Community Banking Partnership

Legal Structures that Work

Achieving Financial Inclusion – Lessons from American credit unions and CDFIs for practitioners in Britain

Clifford Rosenthal, National Federation of Community Development Credit Unions

Photo and front cover photo: David Hake

Community Banking Partnerships (CBPs) are being formed across England and Wales to tackle financial exclusion more successfully. Finding effective ways to structure these partnerships is crucial to their success. This report, the second in the CBP series, looks at what lessons can be learnt from the experience of similar group structures in the USA. The next report will highlight how Community Banking Partnerships fit into the current British policy context.

Contents

Acknowledgments

Special thanks are due to two people on both side of the Atlantic whose separate requests prompted this research. In the USA, Justine Zinkin, executive director of Credit Where Credit is Due, partner organisation of the Neighbourhood Trust Federal Credit Union in New York City, convinced me of the importance of this research, not only for her own institution, but for the future of the CDCU movement in the USA. In Great Britain, Pat Conaty of **nef** (the new economics foundation), whose relentless intellectual curiosity is coupled with a drive to devise workable, sustainable solutions to the financial issues confronting low-income people, has played a unique role in promoting transoceanic collaboration among CDFIs and credit unions for more than fifteen years. His work over the past two years with NFCDCU on a Community Banking Partnership system to enable CDCU methodologies to be adapted to British circumstances highlighted the need to examine the track record of CDCU group structures to date. Working with the three Community Banking Partnership founders in Britain (**nef**, the National Association of Credit Union Workers, and Community Finance Solutions) on this project has been a real pleasure.

The leaders of the organisations whose experience forms the subject of this investigation generously contributed their time and expertise. Among these are Bill Myers (Alternatives FCU), Marcus Bordelon (Appalachian FCU), Robert L. Jackson (1st Delta FCU), Alan Branson (Hope Community CU), Justine Zinkin (Neighbourhood Trust FCU), Ginger McNally (Santa Cruz Community CU), Randy Chambers (Self-Help CU), and Caryl Stewart and Antonia Bullard (Opportunities Credit Union, formerly the Vermont Development Credit Union). None of them bear responsibility for any errors of fact or interpretation in this report.

nef (the new economics foundation), who worked closely with us to complete two previous reports on CDCUs for a British audience in 1997 and 2003, deserves my thanks for commissioning this research and for their important continuing work on behalf of the financially excluded. Along with the Community Banking Partnership national development team, we are very grateful for the generous funding to support this research from Lloyds TSB Bank. Finally, but especially, my thanks to the board of directors of the National Federation of Community Development Credit Unions, whose unwavering commitment to doing ever more to serve low-income communities has made this project possible and necessary. Rita Haynes, Michael Chan, Robert Coleman, Barbara Black, Melissa Marquez, Robert Jackson and Marvin Jensen, personally brought the Federation board's perspective to this effort.

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Foreword

The National Association of Credit Union Workers (NACUW) and the Community Development Finance Association (cdfa) have great pleasure in introducing this report and in doing so also acknowledge the specific contribution that Cliff Rosenthal is making to the development of the Community Banking Partnership (CBP) here in Britain. The report highlights the outcome of research undertaken by Cliff into credit union group structures with valuable emphasis on lessons to be learnt by British practitioners in respect of governance and structures within financial inclusion partnerships.

For the past ten years, the National Federation of Community Development Credit Unions (USA) has been a huge inspiration for a number of credit unions here in Britain and this report provides some very valuable insights for the ways in which we can deliver better services and products through partnership working. We are grateful for the help we have had from the Financial Services Authority in helping us to work up this innovative new approach that from 2006–2008 is to be tested in seven regions in England and Wales through the Community Banking Partnership national demonstration project. Like the CDCUs featured in this report, CBPs have the potential to show a clear and constructive way that credit unions and community development finance institutions (CDFIs) can work together to ensure that clients get the best possible support and services.

We are delighted that thanks to the core funding, feasibility study and business planning support from Lloyds TSB and other funders, we now have developed a sophisticated and robust Community Banking Partnership approach for testing in Britain. As a result of this research and development support, CBP is now at the leading edge of new thinking within the community finance sectors and is well positioned for delivering 'joined up solutions' to achieve financial inclusion in diverse urban and rural areas of England and Wales.

In the wake of the *Lifesaving* report launched at the CDFA annual conference in Cardiff in 2003, this publication has been the result of an ongoing partnership that NACUW, **nef** (the new economics foundation) and Community Finance Solutions have developed since then with the National Federation of Community Development Credit Unions. With this report, ground is now well prepared to demonstrate in practice with Financial Inclusion Fund resources, the role for CDFIs and community development credit unions in Britain to combat financial exclusion.

Brian Geary, Chairperson
National Association of
Credit Union Workers

Bernie Morgan, Chief Executive
Community Development
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Executive Summary

The Changing Financial Landscape in the USA

In the last decade, the financial-service landscape of the United States has been transformed by the proliferation of high-cost lenders who target low-income and other debt-strapped, cash-short consumers.

"Payday lenders" are the most visible of this new breed. Typically, they make short-term loans of up to $500 against the next paycheque of an employed individual with a current account, charging fees equivalent to an annual interest rate of 300–500% or more. Virtually unknown in the early 1990s, their ranks increased to 12,000 locations in 2000 – and 22,000 by 2004. Some are single-store operations; others are part of chains, which may be owned or financed by banking companies.

But other wealth-draining practices have also multiplied in the USA. Predatory mortgage lenders refinance homes, pyramid fees through loan "flipping," and force low-income homeowners into foreclosure, producing personal and social tragedies. Credit card companies have introduced breath-taking increases in late charges, abrupt interest-rate hikes, and other fees that have extracted billions of dollars from their customers. Some banks have implemented products known somewhat euphemistically as a "courtesy overdraft": the institution pays cheques that would otherwise bounce, but at a substantial fee, sometimes without adequate disclosure to the consumer.

Yet another symptom of the worsening household debt crisis is the proliferation of budget counselling, or debt-advice services. While this industry has long been established in the US and includes many reputable, effective organisations, some of the start-ups of the last decade have been exploitative and dishonest. Some of these new entrants have wrongfully obtained non-profit status, of which enforcement agencies are now attempting to strip them.

Who makes up the market for high-cost financial service providers? Estimates place the numbers of "unbanked" or financially excluded households in the US at 10–15 million. These people are especially vulnerable to predatory practices – but they are by no means the entire market: the customers of payday lenders, for example, typically have bank accounts, as well as recurrent earned income.

The challenge of bringing affordable, accessible financial services to this massive market has become greater than ever. This is the challenge that the credit union movement in the United States faces, if it is to live up to its historic legacy. And this is the challenge that community development credit unions (CDCUs) have taken a leading role in addressing.

Credit Unions in the United States: An Overview

The credit union industry in the United States formed nearly a century ago to liberate working people from usurers and to provide a vehicle for them to save modest sums. Non-profit and mutually owned, there are approximately 9,700 credit unions in the US, controlling in aggregate $700 billion in assets. More impressive, their membership numbers nearly 80 million people – almost one-third of the population.

Today, many credit unions primarily serve people of modest means. Others serve members who have risen to solid middle-class status, and who are readily bankable. There are nearly 100 credit unions in the United States with assets exceeding $1 billion, with the largest topping $20 billion; some serve hundreds of thousands, or even millions, of member-owners. All credit unions, large and small, share the same non-profit, co-operative structure.

The credit union industry, like banking, has been marked by steady consolidation over the last 25 years. Credit unions today serve more people than ever before – but the number of institutions has shrunk dramatically, declining by more than half from a peak of some 20,000 separate institutions in the late 1970s. In recent years, 300 credit unions a year have ended their corporate lives through merger or liquidation. As few as a dozen new credit unions are formed each year in the United States. For the most part, the growth in credit union membership occurs through the expansion of existing institutions.

The Role of Community Development Credit Unions

While many credit unions have prospered along with their members, a subset of the credit union movement has remained focused on the low-income market. These institutions, known as community development credit unions, or CDCUs, specialise in serving inner-city and rural communities, immigrants and indigenous people, lone parents and other economically vulnerable, financially excluded households of every race and ethnic group. They are distinguished by their commitment both to low-income individuals and to the broader community. On average, they are not among the largest credit unions, but they are among the most innovative and resourceful.

The federal government has recognised the special role of CDCUs in a number of ways. Scores of CDCUs are designated "community development financial institutions," or CDFIs, which gives them access to capital from the federal CDFI Fund – an institution the CDCU movement helped to create. Most CDCUs have

Photo: David Hake

CDCU Vital Statistics – January 2005

CDCUs	224
Members	879,991
Assets	$3,291,091,671
Member Savings	$2,834,912,618
Loans Issued (2004)	$1,447,727,861
Loans Outstanding	$2,508,935,085
Dividends Paid (2004)	$26,629,615

obtained “low-income designation” from their federal regulator, the National Credit Union Administration. This designation confers special powers such as the ability to raise insured deposits from any source outside their defined “field of membership” (legally permissible through “non-member deposits” from, say, social landlords or banks) and the right to raise secondary capital (deeply subordinated debt that functions, subject to certain conditions, as net worth).

While these powers are helpful, they are not sufficient. Serving the low-income market means assuming and managing additional risk and cost. It means looking beyond low credit scores and high debt ratios; processing large volumes of low-value, labour-intensive transactions; and offering financial counselling and specialist advice without charge to consumers and small-business owners. At the same time, a credit union pursuing this mission must generate sufficient surplus to meet mandatory capital (net worth) standards, as well as a multitude of peer-group operating ratios by which regulators judge credit unions.

Some CDCUs have found that they need to access additional resources and adopt a broader range of financial tools to serve low-income communities effectively.

They have formed or recruited affiliated non-profit organisations to support, complement, and amplify their work, in an effort to offer comprehensive financial services to low-income people and communities in a sustainable way. These group or affiliate structures have emerged over a period of two decades. While they are not yet widespread, they are the products of some of the most innovative, effective, and influential CDCUs in the United States.

This report is an initial attempt to summarise their experience and draw lessons for other organisations thinking about following in the footsteps of these exemplary institutions. It has been commissioned by the national Community Banking Partnership team here in Britain to seek to learn lessons from the practical and regulatory experience of Amercian CDCUs with group structures. In turn these lessons can be utilised to inform the development of similar links between credit unions, CDFIs and non-profit service providers as proposed for Community Banking Partnerships in diverse sub-regions of England and Wales.

The report shows that the American CDCU group structures have enabled multiple problems related to financial exclusion to be addressed in effective and positive ways. CDCU group structures have in general functioned smoothly over many years. But obtaining operational unity and coherence among the companies in the group needs a clear focus. The lessons of good practice to develop effective group structures from the findings are as follows:

- i **Divided authority:** this should be avoided and a common CEO for the different companies in the group is a sound practice;
- ii **Organise by common function wherever possible:** economies of scale and sharing costs can be achieved by sharing specialist expertise. In most CDCU group structures, a common finance and accounting department for all affiliated companies is the norm;
- iii **Keep separate records:** separate books, time records and audits are essential and necessary to maintain complete transparency and to ensure full regulatory compliance;
- iv **Maintain board separation:** while the personnel of various boards may overlap to some degree, it is necessary that the boards are clearly defined as separate entities, with their own minutes;
- v **Segregate activities appropriately:** organisations should take care to ensure that their charitable affiliates perform only tax-exempt activities and that the credit union carries out only its legally permitted functions;
- vi **Wherever possible, ‘off-load’ non-financial support services:** costly services for which other funding may be raised, such as financial education, money & budgeting advice, homeownership advice and business advice should be provided by an affiliate wherever possible so that they do not adversely affect the credit union’s financial statement and key ratios.

I. Overview

About this Study

In commissioning this research, the Community Banking Partnership team were keen to obtain an appraisal of how credit union group structures have operated in the USA and in particular what has stimulated their development, what problems have been encountered, what benefits have been achieved and most importantly how this innovative approach has assisted in the achievement of the community development mission of tackling financial exclusion.

While the American credit union movement is much older than the movement in Britain, there are strong regulatory similarities and both the British and Northern Ireland credit union movements have had direct development support over many years from CUNA (Credit Union National Association). So as the British Government gears up to implement its Financial Inclusion Fund in 2006, it was felt that the findings of this research could provide much useful food for thought to both British credit union and community development finance practitioners on the one hand and on the other hand could provide policy guidance to civil servants in the DTI, DWP, DCA and Treasury. In addition and not least, the subject matter and American experience with Credit Union group structures was felt to be of special interest to regulators at the Financial Services Authority.

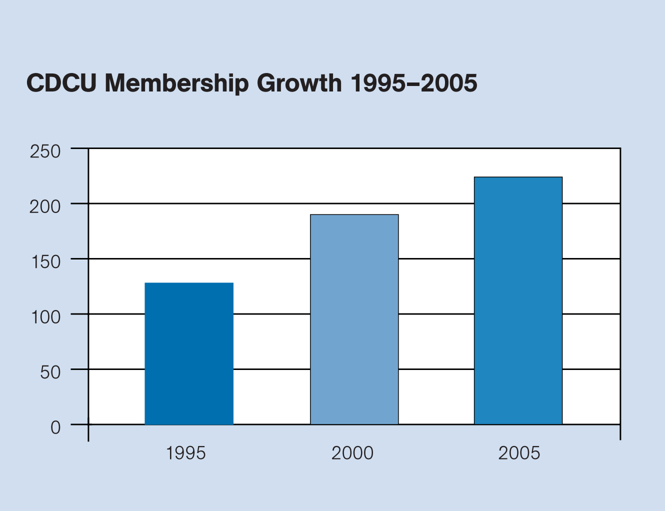
To take forward the research, during the summer and autumn of 2004, the National Federation of Community Development Credit Unions (NFCDCU) surveyed eight community development credit unions (CDCUs) that operate in tandem with affiliated organisations in order to advance their work as community development financial institutions (CDFIs).

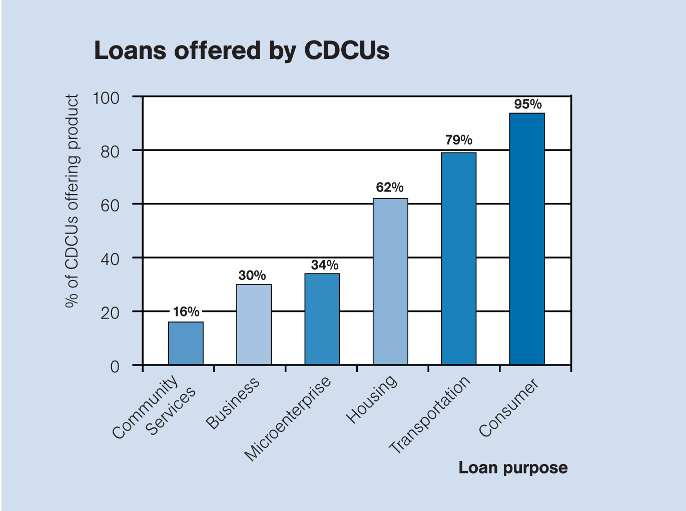
In one sense, it is extremely common for a credit union to have an affiliate or a related sponsor organisation, such as a company, a trade union, a church or a community organisation; these related sponsors formed the basis of the "common bond" that regulations have required of any credit union formed in the US since the early twentieth century. For this study, however, we focused on a particular type of organisation, namely; credit unions allied with affiliates that were created or that evolved specifically to enhance the provision of financial services. Rather than being the by-product or residue of credit union regulation, these "group structures" are distinguished by their intentionality and their integration into common strategic frameworks.

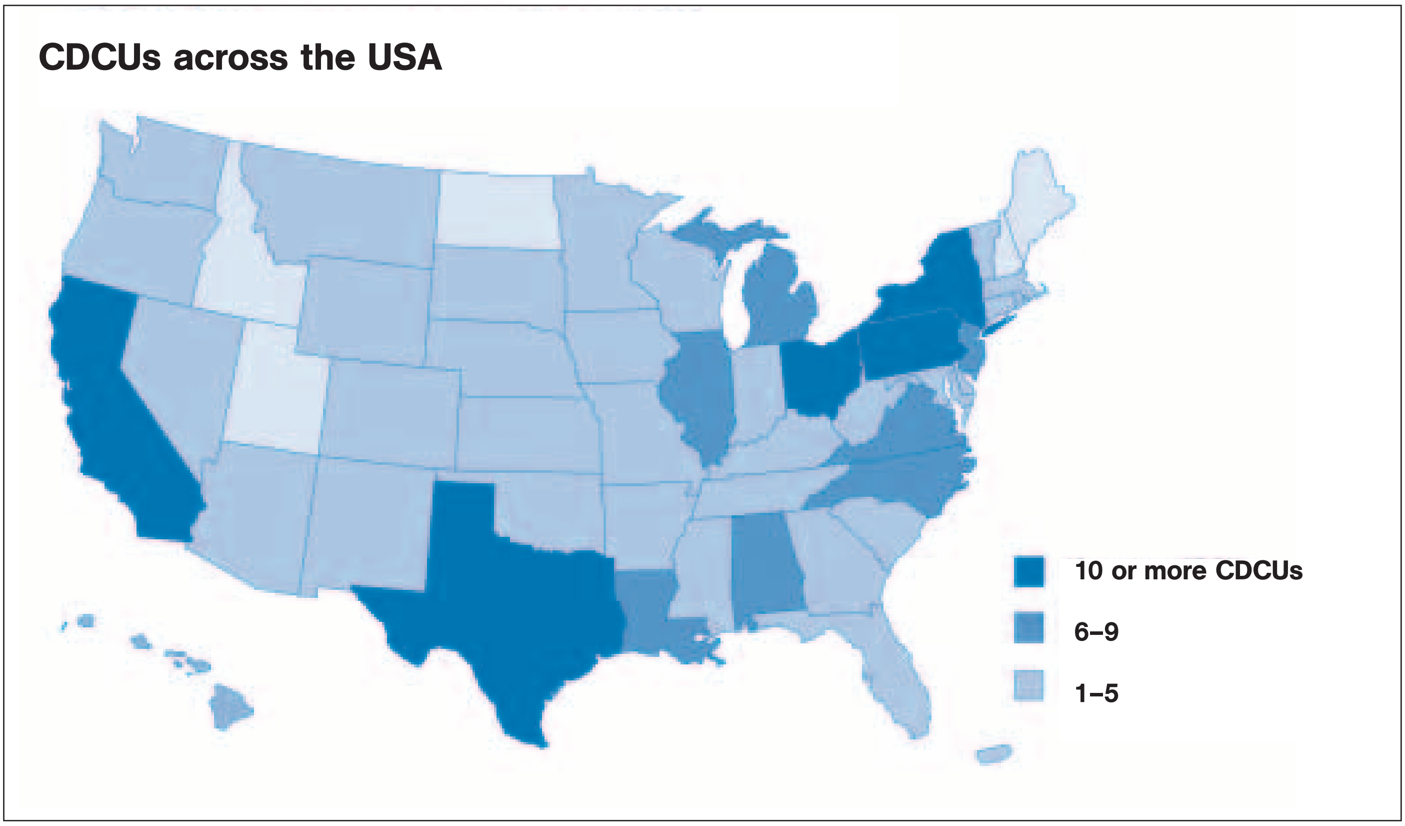
For this study, the NFCDCU surveyed eight CDCU group structures, ranging in age (based on the oldest

NFCDCU Achievements: 2004–2005

- **Growing strength of CDCUs**. Despite a difficult political, economic, and philanthropic climate, CDCUs increased their total assets by $377 million to $3.35 billion, adding nearly 70,000 new members.
- **Investing in CDCUs.** NFCDCU, one of the earliest community development financial intermediaries in the field, invested more than $3.7 million in CDCUs as deposits, loans, and grants. Funding came from banks, foundations, religious organisations and the federal CDFI Fund.
- **Fighting Predatory Lending.** NFCDCU partnered with J.P. Morgan Chase bank to develop CDCU alternatives to high-cost "payday lending."
- **Affordable Mortgages.** The federal CDFI Fund awarded NFCDCU $1.5 million to support the development of a new secondary market, to purchase affordable-housing loans from CDCUs and free up their capital for further lending.
- **Financial Literacy.** NFCDCU's financial literacy "train-the trainer" seminars have developed nearly 600 instructors who have in turn trained 10,000 low-income community residents.
- **Educating CDCU Leadership.** NFCDCU's CDCU Institute™ has completed its seventh successful year. This three-year management training program for CDCUS has educated nearly 150 credit union staff and volunteers from nearly 100 credit unions across the United States.
- **Research.** NFCDCU introduced a semi-annual publication analysing financial trends among CDCUs.







Growth of CDCUs Outpaces Other Credit Unions (2004)

	CDCUs	All federally-insured credit unions
Assets	+13%	+6%
Membership	+8%	+1.5%
Loans Outstanding	+15%	+10%

Note: More than 90% of all US credit unions are federally insured.

component unit) from less than 10 years to more than 30 years; the median age is about 20 years. As a group, they represent some of the most successful and ambitious credit unions in the CDCU movement. Their median size is substantially larger than the typical low-income or community development credit union. The assets of the credit unions alone range from about $4 million to well in excess of $100 million, with a median of about $15 million; tens of millions (or more) of additional capital are controlled by the affiliates. Only one is located in a major city; most are rural, in contrast to the preponderance of urban institutions in the CDCU movement. Two of the credit unions have primary markets that encompass an entire state, while two more have multi-state operations, although with a limited number of physical branches.

CDCU group structures did not emerge from a template, nor has a single model come to dominate. Rather, various models have taken shape at different times, in response to diverse local conditions, financial needs and tasks, organisational cultures and histories. In general, our research found that all the models discussed in this report have worked effectively.

II. The Origins of Group Structures

Assembling the Pieces

The oldest of today's CDCU group structures trace their lineage back more than three decades. Most arose in the 1980s or later. Typically, a non-profit organisation preceded the credit union – sometimes by a year or two, sometimes by a decade – although in one instance, the credit union was the first organisational piece to take shape. The original non-profits were not financial entities; several were churches or ecumenical coalitions, others were advocacy, social service or other community organisations.

None of today's group structures emerged full-blown; rather, they followed a variety of evolutionary paths. Some added organisational pieces over time. In other cases, the original sponsor moved toward a more defined financial mission. Sometimes, the original non-profit sponsor was eclipsed by the growth of the credit union, or disappeared entirely, to be replaced by other, more specialised organisations.

Why Establish Group Structures?

Credit unions establish or maintain group structures to expand their access to resources, diversify their lending and investment and to sustain other supportive services.

Access to Resources

CDCUs often need more resources than they can generate from their core business. However, no matter how poor or disadvantaged their target population, their corporate status excludes them from many sources of funding. Credit unions in the US and in the UK are not-for-profit organisations and exempt from most taxes; however, they are not classified as charities under section 501(c)(3) of the Internal Revenue Code or under UK charity law. Since most US foundations do not fund organisations other than 501(c)(3) charities, credit unions find it difficult to access this major source of funds directly. Similarly, individuals may not claim tax deductions for donations to credit unions. Finally, some government grant programmes are reserved for organisations with charitable status.[1]

Thus, whether to sustain their core operations in their early years, to fund special projects or services or to fuel expansion, CDCUs have often found it helpful or even essential to establish an associated 501(c)(3) charity.

Flexibility in Lending and Investment

CDCUs form affiliates because regulatory restrictions and/or financial limitations prevent them from making the kind and volume of loans their members and communities need Non-regulated affiliates often have greater flexibility to make loans that credit union regulators would discourage as excessively risky; these may be business loans, loans for social enterprises ("children's nurseries", for example) or complex, specialised loans. *Below-market loan programmes* for specific social purposes (e.g. child-care service or disaster recovery) are sometimes better administered by (or delivered in partnership with) a non-credit union partner. CDCUs usually are highly motivated to address these needs, but they cannot cross the line into charitable financing without endangering their core credit union financials and operations.

Some CDCUs operate alongside affiliates that are able to offer financial products that credit unions cannot: for example, equity investments in businesses and social enterprises or training-linked micro-enterprise loans.

Non-financial Services

There are some services that are appropriate and permitted for credit unions, but which are costly and would drag down a credit union's financial performance and regulatory standing. Financial counselling for individuals and small businesses is one example; credit unions can and do provide it, but it may strain staff resources without producing income. Off-loading these services to a non-profit, grant-funded affiliate may help a CDCU carry out its work without impairing its solvency.

Development Services Provided by CDCUs

Type of service	% of CDCUs offering service
Financial counselling	84
Home ownership counselling	35
Financing-related training or technical assistance	24
Technical assistance to organisations	19
Other business training	16
Job training	5

Management and Administrative Functions

Other organisational units may be best adapted to handle certain management and administrative functions. Various CDCUs report that their affiliates are responsible for functions such as:

- Seeking and administering grants and contracts
- Policy advocacy
- Programme evaluation
- Research and development
- Payroll and personnel management.

Facilitating Membership Expansion

Credit unions in the US operate under "field of membership" (FOM) restrictions specified by federal or state law; that is, they are not open to the general public, but only to individuals within specified geographic boundaries, employee groups or organisations. In recent years, these boundaries have become very expansive – and indeed, sometimes virtually meaningless. But they have historically hindered credit unions from opening their doors to anyone who wanted to join.

To address these limitations, a number of CDCUs have maintained, formed or reshaped their affiliates so that they can accept membership from any person or organisation. Membership in the affiliate consequently qualifies an individual to join the credit union.[2]

Missions and Strategies of Group Structures

Unsurprisingly, CDCUs describe their mission and those of their affiliates either as identical or similar, with minimal or no obvious potential for divergence. The typical themes reflected in their mission statements include these:

- Providing access to transactional services, savings and community investment opportunities
- Education about capital and its usages
- Increasing understanding of financial services
- Promoting and encouraging self-help at the individual and community levels
- Strengthening and empowering communities
- Building assets
- Promoting economic justice
- Creating ownership and economic opportunities for minorities, women, rural residents and low-income families
- Working toward a fair and affordable financial system.

In some cases, unity of mission among the affiliates was achieved over time, as distinct organisations came together under one roof with common staffing.

Although there was little or no difference in core values or broad mission within the structures, differences tend to emerge with respect to the following:

- **Function.** Some affiliates specialise in housing, business or social enterprise finance and development.
- **Structure.** Credit unions are member-owned and governed. Other affiliates rarely have an individual-membership structure. For example, one affiliate of a CDCU is a network of organisations, with a mission that includes fostering collaboration among the various member organisations.
- **Market.** Some affiliates serve a wider audience than the credit union's membership or potential membership.

At a practical level, differences may emerge if the organisations do not integrate their strategic plans and policies. As one CDCU leader put it, "with three independent boards responsible for policies, each organisation keeps the potential for divergence alive." Indeed, achieving closer unity and coherence is an ongoing concern for a number of CDCUs with group structures. Some CDCUs with affliates have achieved much more operational unity than others. But as we will see, learning through experience is improving and in turn good practice and efficient delivery systems are evolving year on year in what is still a relatively new operational approach in the credit union world.

III. Governance and Structural Issues

Corporate Structures

Credit unions are independent corporate entities, chartered by an agency of the federal government or the state in which they are headquartered. By law, they have boards of directors elected by and accountable to their members, each of whom has one and only one vote. Credit unions are non-profit and exempt from federal income taxes (although some pay various franchise or other taxes); as noted, they are not charities.

With a few exceptions, the affiliates of the credit unions are 501(c)(3) charities; for-profit affiliates are rare. While the affiliates are always incorporated separately from the credit unions, their board-level linkages to the CDCUs vary. Most commonly, the various affiliates share two or three board members. However, several CDCUs have no overlap at all. At the other end of the spectrum, one CDCU appoints its board members to serve as the affiliate's board.

Even where there is complete overlap of board members, in a legal sense, no ownership relationship exists, since – with the previously noted exception of credit union service organisations (CUSOs) – credit unions are not permitted to own other entities. Nor do credit union members have any direct voice in the selection of the board members of affiliates; they vote only for the credit union's board. In some cases, the credit union's board appoints the board members of the affiliates, but in others, the affiliates have self-perpetuating boards.

Regardless of any overlap of membership, each affiliate must maintain a separate corporate existence with a legally separate board, each with its own legal requirements. Each must hold separate board meetings and maintain separate minutes and corporate records. Within some group structures, minutes are routinely shared among all the affiliated organisations, but others generally keep them rather strictly apart.

Structural Models

The largest institution in our study was the Center for Community Self-Help in

Durham, North Carolina ("Self-Help"). This twenty-five-year-old institution has won national and international recognition for its accomplishments, which are on a scale as yet not replicated by other CDCU groups. Its scale of operations is hugely impressive as it: deploys hundreds of millions of assets for lending and equity investment (the credit union alone has assets approaching $200 million), operates a large secondary-market, and is one of the foremost advocacy organisations attacking the usurious practices of predatory lenders.

Self-Help served as an inspiration for several other group structures, but not as a template. Some of the respondents, of course, were formed years earlier than Self-Help (established 1980), and have followed their own evolutionary path. One credit union "used the example of Self-Help, although we have different operational emphases and our structure is much less complex than theirs." Another reported, "We surveyed the field but each example we found contained too many local peculiarities to be a good general model." Another organisation is a "second-generation" replicator: it modelled itself not after Self-Help directly, but after another institution that had been inspired by the Self-Help model.

Board-level Co-ordination

Given the need for legal separation among the various boards of a group structure, how do the various organisations achieve a satisfactory level of co-ordination?

Credit union regulations require boards to meet monthly; typically, this means that these boards meet more often than those of the affiliates. While at one organisation the affiliate meeting follows the monthly credit union meeting, it is more common for affiliate boards to meet quarterly or less often. Joint meetings or retreats of the various boards are common.

Senior managers play a key role in achieving co-ordination among the various governing bodies. This takes place in a variety of ways:

- The CEO may sit on multiple boards and provide liaison, formally or informally.
- A group structure may have the same CEO for the various affiliates. The CEO reports in turn to each of the respective boards.
- Chairpersons of the various affiliates may report to a single CEO, who shares information throughout the organisation as frequently as daily.
- In one instance, the CEOs and senior staff of the affiliates constitute the board of an umbrella non-profit organisation.

Organisational unity is also fostered through the relationships and interactions of staff. Having a single staff for the entire organisation addresses the problem. Short of this unified structure, other organisations hold staff meetings and retreats that bring together the employees of the various affiliates. One organisation holds combined membership meetings as well.

For the most part, these various arrangements seem successful in ensuring collaboration and operational coherence, even without board-to-board interaction. However, one respondent noted:

> *The most difficult issue confronting our current structure is [the fact that] each [of our affiliates] has separate Boards… With [these] independent boards responsible for the policies of each organisation, [this] keeps the potential for divergence alive.*

IV. Operational and Functional Issues

Financial exclusion encompasses a host of needs. These range in the USA from low cost anti-predatory loans and budget accounts to financial literacy, debt advice and tax credit entitlement assessments. A credit union on its own is not institutionally appropriately equipped to deliver such a broad spectrum of services, encompassing both a range of financial products and a similar range of money advice programmes. CDCU group structures provide a broader based institutional framework to help more effectively tackle the host of financial service related needs that the poorest households face.

CDCU group structures are, by their nature, ambitious and complex undertakings which have been devised to provide a variety of financial and non-financial products and services to low income credit union members and other constituents with diverse needs. Specialisation, fragmentation and compartmentalisation of the various organisational units are constant potential threats. How then, do credit union group structures preserve coherence and achieve operational efficiency?

Staffing

The organisations studied utilise a variety of administrative mechanisms to staff and manage their operations.

- One organisation operates an umbrella service corporation that employs the staff members of all the various affiliates. Although this adds another institution to the structure, it is little more than an administrative shell, and does not add much in the way of cost or complexity.
- Toward the other end of the spectrum, none of the organisations maintain entirely separate staffs, but one has

shared staff only for accounting and finance.

- Most commonly, the organisations have hybrid combined-staffing arrangements. In several organisations, it is the credit union that employs all or nearly all the staff, who in turn carry out projects for the affiliate, billing back direct and indirect expenses for reimbursement. However, it is equally common for one of the affiliates to manage the staffing function for the group.

Even in a combined staffing structure, all employees do not work for all the organisational units; staff members have specific responsibilities that may either fall exclusively under one of the affiliates or may overlap. Staff allocation by *function*, rather than by organisational unit, seems to be the rule. For example, one of the larger organisations divides duties departmentally and in this way a commercial lending unit services both the credit union and the affiliate, applying the lending policies of one or the other, as appropriate.

It is common for employees of group structures to work on various teams and projects. Nonetheless, even if they perform work for more than one affiliate, they generally have a single primary supervisor (although there may be secondary reporting relationships). In one organisation, a credit union staff member responsible for managing one of the affiliates reports both to his/her staff supervisor and to the board of directors of the affiliate.

Shared staffing does introduce an element of regulatory risk. On occasion, credit union regulatory officers have demanded to know the allocation of staff time, in order to ascertain that the credit union was not indirectly subsidising another organisation. This risk has prompted a number of institutions to have staff maintain detailed time sheets and develop careful cost centre allocation procedures. These practices are widespread, but not universal.

Financial Interactions among Affiliates

One of the prime motivators in establishing an affiliate structure is to achieve financial flexibility for meeting the needs of the organisation and its market. At the same time, credit unions are bound by law and regulation to adhere to a high standard of transparency. This requires that the sources, uses, balances and claims upon the credit union must be clearly and unambiguously identifiable. If income, expenses and assets are shifted within the affiliate structures – as they indeed are – they must be consistently and appropriately accounted for.

Given these constraints, how do credit union group structures achieve the synergies and efficiencies they seek?

Lending relationships are key. Collaboration among affiliates takes place in a variety of forms:

- The credit union may underwrite or originate loans for an affiliate, or vice-versa. Fees are paid by one entity to the originator.
- The credit union and an affiliate may lend jointly – i.e. participate in a loan. They may share creditor priority, or allocate first and subordinate positions in relation to security among themselves.
- Loan sales between affiliates may take place.
- Loan guarantees are somewhat less common. Generally, these are made possible by grants to one of the entities.

The source of external funding may determine which affiliate takes the lead. For example, the credit union may be able to access funds for mortgage lending by virtue of its membership in a Federal Home Loan Bank, which is not open to other types of institutions.

Pass-through grants are very common. Typically, an affiliated 501(c)(3) raises grant funds, which it passes through in whole or part to the credit union to cover its expenses in carrying out a grant programme. These grants may also be used as guarantees for a certain type of credit union lending, or to write down the interest rate on some types of loan (for example, 'green loans' to save energy).

Contracting for services among the affiliates is also common. The funds may flow in either (or both) directions – credit union to affiliate, or vice versa.

Overhead and administrative billings, including staffing, occur in virtually all organisations. As noted by one respondent, "We monitor these transactions closely to make sure that there are no conflict of interest situations that may occur."

Division of Functions and Markets

Geographic Scope

Most organisations do not differentiate between the geographic markets served by the credit union and its affiliates. In several instances, however, the affiliates have a broader focus than a single neighbourhood or community; their work may be multi-county (1st Delta), state-wide (Opportunities CU), regional (Enterprise Corporation of the Delta) or even national (Self-Help). This is especially true where the organisation has an advocacy unit or engages in wholesale transactions or specialised lending (e.g. financing housing or community facilities). While a number of the organisations have several offices or branches, none have networks comparable to banks.

Financial Products and Services

Deposit-taking and other consumer finance transactions are always vested in the credit union. Credit unions are the retail financial service providers, offering savings accounts, current accounts, small to mid-sized loans and sometimes bill payment, international money transmission and other services. No other affiliate engages in these functions.

Commercial and Community Development Lending. This is the area with the greatest apparent overlap between a credit union and its affiliates. Several respondents report at least two units that do commercial lending or community-facility and social enterprise lending. The larger credit unions ($50 million or above) may do substantial community development financing from their own balance sheets, but often it is the affiliate that carries this out.

Mortgage Lending and Housing Finance. Mortgage and other home lending take place widely, but not exclusively, in the credit unions. One respondent has an affiliate with the primary mission of housing development and finance, and another is engaged in major secondary-market transactions – buying home loans from other institutions, especially banks.

Other Programmes and Services

Financial Education and Money Advice. Historically, credit unions have played an important role in providing financial and money advice to their members, but usually not as a systematic enterprise. Done intensively or on a wide scale, financial education is a costly function that does not produce immediate income to the credit union. In one instance, a primary function of the affiliate is to provide financial education courses to the broader community, as well as workshops and individual money advice for the credit union's members, thus shifting the costs of this potentially expensive service. On the supply side, as the need for financial education and money advice grows increasingly urgent in the US, various funding pools have been established. Some can be accessed directly by credit unions, others by non-profit organisations. The allocation of the financial education or money advice function between the credit union and its affiliates thus may vary, depending upon who receives the funding; one unit may contract with the other to provide the service.

Policy Advocacy and Research. These functions, as well as monitoring and evaluation (where these take place), are typically performed not by the credit union, but by an affiliate or the umbrella organisation.

Research and Development. An affiliated non-profit is well situated to serve as "a potential incubator of new ideas which need to be tested in a less regulated institution."

Employment Creation and Services. Only one organisation reported an affiliate devoted to job creation. While the credit union may finance businesses, the focus of this activity lies with the affiliate.

Management and Administrative Functions

Fundraising. The umbrella organisation or a non-profit affiliate (where specialised staff expertise tends to be concentrated) is most likely to take the lead in raising operational and capital funds. In at least one instance, however, the credit union takes the lead in sourcing funds for its affiliate.

Accounting and Finance. Almost unanimously, leaders of CDCU group structures believe that the accounting and control function should be concentrated in a single unit, rather than separately carried out by the CDCU and the various affiliates. This approach lends itself to greater efficiency and best performance.

V. Regulatory and Legal Issues

Group Structures and Credit Union Regulators

In the United States, federally chartered credit unions are regulated, supervised, and have their deposits insured by the National Credit Union Administration (NCUA). NCUA also provides deposit insurance for most state-chartered credit unions - approximately 40% of all credit unions – giving this agency major leverage over the non-federal institutions. Effectively, NCUA is the dominant regulator for more than 90% of all credit unions.

State regulators have raised few issues about CDCU affiliate structures. NCUA has raised several related issues concerning potential conflicts of interest, transparency and safety and soundness.

- Potential conflicts of interest may arise because of the multiple roles played by managers, and the distinct goals and accountabilities of the various related organisations.
- Credit union regulatory officers have particularly scrutinised the *allocation of grant income and operational expenses* among the affiliates, attempting to ensure that the credit union does not subsidise another organisation.
- Similarly, NCUA is concerned that the credit union not be exposed to loss because of *"explicit or implicit contingent liabilities"* associated with its affiliates.
- Finally, regulatory officers repeatedly warn credit unions that *dependence on grant funds* derived from affiliates or other sources is risky.

One reported conflict between a CDCU and its regulator illustrates these issues. The credit union was highly capitalised, and, with its affiliate, had been very successful in raising public and private grants. However, its regulatory officer vigorously questioned its relationship to an affiliate, focusing on matters such as:

- Whether the allocation of staff time between the two organisations was appropriate and whether payroll records were accurate?
- Whether the use of grant funds by the affiliate was appropriate?
- Whether the credit union and affiliate were appropriately co-ordinating effort in their grant seeking?

Resolving these issues to the satisfaction of NCUA required the credit union to incur substantial expenditures for the expertise of lawyers and auditors.

However such problems have not been an issue where good record-keeping in respect to all companies in the group are maintained.

Mitigating Conflict

Many, though not all, CDCUs have responded to or avoided regulatory conflict by adopting and adhering to strict *conflict of interest policies*, and by developing formal, written salary and expense reimbursement policies.

Minimizing board overlap has helped to mitigate concerns. Many organisations keep the affiliate's corporate actions and records strictly separate from those of the credit union, and vigorously defend the privacy of the affiliates against inappropriate examination by regulators.

Other Legal and Tax Issues

None of the participants reported any tax-related issues raised by the federal authorities (the Internal Revenue Service) or state tax departments.

Nor do legal costs appear to be a formidable obstacle. Some costs were incurred either in setting up the affiliates, reviewing the structural relationship among them or in obtaining charitable status for an affiliate. One organisation has different legal advisors for the affiliate and the credit union; others tend to rely on the credit union's lawyer or in-house legal expertise, except when arm's length transactions require separate or outside legal counsel.

VI. Conclusion: Lessons Learned

Group structures – like community development credit unions themselves – are driven by mission. They are not constructed to maximise profit, nor are they ideals of corporate efficiency; they are "not as seamless as one would want," as one respondent noted. Another notes: "Affiliates are awkward, time consuming, and hard to explain. However, we can accomplish parts of our mission that would not be achievable with a stand alone credit union." A third summarised the case for group structures this way:

> *[It] makes it possible to more fully reach the shared vision of promoting economic justice. We are convinced that neither the credit union nor [the affiliate] could be as successful working alone as they are working together in bringing innovative approaches to economic justice to the people and communities we serve.*

For many credit unions, of course, the greatest benefit of an affiliate is that it brings access to funding: "It is essential for a growing and developing CDCU to have a non-profit affiliate because a CDCU cannot internally generate the funds nor have the spare capacity to plan for and execute growth." This does not mean that the road is always smooth. Some private funders and the most important federal funder, the CDFI Fund, penalise CDCUs that operate as part of group structures. When reviewing a credit union's application for funds, rather than consider the track record of the affiliate structure *as a whole*, they discount the resources and accomplishments of the affiliate.[3]

What lessons have experienced organisations learned about operating a group structure?

Vulnerabilities of Group Structures

For the most part, CDCU group structures have remained intact and have functioned smoothly. However, there are instances of friction, divorce or even failure. Wherever there is not a tight, unitary structure in a multi-unit organisation, there are "centrifugal" tendencies that may threaten the long-term viability of the group structure.

Divided authority. Having multiple CEOs in a group structure obviously increases the possibility of competition and divergence.

Different cultures. Different organisational units may have different functions, attract different personalities and breed different cultures. Some differences are rooted in the separate histories of the respective units, others in their different business activities. For example, one respondent noted that the credit union was very much transaction-oriented while other units charged with fundraising or planning, for example, have broader purviews and perspectives. Tensions may result when the employees of one organisational unit are compensated at competitive market rates, while others are lower paid with comparison to the salary scales of social service or anti-poverty organisations.

Differences in accountability. In one instance where the non-profit was created for the primary purpose of supporting the credit union, tension arose because the credit union did not bear commensurate responsibility for raising and managing its budget.

Mission creep. Even when an affiliate is established to work in tandem with a credit union, its focus may diverge apart. One respondent related the story of a credit union (outside the current sample) that was formed under the auspices of one non-profit but eventually parted ways from it to concentrate on other activities. The credit union then established another non-profit, but as it expanded, found that this new affiliate did not share its focus on financial services and its geographic expansion strategy.

Economic failure. In inter-related organisations, the possibility always exists that the failure or distress of one operational unit will drain another or trigger a domino-like system failure. Credit unions are insulated from the liabilities of other affiliates, and vice versa; they cannot own, or be owned by, another entity.[4] However, a struggling credit union may drain the resources and credibility of a non-profit that exists primarily to support it. Conversely, a non-profit that is unable to raise sufficient funds may put a dependent credit union in a precarious position.

Recommendations

As we noted at the beginning of this report, CDCU group structures were not shaped by a single template. Neither did the participants in this research agree upon a single model for the next generation of institutions to take-up. But the following recommendations appear to approach a consensus.

- **Build a common structure and shared management.** The dominant view is that a group should have common management, a common CEO, interlocking boards, and shared staff. As one respondent put it, "Unless there is a shared management structure with one executive accountable for linking these operations, there will always be potential for divergence and an inefficient delivery of services."
- **Cultivate a single image among staff and members.** It is desirable for the institution to have a single "brand." Staff "must see themselves as one seamless organisation, with a single mission and goals that are divided into different silos for legal, tax, and regulatory reasons only. And customers/members must see it that way, too."
- **Organise by function wherever possible.** Rather than maintaining parallel staffs with comparable functions for the various affiliates, establish functional units – for example, a common finance and accounting department - to serve the entire organisation. This approach enables the group structure to achieve a certain economy of scale and ensures that specialised expertise can be fully exploited.
- **Keep separate records.** Separate books, time records and audits are essential. It is essential, one respondent stressed, to:

  Keep good records of credit union staff time and the time spent by [affiliate] staff in the operation and ongoing management of the credit union… in order to allay any fears of NCUA officials that the credit union is being taken for a ride and that members are being cheated as a result of the arrangement between the two entities.
- **Maintain board separation.** Even if the personnel of the various boards interlock, it is necessary that the boards be clearly defined as separate entities, with their own meetings and minutes.
- **Segregate activities appropriately.** Organisations should take care to ensure that their 501(c)(3) charitable affiliates perform only tax-exempt activities – and that the credit union carries out only its legally permitted functions.
- **Where possible, "off-load" non-financial support services.** Costly services for which other funding may be raised, such as financial education, money and budgeting advice, micro-enterprise advice, etc. should be provided by an affiliate wherever possible so that they do not adversely affect the credit union's financial statements and key ratios.

Forming Affiliate Structures

Taking into account the various organisational challenges, do respondents recommend that credit unions initiate group structures? The mechanics of setting up affiliate corporations are not especially demanding, according to one respondent: "I've heard many peers overestimate the difficulty of setting up these types of corporations. Three-thousand dollars ought to do the job." However, another cautioned, "Keep it simple. Move to multiple corporations only if the need is truly compelling."

Conversely, what of the establishment of a credit union by a non-profit organisation? One survey participant makes this case:

> *Ideally, a CDCU would be created by an existing non-profit willing to dedicate all of its energies to building the joint venture. The non-profit needs to have a financial base of its own, because its first task should be to create a sound CDCU… The non-profit should be totally dedicated to its CDCU affiliate.*

There is no consensus on what a more perfect organisational model would look like. One participant in this study, Opportunities Credit Union, offered this view:

> *What is needed is a new structure recognised in federal and state laws and by federal and state banking regulators that:*
>
> - *includes an insured depository institution*
> - *is automatically eligible for CDFI certification*
> - *offers the tax benefits of a 501 (c)(3) for donors/contributors*
> - *can operate under a holding company/affiliate structure.*

However, most of the other organisations studied did not endorse this proposed structure as a priority, or even as necessarily desirable. For the most part, they believe that the synergies, economies of scale, and flexibility they desire can be achieved with the organisational tools presently existing.

Appendix: Case Studies

Profile The Vermont Model: Opportunities Credit Union and Affiliates

Burlington, Vermont, on Lake Champlain is the largest city of a small, mountainous rural state in northern New England bordering with Canada. The state is 200 miles north to south, with an average width of 85 miles. Its population is approximately 600,000. While the state has an extensive tourism industry, and thriving niche agricultural and industrial enterprises, its median household income is somewhat below the overall US average, and substantially lower than most north-eastern states. Select urban areas are prosperous, but pockets of rural poverty and a declining rural agricultural sector are extensive.

Opportunities Credit Union – known until February 2005 as Vermont Development Credit Union - is one of the most successful CDCUs to emerge in the last two decades, especially among rural institutions. It has gained national recognition for its highly successful homeownership programmes, as well as for its small business lending. Caryl Stewart, the institution's CEO, was named Vermont's Small Business Advocate of the Year in 2004 and the CDCU is also well known for success with other innovative programmes. At the end of 2004, it held $37 million in assets and had a membership of 13,500. The credit union offers financial services to Vermonters across the state, although it does not maintain a network of branches. The credit union is not only a pre-eminent financial services provider; it is a leader in documenting the social and economic impact of its work.

The institution's leadership describes its mission as "building wealth, community, and opportunity through a fair and affordable financial system."

Evolution of the Affiliate Structure

In the mid-1960s, the Burlington Ecumenical Action Ministry (BEAM) was founded in order to seek faith-based solutions to social problems. This non-profit served as midwife to the Vermont Development Credit Union (VDCU), chartered in 1989 with a mission of providing access to capital for financially underserved Vermonters. BEAM served as VDCU's development affiliate for more than a decade, raising operating grants and providing staff for management, development, evaluation and other functions. In 2002 it was superseded by two new non-profit organisations that assumed and expanded the functions previously provided by BEAM. Today, Opportunities Credit Union operates in tandem with two organisations, both incorporated as 501(c)(3) non-profit organisations:

- **Opportunities, Inc.** is the group's "umbrella" organisation for planning, fundraising and advocacy.
- **Opportunities Ventures** is an unregulated loan fund.

Both Opportunities Credit Union and Opportunities Ventures are certified by the federal CDFI Fund as community development financial institutions (CDFIs).

The credit union and its affiliates were inspired by the Centre for Community Self-Help in North Carolina, which includes the Self-Help Credit Union. Self-Help's statewide model was particularly influential for Opportunities, which since its inception had similar aspirations; however, the Vermont organisation is smaller and less complex than its North Carolina counterpart.

The Vermont Model

By design and practice, the Vermont model is a tightly integrated one. The non-profit affiliates were conceived as a means to enhance the impact of the credit union, and they operate under unified leadership; mission divergence has not been an issue. Opportunities Inc. is the "member" (i.e. 100% shareholder) of Opportunities Ventures.

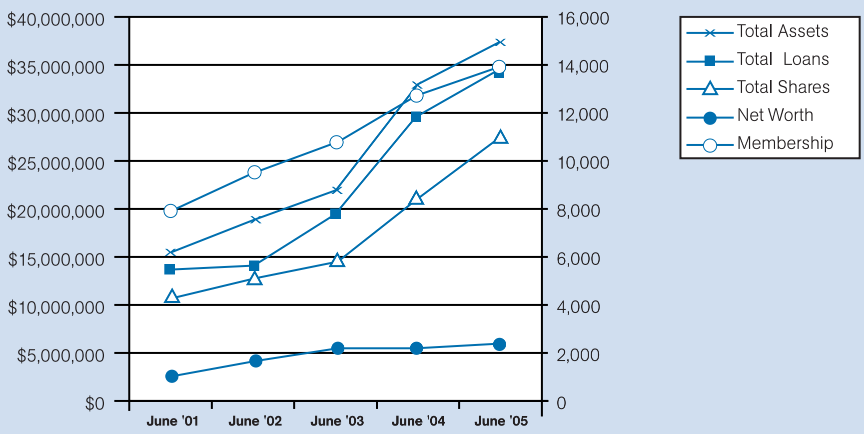
The chairperson and CEO of the credit union also serves as the executive director of Opportunities Inc. and the chairperson of Opportunities Ventures., as well as serving on all three boards. There is a partial overlap of board members; two of the Opportunities Inc.'s four board members and two of the five members of the Opportunities Ventures board are members of the Opportunities Credit Union board. While the original sponsor, BEAM, is no longer part of the institutional structure, one member of the former BEAM board also serves on the Opportunities Inc. board for continuity.

Corporate minutes are shared among the boards and the various organisations aim for an annual joint retreat or meeting. Recently a joint planning group with members from all three boards was created. The Opportunities Inc. board meets the least frequently, between two and four times per year, and holds these sessions jointly with meetings of the Opportunities Ventures board. The Opportunities Ventures board meets more frequently without the Opportunities Inc. board, although in the future, the two groups have decided to meet together six times with no separate Opportunities Ventures meetings planned.

Operations and Staffing

The credit union is a full-service, state-wide institution, providing lending, savings and transactional services, along with associated non-financial "development services" such as financial education and counselling. Opportunities Ventures also provides community development financing with supporting development services; it also conducts broader market research that may lead to new operational initiatives. Opportunities Inc. is not directly engaged in financial

Opportunities CU – Growth Trends, Mid-year: 2001–2005



operations; rather, it provides planning, capitalisation, monitoring & evaluation and policy advocacy functions.

The credit union employs most of the staff (27 people), while Opportunities Inc. employs two staff and one consultant, all of whom work on projects relating to all three companies. Opportunities Ventures does not have a separate staff. In contrast to some other CDCU affiliate structures, the Vermont organisation does not maintain detailed time records broken down by organisational unit. While it is common for staff to work with different people and teams on different projects, they do not have multiple supervisors.

Funds and expenses flow in both directions between Opportunities Inc. and the credit union. For example, Opportunities Inc. passes through grant funding to Opportunities Credit Union, which uses the funds to offset the staffing and other costs required to carry out the grant aided services. The credit union, in turn, pays Opportunities Inc. a fixed monthly fee to partially reimburse it for its services. To provide seed capital for a new Communications Director position, Opportunities Inc. has provided a partial, temporary subsidy (from grant funds). Opportunities Inc. pays the credit union a monthly charge for rent.

Regulatory and Legal Issues

The Vermont structure has been neither costly nor problematic. Creating the non-profit affiliates and obtaining 501 (c)(3) non-profit designations required some initial legal costs, but few recurring or subsequent costs for corporate matters. Each of the three organisations is separately audited (although by the same firm), which increases overhead costs somewhat, but is generally regarded as a good investment by the organisation, since many grant applications require an audit of the applicant and affiliated entities. There have been no major problems with the credit union's state regulator or federal insurer, nor have there been tax-related issues with the Internal Revenue Service.

Benefits and Drawbacks of the Structure

Opportunities (Vermont Development) Credit Union historically has been the engine and focus of the affiliate structure, although Opportunities Ventures is anticipated to play a greater role as it becomes fully capitalised. The leaders of the organisation are unequivocal about the importance of creating non-profit affiliates, and their role in supporting the credit union:

> *It is essential for a growing and developing CDCU to have a non-profit affiliate because a CDCU cannot internally generate the funds nor have the spare capacity to plan for and execute growth. For maximum effectiveness, the affiliate should be 100% dedicated to the CDCU, have a clearly aligned mission and have its own substantial audited financials.*

While mission divergence has not been a problem for the Vermont organisation, the leadership recognises the continuing need to sustain unity:

> *A great deal of communication is needed between the boards and staff of the multiple companies. They must see themselves as one seamless organisation with a single mission and goals that are divided into different silos for legal/tax/regulatory reasons only. And customers/members must see it that way, too.*

Having a unified vision, coherent management structure and a co-ordinated delivery strategy provides great flexibility, but this does not solve all of the Vermont organisation's problems. The various affiliates have made it possible to compete successfully for a variety of funds from government and the private sector – but some funders view the organisation compartmentally, to its detriment. For example, the federal CDFI Fund – an important funder of the credit union – does not count the affiliates' resources toward the Fund's matching requirement. Similarly, other donors tend to disregard the track record of one or another unit of the Vermont organisation when considering a grant proposal. This is not a problem that an unregulated, 501[c](3) loan fund operating as a single corporate entity would face.

New Directions

Opportunities Credit Union and its affiliates clearly have employed the affiliate structure model to great effect and have been very successful in raising resources. However, as its leaders point out, "having three legal entities is cumbersome and not as 'seamless' as one would want." They envision another structure that would make it easier to carry out their mission. What is needed, they argue, is:

> *A new structure recognised in federal and state laws and by federal and state banking regulators that:*
>
> - *includes an insured depository institution*
> - *is automatically eligible for CDFI certification*
> - *offers the tax benefits of a 501 (c)(3) for donors and contributors*
> - *can operate under a holding company/affiliate structure.*

Profile Neighbourhood Trust Federal Credit Union: New York, New York

Tens of thousands of commuters pass by Neighbourhood Trust Federal Credit Union each day, hurrying to or from Manhattan and New Jersey. The credit union and its affiliate, Credit Where Credit is Due, are housed in the George Washington Bridge Bus Terminal, located in Upper Manhattan. The credit union, however, primarily serves the low-income neighbourhood that surrounds it, a largely Latino area that is home to the largest concentration of immigrants from the Dominican Republic in New York City (and the nation).

The formation of the credit union was preceded by the establishment of the non-profit sponsor; Credit Where Credit is Due (CWCID), which was incorporated in 1995 with a primary focus on creating a new financial institution. Two energetic social entrepreneurs in their twenties, Mark Levine and Luis de los Santos, were the driving force behind the enterprise. (Levine later won broad national recognition for his efforts, including the Do Something! Award for $100,000, created by a well-known movie actor to promote social entrepreneurship by young Americans.)

The strategy of first forming the non-profit, CWCID, in order to nurture the credit union resulted from the founders' analysis of previous CDCU experiences. In particular, they looked at a CDCU in Brooklyn, NY – which in turn had drawn on the experiences of the Center for Community Self-Help in North Carolina, the foremost institution of its kind.

The need for a financial institution in Washington Heights was pressing. In this largely immigrant neighbourhood, banks were outnumbered by loan sharks (*prestamistas*), cheque-cashing outlets and unregulated travel agencies that promoted a variety of financial services, including international money transmission. Many mainstream banks had departed and there had never been a neighbourhood credit union before.

The start-up credit union was fortunate enough not merely to secure a place in the bustling bus terminal, but to obtain a former bank facility, located on two levels of the building. The upper level holds office space and teller windows; it is connected by an interior staircase to additional offices, a classroom, a large commercial bank vault and safety deposit boxes on the lower level. At the end of 2004 the credit union had $4.8 million in assets and was serving more than 3,300 members. It had more than $1.3 million in loans outstanding in the community, and had made more than 1,500 loans totalling $5 million since its origin.

As a 501(c)(3) charity, CWCID is able to raise charitable contributions and foundation grants. In 2004, 15% of its budget was allocated to direct grants to Neighbourhood Trust FCU to maintain its operations; CWCID also pays a significant portion of the credit union's overhead expenses. CWCID's market is somewhat broader than the credit union's, extending to people, businesses, and organisations that are not members of the credit union.

CWCID also carries out functions that the credit union could not carry out cost-effectively on its own. In particular, it has the primary duty of developing, implementing, and/or overseeing financial education and budgeting advice, which is a vital service for the community. It provides financial-education: courses, classes and counselling services both to individuals and to small business owners. In the case of small-business owners, financial advice is sometimes a prerequisite for accessing the credit union's small-business loans.

CWCID performs all of Neighbourhood Trust's fundraising duties, working with funders that support Neighbourhood Trust directly and those who prefer to pass grants through CWCID. The credit union is a certified Community Development Financial Institution (CDFI) and has received a series of grants from the Treasury Department's CDFI Fund – most recently, a grant of $200,000. It has also benefited from investments from the Upper Manhattan Empowerment Zone, a federally-funded programme (similar to New Deal for Communities in England) that directs capital into select low-income communities.

Unlike some other non-profits affiliated with CDCUs, CWCID does not provide financial services (for example, for business or other loans). Rather, its activities include education, programme planning, fundraising and administration. It is, says CWCID's Executive Director, Justine Zinkin, "a financial education arm, a fundraising arm, and a potential incubator of ideas which need to be tested in a less regulated institution."

Until late 2004, the governing boards of CWCID and the Neighbourhood Trust FCU had always been separate, except for the marginal overlap of two individuals. The two boards held separate meetings, had different officers and maintained separate corporate minutes. This arrangement has satisfied the credit union regulators, who have not raised substantial issues. They have, however, insisted that financial education activities and advice provided by CWCID be carried out clearly under that organisation's name, to avoid any co-delivery of this function that might incur a potential liability for the credit union.

The separation of the two organisations, while generally essential and beneficial, does have some downside. There is not a single "brand" by which the institution presents itself to the world. Funders, for example, routinely talk about CWCID and refer to Neighbourhood Trust as "that credit union CWCID is linked to." In contrast, for the community, it is the identity of Neighbourhood Trust FCU that is primary; members can be confused when they are referred to CWCID educational services. There is widespread agreement among CDCU practitioners that it is most important that the customer or member have a seamless experience of service. In other words, he or she comes to the organisation for a particular service, and does not particularly care or know which arm provides it.

While there is little divergence in mission between CWCID and the Neighbourhood Trust FCU, the two organisations have different cultures. The credit union is a financial business, devoted to conducting large numbers of transactions in the most efficient and community-friendly way possible. The non-profit is more oriented to the broader mission, and does not engage in day-to-day, retail financial transactions.

The financial relationship between the two organisations is also evolving. CWCID is focused on ensuring the viability of the credit union, and it makes periodic grants to cover operational costs of the credit union. However, the social enterprise's leaders now believe that the credit union's accountability to its supporting affiliate should be articulated more definitively. "The CWCID board and management have no official responsibility for the credit union budget and are not able to hold the credit union management responsible for decisions that result in an operating loss which CWCID is then expected to fund," says CWCID Executive Director Zinkin. While CWCID will continue to support the credit union, the credit union will need to develop and implement its budget in closer co-ordination with, and with greater accountability to, CWCID. The economic relationship between the two organisations will in the future be more formalised, and the two organisations will enter into a joint annual strategic and budget planning process.

Ms. Zinkin believes that a charitable affiliate is all but essential to the development of a new CDCU or one with an ambitious agenda. As she explains: "A non-profit affiliate… provides access to much-needed grant income. Young and small credit unions are especially reliant on this grant income to achieve necessary scale. [The non-profit affiliate] should either be completely aligned with or subordinate to the credit union's strategy and operations."

The experiences of the two organisations have taught Ms. Zinkin that "unless there is a shared management structure with one executive accountable for linking these operations, there will always be a potential for divergence and inefficient delivery of services." While she is not yet convinced that there is a unique, ideal management structure, she believes there "should be a centralised management function… and shared accountability for both raising non-operating income and pursuing positive net income."

The role of CWCID as a provider and funder of financial education services is crucial to this model. Financial education and some allied services are too costly for the credit union to provide with its own resources. While larger, "mainstream" credit unions may be able to offer financial education to better-off credit union members on a fee-for-service basis, few CDCUs can adopt this model.

Endnotes

1 The most prominent exception is the Community Development Financial Institutions Fund of the US Department of the Treasury. The National Credit Union Administration, the federal regulator, also administers a loan and grant programmes that funds credit unions directly. In the private sector, the National Credit Union Foundation and state credit union foundations also fund credit unions directly.

2 The Center for Community Self-Help adopted this approach in the early 1980s, and other organisations have followed. Any person or organisation can join the Center as a member, which in turn provides eligibility for credit union membership.

3 In contrast, non-depository CDFIs – in particular, community development loan funds – usually do not have this problem; they are usually incorporated as charities and thus are able to raise funds directly for their range of activities.

4 As noted previously, there is one exception: a credit union may invest in and own a credit union service organisation (CUSO). Only one CDCU in the study had such an entity.

Clifford Rosenthal leading the first Community Banking Partnership training event in Birmingham, April 2004.

The National Federation of Community Development Credit Unions representsmore than 200 credit unions serving low-income urban and rural communities throughout the United States. A founder and leader of the Community Development Financial Institutions (CDFI) movement in the United States, the Federation provides financial, educational, and human resources to support credit unions in their work.

The Community Banking Partnership Team

nef (the new economics foundation) is an independent think-and-do tank, which aims to improve quality of life by promoting innovative solutions on economic, environmental and social issues. As a 'do' tank **nef** designs and runs practical initiatives that involve people more directly in tackling their own problems and needs. **nef** works in partnership with academia, civil society, government and business, in the UK and internationally.

NACUW (the National Association of Credit Union Workers) is the professional association for credit union workers and volunteers. NACUW members have supported the majority of credit unions in Britain today and it is the movement's lead organisation for delivering accredited training. NACUW works with all trade bodies, providing advice to government and the FSA on improvements to regulations and legislation.

CFS (Community Finance Solutions) is a self-funded unit within the School of English, Sociology, Politics and Contemporary History of the University of Salford. CFS promotes, develops and supports Community Reinvestment Trusts and other community finance initiatives that tackle financial exclusion.

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