from the inception of the programme in March 2006 to December 2007. Research methodology involved statistical analysis of performance, interviews with beneficiaries and research discussions with MAST, STCAB and STCU directors and staff.

Consolidation loan applications

In the 21-month period, £95,064 was lent to 42 borrowers. The value of the loans made ranged from £638 to £5240; the average loan was £2,382. 26 of the loans amounted to more than £2,000 and most were for periods of 36 months.

Over the period, 97 applications were received but 55 people were refused (57% of the total number of applicants). All loan applicants were interviewed and, from August 2006, all had attended a consultation with a CAB adviser. All those refused were referred to STCAB or other agencies for professional debt or other advice.

Applicants were refused loans on grounds of being so over-indebted that a £5,000 loan, the maximum allowed in the MAST programme, would have been insufficient to

make a difference to their overall financial situation; or of lacking the financial capacity to repay a rescheduled consolidated loan; or of there being other more appropriate solutions to their over-indebtedness.

From the outset, the MAST programme accepted that, in the majority of cases, the solution to over-indebtedness is not another loan. For many people, referral to money, debt or budgeting advice or to financial capability education is often a more appropriate response. The fact that 57% of applicants were refused loans, and the time and care taken in granting MAST loans per se, was one of the reasons why the take-up of MAST loans was lower than expected.

The beneficiaries

The majority of those granted loans were women (83%), 74% of whom were young women, the majority of whom were lone parents with dependent children.

93% of all beneficiaries lived in postcode areas identified by the Department of Work and Pensions as being of highest economic deprivation in the borough. All loan recipients were on welfare benefits or in receipt of a low wage. 62% of the women were in receipt of benefits and 29% of the men.

Loans made to beneficiaries were mostly to consolidate loans to doorstep lending companies (48%), catalogues (19%), high-cost retail stores (19%), illegal money lenders (10%), slot television loan companies (7%), store cards (17%), high-cost credit cards or bank overdrafts (29%).

In total, circa 80% of borrowers were previously repaying loans in cash in some form.

Identifying success

20 of the 38 borrowers (52%) who had taken out loans up to the end of September 2007, were able to move forward into financial stability and repay the MAST loan regularly, according to the terms of the loan agreement. Transitioning highly over-indebted individuals, particularly those in debt to home credit companies, is a demanding, risky and time consuming task. A 52% success rate is understandable, given the depth of the over-indebtedness and the extent of financial exclusion among the MAST client group

However, research evidence suggests that the programme made a significant difference in the lives of these 20 people, either by reducing their weekly loan repayments, or by making a substantial saving on the amount they would have paid to the high-cost lender if they had continued repaying their high-cost loan to full term.

One borrower explained in interview:

> "*I'm much better off now, I have had home credit collectors for 11 years but now nobody is coming to the door, no debt letters coming to my house. I was*

getting loans from credit companies and topping then up all the time. I also had a loan from the catalogue. I could not afford to live. Now I am saving a £100 a month on what I paid before".

£45.5k was made in loans to this group of 20 borrowers who collectively saved £38k, calculated on the basis of them continuing with high-cost loans to full term.

In assessing the impact of the MAST programme, success cannot be measured by a reduction in the amount of loan repayments or in the overall cost of credit alone. Borrowers benefited from the programme in a number of ways, all of which had longer-term implications for their financial stability and economic benefit. These included the opportunity to apply for a new, cheaper mortgage on the basis of outstanding debts being settled, to break the habit of high-cost borrowing or to free themselves from the temptation of taking out further high-cost home credit loans.

26% of borrowers, who had taken out loans up to the end of September 2007, were able to migrate into successful STCU membership and to save regularly.

Research into the characteristics of success revealed that:

- Migration to a consolidated loan depends on a high level of borrower motivation and commitment to achieve personal financial stability.

- Successful repayment is linked to the willingness and ability of the borrower to migrate to an electronic repayment system. Only 10% of successful borrowers repaid in cash at the credit union office, whilst all defaulters had agreed to repay in cash via a payment book.

- Financial education and capability are central to successful migration to third sector financial services

The problem of loan delinquency and bad debts

At the end of December 2007, 11 of the 38 consolidation loans, (i.e. 29% of the total), were in serious default. The average loan default was £2,300 with a potential total write-off of £27k which represented 29% of the MAST loan book.

The high level of default confirmed the risk of adverse selection when migrating people from high-cost credit, particularly when the borrower's experience of loan repayment has traditionally been home collection. This level of default, although unacceptable in the long-term, has not been uncommon in third sector finance initiatives. Jones (2003) reported write-offs of up to 46% in some credit union loan guarantee schemes operating in low-income communities. Anecdotally, though not confirmed by the Department of Work and Pensions, it is reported that a 15% to 20% write-off on Financial Inclusion Growth Fund loans has not been unusual, with examples of much higher rates being recorded. Clearly, however, the official write-off target is much lower (less than 10%) and many credit unions and CDFIs

have made progress in attaining this figure.

64% of defaulters were lone women with dependents, 71% of whom were on welfare benefits. 72% of all defaulters were unbanked. It was not insignificant that the level of over-indebtedness of individuals on the programme often exceeded £2,000, which is a challenge to repay when on welfare benefits or a low income.

All people in default were pursued according to standard credit control and debt recovery procedures. Since December 2007, there have been signs that four of the 11 defaulters had started to repay with the assistance of a debt collector making cash collections in the home.

By September 2008, nine months after the programme period researched in this report, the potential write-off had declined to £15,759 on a then loan book of £81,003. This was a decline of nearly 10%, from 29% to 19.45%.

Credit administration

The MAST programme was built on the experience of a former STCU NRF funded debt redemption project and implemented rigorous policies and procedures with regard to the administration and control of consolidation loans.

However, the high default rate on loans led to the following conclusions:

- The development of rigour in credit decision making is fundamental to the development of a successful debt consolidation programme.
- There is a need to identify not just the capacity to repay, but also the willingness and the likelihood of the borrower to repay the loan.
- Further study and training is needed in understanding the relevance of applicant behavioural characteristics, including the use of behavioural scoring techniques, in forecasting financial risk in lending.
- The fundamental principles of lending should not differ between MAST and STCU. MAST serves individuals who would not quality for a credit union loan. However, even If MAST borrowers are regarded as of greater risk, this risk needs to be rigorously assessed and loans should never be made without good evidence both of capacity and willingness to repay.

Working in partnership with STCAB

The operation of the programme is closely linked to the provision of a coordinated service with STCAB. It is recognised that a holistic approach to over-indebtedness and financial exclusion necessarily involves access to money and debt advice as well as access to affordable financial services.

However, 82% of serious defaulters were directly referred to MAST by STCAB and

91% had attended an interview with a CAB adviser. These statistics resulted in a re-evaluation of the dynamics of the relationship between MAST and STCAB, as they led to the conclusion that a consultation with a STCAB adviser in itself makes no significant impact on the lowering of default rates.

There was some observational evidence from MAST staff that some borrowers referred by STCAB may have regarded the MAST referral as a solution to a problem organised by an outside agency. With some borrowers, this resulted in a diminished sense of personal responsibility for repayment of the loan.

In research consultations, reflection on the relationship between MAST and STCAB led to the following conclusions:

- A clear, and preferably written, definition of the roles and responsibilities of MAST and STCAB needs to be determined. The role of STCAB cannot be related to loan granting, explicitly or implicitly, but rather to income and expenditure analysis, budgeting advice, dealing with creditors and the exploration of financial options.

- It needs to be made clear to applicants referred to MAST from STCAB that referral does not imply any expectation that a loan will be granted.

- The outcomes of the programme reinforce the understanding that credit administration is entirely a MAST responsibility.

Conclusion

When borrowers are able to successfully manage the transition to a consolidation loan, it can bring significant financial and personal benefits. The programme demonstrated that for 52% of borrowers, borrowing oneself out of debt is a realistic and achievable tactic. However, the MAST programme confirmed that consolidation loans are only appropriate in particular and limited circumstances and can only be regarded as a tactic to combat over-indebtedness if all other strategies have been exhausted.

Nevertheless, debt consolidation should be retained as an option within the wider context of promoting financial inclusion and stability. However, this will demand the development of enhanced skills and abilities in loan assessment and in the identification of risk. For, even with rigorous credit administration procedures, the risk of adverse selection will remain inevitably high, given the realities and dynamics of the sector of the market within which MAST operates.

A full cost-benefit analysis of the programme was not undertaken as part of the research, as it was judged too early in the programme to arrive at definite conclusions with regard to value for money for the investment made. However, it was clear that the benefits gained by many beneficiaries went beyond the immediate financial savings on reduced loan repayments on consolidated loans.

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Research Unit for Financial Inclusion

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The Research Unit for Financial Inclusion (RUFI) is situated within the Faculty of Health and Applied Social Sciences at Liverpool John Moores University. It undertakes academic, action and evaluative research in a wide range of areas related to the development of financial services for lower income households. RUFI has a particular expertise in research aimed at strengthening credit union capacity and effectiveness.

For further information on RUFI see:
*http://www.ljmu.ac.uk/HEA/financialinclusion/index.*ht

1. Introduction

The Money Answers South Tyneside (MAST) debt consolidation programme is an initiative designed to combat over-indebtedness and financial exclusion in low-income communities in South Tyneside. It enables over-indebted individuals, many of whom are in debt to sub prime lenders, to access a loan at a reasonable rate of interest in order to consolidate and repay high-cost loans. Following a consultation and personal financial analysis with a South Tyneside Citizens Advice Bureau (STCAB) adviser, MAST will grant a loan if it is judged that this is in the long-term financial and personal interest of the borrower. With high-cost debts cleared and links to previous creditors broken, MAST aims to offer the over-indebted individual a new financial start and the opportunity to move on to greater financial security.

However, the limitations of tackling over-indebtedness through consolidation loans have been highlighted in a number of research reports, including a Barclays-commissioned report into credit unions and loan guarantee schemes (Jones 2003). This research focused on credit unions, all based in low-income communities, which had introduced schemes not dissimilar, at least at first sight, to the MAST debt consolidation programme. These credit unions had been funded with external donations to make debt-redemption loans to people in debt to high-cost lenders, primarily home credit providers, weekly-payment retail stores and sub-prime credit cards. As in the MAST programme, the credit union schemes were based on the belief that, once freed from high-cost interest rates, people would repay the consolidated loan more easily and gain greater personal financial stability. In other words, as with MAST, they were founded on the belief that it was possible to *'borrow your way out of debt'.*

In fact, the 2003 research revealed that such an approach was less than successful. Overall, loan default rates were high and few borrowers moved into financial inclusion and stability. The study concluded that if credit unions were to serve over-indebted people effectively, they had to adopt more holistic and strategic approaches. These were identified as being based on access not only to a lower cost loan, but also to debt and money advice, to savings and budgeting accounts, and to ongoing support.

It is the acceptance of this more comprehensive approach that draws a line between the MAST programme and previous credit union debt-redemption schemes. There is no suggestion in the MAST programme that a consolidation loan alone is the solution to a debt problem. In MAST, the granting of a loan is intimately linked to money and debt advice and, importantly, to a pathway to financial inclusion through membership of South Tyneside Credit Union (STCU). The MAST borrower is obliged to attend an interview with a STCAB adviser, must open a STCU savings account and is encouraged to save regularly in order to build up his/her own personal financial security. The focus on linking a consolidation loan and the

opening of a savings account is fundamental to the MAST approach, as it recognises that, in the longer-term, it is saving rather than borrowing that enables people to achieve financial stability (Sherraden 1991, Kober and Paxton 2002). The MAST loan is a one-off intervention and the opportunity to make a new beginning. If a new credit need arises during the period of repayment of the MAST loan, there is no access to a second MAST loan. The borrower, however, is recommended to approach the credit union, of which s/he is now a member, in order to avoid returning to high-cost lenders.

The MAST approach depends on MAST, STCU and STCAB working together in the delivery of a harmonised service. In fact, the defining characteristic of the debt consolidation programme is the service coordination of these three independent organisations. This approach to partnership working arose out of a common commitment to tackling over-indebtedness and financial exclusion and was strengthened through the prior experience of participating in the NRF-funded programme *'Enterprise in Disadvantaged Communities'* (Jones and Rahilly 2006).

Not long into the operation of the MAST debt consolidation programme, the Research Unit for Financial Inclusion at Liverpool John Moores University was engaged to research its impact and effectiveness over an 18-month period from its inception. However, given the relatively low number of consolidation loans made in the early months of the programme, the research project was extended until December 2007. This report outlines the rationale and background of the programme and analyses the key findings of the research.

2. Research project and methodology

The research project was designed to involve MAST, STCAB and STCU directors and staff in a co-operative inquiry into the ongoing management, operation and performance of the loan programme. It was based on action research principles, in which participants engaged to learn from their collective experience of managing the programme and to identify actions to be taken to improve performance.

Research interviews and meetings were held with directors and staff at regular intervals in order to collectively explore, improve and refine the operation of the programme throughout the period of the research.

The research involved capturing key statistical data on beneficiaries and on MAST loans and repayments throughout the period of the project. Systems and procedures designed to capture and monitor key data were established at the outset of the project by MAST staff. Data on progression to credit union saving and borrowing was also recorded. Analysis of the data took place in collaboration with staff members.

Semi-structured individual interviews were conducted with a 10% sample of project beneficiaries to ascertain the impact of a consolidation loan on their personal and economic well-being. Data was collected on a range of other beneficiaries to build up a case study portfolio that captured the outcomes of the programme.

Interim and final evaluation meetings were held with directors and staff on key findings and on identifying actions to address issues and questions that arose from those findings. Research reports and the final report were shared with directors and staff for comment and discussion. The final evaluation research session was held with directors and staff in April 2008.

3. Money Answers South Tyneside

MAST is an independent community development finance institution created in 2005 to promote the economic regeneration of South Tyneside. It was established by a group of people closely associated with South Tyneside Credit Union (SCTU), South Tyneside Citizens Advice Bureau (STCAB) and Tyneside Economic Development Company (TEDCO). Their aim was to found an organisation that would have the flexibility and the capacity to respond to the financial needs of low-income communities in ways that existing organisations found difficult or impossible.

MAST founders were originally attracted by the idea of creating a community banking partnership (NEF, NACUW and CFS 2004; Mellor and Affleck 2005). This form of financial group structure, it was thought at the time, would be able to offer people on low-incomes a *"seamless financial service*". This would include savings facilities, affordable loans, basic banking, bill and debt repayment systems, money advice and support. This argument maintained that by bringing together a credit union, a community development finance initiative (CDFI) and a charitable trust in a one group structure, much more could be achieved than was currently being accomplished by the existing organisations.

For a number of reasons, the South Tyneside community banking partnership did not materialise, in part due to concerns about the nature and operation of the group structure (Jones and Rahilly 2006). Nevertheless, the idea of creating a CDFI remained attractive to founder members, particularly those involved with STCU. It was considered that a CDFI could expand the range of possibilities for intervention within low-income communities. At the time, because of the then credit union legislation and regulation, the flexibility of STCU to intervene in more imaginative or novel ways was often limited and constrained.

Unlike a credit union, a CDFI could open the way to receive financial donations, or loans, from charities or other bodies for on-lending to excluded groups (the constitutions of charities often debarred donations directly to credit unions). It could

also allow loans to be made at higher interest rates, which could support a higher risk loan portfolio and thus enable greater outreach within low-income and financially excluded communities, Importantly, a CDFI would be able to serve people who were not necessarily credit union members. A CDFI promised also to open the door to business and enterprise lending, an area of activity in which credit unions had little background or experience. Developing an independent CDFI working alongside STCU was regarded, therefore, by founders as advantageous all round.

MAST was created as an autonomous organisation. The directors of MAST included people from STCU, STCAB and TEDCO. However, they were not representatives of these organisations, but became MAST directors in their own right. MAST is a stand-alone organisation without legal or constitutional links to STCU, STCAB or TEDCO. Nevertheless, in practice, it was designed to work in close collaboration with the three organisations, particularly STCU and STCAB; a fact reflected in its policies and procedures manual. The MAST registered office is at TEDCO and operates out of STCU premises. For customers, members or clients of the three organisations, MAST is part of the provision of a *"seamless financial service".*

MAST was established with the wide remit of promoting economic regeneration within South Tyneside. However, since its inception, its major and sole area of activity has been the debt consolidation programme, which was established with a £200,000 grant from the Northern Rock Foundation. It was the constitution of MAST as a private company limited by guarantee with objectives that include the relief of poverty that allowed it to receive the Foundation's charitable donation.

MAST began in March 2006. Its effectiveness as an organisation is subject to ongoing evaluation and, given appropriate legislative and regulatory conditions, a closer and more formal relationship with STCU is possible in the future (see Chapter five below).

4. The MAST debt consolidation programme

The MAST programme arose out of the STCU pilot debt redemption initiative created as part of the multi-activity Neighbourhood Renewal Funded programme, *Enterprise in Disadvantaged Communities* (Jones and Rahilly 2006). This comprehensive partnership programme aimed to address poverty and disadvantage throughout South Tyneside and ran from April 2004 to March 2006.

Like the subsequent MAST programme, STCU's loan replacement scheme was designed to offer people on low-incomes the opportunity to consolidate high interest debts through taking out a more affordable credit union loan. It targeted the most deprived neighbourhoods in the borough and focused on offering a service to people who were excluded from mainstream credit options and were in debt to extortionate lenders.

At the time, SCTU had learnt the lessons of previous research studies and was conscious that access to an affordable loan alone could not be the answer to over-indebtedness. It was for this reason that a strong partnership was built with STCAB, as money and debt advice was to be a central characteristic of the loan replacement scheme. By linking credit union services and money advice, STCU endeavoured to put systems and procedures in place that would result in beneficiaries gaining long-term financial stability, control of their finances and, as a step towards financial inclusion, an enduring relationship with a credit union.

The high-cost loan replacement scheme was piloted over an 18-month period from October 2004 to the end of March 2006. It offered initial money advice, advocacy with creditors, money management support, referrals for in-depth debt advice and access to an affordable, consolidated loan.

The STCU scheme assisted 85 people to free themselves from the high interest charged on loans from high-cost lenders. Loan amounts were higher than STCU had originally anticipated with the average loan made being £1,748; this was regarded as an indicator of the level of debt within low-income households and of the need for the debt redemption scheme.

Despite default on the scheme being relatively high (28% of beneficiaries fell into serious arrears, which resulted in 15% loss on the loan portfolio), 71% of beneficiaries went on to save regularly with STCU. Beneficiaries were particularly positive about the value of the debt redemption scheme in their lives, and spoke of how it freed them from the worry and stress of over-indebtedness, released them from feeling ashamed about being in debt to high-cost loans companies, improved their health, assisted them not to return to sub-prime lenders and enabled them to discover the longer-term benefits of credit union membership (Jones and Rahilly 2006).

Given this success and a desire to expand on the benefits of the debt redemption

scheme, the MAST programme was developed to run alongside STCU. Given its status as a CDFI, (unlike STCU), it was able to accept the financial support of the Northern Rock Foundation and was also able to make loans at a higher rate of interest (26% APR) in order to develop a higher risk loan portfolio and to attain greater outreach among financially excluded groups.

The policies and procedures of MAST were based on those of the debt redemption scheme, but were strengthened in order to achieve greater discipline in credit administration and control. Based on the STCU experience, it was accepted that MAST loans would be for higher amounts than normally granted to new members in the credit union.

At an initial interview, an exploration of the nature and origins of the over-indebtedness is conducted by the MAST loans officer. S/he verifies the purpose of the loan, endeavours to understand the financial status of the applicant, tries to ascertain the reliability of the applicant, according to their personal history and references, establishes a personal relationship with the applicant, checks the completed application form, verifies evidence of income and expenditure, agrees the length of the repayment period and explains the importance of joining and saving in the credit union (MAST 2006). Copies of repayment books and documentation on loans to be consolidated, including home credit payment books, are requested to ascertain the regularity of previous payments. Credit checks are undertaken in all cases.

The applicant is then referred to the STCAB adviser based in the MAST office who conducts an in-depth financial analysis of the applicant's situation, including the detailed income and expenditure statement. A debt ratio calculation is made according to a formula based on relating disposable monthly income (after bills have been taken into account) to the monthly MAST repayment. MAST would not normally consider making a loan if over 35% of surplus disposable income had to be committed to the MAST loan repayment. If the ratio was calculated at 40% of surplus income, the applicant would be referred to a specialist debt advice worker at the STCAB office. The development of the debt ratio calculation based on surplus income arose directly out of the experience of the prior STCU debt redemption scheme. In the STCU scheme, the debt ratio calculation was based on income, rather than surplus income. STCU realised that income often is already allocated and should not be used to calculate ability to repay without taking prior commitments into account.

The meeting with the STCAB adviser also allows the applicant to explore a range of alternative financial options, other than an application for a MAST loan. The role of the adviser is not to "sell" a MAST loan, but to enable the applicant to consider this as one option among others. In many cases, as the results of this research will show, a MAST loan was not considered to be in the applicant's best interest.

From the initial meeting with the loan officer and the CAB adviser, a decision is made

on the loan by the MAST loan officer. Subsequent to the decision being made, all negotiations with and payments to creditors are undertaken by MAST. A payment plan for repayment of the consolidated loan is negotiated and a credit union savings plan discussed and recommended. It is stressed to the applicant that a MAST loan is a one-off opportunity to regularise their financial situation and that future loans have to be applied for to STCU in the normal way.

The MAST debt consolidation programme is not advertised publicly. Applicants are mostly referred by STCU, STCAB or other agencies. Some learn about MAST through community and social networks, which, for many people in low-income communities, are their major source of financial information and knowledge (Jones and Barnes 2005).

5. MAST and South Tyneside Credit Union Ltd.

MAST is organised to operate in close collaboration with STCU, with which it has a detailed service level agreement. It is based in STCU offices, is operated by STCU staff and is managed by STCU's general manager. To the STCAB client, the STCU member or any member of the public, the MAST debt consolidation programme appears fully integrated within the overall range of services delivered through STCU offices. In fact, MAST is so linked to STCU that eligibility for a MAST loan depends on the applicant first becoming a member of the credit union.

The link with STCU is central to MAST's purpose and rationale as an intermediary financial institution that enables people to access a pathway to financial inclusion. MAST is a business but, paradoxically, it is not a business that aims primarily to build its own financial strength, as clients are not sought for repeat business. In practice, MAST is a conduit to credit union membership.

MAST's role as an intermediary, however, is based on an important economic reality, now widely accepted, that actions to tackle poverty, over-indebtedness, and financial exclusion cannot be based solely on the provision of affordable credit. Rather, the pathway to financial security is dependent on greater access to financial services that include, in addition to affordable credit, transaction accounts, savings accounts, insurance products and the provision of money and debt advice (HM Treasury 1999, 2004, 2007).

Financial exclusion is a result of poverty (Carbó et al. 2005) but it also leads people into greater poverty and over-indebtedness (Kempson 2002, Jones 2001, Collard et al., 2003, Collard and Kempson 2005). With no access to, and no use of, the financial services taken for granted by most consumers, people have little choice but to pay higher charges on transaction services to cash cheques and pay bills, are vulnerable to high-cost sub-prime lenders and often make poor money management decisions.

This understanding led the founders of MAST to recognise that, if they were to combat over-indebtedness and financial exclusion effectively, they had to offer people in low-income communities, not just instant and accessible loans, but a way to access flexible savings accounts and access to money advice and debt counselling services. This MAST could not do alone, but only in close partnership with STCU and STCAB. Of course, until now, MAST has been unable to offer people access to transaction accounts. However, STCU is now planning the introduction of current accounts for its members before the end of 2008.

A further element missing from the MAST, STCU, STCAB partnership service is financial capability education, increasingly seen as central to a pathway to financial inclusion (HMT 2007). In fact, the need for financial education was to surface as a key learning outcome from the MAST programme.

6. MAST and South Tyneside Citizens Advice Bureau

The link with STCAB is also fundamental to the operation of MAST, as money and debt advice is central to the process of tacking financial exclusion. This is an understanding supported by Citizens Advice, which has urged credit unions, and others, to "*work constructively with money advice agencies who are helping people deal with multiple debt problems*" (CA 2001).

The development of a close working relationship between STCAB and STCU, and subsequently with MAST, was forged during the period of the STCU NRF-funded high-cost loan replacement scheme. STCU and STCU had informally collaborated with one another for a number of years, but it took the NRF project to stimulate a closer formal working relationship that resulted in a strategic partnership aimed at collaboratively promoting financial inclusion in the borough.

Recent research (Jones 2008) has revealed many of the complexities and dilemmas faced by money advice agencies and credit unions, and, by extension, CDFIs, in developing collaborative working relationships. Money advice agencies can be reluctant to refer clients to credit unions and CDFIs for a range of reasons, including worries about compromising agency independence, concerns about suggesting that clients should borrow their way out of debt; and, in relation to credit unions, reservations about holding current, savings and loan accounts in the same institution are deemed as not being in a client's best interest. Credit unions, too, sometimes have concerns about working closely with advice agencies, often in relation to the way advice agencies can underestimate the importance of a credit union protecting its members' assets.

However, through the STCU NRF project, STCAB and STCU were able to develop a high level of common understanding and mutual trust that enabled them to work together and harmonise operational practices, to participate in joint training and to

develop combined promotional and marketing strategies. An analysis of the development of partnership working between the STCAB and STCU, and by extension with MAST, can be found in the NRF report, *'Enterprise in Disadvantaged Communities'* (Jones and Rahilly 2006).

STCAB regards its independence as an advice agency as paramount and always endeavours to act in the interests of its clients. However, it argues that this does not mean that it could not embark on a coordinated course of action with STCU, or with MAST, in order to offer its clients the support they need. STCAB refers clients to MAST or to STCU on the grounds that both of these organisations enable their clients to progress along a road to financial stability.

The relationship between STCAB and MAST, and STCU, is subject to ongoing development and change. As will become clearer in this report, a number of issues were yet to surface that would present both STCAB and MAST with new challenges. These relate to the need for a clearer definition of the roles and responsibilities of the respective organisations in the partnership and the importance of ensuring that MAST always took full responsibility for credit administration decisions.

7. Borrowing your way out of debt

The debt consolidation programme was aimed at enabling people to manage over-indebtedness by repaying high-cost loans by means of a more affordable MAST loan. In general, however, money advisers are very cautious about recommending that a person in debt takes out a further loan. In fact, it is axiomatic among many debt advisers that if someone is in debt, they should never borrow more money, particularly in an attempt to reduce pre-existing debts. This principle has been fundamental to traditional debt adviser training for a long time.

For many debt advisers, the apparent easy option of borrowing to reduce loan repayments has resulted in many people developing a false sense of security. This has been encouraged by the advertising of consolidation loans by sub-prime companies who endeavour to convince people of the advantages of further borrowing. This has led many people, for example, to take out secured loans against property, which have not been in their long-term interest and which have, in fact, often put their homes at risk.

However, there is perhaps a deeper reason why money advisers are wary of consolidation loans. Over-indebtedness is often the result of a lack of control and discipline in borrowing and the way forward, advisers would argue, is for over-indebted people to stop borrowing altogether. It you want to get out of debt, they would claim, you need to cease borrowing and develop different financial behaviours. Simply managing debts by taking out another loan may not result in the radical shift of behaviour often required to reduce over-indebtedness and attain

financial stability.

As was noted in the introduction, it is true that some credit unions have on occasion offered further borrowing as a painless solution to debt problems without due care and attention. Those early examples of credit union loan guarantee schemes demonstrated how easy access to further borrowing did not always result in positive outcomes for the borrower. As recent research argues, *"not only did such access not solve issues relating to deep-seated over-indebtedness and poor money management, but it also resulted in high levels of delinquency that closed off further access to credit union loans for financially-excluded people"* (Jones 2008).

However, the MAST programme is built on the argument that ruling out borrowing altogether for people who are already over-indebted is too strong a position to take. If managed well, and linked to money and debt advice, MAST maintains that there can be circumstances in which settling or reducing a debt with a further loan can entail economic and personal benefits for the borrower.

MAST endeavours to negotiate, for example, a full and final settlement figure for applicants' loans with high-cost creditors which, when settled with a MAST loan, reduces the overall debt significantly. The settlement figure itself can mark an important saving on the overall cost of the high-cost loan. In such cases, a MAST loan to settle a debt can be in the best economic interests of the applicant.

However, more importantly, settling debts with a consolidation loan may be beneficial if it assists a person to free themselves from the habit of using high-cost sub-prime lenders and, instead, a chance of borrowing with MAST and moving into regular credit union membership. The intervention of a MAST loan can then result in a real change in financial behaviour which has long-term benefits for the borrower.

A consolidation loan is, of course, not appropriate for all forms of over-indebtedness. As MAST recognises, a home credit loan is rarely, for example, worth repaying with a consolidation loan unless a low settlement figure can be agreed. Otherwise it would entail the borrower paying interest on the interest already paid to the home credit company. Neither is it appropriate for repaying utility bills and, in most cases, for rent arrears. Rent arrears often mask other more complex and deep-rooted debt problems (Pawson et al., 2005) and debt advice to help people renegotiate repayment is usually the best way forward. This is better than contracting a loan to pay off the arrears in full, not least because rent arrears do not generate interest. The same is true, of course, for utility bills.

However, MAST did leave itself open to the possibility of there being cases where the repayment of rent arrears with a loan could be in the client's best interests if all other measures had been exhausted and such a course of action alone would prevent eviction. However, normally, advisers would strongly argue that there are very few circumstances in which an eviction cannot be avoided through good advice rather than by settlement with a loan (Jones 2008).

The MAST programme also resulted in some borrowers taking out a further loan with STCU. This is an equally difficult issue for many debt advisers. To take out an additional loan when already repaying an existing loan is not regarded as the most effective way forward. However, MAST maintains that people on low-incomes, even if already over-indebted, still depend from time to time on further credit to cope with emergencies or to manage the household budget (Jones and Barnes 2005). MAST argues that it is preferable for borrowers to have a line of credit open in STCU rather than having little choice, in case of necessity, but to return to high-cost lenders. However, applications for credit union loans from MAST borrowers were dealt with according to standard procedures through which they had to demonstrate both the capacity and the willingness to repay.

8. Programme evaluation

a. Programme beneficiaries

97 people applied for debt consolidation loans in the period March 2006 to December 2007 (21 months). 42 of these applicants were granted loans following a credit administration process that involved, from August 2006 onwards, an obligatory interview with a CAB adviser, prior to any agreement of a loan.

The majority of the applicants granted loans were women (83%), 74% of whom were young women, and the majority lone parents with dependent children. Their average age was 29 years. Women with husbands or partners tended to be older, with an average age of 43 years, but, as with the younger women, 65% had children. There was just one female beneficiary of retirement age. The seven male beneficiaries tended to be either young men, with an average age of 30 years, or older married men with an average age of 43 years. The median age of all participants was 32 years and the average was 35 years.

55 loan applicants were refused loans (57% of applicants) and were referred to the Citizens Advice Bureau or other agencies for debt or other advice. These refusals were for a range of reasons. These included applicants being so over-indebted that a £5,000 loan, the maximum allowed in the MAST programme, would have been insufficient to make a difference to their overall financial situation; a lack of financial capacity to repay even a rescheduled debt consolidation loan; and situations where there were other more appropriate solutions to their over-indebtedness.

Council tax and rent arrears and debts to utility companies were always ineligible for a debt consolidation loan. People applying for such loans were directed to the CAB for advice and support or to the British Gas Energy Trust for an energy grant. In addition, according to staff reports, people were also refused a loan because loan officers judged that the likelihood of their repaying was low. This was a particularly difficult area for staff members as these decisions tended to be made either when

information supplied by the applicant failed to match what was revealed through credit check enquiries or, perhaps, more subjectively, through observation of certain behavioural characteristics (see Section 9c below).

The debt consolidation programme was designed to assist over-indebted people into financial stability through borrowing. However, experience on the programme confirmed that, in the majority of cases, the solution to over-indebtedness is not necessarily another loan. For many over-indebted individuals, referral to debt or budgeting advice or to financial capability education is often a more appropriate response. Applicants refused on behavioural criteria and on the basis of a judgement that they were unlikely to repay were also recommended for an appointment at STCAB.

The fact that 57% of applicants were refused loans, and the time and care taken in granting MAST loans, was one of the main reasons that the take-up of MAST loans was slower than expected. In the first six months of the programme, from March to September 2006, only 20 loans had been made, to a value of £51,377.

All loan recipients were on welfare benefits or in receipt of a low wage. 62% of the women were in receipt of benefits and 29% of the men. Of the women in work, 85% were paid no more than the minimum wage and the remainder were on low-incomes just above this level. Five of the seven men were in work, and received wages just in excess of the minimum wage. The project did not target or serve over-indebted people on moderate or higher incomes. 93% of all beneficiaries lived in postcode areas identified by the Department of Work and Pensions as being of the highest social and economic deprivation (these were the same postcode areas served by the DWP Growth Fund through South Tyneside Credit Union).

Loans made to beneficiaries were mostly to pay off loans to doorstep lending companies (48%), catalogues (19%), high-cost retail stores (19%), illegal money lenders (10%), slot television loan companies (7%), store cards (17%), high-cost credit cards or bank overdrafts (29%). 17 people had debts to multiple sources of high-cost credit (45%). Over 58% of loan beneficiaries had previously been paying high-cost loans in cash either to doorstep collectors, high-cost retail stores, through deposits in television sets or illegal lenders. It is estimated that some of those paying catalogues would have also been paying in cash to agents. In total, around 80% of beneficiaries were previously repaying loans in cash in some form.

In the 21 month period, March 2006 – December 2007, £95,064 was lent to the 42 borrowers. The value of the loans ranged from £638 to £5240, the average loan being £2,382 and the median £2,244. 26 of the loans were for over £2,000 and most were made were for periods of 36 months. In fact, following on from the experience of the STCU NRF debt redemption scheme, the relatively high MAST loan balances tended to reflect the amount of unsecured overall total over-indebtedness in low-income and financially excluded households. However, the level of the loan amounts would come to be regarded as one of the reasons for

loan default on the programme.

Programme achievements.

20 of the 38 borrowers (52%) who had taken out loans up to the end of September 2007 were able to move forward into financial stability and repay the MAST loan regularly according to the terms of the loan agreement. The data on the four additional borrowers from September to December 2007 was too recent to make any assessment of repayment.

85% of these 20 borrowers were women, 41% of whom were in employment and 53% on welfare benefits. 59% had dependent children and 35% were lone parents. Their average loan was £2,278.

Evidence suggests that MAST has made a significant difference in the lives of these 20 people, either by reducing their weekly loan repayments or by making a substantial saving on the amount they would have paid to the high-cost lender if they had continued repaying their high-cost loan to full term. £45.5k was made in loans to this group of 20 borrowers who collectively saved £38k, when calculated on the basis of their continuing with the high-cost loans to full term. 11 of the 20 had benefited from reduced repayments of up to £50 per week.

Borrowers who did not benefit immediately from reduced weekly or monthly payments mostly benefited by longer-term saving on the total interest payable over the entire period of the loan (the MAST loan often being repaid in a shorter period than the high-cost loan).

Four of the 20 did not financially benefit directly from the transition to a MAST debt consolidation loan. However, they did benefit in other ways, all of which had longer-term implications for their financial stability and economic benefit. These included being enabled to apply for a new cheaper mortgage on the basis of outstanding debts being settled or being able to free themselves from the temptation of taking out further high-cost home credit loans.

In fact, in assessing the impact of the MAST programme, achievement cannot be measured by a reduction in the amount of regular loan repayments or in the overall cost of credit alone. The aim of MAST was to enable people to take a step forward on the path to financial stability and, once achieved, on to financial inclusion through migration to stable credit union membership. It was this migration into stability that marked the programme's achievement with the group of 20 successful MAST customers.

Of the 20 beneficiaries who were able to migrate successfully to a MAST loan, ten progressed to saving regularly in STCU. Of the 38 borrowers who had taken out loans up to the end September 2007, this therefore represented a 26% success rate in terms of moving people not just out of over-indebtedness but into regular

credit union membership. In fact, overall, 25 of the 38 borrowers had savings deposits, although ten of these had deposits of less than £20, mostly deposited at the time the loan was taken out. Three people in loan default to MAST also had savings deposits. 13 were unable to save at all and had zero savings deposits in the credit union. Of the 23 people who had none or very limited savings, 16 (70%) were on welfare benefits.

18 of the 38 borrowers progressed to take out a second loan with the credit union (47%). However, only seven of the 20 successful borrowers took out a credit union loan (35%). These credit union loans were for much lower amounts, on average around £530 (median £615), and were made available through the DWP Growth Fund. Nine (50%) of these credit union borrowers were paying according to plan (which included the seven who were successful MAST borrowers). This meant that two people repaid their credit union loan whilst defaulting on MAST loan repayments. The rationale for allowing credit union loans, whilst MAST loans were outstanding, is based on the recognition that over-indebted people, whose over-indebtedness has been controlled through the MAST programme, still have credit needs. They were supported to borrow through the credit union's DWP Growth Fund programme in order to assist their non-return to high-cost lenders.

Even though 80% of the 20 had previously paid high-cost loans in cash, from the data available, it was clear that those able to migrate to a MAST loan successfully and make regular repayments were those able to pay by standing order (including one payroll deduction) (50%) or through PayPoint (35%). Only 10% of people who made regular repayments repaid in cash. Of the 11 of the 20 who were unbanked, six paid with PayPoint cards, one by payroll deduction and one through a partner's bank account. Only three continued to repay the MAST loan in cash

Loan delinquency

The 52% success rate in enabling borrowers to manage their over-indebtedness meant that 18 of the loans were problematic. Consequently, loan delinquency and potential loan losses on the loan book were high. At the end of September 2007, 13 of the 38 borrowers had stopped paying altogether, five of whom had proceedings taken out against them for default in the small claims court. Another five continued to pay, but intermittently or paid less than the agreed repayment amount.

As at the end of December 2007, two of those who had been taken to court had restarted payments, leaving 11 borrowers in serious default and not repaying at all (29% of the total). These 11 were placed in the hands of a debt collection agency. By January 2008, there were signs that four of the 11 were starting to repay the debt collector in cash through home collection. The additional five slow payers continued to make payments according to rearranged payment schedules.

64% of defaulters were female lone parents with dependents, 71% of whom were on welfare benefits. In comparison, only 30% of the successful borrowers were

female lone parents with dependents, 66% of whom were on welfare benefits. Seven of the 11 defaulters (63%) had income solely from welfare benefits, including four of the six defaulters with a second loan from the credit union (67%). Whereas nine of the 20 successful borrowers (45%) had income solely from welfare benefits, four of whom had a second loan (44%). Clearly there was some correlation between level of income and success in MAST loan repayments.

The average loan for defaulters on welfare benefits was £2,300, two of whom had loans for £3,000 or over. In addition, the four defaulters with credit union loans had additional average loan balances of £792. The 45% of those who repaid successfully but were also on welfare benefits had slightly lower average loan balances of £1,971. The average loan balance of the four credit union borrowers was £721.

Eight of the 11 defaulters were unbanked (72%), which was a higher percentage than those who repaid successfully (55%). This seemed to confirm that the greater the financial exclusion, the higher the incidence of default on loans.

However, the purposes for which successful borrowers and defaulters sought loans were similar. Loans taken out by serious defaulters were to consolidate debts to home credit companies (36%), illegal lenders (18%), high-cost retail shops (18%), high-cost credit cards (18%), store cards (9%) and slot television loan companies (9%). Loans taken out by the 20 beneficiaries who migrated successfully to a MAST loan were to pay off debts to home credit companies (40%), illegal lenders (10%), high-cost retail shops (20%), high-cost credit cards (20%), store cards (20%), and slot television loan companies (10%).

The 11 serious defaulters represent a potential loan default of £27,450 to the organisation (29% loss on the MAST loan book). In addition, six of these had a second credit union loan, representing nearly £4,000 further loss to STCU.

Identifying common characteristics among the group of serious defaulters, which differentiate them from the group of 20 successful borrowers, is not straightforward, given the relatively small number of borrowers overall. However, there are a number of factors that do appear relevant. As may have been expected, the group of serious defaulters tended to include more unbanked women living on welfare benefits, who were lone parents with children. A higher proportion of defaulters had also returned to STCU for a second loan, which further increased their overall indebtedness to MAST and the credit union combined, and probably put an even greater strain on the household budget.

However, two additional and perhaps more pertinent factors stand out: all defaulters paid in cash on a payment book and 82% of the defaulting group were referred to MAST by STCAB. This compared with only 10% of the successful borrower group repaying in cash and only 45% being referred to MAST by STCAB.

Migrating people from high-cost credit, particularly when that credit has traditionally been home collected, is not easy and the risk of adverse selection for any community finance organisation is high. Given the profile of the customer base, and despite time and care taken in the credit administration process, it is not unexpected that a significant number of people, when under household financial pressure, defaulted when obliged to visit the credit union office in person to pay in cash.

Home credit companies claim that around 44% of all their customers regularly miss more than 50% of their repayments (Competition Commission 2006). Payment irregularity is endemic to the home credit market and recent research for the Joseph Rowntree Foundation (JRF) has demonstrated that only 5% of benefit dependent home credit customers pay to contract terms (Kempson et al. 2008 forthcoming). There is some anecdotal evidence that missing MAST cash payments can also generate defaulter anxieties about visiting the credit union at a later date which leads to an ongoing situation of missed payments. It may be the case that some people, as maintained consistently by the home credit industry, do require the additional support of home collection to make regular payments, particularly when they know that missed payments will not incur penalties. It is significant that three of the 11 defaulters seemed, by January 2008, to be able to repay, once home-collected debt collection services had been arranged

The JRF research project into not-for-profit home credit estimated that around 40% of home credit customers would be able to migrate to more affordable non home credit options per annum. The 52% MAST migration rate is therefore in line with, or even exceeds, migration expectations of those used to repaying loans through cash collection.

However, given the fact that 90% of this group migrated to some form of electronic payment, the MAST programme suggests that it is those with the commitment and capability to use electronic forms of payment who are best able to manage loan repayments successfully.

The significance of the fact that 82% of defaulters were referred to MAST by STCAB has a number of possible interpretations. First, there is some anecdotal evidence from MAST staff that some of these beneficiaries may have regarded a MAST loan as a relatively easy solution to their problem, which was proposed and organised for them by STCAB. It is important to note that, particularly for home credit customers, the decision about the amount of a loan granted and the responsibility for the collection of repayments lies, not with the borrower, but the company itself. The company decides how much a person can borrow and it is the company's responsibility to come to the door to collect. Personal responsibility for repayment does not lie with the borrower. It is conceivable that a solution proposed by an outside agency may have led some borrowers to relinquish responsibility for repayment. The STCAB organised way out of the problem may have led to a belief

that default on the loan was not particularly serious. It became then the responsibility of the credit union to collect rather than their responsibility to repay. In contrast, however, successful MAST borrowers appeared to have a determination and a commitment to repay the MAST loan. As case studies demonstrated, they wanted personally to achieve financial stability in order not to return to their previous dependency on high-cost loan companies. As one successful beneficiary noted:

> *"I have been with home credit companies for years, and I got sick and tired of it. I sometimes did not have enough money for food when I paid the collector. MAST is at the top of my list now, I don't mess credit union up, if I mess my MAST loan up, they will not help me in the future".*

Secondly, there was some evidence arising from interviews with MAST staff that too great a weight was given to a MAST referral than should have been. MAST always undertook its own credit assessment for each application. However, with those who came as referrals from STCAB, on reflection, MAST staff considered that perhaps an assumption was made that a loan could safely be granted. This unfounded assumption led to greater adverse selection. In fact, of the 11 serious defaulters, eight were referred by STCAB. MAST staff have since endeavoured to put in place an even more rigorous credit assessment procedure, and STCAB staff are increasingly clear when dealing with clients that a referral to the credit union does not imply any acceptance of the loan application or expectation that a loan will be granted.

It seems clear from the experience of the programme that the importance of the role of STCAB relates to money and debt advice, but not to the process of loan granting itself. In addition to referrals from the CAB, all MAST applicants (from August 2006) were required to meet with a CAB adviser as part of the loan application process. However, there is no evidence that the meeting with a CAB adviser in the credit union, in order to complete the income and expenditure analysis, made a direct or significant impact on reducing default rates; or at least the impact remains undetermined in this research. 91% of all serious defaulters had an interview with an adviser in the credit union office as compared to 79% of the successful group of borrowers. It is clear that the support offered through the interview with an adviser cannot replace rigorous credit assessment processes as conducted by credit union loan officers themselves.

b. Case studies

For those who were able to successfully migrate to a MAST debt consolidation loan, the programme brought clear personal, social and economic advantages. For 52% of beneficiaries, MAST provided a way forward out of over-indebtedness. For these people, borrowing their way out of debt was not only feasible but it enabled them to achieve a new found financial stability. The first six case studies (A – F) demonstrate how a debt consolidation loan can make a difference in the lives of individuals and families.

The sixth case study, beneficiary G, illustrates the situation where the loan was refused but where the applicant benefited from the advice and support offered through the programme.

The seventh case study, beneficiary H, illustrates how MAST provided a solution to over-indebtedness but where the beneficiary eventually defaulted on the loan, due, possibly, to a change in circumstances.

Beneficiary A.

Mrs. A is a 32 year old married woman with four dependent children living on welfare benefits. Before approaching MAST, Mrs. A was over-indebted to several doorstep lenders and a catalogue company. Life was difficult as she had to repay £210 on the loans every fortnight, which put a great strain on the household budget. A friend suggested that she joined the credit union instead of continuing to be dependent on home credit companies. However, Mrs. A was sceptical about being able to save or take out a new credit union loan while she was still in so much debt. It was then that her friend told her about MAST, as a way to consolidate her existing debts and make a new start.

The total amount outstanding on her three loans was £2,200. This was consolidated into a new MAST loan, payable over 155 weeks at £50 a fortnight. This was more affordable and represented a significant reduction on her original repayments. Mrs. A later took out a £1,000 loan with the credit union and now repays the MAST loan, the STCU loan and also makes a savings deposit at a total amount of £100 per fortnight. Even with the credit union loan repayment and savings deposit, this is a 50% saving on her original fortnightly outgoings.

In interview, Mrs. A was delighted with the opportunity MAST afforded her to take a step forward on the path to financial inclusion and stability.

> "*I'm much better off now", she explained, "I have had home credit collectors for 11 years but now nobody is coming to the door, no debt letters coming to my house. I was getting loans from credit companies and topping them up all the time. I also had a loan from the catalogue. I could not afford to live. Now I am saving a £100 a month on what I paid before".*

She explained how, when she first came to MAST, she was able to hand over all the loan documentation to the worker, who sorted everything out for her. Mrs. A had been a quality home credit customer and hardly ever missed a payment, verified by the payment books she showed to the MAST staff. *"It was easy and straightforward",* she explained, but stressed that the personal contact with the MAST worker was very important for her. It was the worker's friendliness and acceptance that gave her the confidence to proceed with the MAST loan and become a credit union member. She was very satisfied with the speed of the process, which she noted only took one week from the loan application to it being granted.

Mrs. A found the process of migration to MAST and credit union membership relatively problem free.

> *"I pay now with a PayPoint card, it is not difficult. I pay just around the corner. My MAST and credit union payment is now at the top of my list. I just don't want to go back to doorstep lenders, I am quite happy with where I am at now, Don't get us wrong, I have four children, one is a baby but the others in full time education, they have to have boots, trainers, and I do struggle. But even though it is a struggle and I could go back to doorstep lenders very easily. I have been told I could go back to them but I am not going to go back. I had them all, but got sick and tired of it, paying out every single week and being left with nothing. Sometimes I did not have enough money to get my shopping. It was never ever like that. When I had my first child I got a loan, it was a £100 loan and I could manage that, because it was from only one company, but then I started getting more loans from different companies, because I had more children, and it got worse. When I had not got enough for shopping, I had to go and borrow from my Mam. I did this for 11 years"*

Mrs. A typifies beneficiaries on low-incomes that were able to make the transition to a MAST loan successfully. It was the information and the support given by a friend, and subsequently by the MAST staff, that gave her the confidence to take a first step. She was a conscientious customer of home credit and used to making regular repayments. Her over-indebtedness arose not from an unwillingness to repay but from the financial pressures of bringing up a young family on a low-income. As she stressed, she had arrived at a time for change and she seized the opportunity to migrate to a MAST loan.

Mrs. A repaid according to the repayment plan, unlike others who defaulted. One factor that seemed to make the difference was that Mrs. A demonstrated a personal motivation and a real desire to change. She was one of the first MAST customers and, in fact, she did not see a STCAB adviser. She explained that she felt that, once she had been given the information about a MAST loan, she was able to make the transition away from high-cost lenders by herself. She now has no intention of

returning to home credit. Even if a home credit service was offered by MAST itself, she stressed, she would only be interested in it if there was no other option available to her. She now prefers the freedom and control that repaying her MAST loan with a PayPoint card gives her and she values the opportunity of regular credit union membership. However, she still does use a home credit company to cash cheques, which is perhaps a service which STCU itself needs to consider offering in the future, if it wants to ensure that its new members use the credit union for all their financial needs.

Mrs. A believes that the reason why she did not take action before was that information about MAST or STCU was not available to her. She knew little about STCU and nothing about MAST and feels that much more needs to be done to advertise both organisations. The information Mrs. A received about MAST came not via printed publicity but through the recommendation of a friend within her own social and community networks. The use of social networks to advertise MAST rather than more traditional marketing methods is discussed in Section 6 below.

Beneficiary B.

Previous research has demonstrated the importance of social and community networks in disseminating information and knowledge about financial services in low-income communities (Jones and Barnes 2005). This is exemplified in the case of Ms. A above. The Jones and Barnes research found that only 11% of those on very low-incomes regularly read leaflets or publicity in the press. However, beneficiary B was one of those who did. Ms. B is a 75 year old pensioner who had become over-indebted with loans from catalogues, a retail credit company, credit cards and to purchase a car. In total, her debts came to £3,800, which she was having real difficulties paying on her modest pension.

She saw an advertisement in the local press, the Sunderland Echo, about STCU and came into the office to discuss her situation. She was advised that a MAST loan would offer her the opportunity of consolidating her debts in a way that would save her £40 a month. She was granted a loan for £3,893 over a term of 36 months at a rate of £154 a month which she pays through standing order.

For Ms. B, the importance of the MAST loan was not just the reduction in her monthly outgoings, but more the peace of mind and financial stability it gave her. She no longer worried about managing multiple debts simultaneously. Now she has built up her credit status in MAST, she explained that she wants to progress into regular credit union membership.

> *"I've asked now to switch now to a standard credit union loan", she explained, "I want to pay off the MAST loan with a credit union loan because it is at a lower rate*".

Beneficiary C

Mr. C is a 46 year old married man with four children. He approached MAST in order to consolidate credit card and council tax debts, over which he had run into difficulties because of his high monthly mortgage payment. In coming to MAST, Mr. C's overall aim was to put himself in a position where he could apply for and obtain a mortgage at a lower rate from Abbey

His debts on the credit cards and council tax had resulted in Mr. C having county court judgements made against him and his case had been passed to bailiffs. He had approached Abbey about transferring his mortgage from his high-cost lender but had been refused. Abbey would not consider any mortgage application until he had regularised his financial situation and sorted out his debts.

Mr. C's total over-indebtedness came to a total of £2,800, which included the council tax debt. MAST gave Mr. C a loan of £3,096 to pay off all his outstanding debts. Normally, MAST would not have made a loan to pay a council tax bill but, in this case, it was judged to be the simplest way forward. The loan was made over a two year period with monthly repayments of £163.

Mr. C returned to Abbey with all his debts cleared and had his mortgage application approved. He saw his monthly remortgage payment reduce from £559 a month to just £350. With the £163 he was now paying MAST, his monthly outgoings were less than his original mortgage payment. In fact, in Mr. C's case, the interest on his credit cards was less than the amount payable on the MAST loan. What mattered, however, to him was the consolidation of the loans in a way that reduced his monthly outgoings and enabled him to obtain his new mortgage. Once he had achieved financial stability, it was always open to him to repay his MAST loan earlier, thus reducing his overall interest payments.

Beneficiary D

Mr. D is a 45 year old married man with two children. He approached MAST as he was having difficulties repaying an existing loan to a high-cost lender. The balance on this loan was £11,627, which was payable over 47 months at £242 per month. The APR on this loan was 39.9%.

MAST was able to negotiate a settlement figure with the loan company and was quoted £5,215. A MAST loan was made for this amount, repayable over 36 months at £205 per month. The total amount repayable to MAST was £7,400, which included interest payments of £2,184. This represented a saving to Mr. D of £4,227 over the period. Mr. D is £37 per month better off and, in addition, the loan will be paid in 36 rather than 48 months.

Mr. D is now a regular STCU member and has been able to build up a savings balance and access a further loan in the credit union.

Beneficiary E

Ms. E is a 23 year old woman, a lone parent with two young children. She is dependent on welfare benefits and lives in private rented accommodation. She approached the credit union to apply for an instant loan of £300 in order to purchase a new bed for her eldest child and a new washing machine. The washing machine had become a necessity as her mother, to whose house she regularly took her washing, was moving from the area.

However, Ms. E was already paying £25.00 per week as repayment on a home credit loan on which £850 was still outstanding. If the credit union had given Ms. E the loan she asked for, her total weekly repayments would have risen to £35.00 per week (£25 home credit and £10 credit union). Out of her surplus income of £45, this was not a feasible solution.

The credit union referred Ms. E to MAST. MAST was able to negotiate a settlement figure with the home credit company of £639.00, an overall saving on the outstanding loan of £211. A MAST loan was then issued for £939.00, payable over 94 weeks at £10.00 per week. The interest on the MAST loan was £204, which was more than covered by the saving on the home credit settlement figure. Not only did Ms. E obtain the bed and washing machine she required, she also saw her actual weekly outgoings reduced by £15. Compared with taking out the STCU loan she originally sought, this MAST solution saved her £25 per week on overall outgoings.

Ms. E now has a surplus income of £35.00 per week, out of which she is paying £15 into her credit union savings account. Her MAST payment of £10 per week comes in regularly by standing order. If the MAST loan is paid off sooner than agreed, the interest payable will be substantially reduced.

Beneficiary F

Ms. F was aged 19 when she approached MAST for a loan. She has two young children and lives in local authority accommodation. She first approached MAST for a debt consolidation loan in March 2007 as she had debts to several catalogue companies and doorstep lenders and some significant rent arrears. At the time, she had only one child but another was due in early September. She lived in a village and it was difficult for her to visit her parents in South Shields because of the distance. With the baby due, she wanted to move nearer to them but was unable to do so because of the rent arrears. Unfortunately, her application for a MAST debt consolidation loan was declined. It was considered that not only could she not afford the consolidation loan but, as she had rent arrears, she needed further debt advice and was referred to STCAB to see the specialist debt adviser. At this point, Ms. F joined STCU and was advised to save.

She returned to MAST in mid December 2007. She had managed to pay off the rent arrears and reduce her debts considerably. This meant that she could move back to

South Shields to be near her family. Her income had also increased as she now had two children and was receiving additional welfare benefits. She had her child benefit paid directly into STCU and had been able to build up her savings balance.

However, her surplus income was still low as she was continuing to pay loans to two home credit companies and a high-cost retail store. However, she was determined to manage her debts and had resisted the temptation to borrow more money from doorstep lenders, even though it was just before Christmas.

MAST agreed to make her a loan of £1,500 to cover the remainder of her debts. This was payable over 120 weeks at £13.84 per week. This compared to the £45 per week she had been paying to the high-cost lenders. She also had a £400 bank overdraft which she constantly lived on so this was also rolled into the MAST loan in order to give her the opportunity of starting afresh. She used the money she had saved in STCU since joining in March to pay for Christmas.

Ms. F now pays £30.20 into MAST every week through PayPoint. £16.00 comes to MAST (more than her agreed repayment figure but this will reduce her loan more quickly). £14.20 is deposited into her credit union savings account. MAST also assisted Ms. F to work out a weekly household budget. The budget includes a savings plan so that her savings will cover future financial needs without the requirement to increase her borrowing. Ms. F has saved on bank charges (now she has no overdraft) and on reduced weekly payments on loans. In actual fact, the MAST loan will take longer to repay than the original high-cost loans, but, for Ms. F, what mattered was the increased weekly income into the household budget that came from reduced weekly loan repayments.

Beneficiary G

Mr. and Mrs. G, a couple in their late 30s, came to MAST as they heard about the organisation through a neighbour and friend. They had an outstanding unpaid debt of £4,115 with a high-cost loans company and were so worried about it that their health and well-being were being seriously affected.

They arrived at the office with a collection of letters from the company, many of which seemed to be unread. Among them, there was a letter from the loans company which offered to re-schedule the loan at 0% interest over a five-year period. It emerged that Mr. G was unable to read or write and Mrs. G, even though she could read to a basic level, had no understanding of the content or implications of the letter. The date by which the offer from the company expired had already passed. Clearly, a consolidation loan from MAST was not in the couple's best interest if the offer from the loans company was still to stand.

MAST was able to contact the company, which agreed, given the circumstances, to extend the offer. The couple were supported so that they could accept the offer and start making repayments. MAST also referred the couple to STCAB for financial

literacy sessions and gave them information on adult education classes. Both Mr. and Mrs. G joined STCU and became good savers.

Beneficiary H

Ms. H is a 27 year old woman, a lone parent with four children, who lives on benefits. She was referred to MAST by STCAB as she was in difficulties through paying for goods on credit through her television set. She had been repaying about £45 a week through *Buy As You View* slot television for prior purchases of the television itself, a portable television, a washing machine and a single bed. Her cash deposits in the television, which she made regularly through the week, were collected approximately fortnightly by the company collector when he came to empty the television cash box.

The collector emptied the box but gave no receipt to Ms. H nor did he mark her repayment card. Her stated amount of £45 a week repayment was her own calculation. Not only were the cash payments into the television a strain on the family budget, this repayment system left her unsure of how much she had paid or owed the credit company. The original credit agreement was for the television, but, later, other items were added and the agreement 'rolled over' into new ones. The original debt was never paid in full as it also rolled over into yet larger debts to the company.

The telebanking debt was the only debt Ms. H had at the time when it was suggested by STCAB that she sought a consolidation loan. MAST requested a settlement figure from the company for all the goods bought on credit and for all the loans being repaid through the television. Ms. H was granted a MAST loan of £3,000 to settle the entire amount due to the company. This was repayable to MAST over 150 weeks at £27.00 per week, which saved Ms. G £18 per week on her outgoings. With the assistance of the loan, she was able to understand her situation much more clearly and could plan her finances accordingly.

At first, Ms. H repaid MAST regularly and on time each week. She also joined STCU and started to save on a regular basis. The loan was issued at the beginning of December 2006 but by April 2007 she had stopped paying altogether. After a period of fruitlessly contacting Ms. H and encouraging her to pay, MAST implemented court proceedings. Following the court order, Ms. H agreed to make a regular payment but, at the time of writing, this has yet to arrive in the MAST office.

MAST staff have endeavoured to explore the reasons that lay behind Ms. H's default on her loan. She previously repaid her telebanking loan in cash which, if not paid, would result in the disconnection of her television. In addition, the responsibility for the collection of this cash repayment was the loan company's itself. Ms. H did not have to visit any office or take any particular action to repay the loan, apart from feeding the television slot meter. It may be that the migration into more affordable credit repayment options, but a system whereby she had to accept

more personal responsibility for repayment was just too difficult. The JRF research into home credit found that, at most, only 40% of home credit customers per annum, (and repayment through the television is not dissimilar), could be expected to migrate to more affordable options (Kempson et al. 2008). Given the difficulty of this migration progress, any change in personal circumstances that destabilises repayments can rapidly result in default. Ms. H's unemployed partner came back to live with her at about the time when the default on the MAST loan began. It is possible that his rejoining the household brought with it additional financial burdens or a reduction in benefit payments paid directly to herself.

9. Research findings

Research into the effectiveness of the MAST programme aimed to reveal statistical and qualitative data on progress and performance, and to generate organisational learning in programme management, operation and product development.

Research findings are based on statistical data and on interviews and research meetings with MAST staff and beneficiaries, STCU staff and directors and STCAB managers and debt advisers. Reflection on the programme in research consultations has identified ways in which the MAST programme can be improved and strengthened.

a. Assessing overall impact

The MAST debt consolidation programme was an ambitious undertaking. It endeavoured to offer a group of deeply over-indebted people a way forward into financial inclusion and stability. For this group of people, more traditional debt management interventions were considered inappropriate, given the opportunity presented by a MAST consolidation loan linked to credit union membership.

The research revealed that debt consolidation proved successful, and worked according to plan, for approximately 52% of borrowers. It proved particularly successful, leading to a significant advance in financial security, for over a quarter of all borrowers who were able to build up a savings account in STCU.

Not only, as the case studies illustrated, was there an overall saving of £38k in interest payments on consolidated loans for this group of people, but the benefits were significant and led to improved financial stability and security. For many of these 20 people, the value of the MAST loan could not be measured in immediate monetary savings alone, but rather in terms of the freedom from stress and the greater financial security that the loan facilitated.

All these beneficiaries were on low-incomes; many experienced financial exclusion and most lived in some of the most economically disadvantaged areas of South Tyneside.

A 52% success rate of borrowers migrating successfully from over-indebtedness within MAST over the 21-month period is low and indicates high levels of bad debt. However, transitioning highly over-indebted individuals, particularly those in debt to home credit companies, is a demanding, risky and time consuming task. A 52% success rate is understandable, given the depth of the over-indebtedness and the extent of financial exclusion among the MAST client group. Although understandable, it is still a disappointment and fails to match the success rates achieved in the STCU's NRF-funded high-cost loan replacement scheme, through which over 70% of borrowers repaid loans successfully (Jones and Rahilly 2006).

However, it was clear from interviews with beneficiaries that the MAST programme demanded a significant behavioural change on the part of borrowers. Not only were they expected to access debt and money advice, but also to use MAST and STCU as their future sole credit providers. They were also encouraged to save as part of an integrated pathway to financial stability. Clearly, not all borrowers had the commitment and motivation to follow this challenging path.

The fact that 57% of applicants were refused a loan was not regarded as a weakness but as a strong point of the programme. Applicants refused loans were referred to STCAB or other agencies for professional debt advice or other support. In fact, MAST staff spent a significant amount of time with refused applicants, often as much as they did with those who were granted a loan. Staff assisted refused applicants to explore their financial situation and helped them to access STCAB or other support agencies. The achievements of the programme cannot be judged solely, therefore, on the number of loans granted. MAST operated as much as a money advice and signposting service as it did as a lending organisation. The STCAB adviser was able to strengthen the role of MAST in money advice and guidance, and enable applicants to explore their financial options.

In discussions with staff and directors, collective reflection and analysis of the achievements of the programme led to a heightened understanding that:-

- Consolidation loans are only appropriate in particular and limited circumstances, and only if all other strategies have been exhausted or deemed inappropriate. This is particularly the case when endeavouring to serve financially excluded groups whose ability to cope with the transition from high-cost lenders is compromised by the pressures of having to manage on a low-income.

- Migration to a consolidated loan depends on a high level of borrower motivation and commitment to achieve personal financial stability.

- Successful repayment of a MAST loan is linked to the willingness and ability of the borrower to migrate to some form of electronic repayment system (standing orders, PayPoint or payroll deduction). Only 10% of successful borrowers repaid in cash in the credit union office.

- Financial education and capability are central to successful migration to third sector financial services. Staff and directors who were consulted stressed the limited financial capability of many of the people approaching MAST for a loan and how, in their estimation, those who were able to make MAST work for them had a good financial understanding of the benefits and the demands of the programme.

- A consolidation loan can, when managed successfully, contribute effectively to the long-term financial inclusion and stability of the borrower. The results

of the programme evidenced the potential of a consolidation loan to make a difference in the lives of deeply over-indebted people. However, the challenge for MAST is to ensure that a greater percentage of the loans granted result in successful outcomes.

b. Credit control and managing bad debt

At the end of December 2007, 29% of all consolidation loans were in serious default and were placed in the hands of a debt collection agency. The median loan default was £2,300 with a potential total default of £27k, 29% of the MAST loan book.

An analysis of the loans in default revealed that 64% of defaulters were women, lone parents with children, 71% of whom were on welfare benefits.

It was clearly not insignificant that the level of over-indebtedness of individuals on the programme often exceeded £2,000, which is a challenge to repay when on welfare benefits or low-income. It appears that there is evidence for some people borrowing beyond their means on the programme, even though all loan applications were subject to a rigorous income and expenditure analysis, and the amounts which the majority of people repaid MAST were less they had been paying previously to high-cost lenders.

In research discussions on levels of default with MAST staff and directors, the learning points arising from the delivery of the programme included:-

- There is a strong risk of adverse selection in debt consolidation programmes operating in the low-income market. Payment default is endemic to this market, which is made up of a vulnerable customer base.

- All MAST defaulters had undertaken to visit the STCU office and to pay in cash on a MAST payment book. The evident conclusion is that there is a high-risk of default when borrowers are left to visit an office and make cash repayments, when, for the most part, they have been used to having repayments collected by home credit companies. MAST has the potential to achieve more successful outcomes if borrowers are all required to repay loans by standing order from current accounts.

- The introduction of STCU current accounts will enable applicants to pay wages or welfare benefits directly into the credit union, from which loan repayments can then be regularly made. Future MAST loan repayments need to be made dependent on borrowers opening a STCU current account and repaying directly by standing order. Cash repayment methods should not be encouraged within the MAST programme.

- 82% of the 11 serious defaulters were referred to MAST by STCAB. There was some anecdotal evidence from MAST staff that, when the possibility of a MAST loan was proposed to an applicant by a CAB adviser, the loan was

seen as a solution organised and suggested by an outside agency. With some borrowers, this resulted in a diminished sense of personal responsibility for repayment of the loan (see Chapter eight above). This compared with the high level of personal motivation to repay loans and to achieve financial stability among successful borrowers.

- There was recognition that MAST staff may have given too great a weight to STCAB referrals in the loan decision making process in the early days. This led to some loans being granted that should have been refused.

- The level of bad debt confirmed the care needed in making consolidation loans. There was anecdotal evidence, not statistically verifiable, of some borrowers running up multiple debts above and beyond the MAST loan.

- The level of financial illiteracy among the MAST client group was particularly noted by MAST staff and it was stressed that financial capability education was a required element of any programme endeavouring to make an impact among financially excluded consumers.

- There was evidence that some borrowers required additional support over and above a MAST loan. It was considered that a home outreach support service would assist the migration from home-collected credit. This could be linked to the provision of other advice services and provide an opportunity to reach financially excluded individuals effectively.

- There were no recorded cases of borrowers in default revisiting the STCAB for further advice or support. However, it seemed clear, particularly in respect of those clients who had been referred by STCAB, that closer contact and follow-up by STCAB advice workers may have helped the borrower to manage the loan.

All people in default on MAST loans were pursued according to standard credit control procedures and debt recovery procedures. Since December 2007, there have been signs that four of the 11 defaulters have started to repay through the employment of a debt collector. It is envisaged that the overall write-off on the loan book will be less than the 29% calculated at the end of the first 21-month period. The success of the debt collector in making cash collections goes some way to confirm the fact that, for many people, making the transition from home collected credit is not easy.

c. Credit administration

The findings from research into the outcomes of the SCTU NRF debt redemption scheme indicate the importance of continually implementing rigorous credit administration systems (Jones and Rahilly 2006). In fact, the MAST programme aimed specifically to build on learning with regard to credit administration gained from the NRF pilot.

A considerable advance was made by MAST in the development of policies and procedures with regard to the administration of consolidation loans. A systematic and comprehensive approach to the process of credit administration was implemented, as detailed in the MAST policies and procedures manual. A checklist for debt consolidation process was also produced (see Appendix 1).

All those considered for loans were either referred to MAST by STCU, STCAB or from the local authority's welfare rights agency. In fact, the majority of referrals were from STCU, followed by those from STCAB.

All applicants had to attend a financial advice session with the STCAB finance worker based in the MAST office. This worker undertook a full income expenditure statement and analysis and explored with the applicant their financial situation, the background to the debt and their financial options, including the possibility of a MAST loan. The STCAB finance worker is not a debt adviser, but it is recognised that if professional debt advice is required, the person is referred to the STCAB.

Alongside the financial analysis, MAST staff interview each applicant and carry out a credit check, request evidence of income and examine and verify all documentation with regard to the debts to be consolidated. A favourable decision on a loan depended, in part, on a regular repayment history with regard to the debts to be consolidated. The MAST staff member undertook also to contact creditors on behalf of the applicant in order to negotiate and agree loan settlement figures.

In the 21-month period, 97 applications were considered in detail. Each applicant underwent the process of financial analysis and credit assessment to determine whether or not a consolidation loan would be appropriate. The fact that the majority of applications were refused indicates that the credit administration processes were in place and managed effectively. In the pilot STCU NRF debt-redemption scheme, there was no record of any refusals of applicants to the loan fund (Jones and Rahilly 2006).

Reflecting on the fact that the implementation of the MAST credit assessment process still led to a high default rate on loans, staff and directors were led to the following conclusions:

- Rigour in credit decision making is fundamental to the development of a successful MAST debt consolidation programme. Despite advances in the

development of MAST credit assessment procedures, there is still a need for further training and skill development in loan granting and in the assessment of risk. This is a critical requirement if the MAST debt consolidation programme is to continue and survive.

- There needs to be greater analysis of the factors that distinguish the granting of a successful loan from the making of one that quickly goes into default. It would be helpful to learn from the experience of other credit unions and CDFIs who are operating debt consolidation programmes.

- There is a need to identify not just the capacity to repay, but also the willingness and the likelihood of the borrower to actually repay a loan. MAST staff noted in interview that this final judgement call is often based, not just on documentation and credit checks, but on the behavioural characteristics of the applicant. The danger is that this judgment is overly subjective and subject to presumption and bias. It became clear that understanding the importance of behavioural characteristics and behavioural scoring techniques in forecasting financial risk is an area for further study and training.

- MAST staff and directors concluded that the fundamental principles of lending should not differ between MAST and STCU. MAST serves individuals who would not quality for a credit union loan. This may be for a range of reasons, including the amount requested or the lack of savings or credit history in the credit union. However, even if MAST borrowers are regarded as of greater risk, this risk needs to be rigorously assessed. Loans, particularly for higher amounts, should never be made without good evidence of a capacity and willingness to repay. An increase in the number of refusals is preferable to an increase in the level of bad debt.

d. Working in partnership with South Tyneside Citizens Advice Bureau

The operation of the MAST debt consolidation programme is closely linked to the provision of a coordinated service in partnership with the STCAB. The development of the relationship between STCAB, STCU and MAST was forged during the period of the STCU NRF pilot debt redemption scheme and is described and analysed in section six above. Many of the management and organisational issues, and those relating to the vision and purpose of partnership working, were explored at that time by the organisations concerned. In fact, the South Tyneside partnership was recognised nationally as contributing to the development of thinking on money advice agencies and credit unions working together (Jones 2008).

However, the fact that 91% of all serious defaulters had attended an interview with a STCAB adviser led to a re-evaluation of the dynamics of the relationship between MAST and STCAB. Moreover, as noted above, 82% of serious defaulters were directly referred to MAST by STCAB. There was no evidence from the statistics

available that meeting a STCAB adviser had made any significant impact on lowering default rates.

As has also been noted above, there was some evidence that MAST staff may have given too great a weight to STCAB referrals in making loan decisions, and that some of those referred may have seen the MAST loan as a solution to a problem proposed by an outside agency rather than one that demanded their own personal engagement and motivation to make it work.

In research consultations, reflection on the relationship between MAST and STCAB led to the following conclusions:

- A clear definition of roles and responsibilities of MAST and STCAB needs to be determined in written protocols, operational procedures, service level agreements or terms of reference. The role of the STCAB adviser cannot be related to loan granting, either explicitly or implicitly, but rather to income and expenditure analysis, budgeting advice and the detailed exploration of financial options.

- It needs to be made clear to people referred to MAST from STCAB that the referral does not imply any expectation that MAST will grant a loan.

- The outcomes of the debt consolidation programme reinforce the understanding that credit administration is entirely a MAST responsibility. It has to be recognised that MAST is an independent financial organisation, which has to take full responsibility for assessing loan applications and making loan decisions.

e. Marketing the debt consolidation programme

The relatively low take-up of loans over the 21-month period was a concern for the MAST board and for some people in the STCAB. It is true that the number of loans granted was not as high as may have been expected.

The main reason for the number of loans made was that consolidation loans were only granted in particular circumstances, and only in cases where the granting of the loan could be shown to potentially make a significant difference to the financial and personal circumstances of the applicant.

A secondary reason was the organisational capacity of MAST to handle complex and time-consuming applications. MAST was only open to conduct interviews on two afternoons a week. In practice, MAST and STCAB staff could only see a maximum of two people per afternoon, given the time required to process an application.

The third reason was that the MAST debt consolidation programme was not openly marketed. People were referred by STCU, STCAB or, in a few cases, by the local

authority's welfare rights service.

Whether debt consolidation loans should be marketed more openly was subject to varying opinions among MAST and STCAB personnel – some favouring the non-marketing of loans on the grounds that it reduced default, but others contested this and argued that there was scope for some greater information about their availability. It was particularly argued that other organisations and agencies, particularly housing associations and community organisations, should be made more aware of the MAST programme.

From the statistics and interviews, there was no evidence that the non-marketing of loans had any marked impact on default rates. There certainly seems to be greater scope for the marketing of the MAST programme, particularly through a wider group of organisations and agencies.

f. Some thoughts on serving high-risk, low-income borrowers

The high level of default and potential write-off on MAST debt consolidation loans, although clearly unacceptable in the long-term, replicates similar lending experiences within third sector finance initiatives. Jones (2003) reported loan write-offs of up to 46% in some credit union loan guarantee programmes, designed, like the MAST programme, to consolidate the high-cost debts of low-income borrowers. Anecdotally, in discussions with credit union staff nationally, although not confirmed by the Department of Work and Pensions, it is reported that a 15% to 20% write-off on Financial Inclusion Growth Fund loans has not been uncommon. In fact, examples of even higher write-off rates were related by some credit union staff members.

The high potential MAST write-off rate of 29%, as at the end of December 2007, was not therefore particularly exceptional. However, it was accepted by MAST that, even if replicated elsewhere, such a high rate was neither acceptable nor sustainable in the long-term. The official DWP Growth Fund write-off target is 10% or less and, internationally, as reported by Jones (2003), loan loss rates in excess of 10% made on programmes similar to MAST are often regarded as a breach of contract with the funder. Given the demonstrable impact of the debt consolidation programme in the lives of MAST beneficiaries, however, MAST has increasingly endeavoured to reduce the level of bad debts with some positive results.

A recalculation of the bad debt figures prior to this report going to press indicated that, by the end of September 2008, the potential write-off rate had reduced from 29% to 19.45% of the total value of the loans outstanding on the loan book. It stood at £15,759 on the then loan book of £81,003. This was a near reduction of 10% in a period of nine months.

The MAST programme is based on many of the elements of good practice found among third sector lenders familiar with the high-risk, low-income market. There is a

straightforward and easy application process, a rigorous income and expenditure analysis, access to debt advice and affordable loan repayments set at no more than 35% of calculated surplus disposable income (income less expenditure) which gives borrowers a financial cushion against unexpected bills and other unprovided-for expenditure. There is also a stress on building a personal relationship with the borrower and on leaving open a possible future credit line. This is often important for low-income borrowers who may be tempted to return to high-cost alternative providers. There is also, if delinquency occurs, a systematic credit control procedure.

It is true that borrowers were allowed to repay in cash, rather than being obliged to pay directly from wages or benefits already deposited electronically in the credit union. The latter would have afforded MAST a reasonably, guaranteed method of repayment and would also have offered borrowers the knowledge that their repayments were being met without them having to remember to do anything in particular. Not insisting on electronic payment methods, in the early days of the programme, was one factor that explained some of the occurring bad debt, as has been explored earlier in the report. However, this alone cannot explain why potential write-offs rose to such a high level by the end of December 2007.

There is another factor that, in many ways, remains unexplored in this study but was hinted at in a number of research interviews with staff members. This is the fact that there is a range of differentiable borrower segment types with different expectations, life experiences and, importantly, attitudes to repayment. It is sometimes not easy for loan officers to recognise borrower types and, therefore, always to respond accordingly.

Many of the successful borrowers, for example, would have been people who had been relatively reliable users of high-cost credit and who had borrowed either to support a family or to afford the necessities of life. They had become over-indebted through force of circumstances but, in general, despite some irregularities of payment, repaid the high-cost credit provider consistently. Once having migrated to the MAST programme, despite some ongoing missed payments, they would have continued to pay according to the repayment plan. Some of these people may have been tempted to return to high-cost providers when household budgets were stretched, but the forming of a strong relationship with MAST and the credit union, and the fact that they could get larger loans in the credit union, would mostly keep them to their agreed repayment plan.

Other borrowers, and one was described in detail by a MAST staff member, can also be high users of credit, not for necessities, but rather to fund the purchase of many and varied consumer goods. Debts with these borrowers tend to be amassed through multiple forms of credit, including credit and store cards. Many in this group, motivated by an aspirational lifestyle, are likely to be resistant to debt advice and, in their case, missing repayments can be endemic. Even though MAST calculated

disposable income, this would often have been directed to yet greater consumption with the consequent lack of financial capacity to repay the loan. With these borrowers, perhaps the only way to ensure repayment is through direct deduction from wages or benefits already deposited in the credit union.

These are but two segmented types. High-risk, low-income over-indebted borrowers can be divided into many more borrower types, displaying various forms of poor money management and financial literacy skills. For MAST, the challenge is to have the ability, wisdom and good sense to identify those borrowers who are prepared to change through participation on the programme, given the appropriate support and repayment channels, and those who are unwilling or unable to repay, whatever support is offered. This ability only comes with experience and learning. With the decline in potential write-off rates and the continued referrals to the Citizens Advice Bureau debt adviser (of the 29 applications in the period January – June 2008, 26 were declined a loan and referred rather to the CAB for debt advice), there is evidence that MAST is learning the lessons of effective lending to high-risk, low-income borrowers.

10. Conclusion

The MAST debt consolidation programme, in the 21 months of operation researched in this report, demonstrated that for 52% of borrowers, borrowing oneself out of debt is possible and a realistic and achievable tactic. These borrowers were able to successfully manage the transition from repaying high-cost lenders to a MAST consolidation loan. For many, the transition demanded a high level of personal commitment and motivation, especially when their over-indebtedness had been to home collected credit. Yet, for them, this transition brought significant financial and personal benefits. Borrowers freed themselves from cycles of dependence on home credit companies and high-cost lenders; some were able to use the opportunity afforded by a MAST loan to achieve greater financial stability and inclusion as a regular credit union member.

However, given the high level of default on the programme, the MAST programme confirmed that consolidation loans are only appropriate in particular and limited circumstances, and can only be regarded as a tactic to combat over-indebtedness if all other strategies have been exhausted or deemed inappropriate. The high level of default on loans must be one indicator of the inappropriateness of consolidation loans for a significant number of borrowers. Not only were the high loan balances difficult for some people to repay, but it appeared that many had developed neither the motivation nor commitment necessary to consolidate debts successfully and move on to financial stability. Some borrowers merely transferred their over-indebtedness to MAST as a solution to an immediate and pressing problem.

An evident conclusion is that debt consolidation programmes in low-income communities need to be approached with caution. For, even with rigorous credit administration procedures, the risk of adverse selection will inevitably remain high, given the realities and dynamics of the sector of the market within which MAST operates. It was clear that MAST had improved credit administration procedures since the previous STCU NRF debt redemption scheme but, at least in the period under consideration, the level of default was similar in the two programmes. It was only much later, with more rigorous debt recovery procedures in place, that levels began to reduce within the MAST programme. This can only be confirmed by means of an analysis of default levels from January 2008 onwards, which is outside the period of investigation of this report.

However, the 21-month programme did reveal, with greater clarity, what worked and what did not work in debt consolidation programmes within low-income communities. There is a clear need to subject all applications to rigorous credit administration procedures, including credit and behavioural checks; all loans decisions need to be taken clearly by MAST, and a referral from STCAB should not carry any expectation, evident or implicit, that a loan will be granted; loan repayments should be linked to standing order payments from current or benefit direct accounts. Migration from high-cost credit should also include migration from

cash repayments. Finally, debt consolidation loans need to be linked to a system of support and outreach mechanisms, if possible including home visits. Constant contact and support during the process of migration to a MAST loan appears to be key to success for some people.

Access to money guidance (HMT 2008) and financial capability education were revealed as essential to strengthening people's capacity to make the transition to financial inclusion and stability. Some financial capability education was offered through STCAB but this would benefit by being more generally available.

Nevertheless, the success rate on the MAST programme does give some encouragement to the retention of debt consolidation as an option within the wider context of promoting financial inclusion and stability. However, this will demand the development of enhanced skills and abilities in loan assessment and the identification of risk among MAST staff members. It also appears essential to link the granting of a MAST loan, not just to the opening of a STCU savings account, but to a STCU current account. With a current account, MAST borrowers will be able to pay welfare benefits or wages more easily into the credit union. MAST loan repayments can then be made directly by standing order from the account. This should become the normal and accepted method for the repayment of MAST loans. This is, of course, the common practice of all CDFIs in Britain.

A full cost-benefit analysis of the programme was not undertaken as part of the research, as it was judged too early in the programme to arrive at definite conclusions with regard to value for money from the investment made. However, it was clear from the financial expenditure on the MAST programme that it is an expensive option. Yet, in assessing value for money, it is important to remember also the benefits gained by the 55 people who were refused a MAST loan, many of whom gained immediate support and access to money and debt advice. Moreover, those granted a loan, and who were able to repay successfully, gained more than an immediate financial saving. Any cost-benefit calculation would need to take into account the impact of MAST on the longer-term health and well-being of both borrowers and those directed to other organisations and agencies.

MAST was established as an independent CDFI with a wide remit but, since its inception, the debt consolidation programme has been its only area of activity. As an organisation, it has demonstrated the role it can play in pioneering new initiatives aimed at combating financial exclusion. There are arguments, now that credit union legislation and regulation are under reform, that perhaps MAST is no longer required as a distinct entity from the credit union. For it is true that its operational position within STCU does present challenges with regard to the management and accountability of the organisation. However, MAST has shown its value as an organisation that is able to respond rapidly and imaginatively to a gap in provision, and has enabled an intervention that the STCU could not deliver at the time. What role MAST adopts in the future is, of course, open to discussion.

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Appendix One

Debt consolidation checklist

This checklist is designed to inform decision making about applications for loans to repay current debts. It is not designed to offer a scoring system but rather to raise issues that need to be addressed in any debt consolidation loan application.

<table>
<tr><th colspan="2">Action</th><th>YES</th><th>NO</th><th>Notes</th></tr>
<tr><td colspan="2">Has the applicant been referred from an advice agency?</td><td></td><td></td><td></td></tr>
<tr><td colspan="2">Has the applicant already seen a debt adviser?</td><td></td><td></td><td></td></tr>
<tr><td colspan="2">Has the debt adviser agreed that taking out a loan to pay off existing debts is in the best interests of the client?</td><td></td><td></td><td></td></tr>
<tr><td colspan="2">Have other courses of action to deal with the debt been considered?</td><td></td><td></td><td>What were the other courses of action considered and why were they rejected?</td></tr>
<tr><td colspan="2">Is the loan to repay a utility bill, rent arrears or Council tax?</td><td></td><td></td><td></td></tr>
<tr><td colspan="2">If the applicant has not seen a debt adviser, will the applicant agree to an appointment with a debt adviser?</td><td></td><td></td><td></td></tr>
<tr><td rowspan="5">By taking out a consolidation loan, how will the applicant’s circumstances be improved?</td><td>By reduced weekly or monthly repayments</td><td></td><td></td><td></td></tr>
<tr><td>By reducing the total cost of the loan over the term period?</td><td></td><td></td><td></td></tr>
<tr><td>By avoiding court action by existing creditors?</td><td></td><td></td><td></td></tr>
<tr><td>By breaking a connection with high-cost lenders and enabling a new start?</td><td></td><td></td><td></td></tr>
<tr><td>Other improvements in circumstances – please note.</td><td></td><td></td><td></td></tr>
</table>

Has an income and expenditure statement been completed?			
Does the applicant have the capacity to repay a debt consolidation loan?			*What capacity does the applicant have to repay?*
What evidence does the applicant give of having the motivation or commitment to repay a debt consolidation loan?			
Has the applicant any referees that can support the claim of commitment and motivation to repay?			
Is evidence of repayment history to existing creditors available?			*What evidence?*
Has the applicant been in default to existing creditors?			
Has the applicant agreed to make regular wage or welfare benefit deposits into the credit union to cover loan repayments?			
Has the applicant applied to repay using PayPoint?			
Has the applicant applied to repay in cash at the credit union office?			
Does the applicant require further support from the credit union?			
Does the applicant require further support from STCAB?			
Does the applicant have an appointment with a money guidance worker?			
Does the applicant wish to open a credit union budgeting account?			