



# MAXED OUT

Serious personal debt in Britain

A policy report by the CSJ Working Group

November 2013



## In memory of Mark Duncan

The central theme of this report – that we have a duty to alleviate the suffering of Britain’s poorest and most indebted – reflects the deeply felt views of the man who laid the foundations for this research, but tragically never saw the results of his work.

Mark Duncan made an enormous contribution to life at the Centre for Social Justice, in the richness of his thought, his great kindness, intelligence, decency, and humour. He is hugely missed for all of this and more.

On behalf of everyone at the CSJ, the board members, our donors, the Working Group and all those who had the pleasure of knowing Mark, we would like to dedicate this report to him and his memory.



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# About the Centre for Social Justice

The Centre for Social Justice (CSJ) aims to put social justice at the heart of British politics.

Our policy development is rooted in the wisdom of those working to tackle Britain's deepest social problems and the experience of those whose lives have been affected by poverty. Our Working Groups are non-partisan, comprising prominent academics, practitioners and policy makers who have expertise in the relevant fields. We consult nationally and internationally, especially with charities and social enterprises, who are the champions of the welfare society.

In addition to policy development, the CSJ has built an alliance of poverty fighting organisations that reverse social breakdown and transform communities.

We believe that the surest way the Government can reverse social breakdown and poverty is to enable such individuals, communities and voluntary groups to help themselves.

The CSJ was founded by Iain Duncan Smith in 2004, as the fulfilment of a promise made to Janice Dobbie, whose son had recently died from a drug overdose just after he was released from prison.

Director: Christian Guy

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# Breakthrough Britain II

When the Centre for Social Justice (CSJ) published *Breakthrough Britain* in 2007, the British political landscape was fundamentally altered. The policy-making context was changed and a tired national debate about tackling poverty was reinvigorated.

These experience-led reports – shaped by mass domestic and international evidence-gathering – presented an unprecedented diagnosis of poverty in the UK and outlined a fresh vision for fighting it. This vision rested on recognising that using money alone to combat disadvantage, as important as income is, is too narrow an approach.

Through these conclusions and the thousands of people who shaped them, the CSJ demonstrated the need to identify and tackle the root causes of poverty, not merely the symptoms. We showed that for too long, five pathways to poverty have characterised life in our poorest neighbourhoods. These are: family breakdown; economic dependency and worklessness; educational failure; drug and alcohol addiction and serious personal debt. These pathways are interconnected. For example, a child who experiences family breakdown is less likely to achieve at school. Someone who fails at school is less likely to enter work and more likely to be on benefits. Consequently they are then more likely to live in financial poverty and debt. And so the cycle continues.

As a result of *Breakthrough Britain*, a debate was initiated about social and family breakdown in the UK. Yet much has changed in the policy-making environment since we published in 2007. In particular, the economic crisis has led to one of the deepest and longest recessions on record and there will be significant public expenditure reductions to deal with the national deficit. We also have the first Coalition Government since 1945.

However, what remains clear within the debate about putting Britain on a secure financial footing is the need for a social recovery, as well as an economic one. The costs of social breakdown are significant and often preventable. The CSJ believes it is time to revisit *Breakthrough Britain*. In view of the monumental challenges now confronting policy-makers and society, such a review would lay fresh foundations for tackling poverty in an age of austerity. Once again, this must be based on recognition of poverty's root causes.

The CSJ has conducted a national audit of social breakdown for each of the six policy areas which comprise *Breakthrough Britain II*. This 'State of the Nation' report sets out the key problems and trends in relation to serious personal debt and will act as a 'springboard' for the main report to be published in Spring 2014, comprising a number of policy recommendations for government in relation to each of the policy areas.

# Preface

The work of the Centre for Social Justice is rooted in a network of poverty-fighting charities and social enterprises. This Alliance, of nearly 350 members, leads social and personal change across the UK in relation to a number of problems. They turn the lives around of some of the most marginalised people in society, including by helping drug and alcohol addicts, care leavers, gang members and the long-term unemployed. And during the last decade, across all of these themes and others, those of us engaged with these groups have witnessed an explosion of problem debt and the damage it can do to people.

Pockets of intergenerational worklessness, easy high-cost credit, illegal moneylenders, low financial literacy, a lack of reliable community-based advice, a struggle to save and entrenched social breakdown characterised problem debt for a group of people before the economic crash of 2008. In the CSJ's *Breakthrough Britain* report a practical and considered agenda was outlined which, we believed, would begin to deal with this dangerous debt mountain if implemented by those in power.

Some considerable progress has since been made including funding a £38 million credit union expansion project while relaxing regulations, the continued expansion of the free debt advice sector, and recent signalling by the FCA of their intentions to regulate the financial markets where necessary to protect the consumer.

But in looking again at problem debt, we find it has taken root in the mainstream of British society. Despite signs of national economic recovery, personal debt in the UK remains close to its all-time high at £1.4 trillion. Unsecured consumer debt almost tripled in the last 20 years, reaching nearly £160 billion today. Worryingly, indebted households in the poorest 10 per cent of the country have average debts more than four times their annual income.

Yet beneath these headline findings are the lives of people often overlooked. And it is through these families, through the stories we present in the report, that the corrosive nature of unmanageable debt is exposed.

We spoke to James, whose successful business was devastated by the financial crash. He became very ill and as a result lost his job. He slid further and further into debt and eventually had to resort to payday loans to see him through. He described how his "life has turned into a living nightmare" and how it had driven him close to suicide. We also spoke to John, 43, who told us about maxing out six credit cards and how his entire salary would be used

every month to make minimum repayments. Before he managed to get help from a charity, he was £90,000 in debt and had gone into depression, developed high blood pressure and lost his job.

In publishing this report I would like to thank its Chairman, Chris Pond, who has given the process so much expertise and energy, and our working group, which has provided excellent strategic oversight to the work. They have been supported tirelessly by Joseph Henson, our lead researcher, the CSJ's Policy Director Alex Burghart and a wider policy team.

Above all, this report is dedicated to Mark Duncan, its original and outstanding CSJ researcher who died tragically in the spring of 2013. Mark poured an enormous amount of time, passion and academic brilliance into this process. He was an exceptional colleague and friend; we miss him every day. But we hope his invaluable efforts will help to spark change in the lives of those who most need help. It is for him and for them that we commend our findings to those across the political community. Next year we will publish a final report full of important recommendations for dealing with the UK's personal debt problem. It will build on this thorough state of the nation diagnosis.

**Christian Guy**  
Director



# Members of the CSJ Working Group



**Chris Pond (Working Group Chairman),  
Chairman, The Money Charity**

Chris Pond is Chair of The Money Charity (formerly Credit Action) and of the Equity Release Council Standards Board and is a Partner in Kreab Gavin Anderson, the worldwide communications agency. He is a trustee of the Family and Daycare Trust and a Council Member of the Institute for Fiscal Studies. Chris was formerly Director of Financial Capability and Head of Consumer Affairs at the Financial Services Authority, where he was instrumental in setting up the Money Advice Service.

Before joining the FSA, Chris was Chief Executive of Gingerbread/the National Council for One Parent Families and before that Labour MP for Gravesham, serving as Work and Pensions Minister between 2003 and 2005, and as Parliamentary Private Secretary in the Treasury. For many years before entering Parliament, Chris ran the Low Pay Unit, taught economics and social policy at various universities and acted as adviser to HMRC and the European Commission.



**Joseph Henson,  
Author and Researcher**

Joseph currently leads the CSJ's work on serious personal debt, exploring both the root causes and devastating effects for Britain's poorest people and communities. He previously co-authored the CSJ's report, *Turning the Tide: Social justice in five seaside towns*, which examined the distinctive economic and social factors that have contributed to the entrenched poverty in Britain's previously proud holiday resorts.

Initially Joseph started at the CSJ as a policy intern in 2012 after he completed a Masters programme in European Union Law and Integration at the Europa-Institut in Germany. Prior to this he earned a Bachelor of Laws at BPP Law School in London and a Bachelor of Arts in Economics and History from the University of California.



**Sharon Collard,**  
**Director of the Personal Finance Research Centre, University of Bristol**

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Sharon Collard is a Senior Research Fellow and Director of the Personal Finance Research Centre. She has fifteen years' experience of conducting social research, much of it around money management, credit use, problem debt and the provision and use of debt advice services.

The Personal Finance Research Centre (PFRC) is an independent social research centre based at the University of Bristol. Its purpose is to conduct high-quality, policy-focused research in order (1) To generate new knowledge to enhance our understanding of social and personal finance-related issues and (2) To tackle existing problems in order to improve quality of life.



**Martin Coppack,**  
**Head of Partnerships, Financial Conduct Authority**

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Martin has held a number of policy, development and external affairs roles centered around representing and engaging with consumers, generally in partnership with civil society organisations. Martin has held positions with the Financial Services Authority, National Consumer Council, the American Association of Family and Consumer Sciences as well as the Big Lottery Fund where he led the creation of its £31.7 million financial capability and inclusion programme, Increasing Financial Confidence. Martin has held advisory roles with, for example, the Basic Skills Agency, Office of Fair Trading, Bank of Trinidad and Tobago and Queen Margaret University. He started his career teaching consumer and life skills to adults with learning difficulties and disabilities.

Martin is currently a board member of Young Scot and a trustee of the Nationwide Foundation. Previously Martin has been a trustee of the Association of Charitable Foundations and a National Executive Member of the Institute of Consumer Affairs. Finally, Martin is presently Head of Partnerships at the Financial Conduct Authority but for the purposes of this report is an independent member of the advisory group and does not speak on behalf of the FCA.



**Joanna Elson OBE,  
Chief Executive, Money Advice Trust**

Joanna is Chief Executive of the Money Advice Trust, whose vision is to help people across the UK to tackle their debts and manage their money wisely.

Joanna started her career as a primary school teacher, and then became a researcher for a number of different MPs. She moved to the British Bankers' Association in 1997, where she ran their policy department relating to personal and small business customers.

Joanna is a member of the Centre for Social Justice's Serious Personal Debt working party, HM Treasury's Home Finance Forum, poverty alleviation charity Turn 2 Us's Strategic Development Group, the Chartered Banker Professional Standards Board Advisory Panel, and the British Bankers' Association's Consumer Panel. She is also a school governor.

In 2010, Joanna was awarded an OBE for services to people in debt, and achieved the Institute of Directors' Chartered Director Status.

She lives in North London with her husband, Simon Horne, who is deputy head of a comprehensive school, and their three young daughters. In her spare time she reads, cooks and climbs Munros (Scottish mountains over 1000m).

**Damon Gibbons,  
Director, Centre for Responsible Credit**

Damon is the Director at the Centre for Responsible Credit, a dedicated unit established within the Centre for Economic and Social Inclusion to monitor, research and promote responsible credit provision and markets.

Damon has twenty years experience of providing, designing, and commissioning services to meet the needs of disadvantaged groups and communities and has been involved in consumer campaigns at the national level on issues of credit, debt, and financial exclusion for well over a decade. In 1999 Damon founded the Debt on our Doorstep campaign and in 2003 he identified the grounds for a subsequent Competition Commission inquiry into the Home Credit or door to door lending market.

In 2005 Damon was a founding member of the European Coalition for Responsible Credit (ECRC), and he remains a member of its Management Board. In 2008 Damon's paper, written with Sir Ian McCartney, concerning the position of low-income borrowers in the current financial crisis, led directly to the Office of Fair Trading High Cost Credit Review.

Damon has previously been employed as the Head of Policy and Partnership at the Centre for Economic and Social Inclusion, where he led research on tackling worklessness for the DWP. He also worked with Energywatch and the Government Child Poverty Unit on fuel poverty and employment barriers for parents.

Prior to joining Inclusion, Damon worked in local government and with the Local Government Association advising on economic development services, debt and financial inclusion issues. At the very start of his career Damon worked as a press officer for the Money Advice Association and as a money and welfare rights adviser in the voluntary sector.



**Phillip Holdsworth,**  
**Head of External Affairs, Christians Against Poverty**

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Phil is the Head of External Affairs for Christians Against Poverty and works with Government Departments, Regulators, the money advice sector and research bodies to represent the interests of free debt advice charities. He is also a member of the Money Advice Liaison Group, the Money Advice Service Debt Review Forum and the Operational Stakeholder Engagement Forum with the Department for Work & Pensions.

Prior to this executive role Phil worked for over seven years on the frontline giving debt advice, emotional support and hope to families, couples and young people crushed by their debt. Phil also had first-hand experience of debt, both as a youngster growing up in a broken family environment and as an adult following a series of redundancies while trying to provide for his family.

When he was struggling with his debt problem Phil was helped by StepChange Debt Charity and realised just how vital free, informative and non-judgemental services like this are for people truly in need. He and his wife have made sure to teach their three daughters the value of good money management skills, something that is sadly often lacking in many home environments and puts children at real risk.

Phil experienced what it is like to be a youngster in a family plagued by debt due to broken relationships, death and violence. He saw his mother work non-stop in order to provide for her kids at the expense of not seeing them grow up. Then later in life as a father himself he tried everything in his power despite his redundancies and the family's debt to protect his children from the reactions and stigma of others.

Now Phil has dedicated his life to helping the people who too often do not have a voice that people will listen to and who can remain trapped in a life of debt he was fortunate enough to escape from.

*Content within this report does not necessarily mean consensus across all advisory group members and/or with the CSJ.*

# Special thanks

The CSJ would like to extend its heartfelt thanks to the many people and organisations who gave their time, expertise and research findings during evidence sessions with the Working Group and in interviews. Special thanks are due to several debt advice charities – StepChange, National Debtline and Christians Against Poverty – who provided both frontline insight and helped arrange case studies with their clients.

This report would not have been possible without the dedication and constant input of every member of the Working Group who contributed invaluable analysis and feedback on their individual areas of expertise. This level of coordination was only achievable because of the leadership and ability of Chris Pond, the Working Group's Chairman, to pull together such an impressive group of busy people.

Special thanks must be given to all members of CSJ staff who helped with editing and proofing, and most importantly Alex Burghart, Director of Policy, for his guidance, trust and editorial input throughout the entire process.

We are also extremely grateful to the Barrow Cadbury Trust for their very generous support for this research.



*The Barrow Cadbury Trust is an independent charitable foundation, committed to supporting vulnerable and marginalised people in society. The Trust promotes social justice through grant making, research, influencing public opinion and policy and supporting local communities. It provides grants to grassroots voluntary and community groups working in deprived communities in the UK, with a focus on Birmingham and the Black Country. It also works with researchers, think tanks and government, often in partnership with other grant-makers, seeking to overcome the structural barriers to a more just and equal society.*

# Chairman's foreword

As Britain struggles to come to terms with its national debt, the personal debt of individuals and households is once again on the rise. With falling real incomes and increasing costs of basic essentials, many – especially the most vulnerable – are sliding further into problem debt. The costs to those affected, in stress and mental disorder, relationship breakdown and hardship is immense. But so too is the cost to the nation, measured in lost employment and productivity and in an increased burden on public services.

This report focuses on the causes and consequences of problem debt. We have avoided the easy assumption that problem debt is the fault of individual irresponsibility or incompetence, although greater financial capability could equip people better to guard themselves against its consequences. Nor have we succumbed to the popular perception that payday lenders, who still account for less than two per cent of consumer credit, are the primary cause of increasing debt. True, as living standards are squeezed, some are turning increasingly towards high cost lenders (including payday, credit cards, overdrafts, home credit or illegal moneylenders) and there is a need for both more effective self-regulation and statutory regulation. Certainly too, we support the development of alternative sources of credit for those on a low income, but if we believe this will stem Britain's rising tide of problem debt, we will be dangerously distracted. The causes run deeper than that and have their roots in structural changes in the economy and society.

In preparing this report, I am incredibly grateful to those members of the Working Group who so generously lent their time and expertise. The causes of problem debt are complex and not all members of the group, who contributed in their individual capacity, agreed with every aspect of this report, which nevertheless represents the majority view.

Our thanks go to Joseph Henson, the researcher and author for the group, who worked tirelessly and diligently to bring together our thoughts into a coherent report. We are also grateful to the wider CSJ team, who supported and guided us through the process. Above all, this report is dedicated to Mark Duncan, the first researcher for the group, who felt passionately about the impact of debt on the poorest and the injustice of so many sinking under the weight of indebtedness at a time when many others are seeing their living standards rise.

While the spotlight of this first report is on the causes and consequences of serious personal debt, the follow-up will try to identify those measures needed to mitigate the worst effects. As this report has shown, Britain will pay a heavy price if it allows the most vulnerable to continue on their own to struggle with debt that diminishes their ability to function as active citizens.

**Chris Pond**  
Chairman, The Money Charity

# Executive summary

Millions of people in the UK are currently struggling under the weight of their personal debt. Squeezed household budgets, the rising cost of living and a stagnant economy have pushed many people to the edge of or over a financial cliff. The impact of this debt can extend far beyond the monetary consequences, affecting people's health, family stability and employment prospects.

In our 2007 report, *Breakthrough Britain*, the Centre for Social Justice identified some of the root social and economic causes of serious personal debt, including issues of materialism, exploitative lending and poor financial skills. This report also examined how high levels of personal debt were especially prevalent in Britain's poorest communities who were suffering as a result and often left trapped in poverty. Sadly, six years on, this situation has not improved.

This report builds on this research, exploring how the financial and social landscape has changed following the financial crash and how personal debt has continued to grow. While not all debt is bad and while everyone across the income spectrum can struggle financially, we are focussed on 'problem debt' and the impact it can have on low-income and vulnerable people.

**Problem debt:** Debt that is of concern not due to its absolute value in monetary terms, but because of its size relative to the holder's disposable income, their inability to repay it, and because of the impact it can have on their health, relationships and life.

## I Personal debt in the United Kingdom

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The global financial crisis has brought hardship to many British households, but it alone has not caused the current debt crisis. Over the past 20 years people have begun to borrow more and save less, making people particularly vulnerable to the current squeeze on household budgets.

### a) The state of personal debt in the UK

Total personal debt in the UK has reached record highs as household savings have reached historic lows, leaving millions with little financial resilience.

- People in the UK now owe £1.43 trillion including mortgage lending, an average of £54,000 per household, up from £29,000 a decade ago;<sup>1</sup>
- Consumer debt has trebled since 1993, reaching £158 billion in 2013;<sup>2</sup>
- More than 8 million households now have no savings at all, affecting around 50 per cent of low-income households;<sup>3</sup>
- An estimated 5.3 million households would benefit from debt advice but only 2.6 million people sought some form of debt advice in 2011;<sup>4</sup>
- Each year more than 130,000 people declare bankruptcy or some other form of insolvency.<sup>5</sup>

## b) Types of personal debt

Households are struggling with mortgage debt, unsecured consumer debts and debts related to the cost of living (energy bills, rent, council tax etc.). Levels of debt in these areas have generally improved slightly since the height of the recession, but reflect growing trends of problem debt that began long before the financial crisis.

- In 2012, there were arrears on 300,000 mortgages with 34,000 homes being repossessed, down 30 per cent since the peak of recession in 2009, but up 60 per cent overall since 2006;<sup>6</sup>
- More than 5,000 people become homeless each year because of rent or mortgage debts;<sup>7</sup>
- In 2011, almost half of households in the lowest income decile were spending more than a quarter of their income on debt repayments;<sup>8</sup>
- Outstanding debt on credit cards has almost trebled since 1998, reaching £55.6 billion in 2012;<sup>9</sup>

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1 The Money Charity, Debt Statistics – October 2013, London, The Money Charity, 2013 [accessed via: <http://themoneycharity.org.uk/media/Debt-Stats-Full-October-2013.pdf> (24/10/13)]. Bank of England, Table: LPQBZ2A – Quarterly amounts outstanding of total (excluding the Student Loans Company) sterling net lending to individuals and housing associations (in sterling millions) seasonally adjusted, London: Bank of England, 2013 ONS, *Population and Household Estimates for the United Kingdom*, March 2011, London: ONS, 2001 Calculation based on average outstanding debt in the four quarter of 2001 divided by number of households (24.5 million) in 2001

2 Bank of England, LPQB120: Quarterly amounts outstanding of total (excluding the Student Loans Company) sterling net unsecured lending to individuals (in sterling millions) seasonally adjusted, London: Bank of England, 2013

3 DWP, *Family Resource Survey 2011/2012*, DWP, 2013, Table 2.8 [accessed via: <https://www.gov.uk/government/publications/family-resources-survey-201112> (21/10/13)]

4 Money Advice Trust, *Demand capacity and need for debt advice in the United Kingdom – 2012*, Nottingham: Money Advice Trust, 2010 [accessed via: [http://www.infohub.moneyadvicetrust.org/resource.asp?cat\\_id=260&rPath=cat&r\\_id=770](http://www.infohub.moneyadvicetrust.org/resource.asp?cat_id=260&rPath=cat&r_id=770) (14/10/13)]

5 Insolvency Service, *Statistics release: Insolvencies in the second quarter 2013*, London: ONS, 2013 [accessed via: <http://www.insolvencydirect.bis.gov.uk/otherinformation/statistics/201308/alltables.xls> (28/08/13)] Statistic is for the UK and includes Bankruptcy, Insolvency, Debt Relief Orders, Sequestrations, Protected Trust Deeds, and Individual Voluntary Arrangements

6 Ministry of Justice, *Mortgage and landlord possession statistics January to March 2013*, London: ONS, 2013 [accessed via: <https://www.gov.uk/government/publications/mortgage-and-landlord-possession-statistics--2> (21/10/13)]. Bank of England, *Statistical release – Mortgage lenders and administrators statistics Q2 2013*, London: Bank of England, 2013 [accessed via: <http://www.bankofengland.co.uk/praf/Documents/regulatorydata/mlar/2013q2/mlar2013q2statisticalrelease.pdf> (24/10/13)]

7 Stats Wales, *Households accepted as homeless by main reason for loss of last settled home and period*, 2013 [accessed via: <https://stats.wales.gov.uk/Catalogue/Housing/Homelessness/Acceptances-and-Other-Decisions/HouseholdsAcceptedAsHomeless-by-MainReason-Period> (24/10/13)]. DCLG, *Homeless statistics*, London: DCLG, 2013 [accessed via: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/236906/Table\\_774.xls](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/236906/Table_774.xls) (21/10/13)]. The Scottish Government, *Operation of the homeless persons legislation in Scotland, (2009–2013)* [accessed via: <http://www.scotland.gov.uk/Topics/Statistics/Browse/Housing-Regeneration/RefTables> (11/11/13)] DSD, *Northern Ireland Housing Bulletin (2008–2013)*, NiDirect [accessed via: [http://www.dsni.gov.uk/index/publications/housing\\_bulletins.htm](http://www.dsni.gov.uk/index/publications/housing_bulletins.htm) (11/11/13)] Note: averages taken since 2008 for England, Wales, Scotland and Northern Ireland (mortgages only) Legislation differs slightly by country.

8 Bank of England, NMG Consulting Survey 2011, London: NMG Consulting, 2011 [accessed via: <http://www.bankofengland.co.uk/publications/Documents/quarterlybulletin/nmgsurvey2011.xls> (21/10/13)]

9 Bank of England, LPMVZJR: Monthly amounts outstanding of total sterling net credit card lending to individuals (in sterling millions) seasonally adjusted, London: Bank of England, 2013



- Payday lenders, pawnbrokers and home-collected credit providers lent out £4.8 billion in high-cost credit in 2012, rising sharply from an estimated £2.9 billion in 2009<sup>10</sup>
- In 2012 an estimated 1.85 million households were three months in arrears on at least one household bill or payment;<sup>11</sup>
- National Debtline gave advice on 120,000 cost-of-living debts in 2012, up 130 per cent since 2007.<sup>12</sup>

### c) Who is in problem debt?

Certain groups are more vulnerable to problem debt than others because of low levels of savings, low income and a lack of financial resilience. This includes the unemployed, older people, single parents and the poorest people who have little disposable income and who must spend a large proportion of their income on basic living costs.

- An estimated 1.1 million people over 50 years old are in problem debt;<sup>13</sup>
- 87 per cent of Citizen Advice Bureau's debt clients have annual incomes of less than £18,000;<sup>14</sup>
- 41 per cent of StepChange's debt advice clients live in some form of social housing;<sup>15</sup>
- Over three-quarters of Christians Against Poverty's clients receive some form of state benefit and more than one in five are single mothers.<sup>16</sup>

## 2 Driven into problem debt

The scale of personal debt held by households in the UK is massive, yet not all of it is problem debt. There are certain risk factors that can drive people into problem debt including the psychology of how people respond to their debt, how low-income households pay more to access financial services, how high-cost credit can spiral out of control and how illegal moneylenders can exploit people.

### a) The 'debt spiral'

Debt advice charities and CSJ Alliance members recognise that there are several common phases which people tend to go through when accumulating debt and attempting to tackle it. Often these responses are ineffective and can even worsen debt problems, as people tend to be over-optimistic and underestimate the size of their debt, as it quickly spirals out of control.

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- 10 Office of Fair Trading, *Payday Lending: Compliant Review Final Report*, London: Office of Fair Trading, 2013 [accessed via: [http://www.of.gov.uk/shared\\_of/Credit/oft1481.pdf](http://www.of.gov.uk/shared_of/Credit/oft1481.pdf) (22/10/13)]. Apex Insight, *High-cost credit: UK market profile and forecasts*, Apex Insight, 2012 Note: this is estimated by using the total market for payday lending from the OFT review in 2008/09 and 2011/12 combined with the total market for high cost credit in 2008 and 2012 minus 'online payday loans' from Apex Insight which does not record high street payday lending.
- 11 Department for Business, Innovation and Skills, *Credit, Debt and Financial Difficulty in Britain*, 2012, London: Department for Business, Innovation and Skills, 2013 [accessed via: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/208075/bis-13-p187-a-report-using-data-from-the-yougov-debttrack-survey.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/208075/bis-13-p187-a-report-using-data-from-the-yougov-debttrack-survey.pdf) (21/10/13)] Calculation based on 7% having arrears 26.4 million households from ONS Office for National Statistics, *Population and household estimates for the United Kingdom, March 2013*, London: ONS, 2013 [accessed via: [http://www.ons.gov.uk/ons/dcp171778\\_304116.pdf](http://www.ons.gov.uk/ons/dcp171778_304116.pdf) (24/10/13)]
- 12 National Debtline, *Advice Statistics Q1 2013* – in evidence to the CSJ
- 13 ILC, Press Release, *3 in 10 older people in debt are struggling to repay*, 4 June 2013, [accessed via: [http://www.ilcuk.org.uk/index.php/news/news\\_posts/press\\_release\\_3\\_in\\_10\\_older\\_people\\_in\\_debt\\_are\\_struggling\\_to\\_repay](http://www.ilcuk.org.uk/index.php/news/news_posts/press_release_3_in_10_older_people_in_debt_are_struggling_to_repay) (22/10/13)]
- 14 Citizens Advice Bureau, *National debt issue statistics 2012–13* – in evidence to the CSJ
- 15 StepChange, *Statistical Yearbook 2012*, Leeds: Foundation for Credit Counselling, 2013 [accessed via: [http://www.stepchange.org/Portals/0/Documents/media/reports/statisticsyearbooks/Statistical\\_Yearbook\\_2012.pdf](http://www.stepchange.org/Portals/0/Documents/media/reports/statisticsyearbooks/Statistical_Yearbook_2012.pdf) (22/10/13)]
- 16 Christians Against Poverty, *CAP client report 2012*, Bradford: Christians Against Poverty, 2013

- **Delays and denial:** people often fail to realise their debt is becoming a problem;
- **Rationalisation and underestimation:** once people start to realise their debt is a problem they often do not accept the full scale of it and create reasons as to why nothing needs to be done about it;
- **Attempted solutions:** as debt grows and becomes harder to ignore, people often attempt to deal with it alone by cutting back on food and other living costs which is normally not sufficient and can lead to the problem worsening;
- **Acceptance:** eventually it becomes impossible to ignore problem debt, often because of a drastic consequence such as threats from an illegal moneylender, eviction or repossession.

## b) Driving low-income households into problem debt

Low, reduced or irregular income is a major contributory cause of problem debt, with low-income households being particularly at risk due to their lack of savings and financial vulnerability.

- Almost a quarter (23 per cent) of debt advice clients cite low or irregular income as the primary contributory cause of their debt;<sup>17</sup>
- Around 3 million low-income households have no savings, meaning they must often borrow at expensive rates to cover unexpected expenses;<sup>18</sup>
- In 2013, one third of unemployed parents had to borrow to purchase their child's school uniform;<sup>19</sup>
- An estimated 3.9 million British families would be unable to pay their rent or mortgage for more than a month if they lost their job.<sup>20</sup>

There is a lack of financial products designed for the needs of low-income households meaning they often incur penalty charges or must pay a 'poverty premium' to access banking, borrowing and when purchasing goods and services.

- There are currently 1.4 million people in the UK without a transactional bank account, more than a third of whom are in the lowest income decile;<sup>21</sup>
- In 2011, an estimated 6.6 million people incurred more than £100 in overdraft and penalty fees, negating the financial benefits of banking;<sup>22</sup>

17 StepChange, *Statistical Yearbook 2012*, Leeds: Foundation for Credit Counselling, 2013 [accessed via: [http://www.stepchange.org/Portals/0/Documents/media/reports/statisticsyearbooks/Statistical\\_Yearbook\\_2012.pdf](http://www.stepchange.org/Portals/0/Documents/media/reports/statisticsyearbooks/Statistical_Yearbook_2012.pdf) (22/10/13)]

18 DWP, *Family Resource Survey 2011/12*, London: DWP, 2013 [accessed via: <https://www.gov.uk/government/publications/family-resources-survey-201112> (23/10/13)]. ONS, *Families and Households*, 2012, London: ONS, 2012 [accessed via: <http://www.ons.gov.uk/ons/rel/family-demography/families-and-households/2012/stb-families-households.html> (23/10/13)]. Calculation based on those with gross household income under £15,600

19 Citizens Advice, Press Release, *Parents borrowing money to pay for school uniforms*, 18 August 2013 [accessed via: [http://www.citizensadvice.org.uk/index/pressoffice/press\\_index/press\\_office-newpage-2.htm](http://www.citizensadvice.org.uk/index/pressoffice/press_index/press_office-newpage-2.htm) (23/10/13)]

20 Shelter, Press Release, *8 million people one paycheque away from losing their home*, 11 April 2013 [accessed via: [http://england.shelter.org.uk/news/april\\_2013/8\\_million\\_people\\_one\\_paycheque\\_away\\_from\\_losing\\_their\\_home](http://england.shelter.org.uk/news/april_2013/8_million_people_one_paycheque_away_from_losing_their_home) (24/10/13)]

21 DWP, *Credit Union Expansion Project: Feasibility Study Report*, London: DWP [accessed via: <http://www.dwp.gov.uk/docs/credit-union-feasibility-study-report.pdf> (16/10/13)]. Social Finance, *A New approach to banking*, London: 2011 [accessed via: [http://www.socialfinance.org.uk/sites/default/files/SF\\_JamjarAccountReport\\_FULLREPORT.pdf](http://www.socialfinance.org.uk/sites/default/files/SF_JamjarAccountReport_FULLREPORT.pdf) (16/10/13)]

22 Social Finance, *A New approach to banking*, London: 2011 [accessed via: [http://www.socialfinance.org.uk/sites/default/files/SF\\_JamjarAccountReport\\_FULLREPORT.pdf](http://www.socialfinance.org.uk/sites/default/files/SF_JamjarAccountReport_FULLREPORT.pdf) (16/10/13)]

- Half of all payday loan users (600,000) took out the loan because they had no other access to credit.<sup>23</sup>
- An average car insurance policy costs 98 per cent more for low-income households while home contents insurances costs 48 per cent more;<sup>24</sup>

The rising cost of living disproportionately affects low-income households and is pushing many into problem debt.

- The average cost of living has risen by 25 per cent in just the past five years with the greatest increases in essentials such as rent, gas and electricity;<sup>25</sup>
- Real wages have fallen to 2003 levels while all real wage increases since 1986 have been significantly lower for the poorest households;<sup>26</sup>
- The 17 per cent in food bills since 2008 has disproportionately affected the poorest households. The proportion of a low-income household's total expenditure that is spent on food is 50 per cent higher than for higher income households;<sup>27</sup>
- In 2012, four out of 10 households repaying an energy debt had no adult in work and nearly three-quarters contained at least one vulnerable individual.<sup>28</sup>

### c) High-cost credit

The growing pressures on household budgets and restrictions on mainstream lending have led increasing numbers of low-income households to turn to high-cost lenders including pawnbrokers, payday lenders, home credit and illegal moneylenders. There is a worrying minority of users who are already struggling with debt and for whom high-cost credit can often quickly drive them deeper into problem debt.

- An estimated seven million people use high-cost credit in order to cover income shortfalls and meet unexpected expenditures;<sup>29</sup>
- More than 60 per cent of households using high-cost credit are in financial difficulties (insolvency action or arrears) compared with 15 per cent of mainstream credit users;<sup>30</sup>

23 Department for Business, Innovation and Skills, *Credit, Debt and Financial Difficulty in Britain, 2012*, London: Department for Business, Innovation and Skills, 2013 [accessed via: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/208075/bis-13-p187-a-report-using-data-from-the-yougov-debtrack-survey.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/208075/bis-13-p187-a-report-using-data-from-the-yougov-debtrack-survey.pdf) (24/10/13)]

24 Save the Children/ FWA, *The Poverty Premium*, London: Save the Children/ FWA, 2007 [accessed via: [http://www.savethechildren.org.uk/sites/default/files/docs/poverty\\_briefing\\_1.pdf](http://www.savethechildren.org.uk/sites/default/files/docs/poverty_briefing_1.pdf) (23/10/13)]

25 uSwitch, *Household bills up 25% in five years*, 13 March 2013 [accessed via: <http://www.uswitch.com/blog/2013/03/13/household-bills-rise-25-in-five-years/> (24/10/13)]

26 ONS, *Real wages down by 8.5% since 2009*, ONS, 2013 [accessed via: <http://www.ons.gov.uk/ons/rel/regional-trends/regional-economic-analysis/changes-in-real-earnings-in-the-uk-and-london--2002-to-2012/sum-real-wages-down-by-8-5--since-2009.html> (21/10/13)]. ONS, *Real wages up 62% on average over the past 25 years*, London: 2012, ONS [accessed via: [http://www.ons.gov.uk/ons/dcp171776\\_286266.pdf](http://www.ons.gov.uk/ons/dcp171776_286266.pdf) (24/10/13)]

27 ONS, *Family spending 2012*, London: ONS, 2012 [accessed via: <http://www.ons.gov.uk/ons/rel/family-spending/family-spending/family-spending-2012-edition/index.html> (24/10/13)]

28 RS Consulting, *Ability to Pay*, London: RS Consulting, 2013 [accessed via: <http://www.consumerfutures.org.uk/files/2013/07/Ability-to-Pay-RS-Consulting.pdf> (16/10/13)]

29 DWP, *Credit Union Expansion Project Feasibility Study Report*, London: DWP [accessed via: <http://www.dwp.gov.uk/docs/credit-union-feasibility-study-report.pdf> (16/10/13)]

30 Department for Business, Innovation and Skills, *Credit, Debt and Financial Difficulty in Britain, 2012*, London: Department for Business, Innovation and Skills, 2013 [accessed via: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/208075/bis-13-p187-a-report-using-data-from-the-yougov-debtrack-survey.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/208075/bis-13-p187-a-report-using-data-from-the-yougov-debtrack-survey.pdf) (24/10/13)]

- One in eight payday loan users takes out five or more loans in a year, while the average user seeking debt advice has three unpaid payday loans;<sup>31</sup>
- In just the first six months of 2013 StepChange advised more than 30,000 people regarding their payday loan debt, almost the same as for the whole of 2012 and about double the number helped in 2011;<sup>32</sup>
- In Britain's most deprived estates, one in 12 families borrow from illegal moneylenders, compared with just one in 200 people amongst the general population;<sup>33</sup>
- The number of people estimated to be illegal moneylenders has almost doubled since 2008 from 165,000 to 310,000.<sup>34</sup>

### 3 Causes and effects of problem debt

Problem debt is rarely an isolated problem without additional consequence. The stress of managing tight finances and dealing with creditors, as well as the stigma associated with problem debt, can lead to mental health conditions, family breakdown, addiction, worklessness and crime. Many of those negative outcomes are interrelated and can also drive problem debt, trapping people in a 'vicious cycle'.

#### a) Mental health

There is a link between problem debt and an increased risk of suffering from anxiety, stress and depression, all of which can lead to social exclusion and in some extreme cases drive people to commit suicide.

- People with no history of mental health problems are 33 per cent more likely to develop a mental health issue if they find themselves struggling with unmanageable debt;<sup>35</sup>
- Seven out of ten debt-advice clients were prescribed medication by their GP to help them cope with their debt related mental health difficulties;<sup>36</sup>
- One in three debt-advice clients had either attempted or contemplated suicide as a result of their debt;<sup>37</sup>

31 StepChange, *Statistical Yearbook 2012*, Leeds: Foundation for Credit Counselling, 2013 [accessed via: [http://www.stepchange.org/Portals/0/Documents/media/reports/statisticsyearbooks/Statistical\\_Yearbook\\_2012.pdf](http://www.stepchange.org/Portals/0/Documents/media/reports/statisticsyearbooks/Statistical_Yearbook_2012.pdf) (22/10/13)]

32 StepChange, *Briefing document House of Commons debate on high cost credit – September 2013*, London: StepChange, 2013

33 Policis, *Interim Evaluation of the National Illegal Money Lending Projects – Summary*, London: BIS, 2010 [accessed via: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/31889/10-1187-interim-evaluation-illegal-money-lending-summary.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31889/10-1187-interim-evaluation-illegal-money-lending-summary.pdf) (24/10/13)]. Office for National Statistics, *Population Estimates for UK, England and Wales, Scotland and Northern Ireland, Mid-2011 and Mid-2012*, 8 August 2013, [accessed via: <http://www.ons.gov.uk/ons/rel/pop-estimate/population-estimates-for-uk--england-and-wales--scotland-and-northern-ireland/mid-2011-and-mid-2012/index.html> (24/10/13)]

34 OFT, *Stop Loan Sharks Campaign – May 2010*, London: OFT, 2010 [accessed via: [http://oft.gov.uk/shared\\_oft/scams/stop-loan-sharks.pdf](http://oft.gov.uk/shared_oft/scams/stop-loan-sharks.pdf) (24/10/13)]. Policis, *Interim Evaluation of the National Illegal Money Lending Projects – Summary*, London: BIS, 2010 [accessed via: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/31889/10-1187-interim-evaluation-illegal-money-lending-summary.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31889/10-1187-interim-evaluation-illegal-money-lending-summary.pdf) (24/10/13)]

35 Skapinakis P, Weich S, et al., 'Socio-economic position and common mental disorders. Longitudinal study in the general population in the UK', *British Journal of Psychiatry* 2006, 18, pp109–117

36 Moneysavingexpert.com, *Guide to mental health and debt*, Moneysavingexpert.com, 2013 [accessed via: [http://images.moneysavingexpert.com/attachment/mentalhealthguide\\_2013\\_2.pdf](http://images.moneysavingexpert.com/attachment/mentalhealthguide_2013_2.pdf) (16/10/13)]

37 World Suicide Prevention Day, Press Release, *Thousands of suicidal people each year saved each year – by tackling their debt problems*, World Suicide Prevention Day, 2013 [accessed via: <https://capuk.org/downloads/press/suicideprevention2013.pdf> (16/10/13)]

- Adults with a mental disorder are three to four times more likely to have a debt problem than the general population;<sup>38</sup>
- Mental health conditions were the primary driver of debt for one in 12 debt advice clients.<sup>39</sup>

## b) Family breakdown

The added stresses and pressures associated with problem debt can impact on a person's relationships with friends, partners and family. This can lead to family breakdown that can also drive or worsen problem debt due to disagreements over finances, debts incurred during separation and additional costs accrued when living alone.

- In 2012, three out of four debt advice clients in a relationship said their debt had negatively affected it, causing it to end entirely for one quarter of people;<sup>40</sup>
- Families find debt and money incredibly hard to talk about, with one in 10 hiding debts from their partner;<sup>41</sup>
- Separation or divorce was the primary cause of debt for around one in 10 debt advice clients.<sup>42</sup>

## c) Worklessness

People suffering under the burden and stress caused by problem debt can have a significant negative impact on their ability to be productive at work and can prevent those who are unemployed from finding work. Being unable to work or find work can exacerbate debt problems, keeping people trapped, as it becomes harder to finance their living costs or repay their debts.

- One in 10 reported giving up their job as a result of their debt problems;<sup>43</sup>
- One in five found it difficult to find employment as a result of their debt;<sup>44</sup>
- In 2012, unemployment or redundancy was the primary cause of debt for almost one in four debt advice clients;<sup>45</sup>
- A one per cent increase in the unemployment rate results in an estimated 240,000 debt advice enquiries per year.<sup>46</sup>

38 Government Office for Science, *Mental capability and wellbeing: Making the most of ourselves in the 21st century*, London: Government Office for Science, 2008 [accessed via: [http://www.bis.gov.uk/assets/BISCore/corporate/MigratedD/ec\\_group/113-08-FO\\_b.pdf](http://www.bis.gov.uk/assets/BISCore/corporate/MigratedD/ec_group/113-08-FO_b.pdf) (16/10/13)]

39 Christians Against Poverty, *CAP client report 2012*, Bradford: Christians Against Poverty, 2013

40 Marriage Week, Press Release, *For Richer for Poorer – How Money Stress Wrecks Marriages*, 2013 [accessed via: <https://capuk.org/downloads/press/marriageweek2013.pdf> (17/10/13)]

41 The Cooperative Banking Group, Press Release, *Brits hide £41bn in debt from their partners*, 28 August 2012 [accessed via: <http://www.co-operativebankinggroup.co.uk/servlet/Satellite?c=Page&cid=1326094872357&pagename=Corp/Page/tplCorp&currart=1346134400711&currnth=8> (27/10/13)]

42 StepChange, *Statistical Yearbook 2012*, Leeds: Foundation for Credit Counselling, 2013 [accessed via: [http://www.stepchange.org/Portals/0/Documents/media/reports/statisticsyearbooks/Statistical\\_Yearbook\\_2012.pdf](http://www.stepchange.org/Portals/0/Documents/media/reports/statisticsyearbooks/Statistical_Yearbook_2012.pdf) (22/10/13)]

43 Legal Services Research Centre, *Helping Hand: The Impact of Debt Advice on People's Lives*, London: Legal Services Research Centre, 2007 [accessed via: <http://www.justice.gov.uk/downloads/publications/research-and-analysis/lsrc/2007/Impact.pdf> (16/10/13)]

44 Legal Services Research Centre, *Helping Hand: The Impact of Debt Advice on People's Lives*, London: Legal Services Research Centre, 2007 [accessed via: <http://www.justice.gov.uk/downloads/publications/research-and-analysis/lsrc/2007/Impact.pdf> (16/10/13)]

45 StepChange, *Statistical Yearbook 2012*, Leeds: Foundation for Credit Counselling, 2013 [accessed via: [http://www.stepchange.org/Portals/0/Documents/media/reports/statisticsyearbooks/Statistical\\_Yearbook\\_2012.pdf](http://www.stepchange.org/Portals/0/Documents/media/reports/statisticsyearbooks/Statistical_Yearbook_2012.pdf) (22/10/13)]

46 Gathergood, J., *Demand, Capacity and Need for Debt Advice in the United Kingdom*, London: Money Advice Trust, 2010

## d) Addiction

A person's addiction to drugs or alcohol can completely take over their life, driving them and often their family into problem debt as they attempt to fund their addiction. Problem debt can also be a significant barrier for those who are in treatment and worrying about debt can lead people to relapse.

- Addiction treatment centres told the CSJ that problem debt was an issue for almost all of those entering treatment and was a huge barrier to recovery, often creating a vicious cycle of drug use and debt;
- An estimated 80 per cent of substance users' family members experience money related issues;<sup>47</sup>
- Families frequently suffer increased financial stress due to threats and harassment from drug dealers and illegal moneylenders.

## 4 Avoiding and addressing debt

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The high cost of problem debt, both in financial terms and in the number of lives impacted, means that there is a pressing social obligation to help people avoid, manage and escape it. It is crucial that people have access to financial education, free debt advice, effective debt solutions and alternative financial services, such as credit unions, in order to reduce the damaging impacts of problem debt.

### a) Avoiding problem debt – financial capability and education

While a lack of financial capability can be a driver of problem debt – although not the primary driver – having good financial capability can also help people recover from problem debt.

- The lack of financial education costs the UK £3.4 billion each year, of which £716 million is directly attributable to debt issues;<sup>48</sup>
- Two-fifths of young people, 14–25, were unable to differentiate between being overdrawn and being in credit on a bank statement;<sup>49</sup>
- An estimated 5.2 million UK adults lack functional literacy and 6.8 million lack functional numeracy skills, making it difficult to understand financial products.<sup>50</sup>

### b) Debt advice and debt management

There is a clear demand for free debt advice in the UK which can help people both avoid problem debt as well as recover from their debt and start a new life. However, funding for

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47 Adfam, *Adfam Discussion Paper: Family Support in Times of Economic Hardship*, Adfam, 2011

48 Centre for Economics and Business Research, *Potential benefits of implementing financial education*, London: CEBR, 2012 [accessed via: [http://static.moneysavingexpert.com/documents/MSE\\_Cebr\\_Financial\\_Education\\_report.pdf](http://static.moneysavingexpert.com/documents/MSE_Cebr_Financial_Education_report.pdf) (24/10/13)]

49 Press Association, *Young people have 'dangerous gaps' in money knowledge, charity says*, 23 June 2013 [accessed via: <http://www.moneysavingexpert.com/news/family/2013/06/young-people-have-dangerous-gaps-in-money-knowledge-charity-says> (24/10/13)]

50 Consumer Focus, *Response to HMT consultation on Financial Services Bill*, London: Consumer Focus, 2011 [accessed via: <http://www.consumerfocus.org.uk/files/2009/06/Consumer-Focus-response-to-HMT-consultation-on-bill.pdf> (24/10/13)]

free debt advice is currently at risk, while issues of stigma and a failure to recognise problem debt can stop people accessing these vital services.

- 1.7 million people received free debt advice in 2012;<sup>51</sup>
- A quarter of the population do not think it is clear where to go to receive impartial debt advice;<sup>52</sup>
- Only one in 13 people concerned about their debt plan to seek debt advice;<sup>53</sup>
- Those who seek debt advice are twice as likely to have their debts become manageable within 12 months compared to those who do not;<sup>54</sup>
- About a quarter of funding for free face-to-face debt advice services is expected to disappear in 2013/14 due to decreased government funding and reductions in legal aid.<sup>55</sup>

### c) Debt solutions

For those whose debt has become unmanageable some form of debt solution is necessary to help them recover from their debts. There are concerns that some forms of insolvency can make financial recovery too difficult, disincentivise work and even expose people to future debt problems.

- In 2011, around 1.1 million people were involved in an on-going debt solution, which had increased by 60 per cent since 2007;<sup>56</sup>
- More than 31,000 people with almost no assets and less than £50 in disposable income filed for a Debt Relief Order in 2012;
- If a person increases their disposable income above the £50 threshold during the 12 month period after filing for a DRO the insolvency will be cancelled; this can effectively disincentivise work.<sup>57</sup>

### d) Alternative finance: credit unions

Credit unions are currently a small sector but they have cross-party political support and are aiming to expand in both size and professionalism. Able to provide attractive saving rates and low-interest loans, credit unions can hopefully represent a competitive challenge to mainstream financial providers.

51 Money Advice Trust, *Demand capacity and need for debt advice in the United Kingdom – 2012*, Nottingham: Money Advice Trust, 2012 [accessed via: [http://www.infohub.moneyadvicetrust.org/resource.asp?cat\\_id=260&rPath=cat&r\\_id=770](http://www.infohub.moneyadvicetrust.org/resource.asp?cat_id=260&rPath=cat&r_id=770) (14/10/13)]

52 R3, *Personal debt snapshot wave 7 – February 2012*, London: R3, 2012 [accessed via: [http://www.r3.org.uk/media/documents/policy/research\\_reports/personal\\_debt\\_snap/R3-Personal-Debt-Snapshot-Wave-7-2012.pdf](http://www.r3.org.uk/media/documents/policy/research_reports/personal_debt_snap/R3-Personal-Debt-Snapshot-Wave-7-2012.pdf) (24/10/13)]

53 R3, *Personal debt snapshot wave 7 – February 2012*, London: R3, 2012 [accessed via: [http://www.r3.org.uk/media/documents/policy/research\\_reports/personal\\_debt\\_snap/R3-Personal-Debt-Snapshot-Wave-7-2012.pdf](http://www.r3.org.uk/media/documents/policy/research_reports/personal_debt_snap/R3-Personal-Debt-Snapshot-Wave-7-2012.pdf) (24/10/13)]

54 The Money Advice Service, Press Release, *Debt Advice Delivers Improved Outcomes for People*, 19 October 2012 [accessed via: [http://www.infohub.moneyadvicetrust.org/content\\_files/files/debt\\_advice\\_delivers\\_improved\\_outcomes\\_research\\_1901012.pdf](http://www.infohub.moneyadvicetrust.org/content_files/files/debt_advice_delivers_improved_outcomes_research_1901012.pdf) (22/10/13)]

55 London Economics, *Debt advice in the UK*, London: London Economics, 2012

56 DRF/Zero Credit, *Debt Resolution in the UK*, Timperley: DRF/Zero Credit, 2012 [accessed via: <http://www.debtresolutionforum.org.uk/resources/drf-research-18th-june-2012.pdf> (14/10/13)]

57 Insolvency Service, *Statistics release: Insolvencies in the second quarter 2013*, London: ONS, 2013 [accessed via: <http://www.insolvencydirect.bis.gov.uk/otherinformation/statistics/201308/index.htm> (28/08/13)]

- There are now 390 credit unions in the UK offering services to just over a million members, less than two per cent of the population;<sup>58</sup>
- In other countries, such as Ireland, Canada and the US, where credit unions are more competitive and work with employers to promote automatic enrolment and savings, membership rates are as high as 70 per cent;<sup>59</sup>
- The Government has provided £38 million in funding to help credit unions double their membership by 2017 and save low-income households up to a billion pounds in interest;<sup>60</sup>
- Fewer than one in 10 people think a credit union can help them, however once told about credit unions this rises to 60 per cent.<sup>61</sup>

### e) Alternative finance: community development finance institutions (CDFIs) and the social fund

Smaller in scale than credit unions, but with fewer regulatory burdens, CDFIs provide loans to some of the most financially excluded individuals, businesses and communities.

- There are 53 CDFIs in the UK, down from a peak of 80 in 2005;<sup>62</sup>
- In 2012 nine CDFIs made loans worth £11.4 million to almost 30,000 individuals;<sup>63</sup>
- CDFI loans saved over 10,000 people from a debt spiral, 17,000 from high cost creditors and 1,740 from illegal moneylenders;<sup>64</sup>
- If given sufficient capital, CDFIs estimate they could deliver £6 billion annually in loans to over eight million clients.<sup>65</sup>

Parts of the Social Fund have been devolved to the local level, which represents a significant opportunity to engage local providers of alternative finance and provide sustainable interest free loans to the poorest people. However, it remains to be seen whether the local deployment of the programme will make the most of this opportunity and be sustainable in the face of budget cuts.

- 87 per cent of local authorities are issuing grants rather than the interest-free loans which previously funded 50 per cent of the programme;<sup>66</sup>
- Only half of credit unions surveyed were approached by local authorities to help design the local Social Fund replacement scheme.<sup>67</sup>

58 Bank of England, *Introduction to credit union Statistics*, London: Bank of England, 2013

59 ABCUL, *An international movement* [accessed via: <http://abcul.org/credit-unions/international-movement> (24/10/13)]

60 DWP, *Credit Union Expansion Project: Feasibility Study Report*, London: DWP [accessed via: <http://www.dwp.gov.uk/docs/credit-union-feasibility-study-report.pdf> (16/10/13)]

61 DWP, *Credit Union Expansion Project: Feasibility Study Report*, London: DWP [accessed via: <http://www.dwp.gov.uk/docs/credit-union-feasibility-study-report.pdf> (16/10/13)]

62 CDFA, *Inside community finance: The CDFI industry in 2012*, London: CDFA, 2013 [accessed via: <http://www.cdfa.org.uk/wp-content/uploads/2010/02/ICF-full-report-web1.pdf> (09/09/13)]

63 Ibid

64 Ibid

65 CDFA, *Mind the finance gap*, London: 2013, CDFA

66 CSJ analysis of local authorities welfare provision replacement programmes

67 Centre for Responsible Credit, *Local welfare provision, low-income households, and third sector financial services provision*, London: Centre for Responsible Credit, 2013



## Conclusion

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Unless proactive steps are taken, problem debt in the UK will continue to grow unabated. The current levels of debt are worrying because they not only have severe financial implications, but also more wide-ranging impacts on people's mental health, family stability, and ability to work. These are especially pronounced amongst low-income households and the vulnerable.

Based on the findings of this report we will be looking at ways to tackle the root causes of problem debt. This will include the following areas:

- Access to affordable credit for low-income and financially excluded households;
- The development of alternative financial providers through the promotion of membership, savings and partnerships with employers;
- Ensuring lenders are responsible, transparent and that debt collection practices do not inflict harm on people;
- Helping develop financial education and capability for both adults and children to enable people to avoid debt;
- Exploring how to expand free debt advice provision and ensuring that formal insolvency remedies (such as the DRO) do not disincentivise work.



# Introduction

Britain is currently in the midst of a personal debt crisis that is impacting the lives of people, families and communities. Millions of people across the country are struggling with over-indebtedness and many more are living on the edge, just one crisis away from serious problems.

Living with high levels of debt is not just about a lack of money or being poor. It can affect people's mental and physical health, disrupt family stability and keep them from finding and maintaining employment. Personal debt is often overlooked as a natural consequence of poverty, but it is truly the driving force behind some of the most entrenched poverty in Britain today.

This report builds upon work done in *Breakthrough Britain* in 2007 that identified the root causes of serious personal debt and how it can spiral out of control. Sadly, since publication, the problem of serious personal debt in Britain has become worse rather than better. As a nation we now hold £1.43 trillion in personal debt, almost equal to the entire national economic output.<sup>68</sup> This level of personal debt is unsustainable and represents a major pathway to poverty.

While it is easy to blame increasing levels of personal debt on the global economic downturn, which has undoubtedly been a contributory factor, that explanation is too simplistic. Many of the root causes of our nation's debt are structural, existed long before the 2007/08 financial crash and have not subsided since. Most importantly this explanation fails to capture the impact debt has on Britain's poorest communities and families.

This report will focus on this 'problem debt' in low-income households. The value of the debt may be relatively small, but for families with only £50 a week to spend, a debt of £300 or £400 can represent a significant burden. Debt becomes problem debt because of the impact it has on people's decisions, their health, their relationships and other aspects of their life.

Problem debt can become all-consuming. People can suffer from anxiety and stress as a result of worrying about their problem debt. For some, this stress turns into depression, leaving them isolated from their family and community.

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<sup>68</sup> The Money Charity, *Debt Statistics – October 2013*, London, The Money Charity, 2013 [accessed via: <http://themoneycharity.org.uk/media/Debt-Stats-Full-October-2013.pdf> (24/10/13)]

For many, the pressures of problem debt can impact on their ability to find or sustain employment. More than half of people with problem debt admit their performance at work suffers as a result, with four out of ten having to take time off work as a result of their debt-related stress.<sup>69</sup> For those that are unemployed, one in five have problems finding work because of their debt.<sup>70</sup> Without work it becomes harder to repay creditors and recover from problem debt.

The stress of living with problem debt takes centre stage in many British families, driving a wedge between family members. Debt is one of the most frequently cited causes for family disputes and can lead to family breakdown. Three-quarters of people seeking debt advice admit that it has weakened their relationship, with one in four claiming that it caused the relationship to break down entirely.<sup>71</sup>

Much of this conflict is driven by how people think about and react to debt. This 'debt psychology' can mean people ignore the size and extent of their problem debts, can influence how they attempt to deal with their problem debt, and ultimately can exacerbate the problem. An estimated 40 per cent of people wait over a year once they realise their debt is spiralling out of control before they seek help.<sup>72</sup> People are sometimes so ashamed of their debt that more than one in four do not even talk about it to their closest friends or family.<sup>73</sup>

The 'psychology of debt' can also lead people to act irrationally when trying to cope with their spiralling debt. Financial stress can cause people to take on 'quick fix' loans from short-term high-cost lenders that can eventually make underlying financial problems worse. Similarly, when people underestimate the size of their problem debt it can lead them to attempt to solve it in ineffective ways. Borrowing more, juggling payments and cutting back on essentials such as food and electricity to save money, often does nothing to tackle the root cause of problem debt. This can have a significant impact on the quality of life for low-income households and can just make the original debt problem worse.

Increasingly, people are also being driven into problem debt as a result of their low-income, lack of wage growth and the rising cost of living. There has been an increase in the number and proportion of problem debt cases driven by the inability to pay everyday bills. The 25 per cent increase in the cost of living over the past five years combined with job insecurity and low savings mean that many households have been pushed over the edge.<sup>74</sup>

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69 Citizens Advice, Press Release, *3 in 4 of those in debt say money worries are harming their health*, 17 December 2012 [accessed via: [http://www.citizensadvice.org.uk/index/pressoffice/press\\_index/press\\_20121217.htm](http://www.citizensadvice.org.uk/index/pressoffice/press_index/press_20121217.htm) (17/10/13)]; Legal Services Research Centre, *Helping Hand: The Impact of Debt Advice on People's Lives*, London: Legal Services Research Centre, 2007 [accessed via: <http://www.justice.gov.uk/downloads/publications/research-and-analysis/lsrc/2007/Impact.pdf> (16/10/13)]

70 Legal Services Research Centre, *Helping Hand: The Impact of Debt Advice on People's Lives*, London: Legal Services Research Centre, 2007 [accessed via: <http://www.justice.gov.uk/downloads/publications/research-and-analysis/lsrc/2007/Impact.pdf> (16/10/13)]

71 Marriage Week, Press Release, *For Richer for Poorer – How Money Stress Wrecks Marriages*, 2013 [accessed via: <https://capuk.org/downloads/press/marriageweek2013.pdf> (17/10/13)]

72 StepChange, *Statistical Yearbook 2012*, London: 2013 [accessed via: [http://www.stepchange.org/Portals/0/Documents/media/reports/statisticsyearbooks/Statistical\\_Yearbook\\_2012.pdf](http://www.stepchange.org/Portals/0/Documents/media/reports/statisticsyearbooks/Statistical_Yearbook_2012.pdf) (16/10/13)]

73 Ibid

74 uSwitch, Press release, *Household bills up 25% in five years*, 13 March 2013 [accessed via: <http://www.uswitch.com/blog/2013/03/13/household-bills-rise-25-in-five-years/> (24/10/13)]

Those on a low income are not victims of a housing bubble or an international banking crash, but of a financial system that is rigged against them. People on the lowest incomes are forced to the periphery, often only able to access banking and credit at a premium and with a host of onerous terms and conditions. Irregular incomes and small levels of savings mean they are more likely to go overdrawn and suffer penalty charges, further limiting their ability to access banking and credit as their credit rating is impacted.

It is estimated that seven million people use high cost credit such as payday loans, home credit, and pawnbrokers. The cost may be higher still for those using unauthorised overdrafts or making minimum monthly payments on credit cards. Many people do not even have access to these expensive sources of 'mainstream' lending. 1.4 million people have no access to a transactional bank account and are effectively excluded from the entire financial sector.<sup>75</sup> Lack of access to mainstream finance contributes significantly to the 'poverty premium,' a surcharge on everyday goods and services estimated at £1,280, a year or 10 per cent of a low-income households annual income, paid by the poorest families.<sup>76</sup>

For the most financially excluded, there is often no option but to turn to illegal moneylenders. It is estimated that over 310,000 people borrow money from these criminals each year.<sup>77</sup> Illegal moneylenders extort money from their victims, often arbitrarily raising interest rates, demanding payments or charging penalties. Their use of violence and intimidation terrorises people and communities, enforcing a 'veil of silence' that allows them to escape detection. This is an inexcusable crime in modern Britain.

Many of the side effects of problem debt can also work to drive people further into debt, creating a vicious cycle. While it is often hard to prove causation, there is a clear relationship between the following and problem debt: unemployment, family breakdown, addiction, and poor mental health. Similarly, many of these factors are interrelated, meaning problem debt can have diverse causes, requiring multi-dimensional support in order to fully resolve the underlying problems.

The associated consequences of problem debt not only have a human impact but also a financial cost to the state. As people and families fall apart under the crushing weight of their debt, the state must often step in to support them. Mental health conditions are more common than heart disease or cancer, and treating them places a considerable burden on an already strained NHS budget.<sup>78</sup> The state incurs vast expense helping to pick up the pieces following family breakdown and in supporting those who are unable to find employment. Tackling the root causes of problem debt would be cost effective, especially when combined

75 DWP, *Credit Union Expansion Project: Feasibility Study Report*, London: DWP, 2012 [accessed via: <http://www.dwp.gov.uk/docs/credit-union-feasibility-study-report.pdf> (16/10/13)]

76 Save the Children, *The UK Poverty Rip-Off*, London: 2010 [accessed via: [http://www.savethechildren.org.uk/sites/default/files/docs/UK\\_Poverty\\_Rip\\_Off\\_Brief\\_1.pdf](http://www.savethechildren.org.uk/sites/default/files/docs/UK_Poverty_Rip_Off_Brief_1.pdf) (16/10/13)]; Consumer Futures, *Addressing the poverty premium*, 2013: London, Consumer Futures [accessed via: <http://www.consumerfutures.org.uk/files/2013/06/Addressing-the-poverty-premium.pdf> (16/10/13)]

77 Policis, *Interim Evaluation of the National Illegal Money Lending Projects: Final report – the evidence base*, London: Department of Business Innovation and Skills, 2010 [accessed via: [http://www.policis.com/pdf/Illegal\\_Lending/BIS%20IML%20Evaluation%20Evidence%20Report%20final%2008102010.pdf](http://www.policis.com/pdf/Illegal_Lending/BIS%20IML%20Evaluation%20Evidence%20Report%20final%2008102010.pdf) (26/08/13)]

78 Department of Health, *No health without mental health: A cross- Government mental health outcomes strategy for people of all ages*, London: HM Government, 2011 [accessed via: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/215808/dh\\_123993.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/215808/dh_123993.pdf) (24/10/13)]

with early intervention and financial education that help people avoid debt and better manage their finances.

While Britain is in debt as a country, and British people are over-indebted at an individual level, problem debt is an entirely different concept for many of Britain's poorest individuals and families. This is a problem that must be addressed now before more lives are affected by the serious consequences of personal debt.

This 'state of the nation' will be structured in the following way:

- Chapter 1 provides an overview of personal debt in the UK and how it has grown;
- Chapter 2 examines what drives people into problem debt;
- Chapter 3 details the consequences of life in debt and how it destroys people's lives;
- Chapter 4 gives an overview of what support is currently available to help people avoid, manage and resolve their debt problems.

# chapter one

## Personal debt in the UK

Personal debt and over-indebtedness in the UK are rising at an alarming rate. Increased levels of consumer borrowing and decreased levels of savings over the past twenty years have led to worrying levels of personal debt amongst the poorest. Each year around 130,000 people legally declare themselves financially insolvent, such as through bankruptcy, and in 2012 an estimated 1.7 million sought free professional debt advice to resolve their problem debt.<sup>79</sup> Furthermore, an estimated one in five households are currently struggling with their financial commitments and could benefit from professional help.<sup>80</sup>

Consumer borrowing is an essential part of a modern economy as it facilitates purchases, enables individuals to bridge gaps between pay cycles and spread out the payment of expensive household goods. Increasingly households have to use consumer debt to pay for everyday expenses.<sup>81</sup> Borrowing can quickly spiral out of control if people take on too much debt relative to their income or experience an unexpected income shock such as unemployment. Low-income households are particularly at risk as many often lack savings and financial resilience.

Almost everyone in the UK holds some sort of debt, or credit, be it a mortgage, a credit card or an overdraft. For the majority this debt is manageable and proportionate, having no significant negative impact on their lives. Yet for a growing number this is not the case, with individuals' 'normal debt' turning into 'problem debt.' This problem debt can have a significant impact on the lives of people and their families, not just in financial terms but also on their mental health, relationships and well-being.

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79 Insolvency Service, *Statistics release: Insolvencies in the second quarter 2013*, London: ONS, 2013 [accessed via: <http://www.insolvencydirect.bis.gov.uk/otherinformation/statistics/201308/index.htm> (28/08/13)]; Money Advice Trust, *Demand capacity and need for debt advice in the United Kingdom – 2012*, Nottingham: Money Advice Trust, 2012 [accessed via: [http://www.infohub.moneyadvicetrust.org/resource.asp?cat\\_id=260&rPath=cat&r\\_id=770](http://www.infohub.moneyadvicetrust.org/resource.asp?cat_id=260&rPath=cat&r_id=770) (14/10/13)]

80 Ibid

81 Finney A and Davies S, *Facing the Squeeze 2011: A qualitative study of household finances and access to credit*, London: Money Advice Trust, 2011 [accessed via: <http://www.bristol.ac.uk/geography/research/pfrc/themes/credit-debt/pfrc1111.pdf> (21/10/13)]

## Glossary

**Problem debt:** Debt that is of concern not due to its absolute value in monetary terms, but because of its size relative to the holder's disposable income, their inability to repay it, and because of the impact it can have on their health, relationships and life.

**Low-income households:** This term is used as a general term for households that have below average levels of incomes and whose general financial resilience is often low as a result of low savings and irregular or insecure income

**Consumer debt:** Debt that is outstanding on credit cards, overdrafts, personal loans, store cards, home credit, payday loans generally incurred through consumer purchases.

**Cost of living debts:** This refers widely to debts and arrears on bills and commitments for services that are generally considered to be essential: rent, gas, electricity, water, council tax, and telephone services.

This chapter details how three types of personal debt have had a particularly harmful effect on problem debt levels for low-income households: mortgages, consumer credit and cost of living debts (rent, utilities, and taxes). Mortgage debt is a concern because repayments tend to represent a disproportionate burden for low-income households and they can become homeless if they fail to keep up with repayments.<sup>82</sup> Consumer credit is more expensive for low-income households, especially if they can only use short-term high-cost credit that can quickly spiral out of control. Lastly, many essential bills and services can cost more for low-income households and make up a larger percentage of their income, meaning price rises or wage decreases can quickly drive them into arrears and problem debt.

The last section of this chapter will identify the vulnerable groups of people who are often disproportionately affected by the large surge of personal debt in Britain. These include the elderly, ex-offenders, single parents, the unemployed, people dependant on benefits, households with the lowest incomes and young people classed as Not in Education, Employment or Training (NEET). Problem debt amongst these groups is of particular concern because they often lack financial resilience and are more likely to be affected by other issues that can exacerbate their debt or put them at a greater risk of problem debt. Similarly, a lack of financial education and employment barriers can inhibit their ability to manage problem debt or recover from it.

To understand the scale of the problem though, it is necessary to look first at personal debt in the UK at the national level and at recent historic trends.

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82 ONS, *Family Spending 2012 – Table 2.10 Expenditure on rent and mortgages by renters and mortgage holders; Table 3.12 Income and source of income by gross income quintile group, 2011*, London: ONS, 2012 [accessed via: [http://www.ons.gov.uk/ons/rel/family-spending/family-spending-2012-edition/index.html](http://www.ons.gov.uk/ons/rel/family-spending/family-spending/family-spending-2012-edition/index.html) (24/10/13)]



## Breakthrough Britain<sup>83</sup>

In 2007 the CSJ visited communities across the country and the poverty-fighting organisations that work there to identify the social and economic factors that were contributing to personal debt in Britain's poorest communities and the resulting poverty.

The report found that it was too easy to get into debt, that lenders were targeting vulnerable people, Britain's savings culture had virtually disappeared, financial capability was low and that an increasingly materialistic culture was driving unsustainable consumption and debt.

Debt problems were being triggered by a number of different factors and were strongly linked with the root causes of poverty: family breakdown, economic dependency, alcohol and drug addiction and educational failure.

The findings in this report are just as relevant today and will be taken as the starting block for this report that will examine how the financial landscape in Britain has changed since 2007 and identify what is the state of personal debt in the UK in 2013.

## 1.1 The state of personal debt in the UK

Both individuals and families have become significantly more indebted over the past decade. Encouraged to borrow more and save less, whilst experiencing rising costs of living and stagnant wages, millions of households now find themselves at crisis point.

People in the UK now owe a total of £1,425 billion, an average of £54,141 per household when including mortgages.<sup>84</sup> This compares with an average of £29,000 per household just over a decade ago.<sup>85</sup> This now means that households in the UK owe an amount equivalent to 94 per cent of the country's economic output for 2012.<sup>86</sup> Only Ireland has a higher ratio of personal debt to GDP amongst European countries.<sup>87</sup>

Whilst a significant proportion of this is mortgage debt, even when we take this out total household debt has increased by £24.3 billion, from an average of £5,495 per household in 2001, to £6,007 in 2012.<sup>88</sup>

83 Centre for Social Justice, *Breakthrough Britain: Serious Personal Debt*, London: Centre for Social Justice, 2007

84 The Money Charity, *Debt Statistics – October 2013*, London, The Money Charity, 2013 [accessed via: <http://themoneycharity.org.uk/media/Debt-Stats-Full-October-2013.pdf> (24/10/13)]

85 Bank of England, Table: LPQBZ2A – Quarterly amounts outstanding of total (excluding the Student Loans Company) sterling net lending to individuals and housing associations (in sterling millions) seasonally adjusted, London: Bank of England, 2013; ONS, *Population and Household Estimates for the United Kingdom, March 2011*, London: ONS, 2001. Calculation based on average outstanding debt in the four quarter of 2001 divided by number of households (24.5 million) in 2001

86 The Money Charity, *Debt Statistics – October 2013*, London, The Money Charity, 2013 [accessed via: <http://themoneycharity.org.uk/media/Debt-Stats-Full-October-2013.pdf> (24/10/13)]. ONS, *Quarterly national accounts*, London: ONS [accessed via: <http://www.ons.gov.uk/ons/rel/naa2/quarterly-national-accounts/q2-2013/stb-quarterly-national-accounts--q2-2013.html#tab-Historical-context> (12/10/13)]. Calculation made through aggregating quarterly GDP for 2012 and then dividing total debt by total GDP

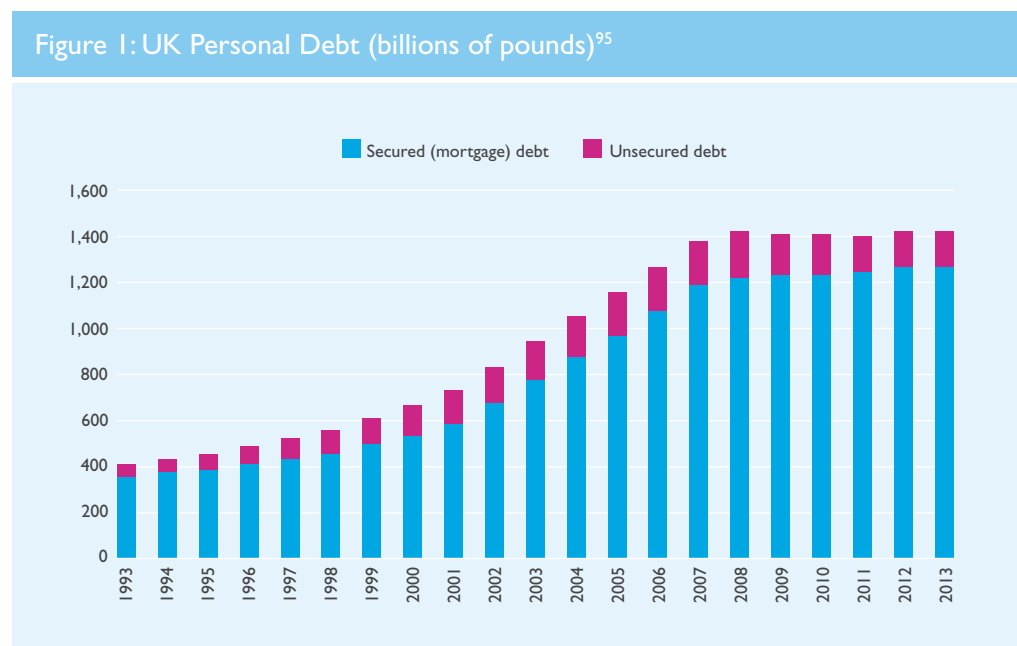
87 Roxburgh C et al, *Debt and Deleveraging: Uneven Progress on the Path to Growth*, London: McKinsey Global Institute, 2012, p5 (Note: comparative estimates are for 2011)

88 Bank of England, *LPMBI20 – Monthly amounts outstanding of total (excluding the Student Loans Company) sterling net unsecured lending to individuals (in sterling millions) seasonally adjusted*, London: Bank of England Interactive Database. ONS, *Population and Household Estimates for the United Kingdom, March 2011*, London: ONS, 2001. Calculations based on the average outstanding debt in the four quarter of 2001 and 2012 divided by number of households (24.5 million and 26.4 million) in 2001 and 2012

Repaying high levels of debt can represent a significant burden, with households paying out £164 million per day on interest repayments, equivalent to £2,272 per household each year.<sup>89</sup> In 2012 banks wrote off £12.1 million worth of debt owed by households every day, almost twice the rate as in 2001 (£6.5 million per day).<sup>90</sup> Of the debt written off, almost 90 per cent was unsecured consumer debt, as opposed to mortgage debt, indicating that this type of debt is inherently more risky as there is no property that can be sold to repay part or all of the debt.<sup>91</sup>

While higher income households may carry higher levels of total debt, this increase in debt has generally been more problematic for those on low incomes as debt repayments tend to make up a greater proportion of their income and they tend to have less financial resilience. For many this increase in debt represents a real threat, and has pushed many into problem debt.

In 2011, households in the poorest income decile had average debts that were more than four times greater than their household income, with average repayments representing almost half of monthly gross income (47 per cent).<sup>92</sup> In contrast those households in the top income decile held average debts worth just more than their annual income and spent just nine per cent of their monthly gross income on debt repayments.<sup>93</sup> It is this greater exposure of debt relative to income that makes low-income households particularly vulnerable to problem debt.<sup>94</sup>



89 The Money Charity, *Debt Statistics – October 2013*, London, The Money Charity, 2013 [accessed via: <http://themoneycharity.org.uk/media/Debt-Stats-Full-October-2013.pdf> (24/10/13)]

90 Bank of England, *RPATFHG – Annual amounts UK resident monetary financial institutions' sterling write-offs of lending to individuals (in sterling millions) not seasonally adjusted*, London: Bank of England Interactive Database

91 Bank of England, *Tables: RPATFHG, RPATFHD, RPATFHE, RPATFHF – Write-off statistics*, London: Bank of England Interactive Database

92 Bank of England, *NMG Consulting Survey 2011*, London: NMG Consulting, 2011 [accessed via: <http://www.bankofengland.co.uk/publications/Documents/quarterlybulletin/nmgsurvey2011.xls> (21/10/13)]

93 Ibid

94 Ibid

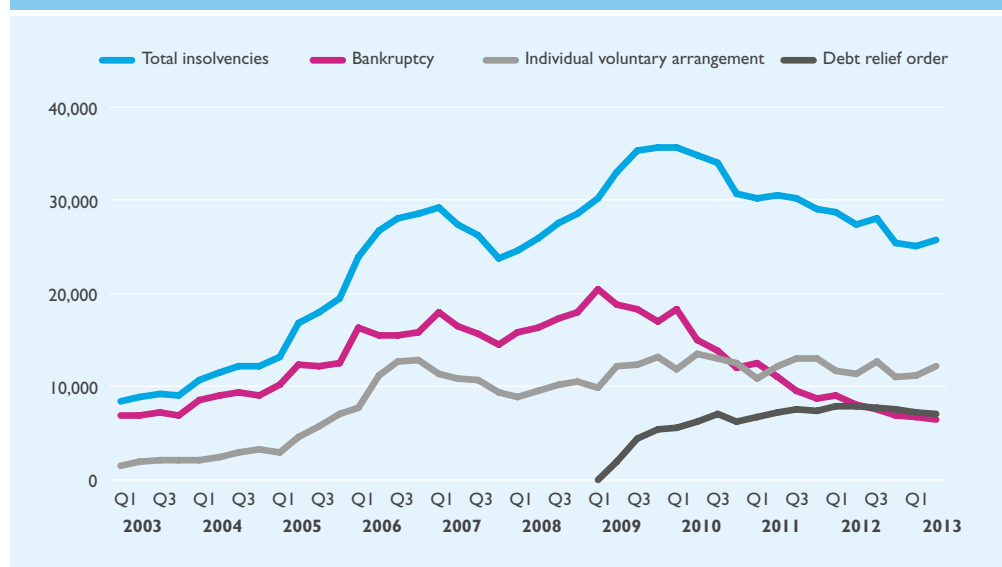
95 The Money Charity, *Debt Statistics – October 2013*, London, The Money Charity, 2013 [accessed via: <http://themoneycharity.org.uk/media/Debt-Stats-Full-October-2013.pdf> (24/10/13)]

This total debt does not even reflect the significant debts owed to illegal moneylenders by an estimated 310,000 individuals who are often excluded from mainstream borrowing and who represent some of Britain's most vulnerable people.<sup>96</sup>

The impact of this soaring debt is clearly evident. In 2011, an estimated 2.6 million sought some form of debt advice, while the number of people seeking free debt advice increased to 1.7 million individuals in 2012.<sup>97</sup> Debt advice charities estimate that there is significant unmet demand, and that as many 5.3 million households would benefit from receiving debt advice regarding their financial difficulties.<sup>98</sup> As of 2011, it is estimated that there are more than 1.1 million engaged in some form of formal or informal debt solution necessary to resolve their problem debt.<sup>99</sup>

Each year more than 130,000 people seek formal debt relief, such as bankruptcy, which writes off their debts but significantly harms their financial credibility and places (for a time) severe restrictions on future borrowing and financial activity.<sup>100</sup> The percentage of people filing for insolvency has tripled since 2003, and while total insolvencies have declined since 2010, due in part to a decrease in the level of new high risk lending issued by banks, the rates of insolvency still remain worryingly high.<sup>101</sup>

Figure 2: Insolvencies in England and Wales (thousands of people)<sup>102</sup>



96 Policis, *Interim Evaluation of the National Illegal Money Lending Projects: Final report – the evidence base*, London: Department of Business Innovation and Skills, 2010 [accessed via: [http://www.policis.com/pdf/Illegal\\_Lending/BIS%20IML%20Evaluation%20Evidence%20Report%20final%2008102010.pdf](http://www.policis.com/pdf/Illegal_Lending/BIS%20IML%20Evaluation%20Evidence%20Report%20final%2008102010.pdf) (26/08/13)]

97 Money Advice Trust, *Demand capacity and need for debt advice in the United Kingdom – 2012*, Nottingham: Money Advice Trust, 2010 [accessed via: [http://www.infohub.moneyadvice-trust.org/resource.asp?cat\\_id=260&rPath=cat&r\\_id=770](http://www.infohub.moneyadvice-trust.org/resource.asp?cat_id=260&rPath=cat&r_id=770) (14/10/13)]

98 Ibid; ONS, *Population and Household Estimates for the United Kingdom, March 2011*, London: ONS, 2011. Estimate based on 20% of households (26.4 million) needing debt advice

99 DRF/Zero Credit, *Debt Resolution in the UK*, Timperley: DRF/Zero Credit, 2012 [accessed via: <http://www.debtresolutionforum.org.uk/resources/dr-f-research-18th-june-2012.pdf> (14/10/13)]

100 Insolvency Service, *Statistics release: Insolvencies in the second quarter 2013*, London: ONS, 2013 [accessed via: <http://www.insolvencydirect.bis.gov.uk/otherinformation/statistics/201308/alltables.xls> (28/08/13)]. Statistic is for the UK and includes Bankruptcy, Insolvency, Debt Relief Orders, Sequestrations, Protected Trust Deeds, and Individual Voluntary Arrangements

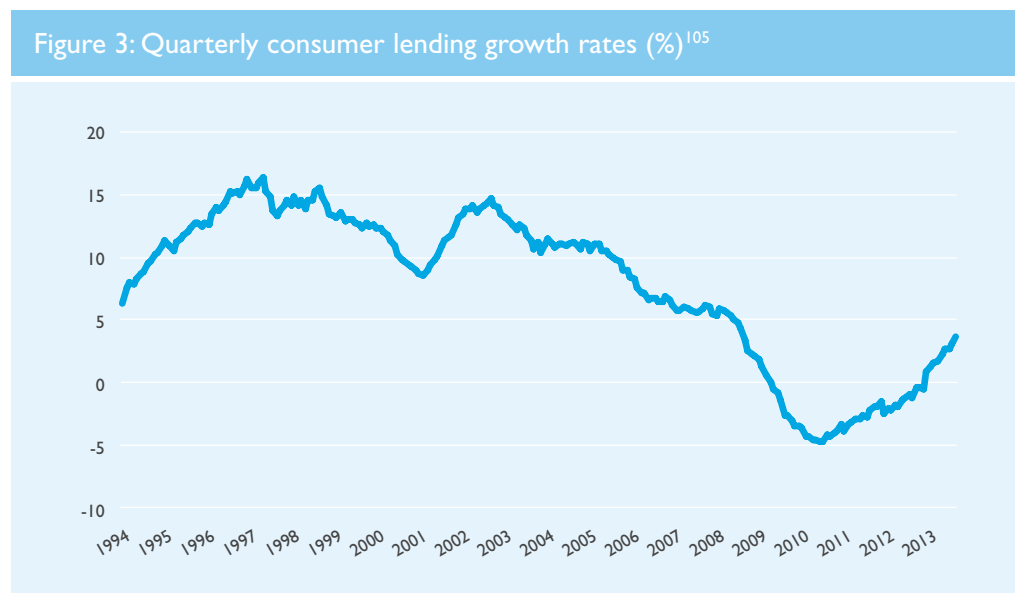
101 Insolvency Service, *Statistics release: Insolvencies in the second quarter 2013*, London: ONS, 2013 [accessed via: <http://www.insolvencydirect.bis.gov.uk/otherinformation/statistics/201308/alltables.xls> (28/08/13)]. Total insolvencies are for the UK, rates of insolvency are based on data for England and Wales only

102 Insolvency Service, *Statistics release: Insolvencies in the second quarter 2013*, London: ONS, 2013 [accessed via: <http://www.insolvencydirect.bis.gov.uk/otherinformation/statistics/201308/index.htm> (28/08/13)]

### 1.1.1 Increases in borrowing

The growth in the UK's total debt has in large part been driven by the rapid growth in the use of consumer credit over the past 20 years. Net consumer borrowing has increased by £207 billion since 1993.<sup>103</sup> Similarly, as a result of increased consumer borrowing, outstanding unsecured debt has trebled from £52 billion to £158 billion over the same period.<sup>104</sup>

As can be seen in Figure 4, the contraction in consumer lending in 2009 due to the financial crash is insignificant in comparison to the expansion in consumer borrowing prior to the financial crash, with lending beginning to grow again since 2012. While not all consumer borrowing is bad or leads to problem debt, the massive expansion of easy to access credit has allowed many people to take on large levels of credit that has subsequently turned into problem debt.



### 1.1.2 Rising levels of over-indebtedness

The recent tail-off in borrowing growth following the financial crisis should not mask just how over-indebted individuals and households had already become. Real wages have fallen to 2003 levels, unemployment is still higher than pre-recession levels, and the cost of living is increasing, making households particularly vulnerable to over-indebtedness.<sup>106</sup>

<sup>103</sup> Bank of England, LPQB3PS: Quarterly changes of total (excluding the Student Loans Company) sterling net unsecured lending to individuals (in sterling millions) seasonally adjusted, London: Bank of England, 2013

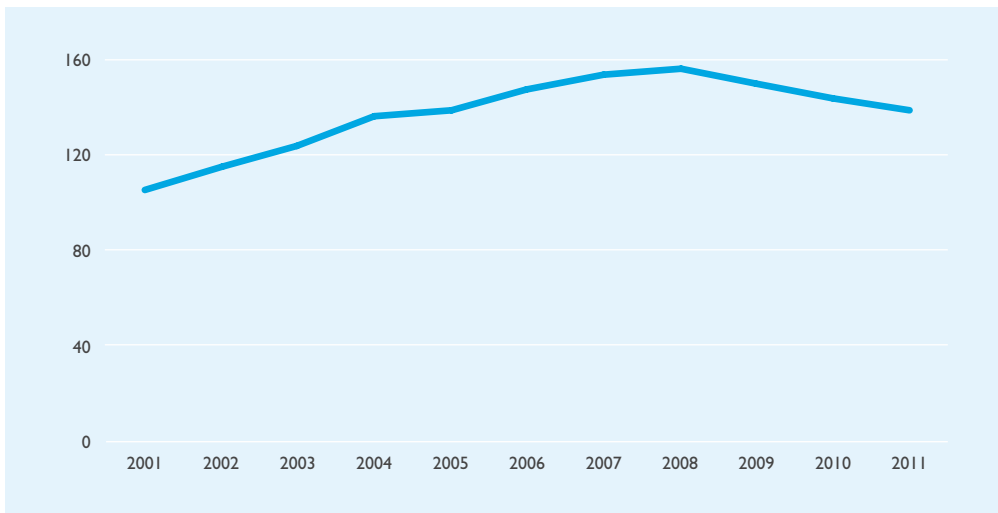
<sup>104</sup> Bank of England, LPQB12O: Quarterly amounts outstanding of total (excluding the Student Loans Company) sterling net unsecured lending to individuals (in sterling millions) seasonally adjusted, London: Bank of England, 2013

<sup>105</sup> Bank of England, LPMB4TQ: Monthly 12 month growth rate of total (excluding the Student Loans Company) sterling net other consumer credit lending to individuals (in percent) seasonally adjusted, London: Bank of England, 2013

<sup>106</sup> ONS, Labour Market Statistics, 16 October 2013, London: ONS, 2013 [accessed via: [http://www.ons.gov.uk/ons/dcp171778\\_327398.pdf](http://www.ons.gov.uk/ons/dcp171778_327398.pdf) (24/10/13)]. ONS, Consumer Price Index, London: ONS, 2013 [accessed via: <http://www.ons.gov.uk/ons/rel/cpi/consumer-price-indices/september-2013/index.html> (24/10/13)]. ONS, Real wages down by 8.5% since 2009, London: ONS, 2013 [accessed via: <http://www.ons.gov.uk/ons/rel/regional-trends/regional-economic-analysis/changes-in-real-earnings-in-the-uk-and-london--2002-to-2012/sum-real-wages-down-by-8-5--since-2009.html> (21/10/13)]

Over the past decade households have taken on increasingly high levels of debt relative to their income. While indebtedness peaked just prior to the financial crisis of 2007/8 the rapid rise in indebtedness began during a period of economic growth. The recent decrease in indebtedness, resulting from debt write-offs, increased repayment efforts amongst some households, and decreases in high-risk lending is relatively insignificant in comparison to previous increases and means many households are still over-indebted.

Figure 4: Gross debt-to-income ratio of UK households (%)<sup>107</sup>



Over-indebtedness can be measured both objectively, by the percentage of income spent on repaying debts, and subjectively, through surveys asking people how much of a burden their debt is. The inconsistency of survey terminology and measures of objective data make exact comparisons over the past decade difficult, but it is clear that problem debt has been rising and has not significantly subsided since the financial crisis.

In 2002, 12 per cent of households found keeping up with their financial commitments to be a 'constant struggle'.<sup>108</sup> Similarly, five per cent of respondents were spending more than a quarter of their gross income on consumer credit repayments, with six per cent answering that they were spending more than half of their income on total secured and unsecured borrowing repayments.<sup>109</sup> Around one in 14 had four or more credit commitments, indicating a high degree of potential exposure to debt.<sup>110</sup> This paints a picture of a significant minority who were already struggling with problem debt before the crash.

At the height of the economic crisis the number of people with problem debt had increased significantly. In 2008/09, 14 per cent of household reported their debts to be a 'heavy burden'.<sup>111</sup>

<sup>107</sup> Eurostat, *Gross debt-to-income ratio of households*, Brussels, Eurostat, 2013 [accessed via: <http://epp.eurostat.ec.europa.eu/tgm/table.do?tab=table&init=1&language=en&pcode=tec00104&plugin=0> (24/10/13)]

<sup>108</sup> Kempson E, *Over-indebtedness in Britain: A report to the department of Trade and Industry*, University of Bristol: Personal Finance Research Centre, 2002 [accessed via: [http://www.ggybris.ac.uk/pfrc/Reports/Overindebtedness\\_Britain.pdf](http://www.ggybris.ac.uk/pfrc/Reports/Overindebtedness_Britain.pdf) (12/10/13)]

<sup>109</sup> Ibid

<sup>110</sup> Ibid

<sup>111</sup> Institute for Social and Economic Research, *Over-Indebtedness in Britain: An analysis using the wealth and assets survey and household annual debtors survey*, University of Essex: BIS, 2010 [accessed via: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/31897/11-747-over-indebtedness-in-great-britain-analysis.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31897/11-747-over-indebtedness-in-great-britain-analysis.pdf) (13/10/13)]

The number of households with more than four credit commitments increased to one in five (20 per cent).<sup>112</sup> Similarly, more than one in 10 in arrears on at least one credit commitment, triple the number in 2002.<sup>113</sup>

By 2012 the situation had only slightly improved and is still significantly worse than a decade before. Just over one in eight borrowing households made unsecured debt repayments that exceeded 30 per cent of their income and around one in 10 made unsecured debt repayments that exceeded 40 per cent of their income.<sup>114</sup> More people still felt the burden of their problem debt, with one in eight finding it to be a 'heavy burden'.<sup>115</sup> Similarly, seven per cent had arrears of more than three months on a credit commitment, still more than double the level seen a decade before.<sup>116</sup>

The financial crisis has undoubtedly exacerbated the situation of problem debt in the UK, but it has not caused the state of financial vulnerability that households across the UK find themselves in today. The build-up began more than a decade ago as consumer borrowing rose to unsustainable levels, debt became normalised and people failed to save for financial shocks.

### 1.1.3 The decline of personal savings

As people borrowed more and took on higher levels of debt they also began to save less, leaving them over-exposed and at risk. Personal saving is necessary for building financial resilience. Household savings are essential for dealing with the income shocks and unexpected costs that can drive problem debt, as is discussed in Chapter Two. A recent survey indicated that 35 per cent of working adults, equivalent to eight million people, could not pay their rent or mortgage from their savings for more than one month.<sup>117</sup>

Between 2000 and 2008, the savings ratio was at historically low levels, as can be seen in Figure 5. This indicates a lack of commitment to saving on a national level, potentially exacerbating the impact of economic cycles and recession.

At the beginning of the crisis, as economic uncertainty increased, people saved more and spent less, meaning the savings ratio has increased since 2009. However, as savings are not measured directly but simply represent the difference between household earnings and spending, apparent saving could in reality be debt repayment.<sup>118</sup> It is predicted that the savings ratio will continue to decline from 7.2 per cent in 2010 to five per cent in 2017, well below the level seen 20 years ago.<sup>119</sup>

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112 Ibid

113 Ibid; Kempson E, *Over-indebtedness in Britain: A report to the department of Trade and Industry*, University of Bristol: 2002, Personal Finance Research Centre [accessed via: [http://www.ggy.bris.ac.uk/pfrc/Reports/Overindebtedness\\_Britain.pdf](http://www.ggy.bris.ac.uk/pfrc/Reports/Overindebtedness_Britain.pdf) (12/10/13)]

114 Department for Business, Innovation and Skills, *Credit, Debt and Financial Difficulty in Britain*, 2012, London: Department for Business, Innovation and Skills, 2013 [accessed via: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/208075/bis-13-p187-a-report-using-data-from-the-yougov-debttrack-survey.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/208075/bis-13-p187-a-report-using-data-from-the-yougov-debttrack-survey.pdf) (21/10/13)]

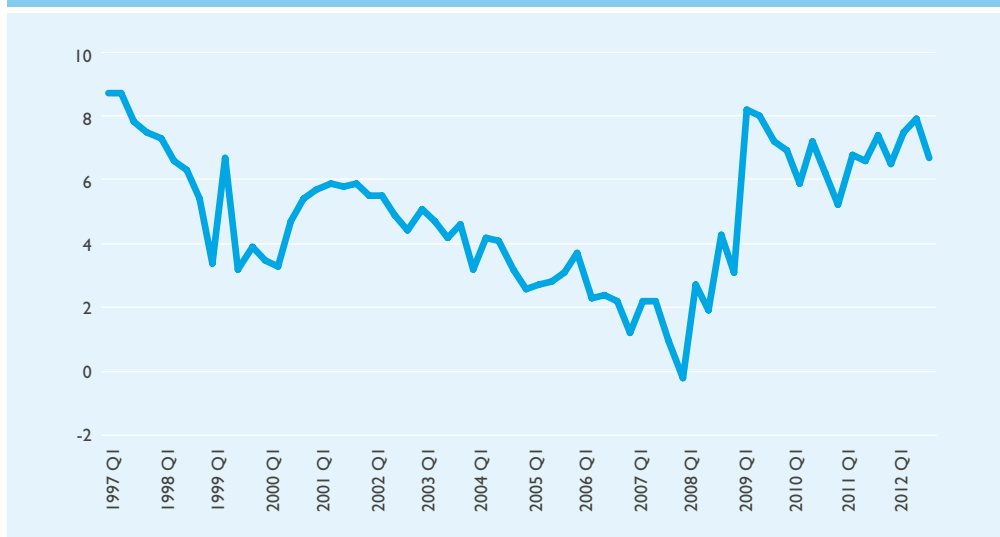
115 Ibid

116 Ibid

117 Shelter, Press Release, *8 million people one paycheque away from losing their home*, 11 April 2013 [accessed via: [http://england.shelter.org.uk/news/april\\_2013/8\\_million\\_people\\_one\\_paycheque\\_away\\_from\\_losing\\_their\\_home](http://england.shelter.org.uk/news/april_2013/8_million_people_one_paycheque_away_from_losing_their_home) (24/10/13)]

118 FSA, *Retail Conduct Risk Outlook*, London: FSA, 2012 [accessed via: [http://www.thepfs.org/media/1735092/fsa\\_financial\\_conduct\\_risk\\_outlook\\_2012\\_insurance.pdf](http://www.thepfs.org/media/1735092/fsa_financial_conduct_risk_outlook_2012_insurance.pdf) (21/10/13)]

119 Office for Budget Responsibility, *Economic and Fiscal Outlook March 2013*, London: Office for Budget Responsibility, 2013 [accessed via: <http://budgetresponsibility.org.uk/wordpress/docs/March-2013-EFO-44734674673453.pdf> (21/10/13)]

Figure 5: Household savings ratio in the UK (%)<sup>120</sup>

With less disposable income, the poorest understandably find it more difficult to save. Approximately 8.4 million households in the UK, one in three, have no savings at all.<sup>121</sup> However, for low-income households with incomes under £15,600 this increases to one in two, meaning that there are around three million low-income households with no savings who are less resilient to financial shocks and at greater risk of incurring debt.<sup>122</sup>

Recent increases in household savings appear to be skewed towards higher income and less vulnerable families.<sup>123</sup> While the percentage of families with savings of more than £100,000 has doubled since 2011, the percentage of families managing to save small amounts under £500 has decreased.<sup>124</sup> Couples with children are three to four times more likely to have savings over £100,000 than a single parent family, who are the most likely to have savings of under £500.<sup>125</sup> This indicates that increased savings are concentrated amongst higher income brackets rather than households with the lowest incomes who are the most susceptible to income shocks and serious personal debt.

The Bank of England's policies have the potential to influence household saving decisions. Historically low interest rates, designed to drive economic growth and increase access to borrowing, also send a clear signal that saving is not as financially beneficial.<sup>126</sup> Interest rates on cash deposits, bonds and ISAs are at all time lows, disincentivising saving amongst

<sup>120</sup> ONS, *The economic position of households Q2 2012*, London: ONS, 2012 [accessed via: [http://www.ons.gov.uk/ons/dcp171766\\_283109.pdf](http://www.ons.gov.uk/ons/dcp171766_283109.pdf) (21/10/13)]

<sup>121</sup> DWP, *Family Resource Survey 2011/2012*, London: DWP, 2013, Table 2.8 [accessed via: <https://www.gov.uk/government/publications/family-resources-survey-201112> (21/10/13)]

<sup>122</sup> Ibid

<sup>123</sup> Building Societies Association, *Deposits from households*, London: Building Societies Association, [accessed via: <http://www.bsa.org.uk/docs/statisticspdfs/housesav.pdf> (21/10/13)]

<sup>124</sup> Aviva, *The Aviva Family finances report: July 2013*, London: Aviva, 2013 [accessed via: [https://www.aviva.com/media/upload/Family\\_Finances\\_Report\\_July\\_2013.pdf](https://www.aviva.com/media/upload/Family_Finances_Report_July_2013.pdf) (28/08/13)]

<sup>125</sup> Ibid

<sup>126</sup> Bank of England, *Statistical Interactive Database – official Bank Rate history*, London: Bank of England, 2013 [accessed via: <http://www.bankofengland.co.uk/boeapps/iadb/repo.asp> (21/10/13)]

households.<sup>127</sup> It is beyond the scope of this report to judge the overall economic impact of these policies, but the decreased incentive to save could have long-term implications on the financial resilience of UK households.

The combination of increased borrowing and decreased savings has driven levels of over-indebtedness in Britain. There are several specific types of personal debt which are of particular concern because of how they drive low-income households into problem debt. We look at the three most common below: mortgage debt, consumer debt and cost of living debts.

## 1.2 Types of personal debt

This section will set out the different types of personal debt and explain how they contribute to problem debt in the UK.

Personal debt can be broadly categorised into three types:

- Mortgage debt;
- Consumer debt (such as credit card debt, overdrafts, personal loans, payday loans etc);
- Cost of living debts (utility bills, rent arrears, council tax).

The rapid growth of mortgages over the past two decades has contributed the largest total amount to Britain's personal debt. However it is not as concerning as the rise in consumer debt over that same period. Unlike mortgage debts, which are tied to the value of a house, unsecured consumer borrowing is at higher interest rates and is more likely to spiral out of control, driving people into problem debt.

Recently, low wages coupled with rises in utility bills and rents have gradually eroded household savings and slowly pushed many people into problem debt. Households are increasingly turning to alternative high-cost credit as a way to make ends meet, due in part to the decrease in mainstream lending offered by banks, and which can drive those on low-incomes deeper into debt.

### 1.2.1 Mortgage debt

The rapid rise in mortgage lending prior to the financial crash has left millions, especially those with interest-only mortgages, saddled with high levels of mortgage debt. Each year thousands of households are driven into problem debt and more than 1,500 become homeless as a result of their mortgage debt.<sup>128</sup> Older people have been hit especially hard as they have little

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<sup>127</sup> Building Societies Association, *Average quoted deposit interest rates at banks and building societies* [accessed via: [http://www.bsa.org.uk/docs/statisticspdfs/Savings\\_Rates.pdf](http://www.bsa.org.uk/docs/statisticspdfs/Savings_Rates.pdf) (21/10/13)]

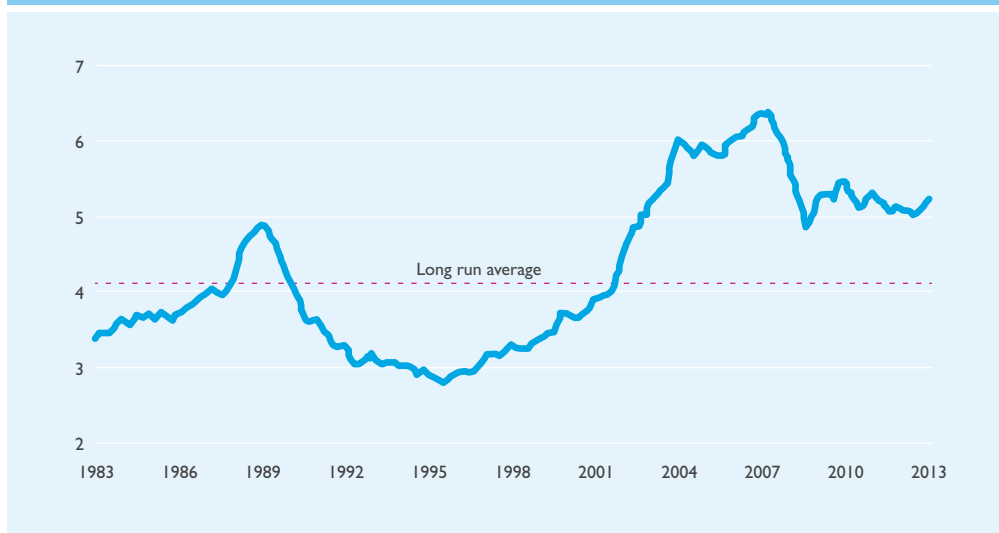
<sup>128</sup> Stats Wales, *Households accepted as homeless by main reason for loss of last settled home and period, 2013* [accessed via: <https://statswales.wales.gov.uk/Catalogue/Housing/Homelessness/Acceptances-and-Other-Decisions/HouseholdsAcceptedAsHomeless-by-MainReason-Period> (24/10/13)]. DCLG, *Homeless statistics*, London: DCLG, 2013 [accessed via: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/236906/Table\\_774.xls](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/236906/Table_774.xls) (21/10/13)]. Averages taken since 2008 for England and Wales



opportunity to increase their earnings, and more are retiring with large levels of mortgage debt.<sup>129</sup>

The growth in mortgage debt seen over the last 20 years can be accounted for in large part by the rise in house prices relative to household earnings and the long-term decline in real interest rates.<sup>130</sup> Currently 11.3 million households hold £1,268 billion in mortgage debt, almost three times as much as in 1999, and an average of £112,640 per household.<sup>131</sup>

Figure 6: UK house price to earnings ratio<sup>132</sup>



Mortgage debt can drive people into problem debt and homelessness, especially for those on low-incomes whose mortgage repayments are often relatively large in relation to their income.<sup>133</sup> Around 719,000 households owe more on their mortgage than their house is worth, putting one in 15 mortgage holding households at serious risk should they fail to make repayments.<sup>134</sup> In poorer parts of the country, where house prices lag behind London and the South East, this affects as many as 15 per cent of households – three times the rate of more prosperous regions.<sup>135</sup>

<sup>129</sup> University of Bristol, Press Release, *Outstanding interest-only mortgages put older people at risk*, 30 September 2013 [accessed via: <http://www.bris.ac.uk/news/2013/9806.html> (21/10/13)]. Age UK, *Economic Tracker: Summer 2013*, London: Age UK, 2013 [accessed via: <http://www.ageuk.org.uk/Documents/EN-GB/For-professionals/Research/Economic%20Monitor%20Report%20Summer%202013.pdf?dtrk=true> (21/10/13)]

<sup>130</sup> Speech by External Member of the Bank of England Monetary Policy Committee, Ben Broadbent, *Deleveraging*, 15 March 2012 [accessed via: <http://www.bankofengland.co.uk/publications/Documents/speeches/2012/speech553.pdf> (28/08/13)]

<sup>131</sup> The Money Charity, *Debt Statistics – October 2013*, London: The Money Charity, 2013 [accessed via: <http://themonetarycharity.org.uk/media/Debt-Stats-Full-October-2013.pdf> (24/10/13)]

<sup>132</sup> Nationwide, *House Price Index July 2013*, London: Nationwide Building Society, 2013 [accessed via: [http://www.nationwide.co.uk/NRVrdonlyres/FBBFE94A-DA8F-44E9-9EF7-62103BDC9DB7/0/Jul\\_2013.pdf](http://www.nationwide.co.uk/NRVrdonlyres/FBBFE94A-DA8F-44E9-9EF7-62103BDC9DB7/0/Jul_2013.pdf) (28/08/13)]

<sup>133</sup> ONS, *Family Spending 2011 Edition*, London: ONS, 2012 [accessed via: [http://www.ons.gov.uk/ons/dcp171766\\_285163.pdf](http://www.ons.gov.uk/ons/dcp171766_285163.pdf) (12/10/13)]

<sup>134</sup> CML, *Mortgage Statistics reference in The Guardian, Negative equity plagues homeowners*, 2 February 2013 [accessed via: <http://www.theguardian.com/money/2013/feb/02/negative-equity-plagues-homeowners> (21/10/13)]

<sup>135</sup> The Guardian, *Negative equity plagues homeowners*, 2 February 2013 [accessed via: <http://www.theguardian.com/money/2013/feb/02/negative-equity-plagues-homeowners> (21/10/13)]

## Sue and Steve – in evidence to the CSJ

We fell into debt when Steve became ill and had to leave work. He took out a loan against the house but did not tell me. When the house was repossessed, I blamed him. I tried to make one meal a day so the boys had something good to eat. Steve and I often did not eat. We'd not long joined Christians Against Poverty when we received a Christmas hamper. It made me cry; I did not feel we deserved it!

There is a strong correlation between areas with high repossession rates, low-household incomes and high levels of unemployment, indicating that poor communities are bearing the brunt of problem debt caused by mortgages.<sup>136</sup> In the most recent Wealth and Assets survey one in four low-income households reported that their mortgage debt was a 'heavy burden.'<sup>137</sup>

In 2012 around 300,000 mortgages were in arrears, with 34,000 homes repossessed due to a failure to keep up with mortgage repayments.<sup>138</sup> In England and Wales alone around 140 households each month are accepted as homeless because of their mortgage default or arrears.<sup>139</sup>

Interest-only mortgages, offered during the economic boom, are of particular concern. Around 1.3 million borrowers are expected to fall short of their repayments, with an estimated one in 10 having no repayment plan at all.<sup>140</sup> This could potentially create an increase in problem debt as people struggle with large financial shortfalls.

This situation, as with mortgage debts in general, is significantly influenced by the Bank of England's interest rate, to which many mortgages are linked.<sup>141</sup> As noted earlier, for the foreseeable future the Bank of England has maintained to keep this rate low.<sup>142</sup> However, it will eventually have to rise from its current level of half a per cent, to somewhere closer to the long-run average of around four or five per cent, which could lead to an increase in problem mortgage debt.<sup>143</sup>

136 Sweet & Maxwell, Press Release, *Home repossession claims in low income areas growing 84% faster than in high income*, July 2010 [accessed via: <http://www.sweetandmaxwell.co.uk/about-us/press-releases/Repossessions%20in%20low%20income%20areas%20on%20the%20up.pdf> (12/10/13)]; Shelter, *Eviction risk monitoring 2012*: London, Shelter, [accessed via: [http://england.shelter.org.uk/\\_data/assets/pdf\\_file/0006/610449/Eviction\\_Risk\\_Monitor\\_2012.pdf](http://england.shelter.org.uk/_data/assets/pdf_file/0006/610449/Eviction_Risk_Monitor_2012.pdf) (21/10/13)]

137 ONS, Main Report: *The Burden of Property Debt in Great Britain, 2006/08 & 2008/10*, London: ONS, 2012 [accessed via: [http://www.ons.gov.uk/ons/dcp171776\\_310008.pdf](http://www.ons.gov.uk/ons/dcp171776_310008.pdf) (21/10/13)]

138 Bank of England, *Statistical release – Mortgage lenders and administrators statistics Q1 2013*, London: Bank of England, 2013 [accessed via: <http://www.bankofengland.co.uk/prd/Documents/regulatorydata/mlar/2013q1/mlar2013q1statisticalrelease.pdf> (21/10/13)]. Ministry of Justice, *Mortgage and landlord possession statistics January to March 2013*, London: ONS, 2013 [accessed via: <https://www.gov.uk/government/publications/mortgage-and-landlord-possession-statistics--2> (21/10/13)]

139 Stats Wales, *Households accepted as homeless by main reason for loss of last settled home and period, 2013* [accessed via: <https://stats.wales.gov.uk/Catalogue/Housing/Homelessness/Acceptances-and-Other-Decisions/HouseholdsAcceptedAsHomeless-by-MainReason-Period> (24/10/13)]. DCLG, *Homeless statistics*, London: DCLG, 2013 [accessed via: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/236906/Table\\_774.xls](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/236906/Table_774.xls) (21/10/13)]. DCLG, *Mortgage repossession statistics*, London: DCLG, 2013 [accessed via: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/137605/130305\\_Table\\_1300.xls](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/137605/130305_Table_1300.xls) (21/10/13)]

140 Experian, *Residential interest only mortgages*, London: FCA, 2013 [accessed via: <http://www.fca.org.uk/static/documents/research/fca-interest-only-mortgage-review.pdf> (24/10/13)]. GfK, *Interest only mortgages – Consumer research*, London: GfK, 2013 [accessed via: <http://www.fca.org.uk/your-fca/documents/research/interest-only-mortgages-gfk> (24/10/13)]

141 Bank of England, *Statistical Interactive Database – official Bank Rate history*, London: Bank of England 2013 [accessed via: <http://www.bankofengland.co.uk/boeapps/iadb/repo.asp> (21/10/13)]

142 Speech by the Governor of the Bank of England, Mark Carney, *Crossing the threshold to recovery*, 28 August 2013 [accessed via: <http://www.bankofengland.co.uk/publications/Documents/speeches/2013/speech675.pdf> (24/10/13)]

143 Bank of England, *Statistical Interactive Database – official Bank Rate history*, London: Bank of England 2013 [accessed via: <http://www.bankofengland.co.uk/boeapps/iadb/repo.asp> (21/10/13)]

The problem of mortgage debt is particularly worrying for older age groups.<sup>144</sup> Around one in eight older people with mortgages are struggling to make their mortgage repayments, with one in five people of those over 50 who still hold mortgage debt owing on average more than £60,000.<sup>145</sup>

Although only around seven per cent of people over the age of 60 currently have a mortgage, that is likely to change.<sup>146</sup> There are approximately 40,000 residential interest-only mortgages due to mature each year from 2017 to 2032 where the consumer will be over the age of 65 when the mortgage reaches its term.<sup>147</sup> While many people will have plans in place to repay their mortgage, these plans may be derailed by having to give up work earlier than expected because of ill health or due to caring responsibilities. One in 10 endowment mortgage holders have no repayment plans, and in the years up to 2020, one-third of endowment shortfalls are expected to be over £50,000.<sup>148</sup>

### Age UK – in evidence to the CSJ

Having to repay an endowment shortfall is likely to have a knock-on impact on other plans for retirement, and a further problem is that even where someone can afford a mortgage, lenders often have arbitrary age limits in place so it may be difficult to extend a loan or re-mortgage. Age UK urges lenders to remove automatic age limits, and instead assess loans on the basis of affordability and the ability to repay, not age.

As this group has limited additional earning potential any shortfall places them at real risk of falling into problem debt. This year it is estimated that around one in five people will retire with outstanding debts, 43 per cent of who will have outstanding mortgage debts. Although the percentage of people retiring with mortgage debt has actually decreased slightly this year, this has been offset by the increase in people retiring with large amounts of consumer debt in the form of credit cards and overdrafts.<sup>149</sup>

## 1.2.2 Consumer debt

The growth in consumer borrowing and debt over the past 20 years is arguably the largest driver of problem debt amongst low-income households and communities. As mainstream lenders have limited access to affordable credit for low-income households in recent years, people have been turning to other sources of high-cost short-term credit.

<sup>144</sup> Age UK, *Economic Tracker: Summer 2013*, London: Age UK, 2013 [accessed via: <http://www.ageuk.org.uk/Documents/EN-GB/For-professionals/Research/Economic%20Monitor%20Report%20Summer%202013.pdf?dtrk=true> (21/10/13)]

<sup>145</sup> University of Bristol, Press Release, *Outstanding interest-only mortgages put older people at risk*, 30 September 2013 [accessed via: <http://www.bris.ac.uk/news/2013/9806.html> (21/10/13)]

<sup>146</sup> TNS survey for Age UK 2012 – Age UK in evidence to the CSJ

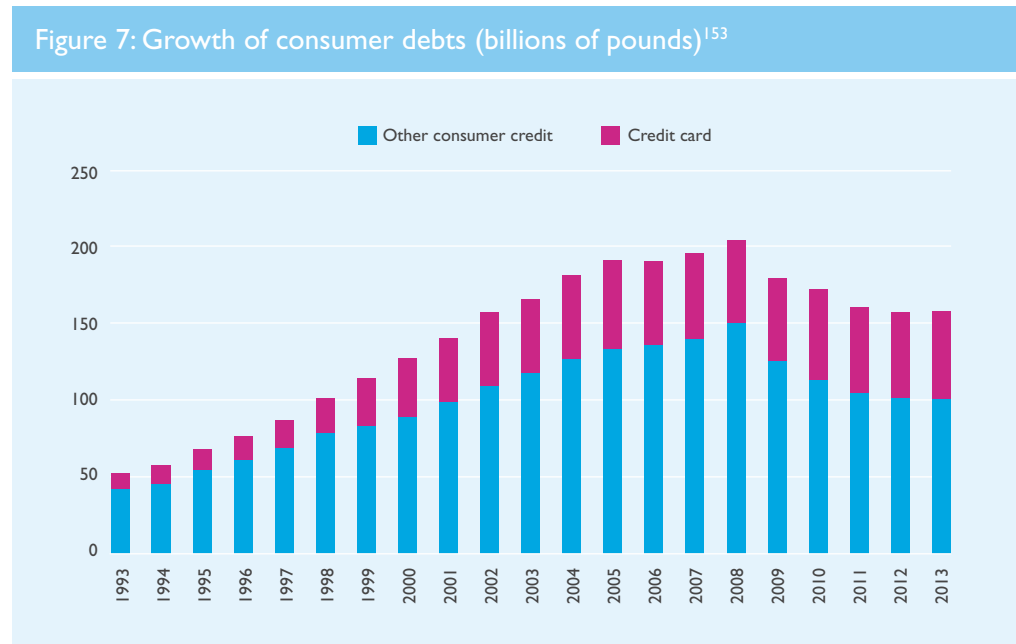
<sup>147</sup> Age UK/ ILC-UK, *Problem Debt Among Older People*, London: Age UK, 2013 [accessed via: [http://www.ageuk.org.uk/Documents/EN-GB/For-professionals/Policy/ageuk\\_ilmc\\_debt\\_report\\_summary\\_040613.pdf?dtrk=true](http://www.ageuk.org.uk/Documents/EN-GB/For-professionals/Policy/ageuk_ilmc_debt_report_summary_040613.pdf?dtrk=true) (22/10/13)]

<sup>148</sup> Experian, *Residential interest only mortgages*, London: FCA, 2013 [accessed via: <http://www.fca.org.uk/static/documents/research/fca-interest-only-mortgage-review.pdf> (24/10/13)]. GfK, *Interest only mortgages – Consumer research*, London: GfK, 2013 [accessed via: <http://www.fca.org.uk/your-fca/documents/research/interest-only-mortgages-gfk> (24/10/13)]. Endowment mortgages are interest only mortgages commonly sold to older people

<sup>149</sup> Prudential, *Class of 2013 retirement survey*, London: Prudential 2013 [accessed via: [http://www.pru.co.uk/pdf/presscenter/nearly\\_1\\_in\\_5\\_retire\\_in\\_debt\\_2013.pdf](http://www.pru.co.uk/pdf/presscenter/nearly_1_in_5_retire_in_debt_2013.pdf) (13/11/13)]

Households in the UK now owe £158.3 billion in unsecured consumer debts, up from just £53 billion in 1993.<sup>150</sup> On average families now owe £12,834 in consumer debt, a figure that has more than doubled since 2011 and is equivalent to just under half of the average net family income.<sup>151</sup>

Greater exposure to consumer credit has been consistently linked with a greater chance of arrears, higher levels of debt, higher levels of over-indebtedness and finding debt to be more of a burden.<sup>152</sup>



Unsecured consumer debt is becoming more problematic for a significant minority and over recent years indebtedness has become increasingly polarised. In 2012 one-quarter of borrowers reported unsecured debts of less than £1,000, while just under one-third owed more than £10,000, a disparity that has widened since 2008.<sup>154</sup> Similarly, one in five low-income households found their consumer debt to be a 'heavy burden' in comparison to around one in nine households with twice the income.<sup>155</sup>

150 The Money Charity, *Debt Statistics – October 2013*, London, The Money Charity, 2013 [accessed via: <http://themoneycharity.org.uk/media/Debt-Stats-Full-October-2013.pdf> (24/10/13)]. Bank of England, *LPMBI20 – Monthly amounts outstanding of total (excluding the Student Loans Company) sterling net unsecured lending to individuals (in sterling millions) seasonally adjusted*, London: Bank of England, 2013

151 Aviva, *The Aviva Family Finance report July 2013*, London: Aviva, 2013 [accessed via: [www.aviva.com/media/upload/Family\\_Finances\\_Report\\_July\\_2013.pdf](http://www.aviva.com/media/upload/Family_Finances_Report_July_2013.pdf) (22/10/13)]. Aviva, *Family Finance report August 2011*, London: Aviva, 2011 [accessed via: [http://www.aviva.com/media/upload/family\\_finances\\_report\\_3\\_aug2011.pdf](http://www.aviva.com/media/upload/family_finances_report_3_aug2011.pdf) (24/10/13)]

152 Kempson E, *Over-indebtedness in Britain: A report to the Department of Trade and Industry*, Bristol: Personal Finance Research Centre, 2002 [accessed via: [http://www.ggybris.ac.uk/pfrc/Reports/Overindebtedness\\_Britain.pdf](http://www.ggybris.ac.uk/pfrc/Reports/Overindebtedness_Britain.pdf) (22/10/13)]. Institute for Social and Economic Research, *Over-Indebtedness in Britain: An analysis using the wealth and assets survey and household annual debtors survey*, University of Essex: BIS, 2010 [accessed via: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/31897/11-747-over-indebtedness-in-great-britain-analysis.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31897/11-747-over-indebtedness-in-great-britain-analysis.pdf) (13/10/13)]

153 Bank of England, *LPMBI20 – Monthly amounts outstanding of total (excluding the Student Loans Company) sterling net unsecured lending to individuals (in sterling millions) seasonally adjusted*, London: Bank of England, 2013

154 Department for Business, Innovation and Skills, *Credit, Debt and Financial Difficulty in Britain, 2012*, London: Department for Business, Innovation and Skills, 2013 [accessed via: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/208075/bis-13-p187-a-report-using-data-from-the-yougov-debttrack-survey.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/208075/bis-13-p187-a-report-using-data-from-the-yougov-debttrack-survey.pdf) (22/10/13)]

155 Bank of England, *NMG Consulting Survey 2012* [accessed via: <http://www.bankofengland.co.uk/publications/Documents/quarterlybulletin/nmgsurvey2012.xls> (21/10/13)]. Low-income households here refers to those making under £15,500

For low-income households consumer debt can accumulate rapidly and vastly exceed household income. Amongst debt advice clients with consumer debts almost half owed more than 10 times their monthly income, with one in 10 owing more than 30 times their monthly income.<sup>156</sup> For those earning under £10,000 a year their average unsecured debt exceeds their annual income by more than £1,000.<sup>157</sup>

### Case study: Too many credit cards<sup>158</sup>

#### John (43) – in evidence to the CSJ

After graduating from university and getting a job, John found it very easy to get loans and credit cards from his bank. John soon maxed out six credit cards and found his entire salary was being used every month to pay the minimum amounts.

*'As you reach the limit on one card they send you an application form for another. And again. I had £10,000 worth of debt on one and they were very happy to advance me another £10,000 because I just kept making those minimum repayments.'*

John owed £90,000 on credit cards and bank loans when he came to StepChange Debt Charity. He had gone into depression, developed high blood pressure and lost his job. He had tried to continue on for about 18 months, unable to bring himself to open his credit card statements.

*'It's more a story of my own stupidity and naivety than anything else... I was driven by trying to keep up with everyone else. Basically the credit cards became an easy means to an end.'*

Credit and debt is rapidly replacing the use of cash in everyday life, exposing low-income households to increasing levels of consumer debt. There were 59 million credit cards in circulation in 2012, an increase of 50 per cent since 1998.<sup>159</sup> In 2012 credit cards were used to make 2.4 billion purchases totalling £154 billion, up from around £50 billion in 1998.<sup>160</sup> Cash now accounts for only 20 per cent of consumer spending and 54 per cent of all transactions.<sup>161</sup> Not only has the use of credit cards increased, but credit card debt has reached worrying levels. Outstanding debt on credit cards has almost tripled since 1998 from £18.5 billion to £55.6 billion in 2012.<sup>162</sup>

This credit card debt appears to be concentrated amongst a minority of users. Amongst people seeking debt advice more than 30 per cent had three or more credit cards with one in 10 having more than five.<sup>163</sup> In 2012, 900,000 credit card users, or one in 30, made only

<sup>156</sup> StepChange, *Statistical Yearbook 2012*, Leeds: Foundation for Credit Counselling, 2013 [accessed via: [http://www.stepchange.org/Portals/0/Documents/media/reports/statisticsyearbooks/Statistical\\_Yearbook\\_2012.pdf](http://www.stepchange.org/Portals/0/Documents/media/reports/statisticsyearbooks/Statistical_Yearbook_2012.pdf) (22/10/13)]

<sup>157</sup> Ibid

<sup>158</sup> Case study provided by StepChange

<sup>159</sup> The UK Cards Association, *Annual report 2013*, London: The UK Cards Association, 2013 [accessed via: [http://www.theukcardsassociation.org.uk/wm\\_documents/Final%20AR\\_2012\\_interactive\\_sml.pdf](http://www.theukcardsassociation.org.uk/wm_documents/Final%20AR_2012_interactive_sml.pdf) (30/08/13)]. The UK Cards Association, *2008 summary figures*, London: The UK Cards Association, 2008 [accessed via: <http://www.theukcardsassociation.org.uk/2008-facts-figures/index.asp> (30/08/13)]

<sup>160</sup> The UK Cards Association, *Card expenditure statistics – June 2013*, London: The UK Cards Association, 2013 [accessed via: [http://www.theukcardsassociation.org.uk/wm\\_documents/June%202013.pdf](http://www.theukcardsassociation.org.uk/wm_documents/June%202013.pdf) (30/08/13)]

<sup>161</sup> Payments Council, *UK cash & cash machines 2013*, London: Payments Council, 2013

<sup>162</sup> Bank of England, LPMVZRJ: *Monthly amounts outstanding of total sterling net credit card lending to individuals (in sterling millions) seasonally adjusted*, London, 2013

<sup>163</sup> StepChange, *Statistical Yearbook 2012*, Leeds: Foundation for Credit Counselling, 2013 [accessed via: [http://www.stepchange.org/Portals/0/Documents/media/reports/statisticsyearbooks/Statistical\\_Yearbook\\_2012.pdf](http://www.stepchange.org/Portals/0/Documents/media/reports/statisticsyearbooks/Statistical_Yearbook_2012.pdf) (22/10/13)]

the minimum repayments for 12 continuous months.<sup>164</sup> While the average credit card debt is estimated at around £4,500, for those that seek debt advice regarding their credit card debt, the average was over £10,000 and accounted for 40 per cent of total debt.<sup>165</sup>

Low-income households that use credit cards are particularly at risk as they often must pay significantly higher interest rates that can drive them into problem debt if they fall behind or only pay off the minimum amount each month.<sup>166</sup> Average interest rates on credit cards have increased from 15.4 per cent APR in 2004 to 17.6 per cent in January 2013.<sup>167</sup> Amongst credit cards, there is significant variation between the rates offered to those with good and bad credit history, with APRs varying from eight per cent to 40 per cent.<sup>168</sup> On the average credit card debt of £4,500 this means that households with bad credit history would pay around £1,800 in interest over a year as opposed to just £350, a significant additional burden.<sup>169</sup>

Following the financial crash net consumer lending decreased by £4.3 billion between 2009 and 2012. Both actual and perceived access to credit was twice as constrained amongst the lowest two income deciles as compared to the two highest deciles.<sup>170</sup>

The market for high cost credit has expanded to meet this new demand, rising sharply from around £2.8 billion in 2009 to £4.8 billion in 2012.<sup>171</sup> Payday lenders, often carrying APRs in excess of 5,000 per cent, have benefited the most from this expansion of high-cost credit. Payday lenders have expanded from issuing £900 million worth of loans in 2008/09 to just over £2 billion (around eight million loans) in 2011/12.<sup>172</sup>

Between 2009 and 2012 there was a 710 per cent increase in the number of clients seeking advice from StepChange with regards to their payday loan debt.<sup>173</sup> On average clients had three payday loans, totalling £1651, an increase of 40 per cent since 2009 and worth more

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164 The UK Cards Association, *Annual report 2013*, London: The UK Cards Association, 2013 [accessed via: [http://www.theukcardsassociation.org.uk/wm\\_documents/Final%20AR\\_2012\\_interactive\\_sml.pdf](http://www.theukcardsassociation.org.uk/wm_documents/Final%20AR_2012_interactive_sml.pdf) (30/08/13)]

165 StepChange, *Statistical Yearbook 2012*, Leeds: Foundation for Credit Counselling, 2013 [accessed via: [http://www.stepchange.org/Portals/0/Documents/media/reports/statisticsyearbooks/Statistical\\_Yearbook\\_2012.pdf](http://www.stepchange.org/Portals/0/Documents/media/reports/statisticsyearbooks/Statistical_Yearbook_2012.pdf) (22/10/13)]. Department for Business, Innovation and Skills, *Credit, Debit and Financial Difficulty in Britain, 2012*, London: Department for Business, Innovation and Skills, 2013 [accessed via: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/208075/bis-13-p187-a-report-using-data-from-the-yougov-debttrack-survey.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/208075/bis-13-p187-a-report-using-data-from-the-yougov-debttrack-survey.pdf) (21/10/13)]

166 Low-income households are more likely to have arrears and high debt to income ratios meaning they are more likely to have a lower credit rating which determines the cost of borrowing. Institute for Social and Economic Research, *Over-Indebtedness in Britain: An analysis using the wealth and assets survey and household annual debtors survey*, University of Essex: BIS, 2010 [accessed via: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/31897/11-747-over-indebtedness-in-great-britain-analysis.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31897/11-747-over-indebtedness-in-great-britain-analysis.pdf) (13/10/13)]

167 The UK Cards Association, *Summary of key statistics for Q1 2013*, London: The UK Cards Association, 2013 [accessed via: [http://www.theukcardsassociation.org.uk/wm\\_documents/2013%20Q1%20Statistical%20Release%20-%20FINAL.pdf](http://www.theukcardsassociation.org.uk/wm_documents/2013%20Q1%20Statistical%20Release%20-%20FINAL.pdf) (30/08/13)]; The UK Cards Association, *Statistical release – 6 July 2010*, London: The UK Cards Association, *Statistical release – 6 July 2010*, London: The UK Cards Association, 2010 [accessed via: [http://www.theukcardsassociation.org.uk/wm\\_documents/Quarterly%20statistical%20release%20Q1%202010.pdf](http://www.theukcardsassociation.org.uk/wm_documents/Quarterly%20statistical%20release%20Q1%202010.pdf) (30/08/13)]

168 CSJ analysis based on information from [www.MoneySupermarket.com](http://www.MoneySupermarket.com) on 22 October 2013

169 Calculation is an estimate assuming a constant balance of £4,500 and APR rates of 8% and 40%.

170 Bank of England, NMG Consulting Survey 2011 [accessed via: <http://www.bankofengland.co.uk/publications/Documents/quarterlybulletin/nmgsurvey2011.xls> (21/10/13)]. Bank of England, *LPMB3PS – Monthly changes of total (excluding the Student Loans Company) sterling net unsecured lending to individuals (in sterling millions) seasonally adjusted*, London: Bank of England Interactive Database, 2013 Note: Net lending between January 2009 and December 2012.

171 Apex Insight, *High-cost credit: UK market profile and forecasts*, Apex Insight, 2012

172 Office of Fair Trading, *Payday Lending: Compliant Review Final Report*, London: Office of Fair Trading, 2013 [accessed via: [http://www.of.gov.uk/shared\\_of/Credit/oft1481.pdf](http://www.of.gov.uk/shared_of/Credit/oft1481.pdf) (22/10/13)]

173 StepChange, *Statistical Yearbook 2012*, Leeds: Foundation for Credit Counselling, 2013 [accessed via: [http://www.stepchange.org/Portals/0/Documents/media/reports/statisticsyearbooks/Statistical\\_Yearbook\\_2012.pdf](http://www.stepchange.org/Portals/0/Documents/media/reports/statisticsyearbooks/Statistical_Yearbook_2012.pdf) (22/10/13)]

than their average monthly income. This group represents some of the most over-indebted debt advice clients, with 65 per cent having total debt exceeding their total annual income.<sup>174</sup>

There has been a similar growth in the use of home collected credit and debt problems. Doorstep lenders have expanded their operations and in 2012 they made £1.4 billion in loans to 2.4 million people, 90 per cent of whom were on low incomes.<sup>175</sup> More people are now struggling to repay these loans, with National Debtline reporting a fourfold increase in problems related to home credit between 2008 and 2013.<sup>176</sup>

In the aftermath of the financial crisis, borrowing has become increasingly expensive for Britain's poorest households, who are already struggling with large levels of consumer debt. The use of high-cost credit is driven in part by the increasing struggle of households to pay everyday bills and an inability to access previously available mainstream borrowing. This situation is exacerbated by the fact that the poorest can often pay more for everyday bills than everyone else. This is explained in the section below.

### Case study: Too much credit<sup>177</sup>

Danielle and Jamie (27, 28) privately rent a four-bedroom house near Southampton. Both are employed full-time in entry-level office jobs. They built up significant household debts by funding significant expenditures through credit – mainly in the form of personal loans (taken out between 2005 and 2007).

They have struggled to manage repayments since 2009 and have made several attempts to re-finance the debts through the use of further credit products, and by engaging the services of one fee-charging debt management company.

None of these services have managed to put together a sustainable debt repayment plan.

### 1.2.3 Cost of living debt

Increasing numbers of low-income households are being driven into debt by the rising cost of living. Household bills, living expenses, rent and council tax are becoming problem debts for households already squeezed by increased unemployment and falling real wages since the financial crash.<sup>178</sup> Similarly, while real wages have risen since 1986, the growth rate has been significantly lower for those on the lowest incomes.<sup>179</sup> In short, being poor is becoming ever more expensive. Half of British households recognise that the cost of living is key to their financial situation in the coming year.<sup>180</sup>

<sup>174</sup> Ibid

<sup>175</sup> Competition Commission, *Understanding past market investigation remedies: Home credit*, London: Competition Commission, 2013

<sup>176</sup> National Debtline, *Advice Statistics – in evidence to the CS*

<sup>177</sup> Case study provided by National Debtline

<sup>178</sup> Resolution Foundation, *What a drag: The chilling impact of unemployment on real wages*, London: Resolution Foundation, 2012

<sup>179</sup> ONS, *Real wages up 62% on average over the past 25 years*, London: ONS, 2012 [accessed via: [http://www.ons.gov.uk/ons/dcp171776\\_286266.pdf](http://www.ons.gov.uk/ons/dcp171776_286266.pdf) (22/10/13)]. TUC, Press Release, *Cost of living is rising faster for the poorest households*, 11 May 2012 [accessed via: <http://www.tuc.org.uk/economic-issues/economic-analysis/labour-market/labour-market-and-economic-reports/cost-living> (22/10/13)]

<sup>180</sup> Genworth, *Genworth Index: Measuring Consumer Financial Security and Vulnerability*, University of Bristol: Genworth Financial, 2013 [accessed via: <http://www.bristol.ac.uk/geography/research/pfrc/themes/credit-debt/pfrc1307.pdf> (22/10/13)]

Low-income households seem to be particularly at risk because of their lack of savings, low disposable income and the increased proportion of their income spent on essentials and household bills.<sup>181</sup> A recent survey found that more than half of adults in the UK are struggling to keep up with debt and bill repayments, up from 35 per cent in 2006.<sup>182</sup> Similarly, 42 per cent said they would be unable to pay for an unexpected bill of £300.<sup>183</sup> In 2012 an estimated 900,000 households were three or more months behind on at least one household bill.<sup>184</sup>

Often households are forced to turn to credit cards and high cost borrowing in order to keep up with these everyday bills.<sup>185</sup> More than one in five households use credit for everyday expenditures, with one in 10 relying on it constantly.<sup>186</sup> Similarly, one in six payday loans are taken out to pay arrears on a household bill.<sup>187</sup>

Debt advice charities are currently experiencing an increase in the number of clients struggling with debts related to household bills including: electricity, gas, water, rent, telephone, and council tax. In 2012, more than one-third of StepChange's debt advice clients had arrears on at least one household bill, up from around one quarter in 2011.<sup>188</sup> In 2012 National Debtline gave advice on just over 120,000 cost of living related debts, up 130 per cent from 2007.<sup>189</sup>

Furthermore, Citizen's Advice Bureau (CAB) data shows that rent arrears and household bills have increasingly become a larger part of the total debts owed by their clients. In 2012 these debts accounted for 37 per cent of all debt issues, up from 27 per cent in 2009.

There is a wide regional variation in the demand for debt advice, with debt issues accounting for 46 per cent of all advice cases handled by CAB in the North East and 38 per cent in Yorkshire and the Humber.<sup>190</sup> These two regions also have the lowest average household disposable income, pointing to the disproportionate burden cost of living and other debts placed on low-income communities.<sup>191</sup> In comparison, debt advice made up only 22 per cent of all issues handled by the CAB in the more prosperous South East.<sup>192</sup>

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181 ONS, *Family Spending 2011 Edition*, London: ONS, 2012 [accessed via: [http://www.ons.gov.uk/ons/dcp171766\\_285163.pdf](http://www.ons.gov.uk/ons/dcp171766_285163.pdf) (12/10/13)]

182 Money Advice Service, *The Financial Capability of the UK*, London: Money Advice Service, 2013 [accessed via: <https://www.moneyadviceservice.org.uk/files/the-financial-capability-of-the-uk.pdf>12/10/13]]

183 Ibid

184 Department for Business, Innovation and Skills, *Credit, Debit and Financial Difficulty in Britain*, 2012, London: Department for Business, Innovation and Skills, 2013 [accessed via: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/208075/bis-13-p187-a-report-using-data-from-the-yougov-debtrack-survey.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/208075/bis-13-p187-a-report-using-data-from-the-yougov-debtrack-survey.pdf) (24/10/13)]. Office for National Statistics, *Population Estimates for UK, England and Wales, Scotland and Northern Ireland, Mid-2011 and Mid-2012*, 8 August 2013, [accessed via: <http://www.ons.gov.uk/ons/rel/pop-estimate/population-estimates-for-uk--england-and-wales--scotland-and-northern-ireland/mid-2011-and-mid-2012/index.html> (24/10/13)]. Estimate based on 26.4 million households from ONS 2011 Census

185 Unite, Press Release, *Workers borrow £660 a month to make ends meet as Wanganomics' grip tightens*, 9 September 2013 [accessed via: <http://www.unitetheunion.org/news/workers-borrow-660-a-month-to-make-ends-meet-as-wanganomics-grip-tightens/> (22/10/13)]

186 Department for Business, Innovation and Skills, *Credit, Debit and Financial Difficulty in Britain*, 2012, London: Department for Business, Innovation and Skills, 2013 [accessed via: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/208075/bis-13-p187-a-report-using-data-from-the-yougov-debtrack-survey.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/208075/bis-13-p187-a-report-using-data-from-the-yougov-debtrack-survey.pdf) (24/10/13)]

187 Ibid

188 StepChange, *Statistical Yearbook 2012*, Leeds: Foundation for Credit Counselling, 2013 [accessed via: [http://www.stepchange.org/Portals/0/Documents/media/reports/statisticsyearbooks/Statistical\\_Yearbook\\_2012.pdf](http://www.stepchange.org/Portals/0/Documents/media/reports/statisticsyearbooks/Statistical_Yearbook_2012.pdf) (22/10/13)]

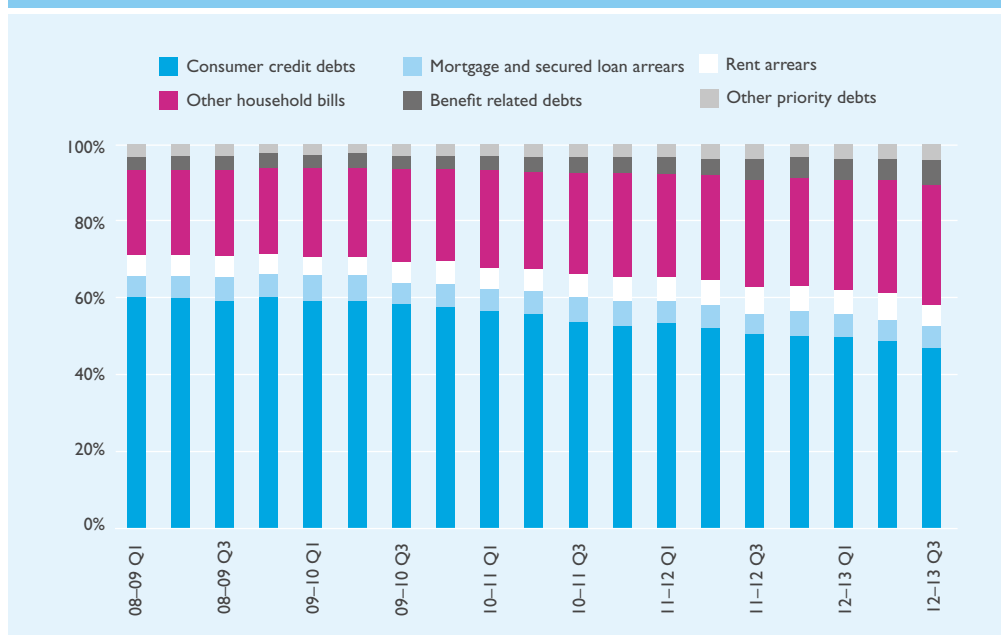
189 National Debtline, *Advice Statistics – in evidence to the CSJ*

190 Citizens Advice Bureau, *Advice Trends: Q3 2012/2013*, London, Citizens Advice Bureau, 2013 [accessed via: [http://www.citizensadvice.org.uk/advice\\_trends\\_q1\\_2013-14.pdf](http://www.citizensadvice.org.uk/advice_trends_q1_2013-14.pdf) (24/10/13)]

191 ONS, *Regional Gross Disposable Household Income, 2011 – Interactive Map*, ONS, 2013 [accessed via: <http://www.ons.gov.uk/ons/rel/regional-accounts/regional-household-income/spring-2013/sum-interactive-map.html> note: this assumes that the breakdown of advice issues is relatively constant across regions (22/10/13)]

192 Citizens Advice Bureau, *Advice Trends: Q3 2012/2013*, London, Citizens Advice Bureau, 2013 [accessed via: [http://www.citizensadvice.org.uk/advice\\_trends\\_q1\\_2013-14.pdf](http://www.citizensadvice.org.uk/advice_trends_q1_2013-14.pdf) (24/10/13)]



Figure 8: Debt types as a percentage of total debt<sup>193</sup>

A recent estimate by the UK Government suggests over £20 billion of outstanding debt is owed to government, with between £7 and £8 billion written-off every year – the equivalent of £400 per working household.<sup>194</sup> Local authorities referred 1.8 million debts to bailiffs in the past year; most commonly for Council Tax arrears.<sup>195</sup> Newham Council, one of the most deprived areas in the country, had the highest rate of bailiff usage per resident household.

The rising cost of gas and electricity has also contributed to problem debt for many low-income households. While the number of energy accounts experiencing debts has gradually decreased, to 1.7 million in 2012, the average amount of arrears for electricity and gas customers has increased dramatically, as can be seen in Figure 9.<sup>196</sup>

Similarly, while the proportion of customers with small debts of under £100 has steadily decreased, the proportion with debts over £600 is increasing.<sup>197</sup> This implies that a significant minority are struggling with increasingly large and problematic energy debts. Evidence from National Debtline suggests energy debt is increasingly becoming problematic, as the number of energy-related debt problems has doubled since 2007.<sup>198</sup>

<sup>193</sup> Citizens Advice Bureau, *Advice Trends: Q3 2012/2013*, London: Citizens Advice Bureau, 2012 [accessed via: [http://www.citizensadvice.org.uk/advice\\_trends\\_q2\\_2012-13.pdf](http://www.citizensadvice.org.uk/advice_trends_q2_2012-13.pdf) (24/10/13)]

<sup>194</sup> Speech by Rt Hon Francis Maude, Minister for the Cabinet Office, to Dods Conference, Oct 15th 2012 [accessed via: <http://www.cabinetoffice.gov.uk/news/tackling-debt-owed-government-speech-francis-maude> (30/08/13)]

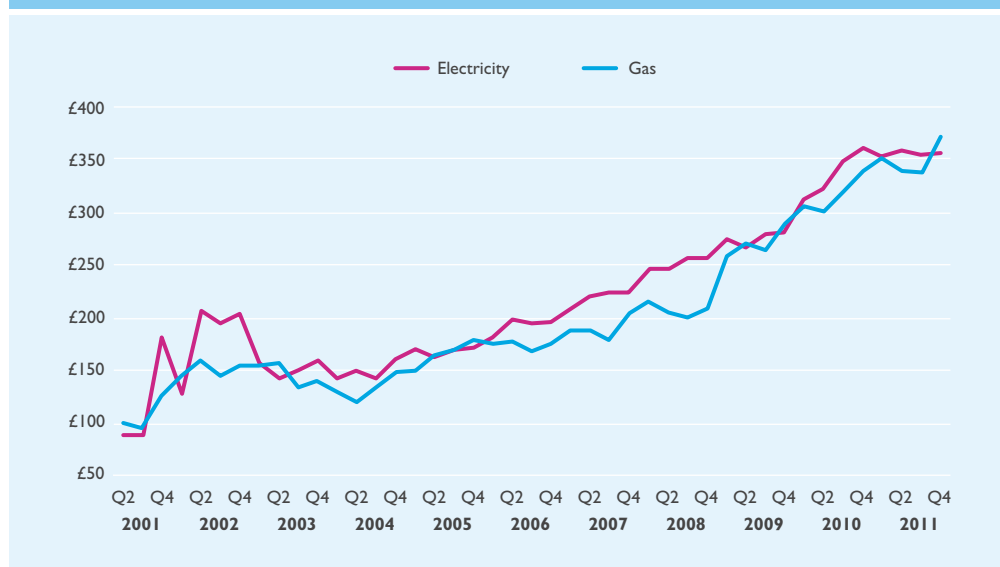
<sup>195</sup> Money Advice Trust, Press release, *Local Authorities in England and Wales refer 1.8 million debts to bailiffs in 12 months*, 22 August 2013 [accessed via: <http://www.moneyadvice.org.uk/media/news/Pages/Local-Authorities-and-Bailiffs0821-6215.aspx> (24/10/13)]

<sup>196</sup> Ofgem, *Supplier performance on social obligations: social obligations reporting – Number of domestic customers repaying an energy debt*, London: Ofgem 2013 [accessed via: <https://www.ofgem.gov.uk/about-us/how-we-work/working-consumers/supplier-performance-social-obligations?chartid=73228> (30/08/13)]. Ofgem, *Domestic suppliers' social obligations: 2011 annual report*, London: Ofgem, 2012 [accessed via: <https://www.ofgem.gov.uk/ofgem-publications/57219/sor-annual-report-2011.pdf> (30/08/13)]

<sup>197</sup> Ofgem, *Domestic suppliers' social obligations: 2011 annual report*, London: Ofgem, 2012 [accessed via: <https://www.ofgem.gov.uk/ofgem-publications/57219/sor-annual-report-2011.pdf> (30/08/13)]

<sup>198</sup> National Debtline, *Advice Statistics* – submitted in evidence to the CSJ

Figure 9: Average level of debt held by gas and electricity consumers 2001–2011<sup>199</sup>



Rising energy prices have had the biggest impact on low-income households and vulnerable people. Customers on pre-payment meters (PPM) generally have substantially lower incomes, are more likely to be unemployed, receive state benefits and are in a household with someone suffering from a disability or mental health condition.<sup>200</sup> An estimated one in eight households use a PPM for their gas or electricity, the majority of which are initially installed because of a debt owed to the supplier.<sup>201</sup> PPM users are about three times more likely to be repaying an energy debt than other customers, highlighting the correlation between low-incomes and problem energy debt.<sup>202</sup>

Debt issues amongst low-income PPM users and the associated negative impacts are particularly troubling. More than half a million British households voluntarily disconnect from their energy supplies each year, of which more than a quarter do so because of a lack of money.<sup>203</sup> One in 10 are left without heating or power for more than a day at a time.

PPM households who disconnect for financial reasons are more likely to disconnect for an extended period of time and are more likely to include disabled and vulnerable individuals.<sup>204</sup> Disconnection from energy supplies, especially heating, can have particularly detrimental effects on the health of vulnerable individuals.

199 Ofgem, *Domestic suppliers' social obligations: 2011 annual report*, London: Ofgem, 2012 [accessed via: <https://www.ofgem.gov.uk/ofgem-publications/57219/sor-annual-report-2011.pdf> (30/08/13)]

200 Consumer Focus, *Cutting-back, cutting down, cutting off*, London: Consumer Focus, 2010 [accessed via: <http://www.consumerfocus.org.uk/files/2010/10/Cutting-back-cutting-down-cutting-off.pdf> (30/08/13)]

201 Ofgem, *Domestic suppliers' social obligations: 2011 annual report*, London: Ofgem, 2012 [accessed via: <https://www.ofgem.gov.uk/ofgem-publications/57219/sor-annual-report-2011.pdf> (30/08/13)]. Consumer Focus, *Cutting-back, cutting down, cutting off*, London: Consumer Focus, 2010 [accessed via: <http://www.consumerfocus.org.uk/files/2010/10/Cutting-back-cutting-down-cutting-off.pdf> (30/08/13)]

202 Ofgem, *Domestic suppliers' social obligations: 2011 annual report*, London: Ofgem, 2012 [accessed via: <https://www.ofgem.gov.uk/ofgem-publications/57219/sor-annual-report-2011.pdf> (30/08/13)]

203 Consumer Focus, *Cutting-back, cutting down, cutting off*, London: Consumer Focus, 2010 [accessed via: <http://www.consumerfocus.org.uk/files/2010/10/Cutting-back-cutting-down-cutting-off.pdf> (30/08/13)]

204 Ibid

More than 200,000 households miss bill payments and one in five cut back on food in order to top-up their PPM. As a result of this financial burden, more than a quarter of a million people suffer debt-related stress, leading to depression in 120,000 households and negatively affecting the health of more than one in four PPM households.<sup>205</sup>

Large water bills have also contributed to the mounting debt problems of low-income households. An estimated 5.5 million households had water bill debts totalling £2 billion in 2011.<sup>206</sup> This is in large part due to a 35 per cent increase in average household water bills between 2003 and 2013, causing the total debt owed to water companies to jump by over 80 per cent in the same period.<sup>207</sup> The rising cost of essential services is clearly putting a strain on households and driving problem debt.

Soaring house prices mean that millions of low-income households are forced to rent, which is not only less secure than home ownership, due to the increasing trend towards short-term leases, but can drive them into problem debt and homelessness as rents rise. Renting is far more expensive in the long run: it is estimated that low-income households who rent pay an annual premium of £900 over if they were home-owners, adding another pressure to squeezed household budgets.<sup>208</sup>

After a brief dip in 2009 during the financial crisis, average rents for the private sector in England and Wales have continued to rise again, with one index finding an average increase from £689 per month in 2010 to £757 in September 2013.<sup>209</sup> This 10 per cent increase, mirrored by findings from a UK-wide rental index, has had a significant impact with 8.5 per cent of all private renters in the UK and Wales owing arrears as of September 2013, totalling £294 million.<sup>210</sup> The rising cost of housing has hit older age people particularly hard, with those aged over 55 experiencing a nine per cent rise in housing costs during the 12 months prior to May 2013.<sup>211</sup>

Rent arrears were a problem debt for just over one in 10 of National Debtline's clients in 2012, double the 2007 rate.<sup>212</sup> The consequences of rent-related debts are significant: more than 140 households are made homeless each month as a result of their rent-related debts.<sup>213</sup>

Rising living costs disproportionately burden low-income households due to their limited disposable income, lack of savings and the greater proportion of their disposable income

205 Ibid

206 Ofwat, *Tackling debt*, Presentation given by Marian Spain on 12 December 2012 [accessed via: [http://www.ofwat.gov.uk/publications/events/prs\\_pre120712afforddebt.pdf](http://www.ofwat.gov.uk/publications/events/prs_pre120712afforddebt.pdf) (22/10/13)]

207 Ofwat, Press Release, *Water and sewerage bills to increase*, 5 February 2013 [accessed via: [http://www.ofwat.gov.uk/mediacentre/pressnotices2008/prs\\_pn0313bills](http://www.ofwat.gov.uk/mediacentre/pressnotices2008/prs_pn0313bills) (22/10/13)]

208 Sliced Bread Consulting, *Helping private tenants achieve financial inclusion*, University of Bristol: Sliced Bread Consulting, 2013 [accessed via: <http://www.bristol.ac.uk/geography/research/pfrc/themes/finexc/pfrc1311.pdf> (22/10/13)]

209 LSL Property Services, *Buy-to-let index – September 2013*, Newcastle upon Tyne: LSL Property Services, 2013 [accessed via: [http://www.lslps.co.uk/documents/buy\\_to\\_let\\_index\\_sep13.pdf](http://www.lslps.co.uk/documents/buy_to_let_index_sep13.pdf) (24/10/13)]

210 Ibid. HomeLet, *Rental index – September 2013*, Lincoln: HomeLet, 2013 [accessed via: <https://homelet.co.uk/contact-us> (24/10/13)]

211 Aviva, *The Aviva real retirement report – Spring 2013*, London: Aviva, 2013 [accessed via: [http://www.aviva.com/media/upload/RRR\\_spring\\_2013\\_1.pdf](http://www.aviva.com/media/upload/RRR_spring_2013_1.pdf) (24/10/13)]

212 National Debtline, *Advice Statistics – in evidence to the CSJ*

213 Stats Wales, *Households accepted as homeless by main reason for loss of last settled home and period*, 2013 [accessed via: <https://statswales.wales.gov.uk/Catalogue/Housing/Homelessness/Acceptances-and-Other-Decisions/HouseholdsAcceptedAsHomeless-by-MainReason-Period> (24/10/13)]. DCLG, *Homeless statistics*, London: DCLG, 2013 [accessed via: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/236906/Table\\_774.xls](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/236906/Table_774.xls) (21/10/13)] Average for England and Wales in 2012–2013

they spend on these expenses. Increasingly households seem to be resorting to expensive unsecured borrowing in order to finance their other debts, rent and household bills. A recent survey found that 40 per cent of payday loans taken out by households are used to pay for essentials like food, rent and bills.<sup>214</sup> Similarly, one in seven respondents to a recent Shelter survey reported paying for rent with a credit card within the last year.<sup>215</sup>

The use of credit to pay bills and rent indicates that household bills represent a significant problem and could be exposing low-income households to a greater risk of problem debt. Debt can affect households of all types across the country, however, there are specific groups that are especially vulnerable and for whom problem debt can be particularly concerning.

### Case Study: The bills keep coming<sup>216</sup>

Jill lives with her two children – aged four and five years – in a small, privately rented, two bedroom flat in Birmingham's commuter belt. She split from her partner (her children's father) 18 months ago. Jill works full-time and pays for early evening childcare three days a week. Her parents pick up the children from school on Thursday and Friday.

The split from her partner hit her hard financially, as he owned most of the household goods and she has had to fit out an unfurnished property, which she did on a credit card. She is unable to meet monthly repayments alongside childcare costs, rent costs, and other basic living expenses.

National Debtline has now helped her negotiate a lower monthly repayment arrangement as well as for interest and charges on her credit card account to be frozen.

## 1.3 Who is in debt?

Levels of debt vary widely across households and communities in the UK. However, problem debt is disproportionately concentrated amongst certain vulnerable low-income groups and regions. Certain trends and characteristics can indicate who is at risk of incurring problem debt and where support should be targeted.

Across the whole population there are three types of characteristics associated with a higher risk of being over-indebted:<sup>217</sup>

- *Personal circumstances* (being young, single and having children);
- *Economic circumstances* (having a low income, being economically inactive and renting a home);
- *Money management factors* (attitudes towards paying bills and spending; the use of unsecured credit; and a lack of savings).

214 Sunday Express, *Desperate families are using high interest payday loans to buy food*, 30 June 2013 [accessed via: <http://www.express.co.uk/news/uk/411367/Desperate-families-are-using-high-interest-payday-loans-to-buy-food> (22/10/13)]

215 Shelter, Press release, *Impact of rising rents on family life revealed*, 14 March 2013 [accessed via: [http://england.shelter.org.uk/news/march\\_2013/impact\\_of\\_rising\\_rents\\_on\\_family\\_life\\_revealed](http://england.shelter.org.uk/news/march_2013/impact_of_rising_rents_on_family_life_revealed) (12/11/13)]

216 Case study provided by National Debtline

217 Institute for Social and Economic Research, *Over-indebtedness in Great Britain: an analysis using the wealth and assets survey and household annual debtors survey*, University of Essex: Institute for Social and Economic Research, 2010 [accessed via: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/31897/11-747-over-indebtedness-in-great-britain-analysis.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31897/11-747-over-indebtedness-in-great-britain-analysis.pdf) (22/10/13)]

Similarly, there are a number of factors that explain why over-indebtedness disproportionately affects those on the lowest incomes:<sup>218</sup>

- A greater percentage of household income is spent on essentials such as rent, food and utilities;
- Lower levels of household savings mean there is less of a buffer in the face of unexpected financial shocks;
- Higher levels of unemployment and underemployment;
- Those on lower incomes often have to rely on more expensive forms of credit such as high interest credit cards, home credit and payday loans due to their financial exclusion.

Several surveys and studies have quantified this correlation between low-income households and problem debt. Taken together, this research provides a portrait of who is currently struggling with problem debt.

The majority of those with problem debt have very low incomes (mostly an income less than half of the UK national average), are often single parents generally not in employment and are significantly more likely to rent, rather than own their own home.<sup>219</sup>

Data from the Bank of England's NMG Consulting survey suggests that 44 per cent of households in the poorest income decile are spending more than a quarter of their gross income on debt repayments and on average spend almost half of their gross income on debt repayments.<sup>220</sup> In comparison, only 20 per cent of households in the middle of the income spectrum are in this situation and their average monthly repayments are only around 16 per cent of their income.<sup>221</sup>

There are several vulnerable groups that are especially burdened by problem debt as a result of their circumstances including older people; ex-offenders; substance abusers and their families, and young people not in education, employment or training (NEET).

Debt disproportionately burdens young people in Britain. Over half of England's teenagers report they have been or are in debt by the time they are 17, with 77 per cent in debt by age 21.<sup>222</sup> While much of this is student debt and most debts cannot be enforced against people under 18, a significant amount is other unsecured debts that can represent a substantial burden.<sup>223</sup> One report found that over 15 per cent of those classified as NEET reported debt problems in comparison with less than five per cent of non-NEETs.<sup>224</sup> Over 20 per cent of those young people recently arrested also reported money and debt troubles.<sup>225</sup> These problems are compounded by higher than average levels of youth unemployment and the limited options young people have when accessing credit.<sup>226</sup>

218 Joseph Rowntree Foundation, *Credit and debt in low income families*, Loughborough University: JRF, 2010 [accessed via: <http://www.jrf.org.uk/sites/files/jrf/credit-debt-low-incomes-full.pdf> (12/11/13)]

219 London Economics, *Debt advice in the UK*, London: London Economics, 2012

220 Bank of England, *NMG Consulting Survey 2011* [accessed via: <http://www.bankofengland.co.uk/publications/Documents/quarterlybulletin/nmgsurvey2011.xls> (21/10/13)]

221 Ibid

222 Kendrick J, *The outcomes & impact of youth advice – the evidence* London: Youth Access, 2011

223 Ibid

224 Pleasance P, *Civil Legal Problems: Young People, Social Exclusion and Crime*, London: The Law Centres Federation and Youth Access 2011 pp11–12

225 Ibid

226 Centre for Social Justice, *Signed on, Written off*, London: Centre for Social Justice, 2013

The CSJ was told about how disadvantaged young people can struggle on a day to day basis with money and debt.

The vast majority of the young people we work with do not have their own bank account and have never been taught how to manage money. This can often lead them into debt. As they cannot be 'bailed out' by safe and secure places/people when in hardship, they instead go down dodgy pathways attempting to solve small battles, whilst inadvertently creating wars.

Andy Cook, co-founder and operations manager at Twenty Twenty – in evidence to the CSJ

A significant portion of the older age group are particularly vulnerable to problem debt, in large part due to their decreased earning potential, vulnerability to interest rate fluctuations and health problems.<sup>227</sup> An estimated three in ten people aged over 50 (a total of 1.1 million people) are considered to be in problem debt.<sup>228</sup> One in five people will retire in 2013 with an average debt of £31,200 and more than one in 10 believe they will never be able to repay that debt.<sup>229</sup> This is largely because of this group's low average income (£15,300) that has decreased by just under 20 per cent when compared to those retiring in 2008.<sup>230</sup> Financial vulnerability amongst older people is also in part due to decreased levels of savings, down 25 per cent since last year for people aged over 55.<sup>231</sup>

Research by the International Longevity Centre UK on behalf of Age UK looked at debt amongst this group between 2002 and 2010. Over this period while the proportion of people aged 50 and over in debt had fallen overall, among those with unsecured debt the amount owed had increased.<sup>232</sup> Around six per cent of people aged 50 and over were judged to be in problem debt – more than one in four of those with unsecured debt. Amongst StepChange debt advice clients in 2012, people aged 60 and over had the highest levels of unsecured debt of any age group.<sup>233</sup> Similarly, the demand for debt advice amongst this group has risen by 36 per cent since 2009.<sup>234</sup>

227 Age UK/ ILC-UK, *Problem Debt Among Older People*, London: Age UK, 2013 [accessed via: [http://www.ageuk.org.uk/Documents/EN-GB/For-professionals/Policy/ageuk\\_ilc\\_debt\\_report\\_summary\\_040613.pdf?dtrk=true](http://www.ageuk.org.uk/Documents/EN-GB/For-professionals/Policy/ageuk_ilc_debt_report_summary_040613.pdf?dtrk=true) (22/10/13)]

228 ILC, Press Release, *3 in 10 older people in debt are struggling to repay*, 4 June 2013, [accessed via: [http://www.ilcuk.org.uk/index.php/news/news\\_posts/press\\_release\\_3\\_in\\_10\\_older\\_people\\_in\\_debt\\_are\\_struggling\\_to\\_repay](http://www.ilcuk.org.uk/index.php/news/news_posts/press_release_3_in_10_older_people_in_debt_are_struggling_to_repay) (22/10/13)]

229 Prudential, *Class of 2013 retirement survey*, London: Prudential 2013 [accessed via: [http://www.pru.co.uk/pdf/presscenter/nearly\\_1\\_in\\_5\\_retire\\_in\\_debt\\_2013.pdf](http://www.pru.co.uk/pdf/presscenter/nearly_1_in_5_retire_in_debt_2013.pdf) (13/11/13)]

230 Ibid

231 Aviva, *The Aviva real retirement report – Spring 2013*, London: Aviva, 2013 [accessed via: [http://www.aviva.com/media/upload/RRR\\_spring\\_2013\\_1.pdf](http://www.aviva.com/media/upload/RRR_spring_2013_1.pdf) (24/10/13)]

232 AgeUK/ILC-UK, *Problem Debt Among Older People*, London: Age UK, 2013 [accessed via: [http://www.ageuk.org.uk/Documents/EN-GB/For-professionals/Policy/ageuk\\_ilc\\_debt\\_report\\_summary\\_040613.pdf?dtrk=true](http://www.ageuk.org.uk/Documents/EN-GB/For-professionals/Policy/ageuk_ilc_debt_report_summary_040613.pdf?dtrk=true) (22/10/13)]

233 StepChange, *Statistical Yearbook 2012*, Leeds: Foundation for Credit Counselling, 2013 [accessed via: [http://www.stepchange.org/Portals/0/Documents/media/reports/statisticsyearbooks/Statistical\\_Yearbook\\_2012.pdf](http://www.stepchange.org/Portals/0/Documents/media/reports/statisticsyearbooks/Statistical_Yearbook_2012.pdf) (22/10/13)]

234 StepChange, Press release, *Debt crisis for the over 60s*, 8 May 2013 [accessed via: <http://www.stepchange.org/Mediacentre/Pressreleases/Debtcrisisover60s.aspx> (24/10/13)]

For the minority of older people with serious debts, life can be very difficult. People contact Age UK for help with money problems for a variety of reasons including debts following major life changes such as bereavement or redundancy, difficulties due to money management resulting from ill health and as a result of being a victim of scams.

Age UK – in evidence to the CSJ

Unmanageable debt is an acknowledged driver of crime and vice versa, with a majority of prisoners and ex-offenders struggling with high levels of debt.<sup>235</sup> Similarly, those with addictions and their families are much more likely to be over-indebted as a result of debts incurred in order to fund their addiction.<sup>236</sup> These vulnerable groups often face barriers to accessing financial services and employment that can cause them to become trapped in poverty by their personal debt.

The disproportionate levels of problem debt amongst low-income households and certain vulnerable groups are also reflected in statistics recorded by debt advice charities about their clients. Unemployment, living in social housing, low-income, reliance on state-benefits and family breakdown all seem to correlate with problem debt issues.

The statistics below represent a few notable characteristics of clients accessing the debt advice services.

#### StepChange<sup>237</sup>

- 55.7 per cent receive at least one type of benefit, amounting to 36.6 per cent of all income;
- 41 per cent live in some form of social housing.

#### Citizens Advice Bureau<sup>238</sup>

- 37 per cent are unemployed;
- 87 per cent had an annual income of less than £18,000;
- One in five are a lone parent.

#### Christians Against Poverty<sup>239</sup>

- Over three quarters receive state benefits, which was the sole income for 41 per cent;
- More than one in five are single mothers.

235 Prison Reform Trust, *Time is Money*, London: Prison Reform Trust, 2010 [accessed via: <http://www.prisonreformtrust.org.uk/uploads/documents/timeismoney.pdf> (02/09/13)]

236 Centre for Social Justice, *No Quick Fix*, London: Centre for Social Justice, 2013. Adfam, *Adfam Discussion Paper: Family Support in Times of Economic Hardship*, Adfam, 2011 [accessed via: <http://www.drugscope.org.uk/Resources/Drugscope/Documents/PDF/Policy/AdfamAlcoholConcernDrugScopeChildPovertyConsultation.pdf> (22/10/13)]

237 StepChange, *Statistical Yearbook 2012*, Leeds: Foundation for Credit Counselling, 2013 [accessed via: [http://www.stepchange.org/Portals/0/Documents/media/reports/statisticsyearbooks/Statistical\\_Yearbook\\_2012.pdf](http://www.stepchange.org/Portals/0/Documents/media/reports/statisticsyearbooks/Statistical_Yearbook_2012.pdf) (22/10/13)]

238 Citizen's Advice Bureau, *Advice Statistics – in evidence to the CSJ*

239 Christians Against Poverty, *CAP client report 2012*, Bradford: Christians Against Poverty, 2013

The UK's problem debt is disproportionately concentrated amongst those on the lowest incomes and the most vulnerable groups. Low levels of financial resilience and greater prevalence of other risk factors amongst these groups make problem debt a particularly troubling issue. Not only are they more likely to be affected by problem debt, but previous CSJ research in *Breakthrough Britain*, has shown these vulnerable groups are often at greater risk of the associated consequences of problem debt including addiction, family breakdown, mental health conditions and worklessness.

### Case study: The debt pathway<sup>240</sup>

#### James (55) – in evidence to the CSJ

James ran a successful business for 12 years that was devastated by the recession. He had accrued loans and credit card debts during the good times, never having to worry, but after the recession and the loss of his business they became a big problem.

He also became very ill and was not able work as many hours as he would have liked and, as a result, lost a part time job. From 2010 onwards, unable to work and unable to manage his finances, he slid further and further into debt and eventually had to resort to payday loans to see him through.

'I [had] never missed a payment; I've had credit cards since I was 18. I'm now in my 50s, but none of that means anything to any of these companies when you start defaulting and you find very quickly that you're on your own.

I put the blinkers on as long as I could and I tried ignoring the telephone calls. This was in the context of me recovering from a very serious illness. I was not in a position to deal with what was happening – but it kept happening.

I've not committed any crime, I've not robbed a bank, not been a violent person and yet the degree of humiliation these companies put you through is really astonishing. I'm really surprised that it's all legal... It is pretty unbearable and I'm speaking as someone who really does have a lot of experience with mental health as a professional... you cannot explain what it does to you. My life has turned into a living nightmare... It certainly drives people to despair and suicide; it's driven me very, very close to that.'

## Conclusion

Problem debt in the UK has reached a crisis point and is impacting the lives of people and families. Debt accrued through mortgages, consumer borrowing and arrears on rent and utility bills has increased over the last twenty years while savings have decreased, leaving millions with high levels of debt. Rising living costs coupled with decreases in real wages has put significant additional pressures on low-income households and vulnerable groups, driving many into problem debt. There are many specific triggers or drivers of problem debt discussed in Chapter Two as well as aspects of living on a persistent low-income that put households at a disadvantage when accessing financial services and which put them at risk.

<sup>240</sup> Case study provided by StepChange



# chapter two

## Driven into debt

The scale of personal debt held by households in Britain is massive, yet not all of it is 'problem debt'. As set out in Chapter One, there are certain groups of people who are more vulnerable to their debt becoming problem debt and certain types of debt that are more likely to become problematic. In this chapter we will focus on what drives people into problem debt.

**Problem Debt** refers to debt that is of concern not due to its absolute value in monetary terms, but because of its size relative to the holder's income, their inability to repay it, and because of the damage it is causing in terms of mental health problems, family breakdown, addiction, and acting as a barrier to employment.

**Low-income households** are more likely to have low savings and irregular incomes that are often significant factors in dictating behaviour, especially when accessing financial services such as banking and borrowing, and put them at risk of incurring debt.

Debt problems can be exacerbated by people's failure to both recognise their precarious financial position and address it before it becomes a problem. Low-income households are particularly vulnerable as not only do they live on the financial margin, but they are generally placed at a significant disadvantage when accessing financial products and services.

### 2.1 The debt spiral

The widespread accumulation of consumer credit prior to the financial crisis has left many households with high levels of debt and at risk. The process by which many people's debt problems escalate is commonly referred to as the 'debt spiral.' It was first discussed by the CSJ in 2007 as part of the *Breakthrough Britain* project and includes the ten steps listed below.

- |                             |   |
|-----------------------------|---|
| 1 Initial trigger           | 6 Personal and financial chaos                |
| 2 Missed payments           | 7 Unrealistic promises                        |
| 3 Escalating penalty charge | 8 Legal proceedings                           |
| 4 Juggling of finances      | 9 Enforcement orders, bankruptcy and eviction |
| 5 Pressure from creditors   | 10 Total loss                                 |

In this report we provide another dimension to the debt spiral model, by looking at it from the perspective of people's psychology, how they interpret what is happening and how that influences their reactions. Typically, it can be broken down into three phases, which each have financial elements and reflect how people respond to and think about their debt problems.

**Phase one:** An initial trigger such as the loss of a job, a family illness or an unexpected expense starts the debt spiral. As arrears on bills and credit commitments begin to accumulate people are typically slow to recognise or accept the extent of their growing problem, tending to believe it is just temporary and that no action is needed.

**Phase two:** When outstanding debts and arrears can no longer be ignored, people attempt to make up the financial shortfall and address their debts alone. Efforts to juggle different priority debts, cut back on household expenditures and borrow more to cover essentials such as rent and food, often does little to address the underlying problem debt. Denial and underestimation of the problem can make matters worse as penalty fees and interest charges accumulate. Believing they are handling the situation people still do not seek help.

**Phase three:** The increasing pressure from creditors and threats of legal proceedings, as all attempts to meet even minimum repayments fail, can drive people into isolation and a state of constant anxiety. Feelings of hopelessness, depression, suicidal thoughts and strained relationships become unbearable at which point one final incident will normally lead to acceptance of the size of the problem debt and the need for help. Sadly, by this point the original debt problem has been magnified and is often harder to resolve.

While all aspects of the debt spiral are not seen in every case of problem debt, there are distinct common themes regarding how people react to and attempt to deal with their debt.

There is often a substantial mismatch between people's actual financial situation and how they perceive it. This can lead to certain behaviour when attempting to deal with problem debt including underestimating the scale of the problem, ignoring the problem, or taking actions to resolve it that in actuality make their debt worse.

In order to understand how the various types of debt discussed in Chapter One can become problematic it is necessary to examine the psychology and thought processes that influence how people respond to their debt and help explain why it can so often spiral out of control.<sup>241</sup>

### 2.1.1 Delays and denial

One of the most common themes for people who fall into problem debt is their initial tendency not to recognise that their debt is a deeper problem. For a variety of reasons

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<sup>241</sup> Due to the sensitivity of debt issues and that people often internalise their problems and convince themselves of a particular opinion there is a lack of extensive quantitative research in this area. However, the views expressed in the large number of interviews conducted on this topic are extremely valuable as what people attempt to portray they think about their debt is as pertinent as what they actually think.

including over optimism, denial and the general belief that carrying debt is just part of modern life, people often do not realise their mounting debts have become a problem until it is too late.<sup>242</sup>

'We felt embarrassed, trapped and ashamed. We were getting deeper in the red on a monthly basis and pretending to ourselves that things were going to get better.'

Mark and Lisa – in evidence to the CSJ<sup>243</sup>

The increasing acceptance of debt in society as part of life allows people to borrow large amounts without reservation and believe their resulting debt levels are not an issue.<sup>244</sup> Similarly, young people often borrow heavily against their future, as overoptimistic expectations of their future earnings leads them to believe their debt is not a problem.<sup>245</sup>

For those who have incurred mounting debts as a result of unemployment, they are often over optimistic about their ability to quickly find work again, meaning they do not correctly anticipate problems in repaying their growing debts.<sup>246</sup>

'When I lost my job, I was confident that I would find employment again. I never dreamt that I could end up in debt. Things got so bad and I considered suicide. After hearing about Christians Against Poverty, it took me 48 hours to muster up the courage to call; I felt so ashamed and embarrassed. Brian got all of my paperwork, took it and sent it away to Christians Against Poverty's head office. It was such a fantastic feeling to know someone was taking the burden off me.'

Mervyn – in evidence to the CSJ<sup>247</sup>

The opposite can also be true – when debts simply seem too large, people can be paralysed and unable to address them. It is estimated that one fifth of people have financial phobia that can immobilise them during times of crisis.<sup>248</sup>

242 CRSP, *Seeking direction: Men, money advice and the road to financial health*, London: Money Advice Trust, 2013 [accessed via: [http://www.infohub.moneyadvicetrust.org/content\\_files/files/seeking\\_direction\\_men\\_money\\_advice\\_and\\_the\\_road\\_to\\_financial\\_health\\_final\\_160311.pdf](http://www.infohub.moneyadvicetrust.org/content_files/files/seeking_direction_men_money_advice_and_the_road_to_financial_health_final_160311.pdf) (22/10/13)]

243 Case study provided by Christians Against Poverty

244 Personal Finance Research Centre, *Easy Come, Easy Go: Borrowing over the Lifecycle*, Edinburgh: Personal Finance Research Centre, 2007 [accessed via: [http://www.infohub.moneyadvicetrust.org/content\\_files/files/easy\\_come\\_easy\\_go\\_fullreport.pdf](http://www.infohub.moneyadvicetrust.org/content_files/files/easy_come_easy_go_fullreport.pdf) (22/10/13)]. CSJ, *Breakthrough Britain: Serious personal debt*, London: CSJ, 2007

245 Personal Finance Research Centre, *Working households' experiences of debt problems*, University of Bristol: StepChange, 2012 [accessed via: [http://www.infohub.moneyadvicetrust.org/content\\_files/files/bristol\\_report.pdf](http://www.infohub.moneyadvicetrust.org/content_files/files/bristol_report.pdf) (22/10/13)]

246 Personal Finance Research Centre, *Easy Come, Easy Go: Borrowing over the Lifecycle*, Edinburgh: Personal Finance Research Centre, 2007 [accessed via: [http://www.infohub.moneyadvicetrust.org/content\\_files/files/easy\\_come\\_easy\\_go\\_fullreport.pdf](http://www.infohub.moneyadvicetrust.org/content_files/files/easy_come_easy_go_fullreport.pdf) (22/10/13)]

247 Case studies provided by Christians Against Poverty

248 Burchell B, *Identifying, describing and understanding Financial Aversion: Financial phobias*. University of Cambridge: 2003, [accessed via: [http://martinfrost.ws/htmlfiles/financial\\_aversion.pdf](http://martinfrost.ws/htmlfiles/financial_aversion.pdf) (22/10/13)]

'I felt I was drowning and that my debts were a mountain I would never be able to scale alone.'

Jane – in evidence to the CSJ<sup>249</sup>

'I could not manage my debt. I could not see any way out of the situation, and was getting more and more depressed. I often thought of ways to disappear including suicide.'

David – in evidence to the CSJ

### 2.1.2 Rationalisation and underestimation

As levels of debt owed on credit cards and loans continue to rise and household bills are increasingly hard to pay on time people find it harder to completely ignore their debt problem. However, they often still try to rationalise their situation and normally underestimate the scale of their problem debt.<sup>250</sup>

'I was the only person who knew about it, I even kept it from my partner. I could not see a way out, and carried on borrowing money just to keep up appearances. Although on the outside everyone thought I was okay, inside I was in turmoil. As soon as I spoke to Christians Against Poverty it was as if the weight of the world had been lifted from me, and I could actually breathe again. I was pleased that nobody at Christians Against Poverty seemed to have judged me.'

Rachel – in evidence to the CSJ<sup>251</sup>

For many people in a variety of groups their own belief in their ability to manage money prevents them from recognising the full extent of their problem debt as they are able to rationalise it.

Research suggests that women in low-income families often take pride in their budgeting skills, leading them to believe they can continue to manage as debt levels increase.<sup>252</sup> A similar trend has been identified amongst men who take pride in their ability to manage money and investments from the perspective of being the household earner.<sup>253</sup>

249 Case study provided by Christians Against Poverty

250 Personal Finance Research Centre, *Working households' experiences of debt problems*, University of Bristol: StepChange, 2012 [accessed via: [http://www.infohub.moneyadvicetrust.org/content\\_files/files/bristol\\_report.pdf](http://www.infohub.moneyadvicetrust.org/content_files/files/bristol_report.pdf) (22/10/13)]

251 Case study provided by Christians Against Poverty

252 CRSP, *Seeking direction: Men, money advice and the road to financial health*, London: Money Advice Trust, 2013 [accessed via: [http://www.infohub.moneyadvicetrust.org/content\\_files/files/seeking\\_direction\\_men\\_money\\_advice\\_and\\_the\\_road\\_to\\_financial\\_health\\_final\\_160311.pdf](http://www.infohub.moneyadvicetrust.org/content_files/files/seeking_direction_men_money_advice_and_the_road_to_financial_health_final_160311.pdf) (22/10/13)]

253 Ibid

‘For a while we thought we could control it but soon we realised things were not in control. We did not want to ask for help, but when things became serious we asked for support.’

Steve and Sue – in evidence to the CSJ<sup>254</sup>

There is some evidence that older people are reluctant to report that they are struggling financially, despite increasing numbers becoming over-indebted, with a likely explanation being their own belief in their ability to manage their financial problems.<sup>255</sup>

### 2.1.3 Attempted solutions

Once it is clear that personal debt has grown to dangerous levels, many people become increasingly desperate in their attempts to manage their growing debts. People will often make significant personal sacrifices – such as turning off the heating and skipping meals – or take on high interest loans from payday lenders, or are even forced to borrow from an illegal moneylender.<sup>256</sup> These efforts at controlling their debt are often ineffective and can be harmful to their health, exacerbating their problem debt.

‘I was up to my eyes in it, I had taken out loans to buy clothes and shoes and to help my children. I got in so deep and could not find a way out. I was hiding away. I would get food for my children and would miss out myself.’

Sarah – in evidence to the CSJ<sup>257</sup>

As debts grow, trying to keep creditors at bay can become an all-consuming task, often severely impacting on personal health.

‘I was totally desperate and depressed, I could not sleep for worry and stress. I spent most days juggling different debts and missing payments to one company to pay another.’

Teresa – in evidence to the CSJ<sup>258</sup>

254 Case study provided by Christians Against Poverty

255 Consumer Focus Wales, *Financing the future*, Cardiff: Consumer Focus Wales, 2010 [accessed via: [http://www.consumerfocus.org.uk/wales/files/2010/10/older\\_peoples\\_finances-FOR-WEB-2.pdf](http://www.consumerfocus.org.uk/wales/files/2010/10/older_peoples_finances-FOR-WEB-2.pdf) (22/10/13)]

256 Citizens Advice Scotland, *Coping with Debt*, Edinburgh: Citizens Advice Scotland, [accessed via: [http://www.infohub.moneyadvicetrust.org/content\\_files/files/drowning\\_in\\_debt\\_01\\_\\_\\_coping\\_with\\_debt\\_6727\\_93861.pdf](http://www.infohub.moneyadvicetrust.org/content_files/files/drowning_in_debt_01___coping_with_debt_6727_93861.pdf) (22/10/13)]. Kotvis P G, *Effects of Acute Stress on Risk Taking in Financial Decisions*, University of Michigan: 2012 [accessed via: <http://bma.org.uk/news-views-analysis/news/2013/september/debt-ridden-students-forced-to-cut-back-on-food> (22/10/13)]

257 Case study provided by Christians Against Poverty

258 Ibid

There is evidence that as people become more stressed, for instance as a result of mounting debts and the collection efforts of creditors, they are less able to make well informed decisions, focussing instead entirely on short-term solutions.<sup>259</sup> Experts have suggested that this can lead people to take on unaffordable credit as they place a high value on meeting immediate financial needs, such as paying for food or rent, which can ultimately worsen their long-term financial problems.<sup>260</sup>

'I was always being threatened by creditors. I felt so low at times, i.e. having no money, not eating, feeling so low and depressed. I even attempted suicide by overdosing. Just felt like I could not cope anymore. I took more loans out to pay debts off, but that got me in more trouble.'

John – in evidence to the CSJ<sup>261</sup>

#### 2.1.4 Acceptance

Eventually there comes a crisis point in the debt spiral where people can simply no longer continue to ignore their debts or try to deal with it alone.

'Before the charity became involved in my affairs I felt I was drowning in a sea of despair and could see no way out I was just getting deeper and deeper into debt and could see no way out. I felt so much relief from the charity when they took over and felt that at last someone was helping me by showing me that there was a way out.'

Chris – in evidence to the CSJ<sup>262</sup>

Unfortunately, often by the time many people seek the help of debt advice services their problem debt is much harder to resolve than if they had sought help earlier.<sup>263</sup> The clients who contacted the debt advice charity StepChange were most likely to have waited more than a year after first realising they were having debt problems, before seeking help.<sup>264</sup> During

259 Kotvis P G, *Effects of Acute Stress on Risk Taking in Financial Decisions*, University of Michigan: 2012 [accessed via: <http://bma.org.uk/news-views-analysis/news/2013/september/debt-ridden-students-forced-to-cut-back-on-food> (22/10/13)]. Royal College of Psychiatrists, *Mental Health: What do we know? What should we do?*, London: Royal College of Psychiatrists, 2009 [accessed via: [https://www.rcpsych.ac.uk/pdf/Debt%20and%20mental%20health%20\(lit%20review%20-%2009\\_10\\_18\).pdf](https://www.rcpsych.ac.uk/pdf/Debt%20and%20mental%20health%20(lit%20review%20-%2009_10_18).pdf) (24/10/13)]

260 Mullainathan S, *Scarcity: Why having too little means so much*, London: Allen Lane, 2013. The Guardian, *How payday lenders profit from our psychological vulnerabilities* 3 September 2013 [accessed via: <http://www.theguardian.com/science/head-quarters/2013/sep/03/payday-lenders-psychological-vulnerabilities-wonga> (22/10/13)]

261 Case study provided by Christians Against Poverty

262 Ibid

263 The Money Advice Service, Press Release, *Debt Advice Delivers Improved Outcomes for People*, 19 October 2012 [accessed via: [http://www.infohub.moneyadvicetrust.org/content\\_files/files/debt\\_advice\\_delivers\\_improved\\_outcomes\\_research\\_1901012.pdf](http://www.infohub.moneyadvicetrust.org/content_files/files/debt_advice_delivers_improved_outcomes_research_1901012.pdf) (22/10/13)]

264 StepChange, *Statistical Yearbook 2012*, Leeds: Foundation for Credit Counselling, 2013 [accessed via: [http://www.stepchange.org/Portals/0/Documents/media/reports/statisticsyearbooks/Statistical\\_Yearbook\\_2012.pdf](http://www.stepchange.org/Portals/0/Documents/media/reports/statisticsyearbooks/Statistical_Yearbook_2012.pdf) (22/10/13)]

this period not only do their debts often get worse but they also can continue to suffer from related stress, anxiety and depression.

The stories detailed here are by no means unique or even unusual, but rather represent the personal damage inflicted upon thousands of people on a daily basis as they descend into debt. Just as certain psychological factors influence people's response to the growth of their problem debt, there are also certain behavioural factors that influence how low-income households manage their finances and interact with banks and other financial institutions.



## 2.2 Driving low-income families into problem debt

Low, reduced, or irregular household income is a major contributory cause and driver of problem debt. Low income is the primary contributory cause of problem debt for almost one in five of Christians Against Poverty's clients.<sup>265</sup> Similarly, StepChange found that reduced or irregular income was cited as the primary cause of debt for almost one quarter (23 per cent) of its clients.<sup>266</sup>

The poorest are especially at risk of being driven into problem debt due to their initial position of financial vulnerability. It often means they interact with banks, businesses, and lenders from a position of weakness, which can lead to exclusion, higher prices and ultimately put them at a greater risk of incurring problem debt.

This phenomenon has been identified as the 'poverty premium' and it is essentially a surcharge payable by low-income families for everyday goods and services solely as a consequence of their low income.<sup>267</sup> It has been estimated that this additional cost burden amounts to about

<sup>265</sup> Christians Against Poverty, *CAP client report 2012*, Bradford: Christians Against Poverty, 2013

<sup>266</sup> StepChange, *Statistical Yearbook 2012*, Leeds: Foundation for Credit Counselling, 2013 [accessed via: [http://www.stepchange.org/Portals/0/Documents/media/reports/statisticsyearbooks/Statistical\\_Yearbook\\_2012.pdf](http://www.stepchange.org/Portals/0/Documents/media/reports/statisticsyearbooks/Statistical_Yearbook_2012.pdf) (22/10/13)]

<sup>267</sup> Save the Children, *The UK Poverty Rip-Off*, London: Save the Children, 2010 [accessed via: [http://www.savethechildren.org.uk/sites/default/files/docs/UK\\_Poverty\\_Rip\\_Off\\_Brief\\_1.pdf](http://www.savethechildren.org.uk/sites/default/files/docs/UK_Poverty_Rip_Off_Brief_1.pdf) (16/10/13)]. Consumer Futures, *Addressing the poverty premium*, 2013: London, Consumer Futures [accessed via: <http://www.consumerfutures.org.uk/files/2013/06/Addressing-the-poverty-premium.pdf> (16/10/13)]

£1,280 a year or around ten per cent of a low-income household's annual income.<sup>268</sup> These estimates are calculated by examining a basket of goods and services – such as a cooker, a short-term loan and an average electricity bill – and then estimating how much more low-income families have to pay for these same goods and services.

However, it is also important to capture the perspective of those on low-incomes and what is driving them to make financial decisions that result in large additional burdens being placed on already squeezed household budgets.

We will examine the same four areas others have looked at (banking, borrowing, services and utilities, and insurance) when estimating the poverty premium, but focussing on the mismatch between the products and services available and the needs and behaviour of low-income households.

In all of the examples above there is a clear link between the underlying behavioural and financial aspects of low-income households and the increased costs and penalties they incur. The primary recurring causes are related to several key implications more common amongst low-income households: a lack of disposable income, low savings and decreased job security. Other psychological determinants include the desire to have greater control and transparency over their household finances, fear of debt and fees, as well as significant stresses that affect their decision making processes when considering financial decisions.

There is more to the poverty premium than an additional cost payable by low-income households when purchasing goods and services. The root causes are significantly more complex and there appears to be a disconnect between the products and services offered to low-income households and what people actually want, especially in the finance and banking sectors. Low-income households are often in a position of disadvantage when purchasing or using any of the products and services mentioned in this chapter and can suffer significant financial hardships as a result. These can extend beyond the actual cost premium and as many can lead to increased borrowing, often from high cost lenders, there are significant financial implications that can drive problem debt.

The increased levels of financial hardship that can result put low-income households at risk of falling into problem debt and contribute to the cost of living crisis which is plaguing low-income families.

### **2.2.1 Banking and the cash economy**

Many of the costs associated with the poverty premium can be traced back to the one-sided relationship between low-income households and mainstream banks. Very little in mainstream banking is designed or suitable for those on low incomes, many of whom avoid banking altogether, despite the benefits and security it provides.

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<sup>268</sup> Ibid



There are currently 1.4 million people in the UK who do not have a transactional bank account, and almost one million who have a bank account but who do not utilise it, operating instead primarily within a cash economy.<sup>269</sup> In 2011 a further 6.6 million people were estimated to have not benefitted financially from their bank account, as they incurred more than £100 in overdraft and penalty fees, outweighing any monetary savings.<sup>270</sup> While it is true that the vast majority of people in the UK are now banked, largely a result of the drive by mainstream banks to offer 'basic bank accounts', there still remains a substantial unbanked minority who incur a financial disadvantage as a result.

These 'unbanked' people are amongst the most disadvantaged. More than one-third are in the lowest income quintile, while 89 per cent receive some means-tested state benefit.<sup>271</sup> Two-thirds of unbanked people previously had a bank account, but had trouble with overdraft and penalty fees, while one-third have a Post Office Card Account (POCA).<sup>272</sup> The group that is 'voluntarily unbanked' is only slightly better-off, with low incomes, high levels of dependence on state benefits and with a vast majority living in social housing.<sup>273</sup>

Banking in the UK is predicated on a 'free in credit' model that is not typical in other developed economies such as Australia, Italy or Sweden.<sup>274</sup> Under this business model the vast majority of a bank's services are free, so long as the customer always maintains a positive minimum balance in their account. This system provides a free service with many additional benefits for the vast majority of the UK's population who receive a regular fixed salary that comfortably covers their typical monthly expenditures.

For those living on low incomes there are several factors which make this model of business inappropriate and can result in them paying large sums to access banking.<sup>275</sup> This is primarily due to the irregular incomes, lack of savings and lower levels of job security commonly found amongst low-income households. This can make it much harder for them to ensure their account is always in credit as the dates and amounts of their paycheque may vary, but their outgoings through direct debits and continuous payment authorities are often fixed, less transparent and harder to control.

Low-income households often have an irregular income as they are more likely to be employed in a job which pays them based on hours worked rather than on a fixed monthly salary, with hours worked varying from week to week. In recent years the growth in 'zero-hour' contracts, which do not provide any stable guarantee of work and income, has potentially increased the number of people with an unstable income source.

269 DWP, *Credit Union Expansion Project: Feasibility Study Report*, London: DWP [accessed via: <http://www.dwp.gov.uk/docs/credit-union-feasibility-study-report.pdf> (16/10/13)]. Social Finance, *A new approach to banking*, London: 2011 [accessed via: [http://www.socialfinance.org.uk/sites/default/files/SF\\_JamjarAccountReport\\_FULLREPORT.pdf](http://www.socialfinance.org.uk/sites/default/files/SF_JamjarAccountReport_FULLREPORT.pdf) (16/10/13)]

270 Ibid. Note: this figure is most likely reduced now due to reduction in fees after OFT review, but still substantial

271 Ibid

272 There is possible overlap between these two groups. A POCA is a form of non-transactional bank account that allows for state benefits to be paid in but only allows cash to be taken out at post offices. Social Finance, *A New approach to banking*, London: 2011 [accessed via: [http://www.socialfinance.org.uk/sites/default/files/SF\\_JamjarAccountReport\\_FULLREPORT.pdf](http://www.socialfinance.org.uk/sites/default/files/SF_JamjarAccountReport_FULLREPORT.pdf) (16/10/13)]

273 Ibid

274 This is Money, *Banks urged to axe free current accounts by senior Bank of England officials to stop mis-selling scandals*, 25 May 2012 [accessed via: <http://www.thisismoney.co.uk/money/saving/article-2149251/Banks-urged-stop-offering-free-current-accounts.html> (24/10/13)]

275 Ellison A, Whyley S, Forster R and Jones P, *Credit and low-income consumers: A demand-side perspective on the issues for consumer protection*, Dorking, Surrey: Friends Provident Foundation, 2011

For many these contracts are a positive thing, as they allow greater flexibility to balance work with other aspects of their life such as school or family. But they provide little certainty of income on which to budget, and make arrangements for child-care particularly difficult. These jobs are typically low-wage jobs, and tend to be concentrated in the retail and service industries with employers such as McDonalds, Sports Direct, JD Wetherspoons and Cineworld, all employing up to 90 per cent of their employees on such contracts.<sup>276</sup>

Estimates of the total number of people employed on zero-hour contracts vary wildly, from the official newly revised ONS estimate of 250,000, to the one million estimate from the Chartered Institute of Personal Development, all the way up to the 5.5 million estimate made by the trade union Unite.<sup>277</sup> Either way, it represents a significant portion of the population who are likely to have low-incomes and could find it hard to maintain the type of consistent income stream necessary to avoid bank penalty fees.

The level of penalty fees incurred by low-income bank account holders when compared to that of other income groups clearly demonstrates the myth of the 'free bank account'. Each year an estimated four million people incur penalty charges resulting from the use of their bank account, either through unauthorised overdrafts or returned transactions.<sup>278</sup> A previous estimate in 2011 put this figure as high as 6.6 million people incurring charges greater than £100 per year. In 2011, customers incurred £1.72 billion in these penalty charges, with the Office of Fair Trading (OFT) finding they were disproportionately borne by those on the lowest incomes.<sup>279</sup>

While these fees have gone down on average since the first OFT investigation in 2008, this has done little to help those on the lowest incomes as nothing has been done to address the core issue of why they incur such charges in the first place – namely the incompatibility of 'free banking' with irregular income cycles and low savings.<sup>280</sup> That the fees have decreased is also slightly irrelevant for those on the lowest incomes, as they still represent a significant amount, especially when compared to their low levels of disposable income.<sup>281</sup>

Figure 10 below shows some examples of penalty charge scenarios, including for a Basic Bank Account, which has been advertised as the 'fee-free' account designed for those on

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276 Pyper D and McGuinness F, *Zero-hours contracts*, London: The House of Commons Library, 2012 [accessed via: <http://www.parliament.uk/briefing-papers/SN06553.pdf> (23/10/13)]. The Guardian, *McDonald's ties nine out of 10 workers to zero-hours contracts*, 5 August 2013 [accessed via: <http://www.theguardian.com/business/2013/aug/05/mcdonalds-workers-zero-hour-contracts> (23/10/13)]. The Guardian, *Sports Direct former employee takes legal action over zero-hours contracts*, 7 August 2013 [accessed via: <http://www.theguardian.com/uk-news/2013/aug/07/sports-direct-zero-hour-contracts> (23/10/13)]

277 CIPD, Press Release, *Zero hours contracts more widespread than thought – but only minority of zero hours workers want to work more hours*, 5 August 2013 [accessed via: <http://www.cipd.co.uk/pressoffice/press-releases/zero-hours-contracts-more-widespread-thought-050813.aspx> (23/10/13)]. Pyper D and McGuinness F, *Zero-hours contracts*, London: The House of Commons Library, 2012 [accessed via: <http://www.parliament.uk/briefing-papers/SN06553.pdf> (23/10/13)]. Unite, Press Release, *Research uncovers growing zero hour subclass of insecure employment*, 8 September 2013 [accessed via: <http://www.unitetheunion.org/news/research-uncovers-growing-zero-hour-subclass-of-insecure-employment/> (23/10/13)]

278 DWP, *Credit Union Expansion Project: Feasibility Study Report*, London: DWP [accessed via: <http://www.dwp.gov.uk/docs/credit-union-feasibility-study-report.pdf> (16/10/13)]

279 OFT, *Evaluating the impact of the 2008 OFT market study and UTCCR test case into personal current accounts*, London: OFT, 2013 [accessed via: [http://www.of.gov.uk/shared\\_of/reports/financial\\_products/OFT1005eval](http://www.of.gov.uk/shared_of/reports/financial_products/OFT1005eval) (23/10/13)]

280 Ibid

281 Ibid

low incomes.<sup>282</sup> The level of the charges are low, but since multiple charges can be incurred within a matter of minutes through several small purchases at different stores, it can quickly add up to the maximum amounts which are just below or even above the weekly income for someone on Jobseeker's Allowance.

Figure 10: Representative bank charges<sup>283</sup>

Cost of:	Barclays Basic Bank Account	Lloyds Current Account	Nationwide Building Society Flex Account
Going overdrawn by £16 with 2 payments over 2 days without authorisation	n/a	£16	£50
Going overdrawn by £16 in 3 payments for 2 weeks without authorisation	n/a	£40	£55
Insufficient funds to pay a direct debit	£8	£10	£15
Insufficient funds to pay a in-store card payment	£8	£10	£15
Maximum charges per month	£40	£46	£95

Recently, banks have begun to offer accounts where transactions will be denied at the point of sale if there are insufficient funds and which cannot incur overdraft charges. However, these accounts can cost as much as £15 per month, more than the cost of a single penalty fee and the £180 a year represents more than one week's income for the bottom ten per cent of households.<sup>284</sup> There is limited value in an account that is perhaps unaffordable to those who need it most.

The previous government made a significant push to give every unbanked individual a transactional bank account through the work of the Financial Inclusion Task Force, with the aim of reducing the poverty premium in this area.<sup>285</sup> They were successful in getting 1.1 million individuals to sign up for a bank account, more than half of whom were in the lowest 25 per cent of household incomes.<sup>286</sup> However, the poverty premium is about much more than just equal access to the same goods and services, or price differentials, as low-income households use financial products differently.

282 Consumer Focus, *Best of British Banking 2012*, London: Consumer Focus, 2012 [accessed via: <http://www.consumerfocus.org.uk/files/2012/10/The-best-of-British-banking.pdf> (16/10/13)]. This Is Money, *Keep getting slammed with overdraft charges or turned away from banks? The best of the basic bank accounts*, 24 October 2013 [accessed via: <http://www.thisismoney.co.uk/money/guides/article-2318954/This-Moneys-best-basic-bank-accounts.html> (23/10/13)]. The Money Advice Service, *Basic Bank Accounts* [accessed via: <https://www.moneyadviceservice.org.uk/en/articles/basic-bank-accounts> (23/10/13)]

283 Information sourced from the relevant bank's websites on October 30, 2013

284 HSBC, *Bank Account Pay Monthly* [accessed via: <http://www.hsbc.co.uk/1/2/current-accounts/bank-account-pay-monthly> (23/10/13)]. ONS, *Household income and expenditure by income decile group*, ONS, 2011 [accessed via: <http://www.ons.gov.uk/ons/about-ons/business-transparency/freedom-of-information/what-can-i-request/published-ad-hoc-data/econ/february-2013/household-income-and-expenditure-by-income-decile-group---2011--united-kingdom.xls> (23/10/13)]

285 Whyley C, *Financial Inclusion Evidence Review: the costs of banking exclusion and the benefits of access to bank accounts*, London: Policis, 2010 [accessed via: <http://www.policis.com/pdf/banking/HMT%20Newly%20banked%20and%20unbanked%20research%20final%20report%20090810.pdf> (23/10/13)]

286 Ibid

Almost half of those newly banked incurred penalty charges, with those in the lowest income quintile incurring on average a penalty charge every nine weeks.<sup>287</sup> While there were savings amongst all of the newly banked totalling £69 million, there were also losses of £49 million because of penalty fees.<sup>288</sup> Since these were concentrated amongst the poorest people, it is likely this group achieved no benefit and helps to explain why one in five closed their account.<sup>289</sup>

## 2.2.2 Borrowing

Similar financial penalties incurred by those on low-incomes as a result of the nature of their low-income and the psychology of low-income households can also be seen with regards to borrowing.

The higher rates of interest offered to those on low-incomes, justified to some degree by the increased risk of default associated with the loan, only begin to scratch the surface of how low-income households are at a severe disadvantage in relation to borrowing. Certain social and economic factors mean that low-income households must often utilise borrowing differently, and can often incur a financial penalty as a result.

Irregular income cycles and low levels of savings amongst low-income households implies a lower level of financial resilience and means households may have to rely on high-cost borrowing to smooth income gaps and cover one-off expenses. There are currently 3.2 million low-income households who have no savings at all.<sup>290</sup> Similarly, an estimated one in 11, or 4.5 million adults, have just £10 a month in disposable income after all regular expenditures have been paid.<sup>291</sup> This means that large unexpected costs, and some expected costs that exceed the household budget for that month, are likely to be financed through borrowing.

There are many examples of unavoidable expenditures that are significant when considered in relation to the disposable income of low-income households, such as school supplies, a new tyre, or a minor boiler repair. In 2013, for instance, 90 per cent of parents had to buy a new uniform for their child, at an average cost of around £100.<sup>292</sup> Surveys suggest one in four parents had to borrow money for the purchase, rising to one-third amongst unemployed parents.<sup>293</sup>

Other factors can influence behaviour amongst low-income households and result in increased use of credit. One example is social and familial pressures to spend more around certain events, such as a school trip, Christmas or a child's birthday, which must often be

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287 Ibid

288 Ibid

289 Ibid

290 DWP, *Family Resource Survey 2011/12*, London: DWP, 2013 [accessed via: <https://www.gov.uk/government/publications/family-resources-survey-201112> (23/10/13)]. ONS, *Families and Households, 2012*, London: ONS, 2012 [accessed via: <http://www.ons.gov.uk/ons/re/family-demography/families-and-households/2012/stb-families-households.html> (23/10/13)]. Gross household income under £15,600

291 The Money Advice Service, *One in 11 Britons has less than £10 a month disposable income*, 2 October 2013 [accessed via: <https://www.moneyadviceservice.org.uk/en/news/one-in-11-britons-has-less-than-gbp10-a-month-disposable-income-02102013> (23/10/13)]

292 BBC News, *School uniform costs 'coming down'*, 31 August 2013 [accessed via: <http://www.bbc.co.uk/news/business-23899639> (23/10/13)]

293 Citizens Advice, *Press Release, Parents borrowing money to pay for school uniforms*, 18 August 2013 [accessed via: [http://www.citizensadvice.org.uk/index/pressoffice/press\\_index/press\\_office-newpage-2.htm](http://www.citizensadvice.org.uk/index/pressoffice/press_index/press_office-newpage-2.htm) (23/10/13)]

funded through borrowing.<sup>294</sup> Similarly, parents can feel anxious that their children will be bullied or stigmatised for not having the 'right' clothes or toys, which can influence them to borrow in order to buy expensive items.<sup>295</sup> Such borrowing results from the complex set of psychological factors and social pressures related to living on a persistent low-income.

The stresses of living on a low income, especially for people already struggling with debt, can actually affect people's thought processes and decision making when taking on loans. Research has shown that the stresses associated with debt and money inhibit parts of the brain, causing people to place a greater value on relatively small immediate gains, despite the long-term negative implications and high repayment costs.<sup>296</sup> Payday loans, offering speed in processing and therefore providing an immediate 'solution', appeals to this psychological trait.

### 2.2.3 Utilities and services

Much research on the impact of the poverty premium in relation to utility and service bills such as electricity, gas, water and telecommunications, has focussed on the increased costs associated with pre-payment meters (PPM), which are predominantly used by low-income households. However, the root of the poverty premium for low-income households in this area has a deeper, more concerning psychological and behavioural component.

Despite recent improvements, PPM users still pay an annual premium for their gas and electricity while low-income households are at risk of paying a 20 per cent premium due to not having the best possible tariff.<sup>297</sup> This problem is exacerbated by the fact that many low-income consumers do not live in energy efficient housing, notably those in local authority or housing association properties, meaning their bills are unnecessarily high.<sup>298</sup> An estimated 4.5 million households are in 'fuel poverty' meaning they spend more than ten per cent of their annual income on energy costs.<sup>299</sup> Families sometimes have to choose between heating and eating.<sup>300</sup>

For many utilities and services – mobile phone, broadband, energy, water, television, and phone line rental – the best tariffs and discounts require the customer to take on a contract and pay with a direct debit. Some companies even add a small surcharge to pay through an alternative method, or do not allow payments via cash at all.<sup>301</sup> Low-income households may

294 Barnado's, *From Crunch to Crisis: Winter hardship for families in the UK*, Essex: Barnado's 2009 [accessed via: [http://www.barnardos.org.uk/from\\_crunch\\_to\\_crisis.pdf](http://www.barnardos.org.uk/from_crunch_to_crisis.pdf) (23/10/13)]

295 Ibid. About Families, *Parenting on a Low Income*, Edinburgh: About Families, 2013 [accessed via: <http://socialwelfare.bl.uk/subject-areas/services-client-groups/families/aboutfamilies/145754about-families-report-parenting-on-a-low-income.pdf> (23/10/13)]

296 Shah I A K, Mullainathan S, Shafir E, 'Some Consequences of Having Too Little'. *Science*, 338 (6107), 2012, pp682-685 [accessed via: <https://www.sciencemag.org/content/338/6107/682> (23/10/13)]. Figner B et al, 'Lateral prefrontal cortex and self-control in intertemporal choice', *Nature Neuroscience*, 13, 2010, pp538–539 [accessed via: <http://www.nature.com/neuro/journal/v13/n5/abs/nn.2516.html> (23/10/13)]

297 Consumer Futures, *Addressing the poverty premium*, London: Consumer Futures, 2013 [accessed via: <http://www.consumerfutures.org.uk/files/2013/06/Addressing-the-poverty-premium.pdf> (16/10/13)].

298 JRF, *Time to reconsider UK energy and fuel poverty policies?*, York: JRF, 2011 [accessed via: <http://www.jrf.org.uk/sites/files/jrf/fuel-poverty-policy-summary.pdf> (23/10/13)]. DECC, Fuel poverty report – updated August 2013, London: DECC, 2013

299 Ibid

300 IFS, *Is there a 'heat or eat' trade-off in the UK?*, London: IFS, 2011 [accessed via: [http://www.nuffieldfoundation.org/sites/default/files/files/Is%20there%20a%20heat%20or%20eat%20trade-off%20in%20the%20UK\\_IFS%20Working%20Paper.pdf](http://www.nuffieldfoundation.org/sites/default/files/files/Is%20there%20a%20heat%20or%20eat%20trade-off%20in%20the%20UK_IFS%20Working%20Paper.pdf) (23/10/13)]

301 Whyley C, *Financial Inclusion Evidence Review: the costs of banking exclusion and the benefits of access to bank accounts*, Policis, 2010 [accessed via: <http://www.policis.com/pdf/banking/HMT%20Newly%20banked%20and%20unbanked%20research%20final%20report%20090810.pdf> (23/10/13)]

be reluctant to take on extended contracts, often for one or two years, due to potential job instability or a desire to maintain control of finances. Similarly, due to credit scoring, many low-income households can be prevented from taking out cost-saving contracts. For those that do pay by cash, there are associated travel and time costs associated with paying bills in cash.<sup>302</sup> Lastly, the pricing structure for many utilities and services, often consisting of an access charge and a per-unit charge, means low-volume users often pay more per unit, which tends to disproportionately affect low-income users as they tend to consume less in order to cut total costs down.<sup>303</sup>

What is more concerning than these increased costs is that, in effect, low-income households are left between a rock and a hard place. If they wish to save money on bills, they must accept the use of contracts and direct debits. However, as discussed earlier these are often not compatible with the irregular nature of many low-income households' earnings and can lead to large bank penalty charges or arrears. Paying in this manner also removes a degree of control over spending on bills, which is noted by many low-income households as the primary reason they use cash and prepayment methods.<sup>304</sup>

## 2.2.4 Insurance

When purchasing insurance services such as car, home contents and life insurance policies, low-income households are in a position of particular disadvantage, often have to pay substantially more for the insurance and the resulting impact can be especially harmful.

Just as banks assess credit when offering loans, insurance companies conduct a risk assessment on the customer in order to determine the price of the policy. Low-income households tend to live in more deprived areas with higher crime rates, meaning that their premia for car and home contents insurance will often be more expensive. A car insurance policy for low-income households is estimated to be 98 per cent higher on average, while the average home contents policy costs 48 per cent more.<sup>305</sup> A lack of savings means low-income households often pay through a credit agreement, rather than upfront, which can cost more due to poor credit ratings.

All of these associated costs mean low-income households are much less likely to purchase home contents insurance, and may choose car insurance with less protection in order to save money. Less than half of households in the lowest income quintile have home contents insurance, a percentage that has stayed roughly constant for the past ten years.<sup>306</sup>

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302 Friends Provident Foundation, *Developing a vision for financial inclusion*, University of Bristol: Friends Provident Foundation, 2012 [accessed via: <http://www.bristol.ac.uk/geography/research/pfrc/themes/finexc/pfrc1205.pdf> (23/10/13)]. Whyley C, *Financial Inclusion Evidence Review: the costs of banking exclusion and the benefits of access to bank accounts*, Policis, 2010 [accessed via: <http://www.policis.com/pdf/banking/HMT%20Newly%20banked%20and%20unbanked%20research%20final%20report%20090810.pdf> (23/10/13)]

303 Consumer Futures, *Addressing the poverty premium*, 2013: London, Consumer Futures [accessed via: <http://www.consumerfutures.org.uk/files/2013/06/Addressing-the-poverty-premium.pdf> (16/10/13)]

304 Consumer Focus Wales, *Cost of Cash*, Cardiff: Consumer Focus Wales, 2009 [accessed via: [http://www.consumerfocus.org.uk/assets/4/files/2009/11/404\\_20091112105252\\_e\\_@@\\_CFWTheCostofCashEnglishWEB.PDF](http://www.consumerfocus.org.uk/assets/4/files/2009/11/404_20091112105252_e_@@_CFWTheCostofCashEnglishWEB.PDF) (23/10/13)]. Consumer Focus, *Cutting back, cutting down, cutting off*, Consumer Focus, 2010 [accessed via: <http://www.consumerfocus.org.uk/assets/1/files/2010/02/Cutting-back-cutting-down-cutting-off.pdf> (23/10/13)]

305 Save the Children, *The UK Poverty Rip-Off*, London: 2010 [accessed via: [http://www.savethechildren.org.uk/sites/default/files/docs/UK\\_Poverty\\_Rip\\_Off\\_Brief\\_1.pdf](http://www.savethechildren.org.uk/sites/default/files/docs/UK_Poverty_Rip_Off_Brief_1.pdf) (16/10/13)]

306 The Poverty Site, *Without Home Contents Insurance* [accessed via: <http://www.poverty.org.uk/74/index.shtml> (24/10/13)]

In comparison, around 90 per cent of households in the upper 40 per cent of incomes have home contents insurance. Low-income households are also less likely to have life insurance policies.<sup>307</sup> The effects of this discrepancy add significantly to the additional financial burden for low-income households and expose them to a greater risk of incurring debt.

Households without home contents insurance are four times more likely to be burgled than homes with insurance.<sup>308</sup> Without insurance, households are left to cover all of the damages caused as a result of crimes, typically damage or theft. Similarly, low-income households are more likely to experience illness and premature death, which can cause a significant income shock.<sup>309</sup> In both situations, as low-income households often have low savings and little disposable income these unexpected cost will likely be met through the use of borrowing, which has associated poverty premium costs and implications as mentioned before.

The poverty premium is largely driven by financial behaviour and a mismatch between the needs of low-income households and the available products and services. In contrast the general rise in the cost of living is a financial burden that is largely unrelated to behaviour and yet has also had a disproportionate impact on low-income households.

### 2.2.5 Rising cost of living for low-income households

As the cost of living has increased, outstripping real wage growth, there has been an increase in prevalence of 'cost of living debts'.<sup>310</sup> Low-income households are especially susceptible to cost of living debts due to the large proportion of their income being spent on household bills and low levels of disposable income.<sup>311</sup> More than three million people over the age of 50 report they are 'very worried' about the cost of living.<sup>312</sup>

**Cost of living debts** are those debts related to necessary expenditures and household bills such as rent, food, gas, electricity, transport, water, phone line, internet access etc.

The primary drivers of cost of living debts are related to energy, water, transport, rent and council tax.<sup>313</sup> Any small increase in these can disrupt delicate household finances and push people into problem debt. As an overall estimate, living costs have increased by 25 per cent in just the last five years.<sup>314</sup>

307 Friends Provident Foundation, *Delivering insurance to low-income Households*, University of Salford: Friends Provident Foundation, 2009 [accessed via: [http://usir.salford.ac.uk/19119/1/Insurance\\_SUMMARY\\_Nov09.pdf](http://usir.salford.ac.uk/19119/1/Insurance_SUMMARY_Nov09.pdf) (24/10/13)]

308 The Poverty Site, *Without Home Contents Insurance* [accessed via: <http://www.poverty.org.uk/74/index.shtml> (24/10/13)]

309 Friends Provident Foundation, *Delivering insurance to low-income Households*, University of Salford: Friends Provident Foundation, 2009 [accessed via: [http://usir.salford.ac.uk/19119/1/Insurance\\_SUMMARY\\_Nov09.pdf](http://usir.salford.ac.uk/19119/1/Insurance_SUMMARY_Nov09.pdf) (24/10/13)]

310 TUC, Press Release, *Cost of living is rising faster for the poorest households*, 10 May 2012 [accessed via: <http://www.tuc.org.uk/economic-issues/economic-analysis/labour-market-and-economic-reports/cost-living> (24/10/13)]

311 DWP, *Family Resources Survey 2010/2011*, London: DWP, 2012 [accessed via: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/222839/frs\\_2010\\_11\\_report.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/222839/frs_2010_11_report.pdf) (23/10/13)]

312 Age UK, *Economic tracker – Summer 2013*, London: Age UK, 2013 [accessed via: <http://www.ageuk.org.uk/Documents/EN-GB/For-professionals/Research/Economic%20Monitor%20Report%20Summer%202013.pdf?dtrk=true> (24/10/13)]

313 Ridge T, *Living with poverty: a review of the literature on children's and families' experiences of poverty*, London: DWP, 2009. CPEC, *The over-indebtedness of European households*, University of Bristol: CPEC, 2013 [accessed via: <http://www.bristol.ac.uk/geography/research/pfrc/news/pfrc1301.pdf> (23/10/13)]

314 uSwitch, *Household bills up 25% in five years*, 13 March 2013 [accessed via: <http://www.uswitch.com/blog/2013/03/13/household-bills-rise-25-in-five-years/> (24/10/13)]

Energy bills make up a large part of a low-income household's annual budget, and recent increases have put a strain on households. The cost of energy is of particular concern because a lack of heating can have negative health impacts for vulnerable people including older people, the disabled and young children.<sup>315</sup>

We know that many older people with fixed low incomes worry greatly about spiralling energy costs. There is a danger they will keep less than adequately warm, with inevitable consequences for their health and wellbeing.

Age UK – in evidence to the CSJ

In the last seven years the cost of electricity has almost doubled and the cost of gas has almost trebled.<sup>316</sup> This has resulted in the average household spending 15.5 per cent more on electricity and 37.3 per cent more on gas since 2007.<sup>317</sup> Not only does any increased spending represent a larger component of low-income families' disposable income, but it can also put them at risk during periods of exceptionally cold weather.<sup>318</sup>

During the winter of 2012–2013, average fuel bills were 15 per cent higher than the previous year.<sup>319</sup> The resulting £125 increase to the average winter fuel bill is an example of an income shock that can push low-income households into problem debt, as they may not have sufficient savings to pay a bill that is higher than expected. This situation also represents an example of the unexpected charges that many low-income households seek to avoid through the use of pre-payment meters, despite the additional cost to do so.

There are specific characteristics that define households struggling with cost of living debts. In 2012 four out of ten households repaying an energy debt had no adult in work, and nearly three-quarters contained at least one vulnerable individual.<sup>320</sup> These debts are primarily consistent arrears as a result of persistent low income, with 71 per cent also owing money on other bills.<sup>321</sup> Around two-thirds cut back on energy usage in order to lower arrears, something that can be unhealthy considering the presence of vulnerable individuals in these homes.<sup>322</sup>

315 IFS, *Is there a 'heat or eat' trade-off in the UK?*, London: IFS, 2011 [accessed via: [http://www.nuffieldfoundation.org/sites/default/files/files/Is%20there%20a%20heat%20or%20eat%20trade-off%20in%20the%20UK\\_IFS%20Working%20Paper.pdf](http://www.nuffieldfoundation.org/sites/default/files/files/Is%20there%20a%20heat%20or%20eat%20trade-off%20in%20the%20UK_IFS%20Working%20Paper.pdf) (23/10/13)]

316 Castle Cover, *The Changing Costs of Utility Prices in the UK*, 2011 [accessed via: [http://www.castlecover.co.uk/historic-home-utility-prices/\(24/10/13\)](http://www.castlecover.co.uk/historic-home-utility-prices/(24/10/13))]

317 Department of Energy and Climate Change, *Annual domestic energy bills*, London: Department of Energy and Climate Change, 2013 [accessed via: <https://www.gov.uk/government/statistical-data-sets/annual-domestic-energy-price-statistics> (24/10/13)]

318 IFS, *Is there a 'heat or eat' trade-off in the UK?*, London: IFS, 2011 [accessed via: [http://www.nuffieldfoundation.org/sites/default/files/files/Is%20there%20a%20heat%20or%20eat%20trade-off%20in%20the%20UK\\_IFS%20Working%20Paper.pdf](http://www.nuffieldfoundation.org/sites/default/files/files/Is%20there%20a%20heat%20or%20eat%20trade-off%20in%20the%20UK_IFS%20Working%20Paper.pdf) (23/10/13)]

319 Department of Energy and Climate Change, *Energy Trends: June 2013, special feature articles – The effect of the cold 2012/13 winter on energy bills*, London: Department of Energy and Climate Change, 2013 [accessed via: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/208610/the\\_effect\\_of\\_the\\_cold\\_2012\\_13\\_winter\\_on\\_energy\\_bills.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/208610/the_effect_of_the_cold_2012_13_winter_on_energy_bills.pdf) (24/10/13)]

320 RS Consulting, *Ability to Pay*, London: RS Consulting, 2013 [accessed via: <http://www.consumerfutures.org.uk/files/2013/07/Ability-to-Pay-RS-Consulting.pdf> (16/10/13)]

321 Ibid

322 Ibid



Problem debt is not just driven by low incomes, but by a host of other factors that can place increased pressure on household budgets. In many cases low-income households are at a greater risk of incurring problem debt as a result of their lack of financial resilience.

### Kenny (46) – in evidence to the CSJ<sup>323</sup>

Kenny's debt built up over a couple years as he was struggling to keep up with the rising cost of living. He admits he was not budgeting very well and found himself relying on credit cards to pay for bills and shopping. After being refused any more credit Kenny started missing out on payments for his council tax and other bills.

*'When I was running out of money I was relying on my credit card to use for shopping, and a few bills that sort of thing, and it seemed to just go on from there. At the time I was getting credit easy enough...in the last year it [came to] a position where I was struggling to get any more credit and struggling to make ends meet.*

*'I missed out on my council tax and some of the more important bills. I had to rely on payday loans to get me through. I had to do something before it got any worse.*

*'I did not go to the doctors or anything but I knew I was suffering. I can remember waking up in the mornings and thinking "god this is going to be a struggle".'*

## 2.2.7 Rising rent arrears

Britain is currently experiencing a severe housing shortage that is pushing up rents across the country and having a particularly negative effect for low-income households. Average rents in the UK have been increasing, both in the private and social sector, with an estimated increase of around 10 per cent since 2010.<sup>324</sup> Rent increases impact government spending as the housing benefit bill has risen to £23 billion, up 50 per cent in the past decade.<sup>325</sup> Furthermore, there are an estimated 250,000 households currently living in overcrowded social housing with 4.5 million people in England waiting for social housing.<sup>326</sup>

In an effort to alleviate overcrowding by reducing under-occupancy the Government has extended the removal of the Spare Room Subsidy from the private rental sector to social housing.<sup>327</sup> In 2008 the Labour Government introduced the same measure to the private rental sector.<sup>328</sup> There are an estimated one million spare bedrooms in the social housing

323 Case study provided by StepChange

324 LSL Property Services, *Buy-to-let index – September 2013*, Newcastle upon Tyne: LSL Property Services, 2013 [accessed via: [http://www.lslps.co.uk/documents/buy\\_to\\_let\\_index\\_sep13.pdf](http://www.lslps.co.uk/documents/buy_to_let_index_sep13.pdf) (24/10/13)]. HomeLet, *Rental index – September 2013*, Lincoln: HomeLet, 2013 [accessed via: <https://homelet.co.uk/contact-us> (24/10/13)]. DCLG, *Live tables on rents, lettings and tenancies – Table 701*, London: DCLG, 2013 [accessed via: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/10744/2039623.xls](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/10744/2039623.xls) (24/10/13)]

325 Hansard, *Oral answers to questions*, Column 584, 27 February 2013, Column 307 [accessed via: <http://www.publications.parliament.uk/pa/cm201213/cmhansrd/cm130227/debtext/130227-0001.htm> (24/10/13)]

326 HM Government, *Laying the foundations: A housing strategy for England*, London: DCLG [accessed via: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/7532/2033676.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/7532/2033676.pdf) (24/10/13)] <http://www.publications.parliament.uk/pa/cm2012/v13/cmhansrd/cm130227/debtext/130227-0001.htm>

327 DWP, Press release, *Housing benefit reform: removal of the spare room subsidy: fact sheet*, 27 February 2013 [accessed via: <https://www.gov.uk/government/news/housing-benefit-reform-removal-of-the-spare-room-subsidy-fact-sheet> (24/10/13)]

328 Wilson W, *Housing benefit: size criteria in the private rented sector*, London: House of Commons Library, 2013 [accessed via: <http://www.parliament.uk/briefing-papers/SN04887.pdf> (24/10/13)]

sector that are currently unused and could help overcrowded households.<sup>329</sup> Living in such an environment can affect mental and physical health as well putting a huge strain on families.<sup>330</sup> According to the Government this policy aims to ensure that all households are able to live in social housing appropriate for their needs as a short-term response to a massive housing shortage.

The CSJ is concerned for those who are living in overcrowded accommodation and those who are stuck on the social housing waiting list in desperate need of an appropriate place to live. That said, the CSJ has been clear that it would have included a 'reasonable offer clause' within the initiative which would have meant that the subsidy would only have been removed from households who refused a reasonable offer to 'downsize' or refused to take extra working hours to make up the difference.

Notwithstanding differences over its design, since the introduction of the policy in April 2013 there seems to have been genuine confusion about its impact – ministers claim that exemptions are clear and that local authorities have enough money to help those who cannot cope, whilst opponents argue that arrears are increasing, housing stock is not available for moves and the discretionary resources available are inadequate.<sup>331</sup> Evidence obtained by the CSJ through a Freedom of Information request for example, indicates that some local authorities are failing to fully allocate their portion of the £25 million in discretionary housing payments (DHPs).<sup>332</sup> We therefore welcome the recent announcement by the Deputy Prime Minister that an independent assessment of it is to be made in the coming months.<sup>333</sup>

This inquiry should pay particular attention to one of the current concerns being raised by those in the housing sector; which relates to the impact of the removal of the spare room subsidy on rent collection. Although the Department for Work and Pensions has estimated there is sufficient DHP funding to support around 40,000 vulnerable people, some early data suggests help is not reaching those who need it.<sup>334</sup> As a result, the National Housing Federation estimates that 51 per cent of their tenants affected by the removal of the Spare Room Subsidy are now in rent arrears, with 25 per cent of those affected who were up to date with rent payments having now entered arrears.<sup>335</sup>

While radical policies are required to reduce under-occupancy and to create the necessary capacity within the current stock to help those who need more appropriate housing, the potential short-term impact of removing the spare room subsidy on rent arrears is of concern in relation to the threat of problem debt. There is some evidence, for instance, that

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329 Wilson W, *Under-occupation of social housing: Housing benefit entitlement*, London: House of Commons Library, 2013 [accessed via: <http://www.parliament.uk/briefing-papers/SN06272.pdf> (24/10/13)]

330 Peabody, *Response to London Assembly Planning and Housing Committee – Overcrowding in London*, London [accessed via: <http://www.peabody.org.uk/media/7470034/overcrowding%20in%20london.pdf> (24/10/13)]

331 The government recently announced an additional £35 million to supported those affected by the removal of the spare room subsidy. DWP, Press release, *Spare room subsidy: funding update*, 30 July 2013 [accessed via: <https://www.gov.uk/government/news/spare-room-subsidy-funding-update> (24/10/13)]

332 Freedom of Information request, submitted by Ben Walker on behalf of CSJ, 06 February 2013 [accessed via: [https://www.whatdotheyknow.com/request/discretionary\\_housing\\_payment\\_2](https://www.whatdotheyknow.com/request/discretionary_housing_payment_2) (24/10/13)]

333 Hansard, *Oral answers to questions*, 15 October 2013 [accessed via: <http://www.publications.parliament.uk/pa/cm201314/cmhansrd/cm131015/debtext/131015-0001.htm> (24/10/13)]

334 Wilson W, *Under-occupation of social housing: Housing benefit entitlement*, London, House of Commons Library, 2013 [accessed via: <http://www.parliament.uk/briefing-papers/SN06272.pdf> (24/10/13)]

335 National Housing Federation, Press release, *More than half of families hit by bedroom tax pushed into debt*, 18 September 2013 [accessed via: <http://www.housing.org.uk/media/press-releases/more-than-half-of-families-hit-by-bedroom-tax-pushed-into-debt> (24/10/13)]

tenants who have arranged a property swap are being prevented from moving by Housing Associations until full payment is made of their current rent arrears.<sup>336</sup> This seems entirely counter-productive and until this clause can be removed, personal debts risk piling up even in the face of a potential solution. We will monitor its impact in relation to arrears and debt, and await the findings of the Government's impact review.

Ultimately, however, the core issue that must be addressed is Britain's housing shortage. It is this that has in large part led to overcrowding, rising housing benefit and a crisis of supply. A new CSJ housing review will make a contribution to this debate in the coming months.

## 2.3 High-cost credit

Following the financial crisis high street banks and lenders have increased their lending requirements and decreased the amount of credit available. This, combined with increased income shortfalls and rising living costs discussed above, has provided an ideal market for the expansion of short-term high-cost lending. It is estimated that as many as seven million people use short-term high-cost credit in order to cover income shortfalls and meet unexpected expenditures.<sup>337</sup> This market includes payday lenders, home credit lenders, pawnbrokers, and rent-to buy-programmes.

Compared with users of mainstream credit, households using high-cost credit have low income and very low levels of savings.<sup>338</sup> They are also more likely to live in rented accommodation, have dependent children and have no adults in paid employment.<sup>339</sup> More than three-fifths (62 per cent) of households using high-cost credit are in financial difficulties (insolvency action or arrears) compared with 15 per cent of other users of unsecured credit.<sup>340</sup> Similarly, they are much more likely to already be struggling with arrears or other debts and have been rejected for another form of credit prior to taking out the loan.<sup>341</sup>

There is a legitimate market for high-cost, short-term credit. The cost of such loans is high measured in APR terms, typically between 450 and 2,500 per cent because of the cost of administering relatively small short-term loans and because of the higher default risk involved.<sup>342</sup> However, the use of APRs has been criticised as inappropriate where the loans are very short-term, and it has been pointed out that bank charges and credit card costs can easily outweigh the total cost of short-term credit.<sup>343</sup>

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- 336 Shelter, *Tenancy exchanges: when a landlord refuses permission for a tenancy exchange* [accessed via: [http://england.shelter.org.uk/get\\_advice/finding\\_a\\_place\\_to\\_live/transfers\\_and\\_exchanges/exchanges#when\\_a%26nbsp%3Blandlord\\_refuses\\_permission\\_for\\_a\\_tenancy\\_exchange](http://england.shelter.org.uk/get_advice/finding_a_place_to_live/transfers_and_exchanges/exchanges#when_a%26nbsp%3Blandlord_refuses_permission_for_a_tenancy_exchange) (24/10/13)]
- 337 DWP, *Credit Union Expansion Project*, London: DWP, 2012 [accessed via: <http://www.dwp.gov.uk/docs/credit-union-feasibility-study-report.pdf> (24/10/13)]
- 338 Department for Business, *Innovation and Skills, Credit, Debt and Financial Difficulty in Britain, 2012*, London: Department for Business, Innovation and Skills, 2013 [accessed via: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/208075/bis-13-p187-a-report-using-data-from-the-yougov-debttrack-survey.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/208075/bis-13-p187-a-report-using-data-from-the-yougov-debttrack-survey.pdf) (21/10/13)]
- 339 Ibid
- 340 Ibid
- 341 Ibid
- 342 Parliamentary Commission on Banking Standards, *Written evidence from the Community Investment Coalition*, London: 11 February 2013 [[http://www.publications.parliament.uk/pa/jt201314/jtselect/jtpebs/27/27viii\\_we\\_fl8.htm](http://www.publications.parliament.uk/pa/jt201314/jtselect/jtpebs/27/27viii_we_fl8.htm) (24/10/13)]
- 343 Edmonds T, *Payday loans: regulatory reform*, London: House Of Commons Library, 2013 [accessed via: <http://www.parliament.uk/briefing-papers/SN06676.pdf> (24/10/13)]

While this form of credit can be used without problem, like any form of credit, and the market is relatively small in comparison to other forms of credit, it appears to be a significant problem for many people. For this group of borrowers, high cost credit can quickly spiral out of control. The CSJ has been told of households that have been left with no money for food and rent after high-cost creditors have taken all of their money to repay debts.

'I contacted them the day I was due to repay because whilst I had the money in my account, I also had to buy food and pay rent for the rest of the month. They'd already taken the money and that was that. Then I had to get another loan to pay off the gas bill, and make sure I could eat – it all went downhill from there really.'

Anonymous – in evidence to the CSJ<sup>344</sup>

While there may be precursors such as family breakdown or unemployment that drive people to take on high-cost loans, the nature of this type of credit and how it can grow out of control, can be a primary driver of problem debt in itself.

### 2.3.1 Payday lenders

There has been a significant expansion of high-cost credit in recent years, with this particularly apparent in the payday lending market. Payday lending increased from £900 million in 2008/2009 to just over £2 billion (around eight million loans) in 2011/2012.<sup>345</sup> While this is small in comparison to other forms of lending such as credit cards and overdrafts, there is a significant minority that appear to be struggling with this form of credit.

An estimated 1.2 million people use payday loans each year and this number is growing rapidly.<sup>346</sup> CSJ research indicates that young people are the biggest users of payday loans, with one in 10 having taken out a payday loan in the past four years.<sup>347</sup> In particular the CSJ has heard from support workers for homeless young people that payday lending is becoming a problem for this vulnerable group.

Aside from the cost of payday loans – which average around £25 for every £100 borrowed, concerns about payday lending focus on five key issues: advertising; risk assessment and affordability checks; rollover loans; the use of continuous payment authority to collect loan repayments; and debt collection practices.

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344 Case study provided by National Debtline

345 Office of Fair Trading, *Payday Lending: Compliant Review Final Report*, London: Office of Fair Trading, 2013 [accessed via: [http://www.of.gov.uk/shared\\_of/Credit/oft1481.pdf](http://www.of.gov.uk/shared_of/Credit/oft1481.pdf) (22/10/13)]

346 Ibid

347 CSJ/YouGov Polling November 2012

'Whilst people will always need access to credit, it's vital that lenders act responsibly. Amongst the young people we support, more and more are being targeted by unsolicited mailings and signing up for credit without suitable checks to establish if they can afford the repayments.'

Seyi Obakin, Chief Executive, Centrepoin – in evidence to the CSJ

### Advertising

The five largest payday lenders are estimated to have spent £36.3 million on advertising, up 26 per cent from the year before.<sup>348</sup> Advertising emphasises the ease of borrowing, that loans can be used to fund a social life, that this form of borrowing is 'risk free' and that it is a solution to the money problems of people who are already in debt.<sup>349</sup>

A review by the Office for Fair Trading (OFT) in 2013 found widespread examples of misleading advertising practices in the payday lending industry.<sup>350</sup>

In 2013 a payday loan firm sent out mass text messages to prospective customers designed to appear as if they were from a friend and encouraging the receiver to visit the firm's website and take out a loan.<sup>351</sup>

*'Hi mate. I'm still out in town, just got £1,000 in my account from these guys'*

*'I'm still out in town, just got £850 in my account from these guys'*

*'You have been pre-approved for up to £1,000 cash today. Apply now and receive your cash within 15 minutes.'*

### Risk assessment and affordability checks

There is evidence that payday lenders do not carry out appropriate risk and affordability checks on borrowers before making loans, which in turn increases the likelihood that people will struggle to repay the loan and be driven into problem debt.<sup>352</sup> During the OFT compliance review only 12 per cent of lenders were able to provide proof that they had considered an applicant's disposable income as part of their affordability check.<sup>353</sup>

348 Hansard, Commons Debates, *Backbench business – High cost credit*, Column 502, 5 September 2013 [accessed via: <http://www.publications.parliament.uk/pa/cm201314/cmhansrd/cm130905/debtext/130905-0002.htm> (24/10/13)]

349 Office of Fair Trading, *Payday Lending: Compliant Review Final Report*, London: Office of Fair Trading, 2013 [accessed via: [http://www.of.gov.uk/shared\\_of/Credit/oft1481.pdf](http://www.of.gov.uk/shared_of/Credit/oft1481.pdf) (22/10/13)]

350 Ibid

351 The Telegraph, *Payday loan ad banned for '£1,000 night out' offer*, 19 June 2013 [accessed via: <http://www.telegraph.co.uk/finance/personalfinance/borrowing/loans/10129741/Payday-loan-ad-banned-for-1000-night-out-offer.html> (24/10/13)]

352 Office of Fair Trading, *Payday Lending: Compliant Review Final Report*, London: Office of Fair Trading, 2013 [accessed via: [http://www.of.gov.uk/shared\\_of/Credit/oft1481.pdf](http://www.of.gov.uk/shared_of/Credit/oft1481.pdf) (22/10/13)]

353 Ibid

The difficulty people have repaying loans and their average level of indebtedness also points to a lack of adequate risk assessment by payday lenders. For example, around one-third of all payday loans are either repaid late or not repaid at all.<sup>354</sup> One in five report paying more than 40 per cent of their income on debt repayments.<sup>355</sup> In turn, national debt advice services report rapidly increasing numbers of clients with payday loan debts.<sup>356</sup>

#### Rollover loans

According to the OFT, payday lenders currently make half of their revenues from the 28 per cent of loans that are rolled over or refinanced, normally as the borrower cannot repay on time.<sup>357</sup> Similarly, 19 per cent of all revenue is made from the five per cent of loans that are rolled over four or more times.<sup>358</sup> This uneven distribution of revenue indicates that firms are profiting greatly from the minority of customers who are struggling financially.

'It all got a bit confusing, I had four or five loans out, and some of them had gone beyond the repayment date. Every time I started to look into it, I owed so much more than the last time, I just could not face it, so I was happy to keep the loans going.'

Anonymous – in evidence to the CSJ<sup>359</sup>

#### Case study: The Payday Loan spiral<sup>360</sup>

Sean's debt problems started when he was struggling to pay for basic living expenses whilst working in a temp job that did not pay very well.

He maxed out his overdrafts and, after two unexpected bills, resorted to payday loans. He was taking out small payday loans to start with, but, as he could (initially) pay them back without issue, he then found himself taking out more and more, until it grew out of control.

*'I would borrow £100 and pay back £125, then the next month I would borrow £125 and be paying back more and it got to the point where I was paying back, at one stage, £900 to one company'*

Sean realised he needed help when all of his creditors were chasing him and he could not afford to pay back anyone, so he needed a third party to be involved to negotiate on his behalf. He owed £9500 when he went to the debt charity StepChange.

354 Ibid

355 Department for Business, Innovation and Skills, *Credit, Debit and Financial Difficulty in Britain*, 2012, London: Department for Business, Innovation and Skills, 2013 [accessed via: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/208075/bis-13-p187-a-report-using-data-from-the-yougov-debtrack-survey.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/208075/bis-13-p187-a-report-using-data-from-the-yougov-debtrack-survey.pdf) (21/10/13)]

356 Office of Fair Trading, *Payday Lending: Compliant Review Final Report*, London: Office of Fair Trading, 2013 [accessed via: [http://www.offt.gov.uk/shared\\_offt/Credit/oft1481.pdf](http://www.offt.gov.uk/shared_offt/Credit/oft1481.pdf) (22/10/13)]. StepChange, *Briefing document House of Commons debate on high cost credit – September 2013*, London: StepChange, 2013. National Debtline, *Key statistics for the Bank of England – in evidence to the CSJ*

357 Office of Fair Trading, *Payday Lending: Compliant Review Final Report*, London: Office of Fair Trading, 2013 [accessed via: [http://www.offt.gov.uk/shared\\_offt/Credit/oft1481.pdf](http://www.offt.gov.uk/shared_offt/Credit/oft1481.pdf) (22/10/13)]

358 Ibid

359 Case study provided by National Debtline

360 Case study provided by StepChange

### *Continuous Payment Authority*

The OFT review of the payday lending industry identified several issues regarding the collection of repayments and the use of Continuous Payment Authority (CPA). CPA allows payday lenders to make repeated attempts to take money of various amounts from a borrower's bank account without informing them of when or how much they will take.<sup>361</sup>

One in six Citizens Advice Bureau (CAB) clients reported that payday lenders had taken more money than was originally agreed through the CPA.<sup>362</sup> One in three CAB clients with a payday loan had complaints about the use of CPA and nine out of ten had grounds to make a complaint to the financial ombudsman.<sup>363</sup>

The use of CPA, required as part of the loan contract, effectively makes payday lenders a priority creditor and significantly reduces their exposure to risk. The CSJ has been told of how people are often left without enough money to pay for food and electricity as a result of their bank accounts being drained by payday lenders seeking repayment.

'I got charged every time they tried to take money from my account, I asked them to stop and offered to make payments the following month – after payday, but several more attempts were made to take money from my account. I was over my overdraft limit and receiving charges for that too. I felt like I was fire fighting trying to stop charges happening here and there rather than actually sorting my problems out.'

Anonymous – in evidence to the CSJ<sup>364</sup>

While a CPA can be revoked at any time by the borrower, either by contacting the lender or their own bank, in practice this is often not so straightforward with many borrowers not knowing that they can cancel it.<sup>365</sup>

### *Debt collection*

Finally, there are also concerns about the poor collection practices employed by some payday lenders, which can result in high levels of stress for borrowers. There have been reports of payday lenders harassing borrowers via phone and text, sometimes calling up to 16 times a day, demanding immediate payment and not taking the consumers vulnerable situation

361 OFT, *Principles for use of continuous payment authority* [accessed via: <http://www.of.gov.uk/business-advice/treating-customers-fairly/cpa-principles/#.UoJZVpH0Eds> (12/11/13)]

362 Citizens Advice, Press Release, *Citizens Advice calls for 'health warnings' in payday loan marketing*, 11 September 2013 [accessed via: [http://www.citizensadvice.org.uk/index/pressoffice/press\\_index/press\\_office-newpage-20130903.htm](http://www.citizensadvice.org.uk/index/pressoffice/press_index/press_office-newpage-20130903.htm) (24/10/13)]

363 Ibid

364 Case study provided by National Debtline

365 FCA, Press Release, *FCA reminds banks of their obligations when cancelling Continuous Payment Authorities*, 28 June 2013 [accessed via: <http://www.fca.org.uk/news/continuous-payment-authorities> (24/10/13)]

into account.<sup>366</sup> In some extreme examples lenders threatened to contact the borrower's employer to inform them of their debts.<sup>367</sup>

Only one-fifth of payday lenders have specialist teams to deal with people who are struggling financially.<sup>368</sup> For a significant minority of payday loan customers, especially those dealing with lenders not conforming to standards expected by the OFT, payday loans can quickly become problem debt. The negative effects problem debt has on people's mental health and lives will be detailed fully in Chapter Three but the collection practices utilised by some in the industry undoubtedly hold the potential to cause stress, anxiety and depression.

### *Industry Reform*

In light of the concerns raised by debt advice charities, academics, politicians and the OFT there have been attempts to reform the payday lending both externally through regulation and internally through efforts led by the Consumer Finance Association (CFA).

The CFA, a trade body that represents major online and high street payday lending firms, including The Money Shop, QuickQuid and Cash Converters, has done much to improve practice amongst its members. Their voluntary code of conduct includes policies on limiting rollovers at three, ensuring transparent communication with customers as well as freezing interest rates and allowing an extended repayment period for customers experiencing financial hardship.<sup>369</sup> This code of conduct highlights that many of the biggest and most well known companies offering payday loans are probably not the ones who are committing the bad practice highlighted by the OFT.

After its review in 2012 the OFT referred the payday lending industry to the Competition Commission. The Commission has already begun to take evidence from third parties and will publish interim findings in January 2014, with a final decision coming at the end of 2014.<sup>370</sup>

The FCA will take over responsibility for regulating consumer credit in April 2014 and has already revealed some regulatory proposals that apply specifically to payday lenders in its draft consultation document. It is too early to comment on whether these will be effective in ending bad practice within the industry, but they do appear to mirror aspects of the CFA's voluntary code and also address some of the concerns highlighted by advice charities and the OFT.

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366 Office of Fair Trading, *Payday Lending: Compliant Review Final Report*, London: Office of Fair Trading, 2013 [accessed via: [http://www.of.gov.uk/shared\\_of/Credit/of1481.pdf](http://www.of.gov.uk/shared_of/Credit/of1481.pdf) (22/10/13)]

367 BBC News, *Payday lender MiniCredit apologises over 'threats'*, 25 February 2012 [accessed via: <http://www.bbc.co.uk/news/business-17127951> (24/10/13)]

368 Office of Fair Trading, *Payday Lending: Compliant Review Final Report*, London: Office of Fair Trading, 2013 [accessed via: [http://www.of.gov.uk/shared\\_of/Credit/of1481.pdf](http://www.of.gov.uk/shared_of/Credit/of1481.pdf) (22/10/13)]

369 Consumer Finance Association, *Lending Code* [accessed via: <http://www.cfa-uk.co.uk/assets/files/Code%202013.pdf> (24/10/13)]

370 Competition Commission, *Administrative timetable*, 07 August 2013 [accessed via: [http://www.competition-commission.org.uk/assets/competitioncommission/docs/2013/payday-lending/administrative\\_timetable.pdf](http://www.competition-commission.org.uk/assets/competitioncommission/docs/2013/payday-lending/administrative_timetable.pdf) (24/10/13)]



## Financial Conduct Authority – Regulatory proposals<sup>371</sup>

- Limit the number of rollovers to two;
- Limit the number of CPA attempts to two;
- Clear risk warnings on advertisements;
- Requirement to provide information on debt advice to people who roll over a loan.

### 2.3.2 Home Credit

Home collected credit is not a new phenomenon, having expanded rapidly during the 1960's and 1970's. It continues to grow due to the need for credit amongst low-income communities that are often financially excluded and considered unprofitable by mainstream lenders.<sup>372</sup> These small cash loans, given and collected by a large number of local agents, carry high interest rates and can drive people into problem debt.

The market for home credit has grown by 30 per cent between 2007 and 2012 from just over £1 billion to almost £1.4 billion.<sup>373</sup> This growth since the credit crash can in part be explained by the decrease in the availability of mainstream credit, causing some low-income users to turn to alternative source for credit.

The OFT review of high-cost credit found that nearly 20 per cent of home credit users had incomes in the bottom decile, and nearly 30 per cent of users had incomes in the second lowest decile.<sup>374</sup> Other research found that only a quarter of home credit users have access to mainstream credit and 42 per cent are benefit-dependent.<sup>375</sup> Approximately half of home credit users appeared dependent on the product, either holding multiple loans, constantly rolling them over, using no other forms of credit or expressing an opinion that they were dependent.<sup>376</sup>

A 2004 report into the characteristics and needs of home credit users found that common factors among users were: a limited understanding of finance and financial products; previous over-indebtedness; a damaged credit-rating; poor experiences or rejection from mainstream credit providers; and a family tradition of using home credit rather than other types of credit.<sup>377</sup>

371 FCA, Press release, *The FCA sets out in detail how it will regulate consumer credit, including payday lending, when it takes over responsibility in April*, 03 October 2013 [accessed via: <http://www.fca.org.uk/news/firms/consumer-credit-detail> (24/10/13)]

372 O'Connell S, *Credit and Community: Working Class Debt in the UK since 1880*, Oxford: Oxford University Press, 2009

373 Apex Insight, *High-cost Credit: UK market profile and forecasts*, London: Apex Insight, 2012

374 OFT, *Review of high-cost credit – Annexe C*, London: OFT, 2010, [accessed via: [http://www.of.gov.uk/shared\\_of/reports/consumer\\_credit/High-cost-credit-review/OFT1232c.pdf](http://www.of.gov.uk/shared_of/reports/consumer_credit/High-cost-credit-review/OFT1232c.pdf) (24/10/13)]

375 Ellison et al, *Credit and low-income Consumers*, Surrey: Friends Provident Foundation, 2011 [accessed via: [https://www.ljmu.ac.uk/Faculties/HEA/HEA\\_docs/Credit\\_and\\_low-income\\_consumers\\_Dec2011\\_REPORT.pdf](https://www.ljmu.ac.uk/Faculties/HEA/HEA_docs/Credit_and_low-income_consumers_Dec2011_REPORT.pdf) (24/10/13)]

376 OFT, *Review of high-cost credit – Annexe C*, London: OFT, 2010, [accessed via: [http://www.of.gov.uk/shared\\_of/reports/consumer\\_credit/High-cost-credit-review/OFT1232c.pdf](http://www.of.gov.uk/shared_of/reports/consumer_credit/High-cost-credit-review/OFT1232c.pdf) (24/10/13)]

377 Whyley C and Brooker S, *Home Credit: an investigation of the UK home credit market*, London: National Consumer Council, 2004 [accessed via: [http://collections.europarchive.org/tna/20080804145057/http://www.ncc.org.uk/nccpdf/poldocs/NCC062pd\\_home\\_credit.pdf](http://collections.europarchive.org/tna/20080804145057/http://www.ncc.org.uk/nccpdf/poldocs/NCC062pd_home_credit.pdf) (24/10/13)]

As with payday lenders, as well as high interest rates, other aspects of the business model can lead to vulnerable people being given loans they cannot afford and which can push them into problem debt. A Competition Commission investigation pointed to concentration and a lack of competition in the market while highlighting concerns around the undue pressure placed on customers to take out loans.<sup>378</sup> Similarly, because agents are paid based on the collections they make it can encourage bad collection practices.<sup>379</sup> Appropriate assessments of mental capacity to take out loans and the stress and mental illness related to debt collection also remain on-going challenges.<sup>380</sup>

For many who are financially excluded, home credit providers are a trusted source of credit providing a service and loans they cannot get from mainstream banks. Because of their more 'old-fashioned' approach to lending, providers have an understanding of their clients' financial circumstances and offer them greater flexibility in regards to missed payments without charging large penalty fees.<sup>381</sup> However, the fact remains that these lenders are marketing credit to vulnerable and low-income customers, which could encourage irresponsible use of credit that can in turn drive people into problem debt.

### 2.3.3 Illegal moneylenders

In the most deprived estates in Britain around one in 12 families borrow from illegal moneylenders, compared with just one in 200 people amongst the general population.<sup>382</sup> The vast majority (82 per cent) borrow because they cannot access credit any other way when they have an emergency, something that has worsened since the financial crash.<sup>383</sup>

Illegal moneylenders operate without any regulation or oversight at all. Their loans have no legally enforceable contract and their interest rates are arbitrary and exponentially higher than any other form of borrowing.<sup>384</sup> Worse still, their violent collection practices can dwarf any amount of text messaging, demanding letters or harassing phone calls meaning their victims are often too scared to approach police for assistance.<sup>385</sup> Illegal moneylenders represent the very worst and most dangerous driver of problem debt in the UK.

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378 Office of Fair Trading, *Regulating Consumer Credit*, London: National Audit Office, 2012 [accessed via: <http://www.nao.org.uk/wp-content/uploads/2012/12/1213685.pdf> (24/10/13)]

379 Competition Commission, *Understanding past market investigation remedies*, London: Competition Commission, 2013 [accessed via: [http://www.competition-commission.org.uk/assets/competitioncommission/docs/2013/remedies/130228\\_home\\_credit\\_evaluation.pdf](http://www.competition-commission.org.uk/assets/competitioncommission/docs/2013/remedies/130228_home_credit_evaluation.pdf) (24/10/13)]

380 Mind, *In the red: Debt and mental health*, London: Mind, 2008 [accessed via: [http://www.mind.org.uk/assets/0000/9121/in\\_the\\_red.pdf](http://www.mind.org.uk/assets/0000/9121/in_the_red.pdf) (15/10/13)]

381 Ibid

382 Policis, *Interim Evaluation of the National Illegal Money Lending Projects – Summary*, London: BIS, 2010 [accessed via: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/31889/10-1187-interim-evaluation-illegal-money-lending-summary.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31889/10-1187-interim-evaluation-illegal-money-lending-summary.pdf) (24/10/13)]. Office for National Statistics, *Population Estimates for UK, England and Wales, Scotland and Northern Ireland, Mid-2011 and Mid-2012*, 8 August 2013, [accessed via: <http://www.ons.gov.uk/ons/rel/pop-estimate/population-estimates-for-uk--england-and-wales--scotland-and-northern-ireland/mid-2011-and-mid-2012/index.html> (24/10/13)]

383 Policis, *Interim Evaluation of the National Illegal Money Lending Projects – Summary*, London: BIS, 2010 [accessed via: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/31889/10-1187-interim-evaluation-illegal-money-lending-summary.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31889/10-1187-interim-evaluation-illegal-money-lending-summary.pdf) (24/10/13)]

384 Ibid

385 Ibid

## Victims of illegal money lender – in evidence to the CSJ<sup>386</sup>

'I only borrowed £400 but ended up paying back £5,000. He beat up my partner in front of my kids, just for missing a payment. It's just not worth it.'

'It was when my children were put in danger that I knew I had to do something. I am really happy now and I feel much safer. Without the loan shark team I would not have coped.'

'I've been ripped off, threatened, bullied and intimidated at my door. It's horrible – I had to take the kids out of school. I'm so unsettled.'

'I could no afford to pay my bills and the rent as I had to pay the loan shark so life was getting pretty desperate. He said 'pay me do no feed the children'. The kids have been subjected to a hostel and have attended 5 schools 'cos' I had to move. It nearly cost me my marriage.'

Due to the illicit nature of their 'business' and their widespread use of threats and violence it is difficult to calculate the true scope of illegal moneylending and the number of their victims. However, it is estimated that there are 310,000 people who borrow from illegal money lenders, up significantly from 165,000 in 2008.<sup>387</sup> They borrow an estimated £120 million each year and make repayments of approximately £450 million, more than three times as expensive as the most costly legal form of borrowing.<sup>388</sup>

The Illegal Money Lending Team receives only around £4.5 million annually, but despite this limited funding their hard work has led to the identification of over 2,000 illegal moneylenders. More than a quarter of which have since been arrested.<sup>389</sup>

'The Stop Loan Sharks team have supported me through an emotional time. I was enrolled in counselling to help with my confidence and self esteem and now have savings for the first time in my life through the local credit union. I have received budgeting and debt counselling advice from the Citizens Advice Bureau and am now in full time employment, doing a level 2 NVQ and off benefits. I now no longer just exist but live my life and look forward to the future. I am happier than I've ever been.'

Anonymous – in evidence to the CSJ<sup>390</sup>

386 Case study provided by England's Illegal Money Lending Team

387 Ibid. OFT, *Stop Loan Sharks Campaign – May 2010*, London: OFT, 2010 [accessed via: [http://oft.gov.uk/shared\\_oft/scams/stop-loan-sharks.pdf](http://oft.gov.uk/shared_oft/scams/stop-loan-sharks.pdf) (24/10/13)]

388 Polciss, *Interim Evaluation of the National Illegal Money Lending Projects – Summary*, London: BIS, 2010 [accessed via: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/31889/10-1187-interim-evaluation-illegal-money-lending-summary.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31889/10-1187-interim-evaluation-illegal-money-lending-summary.pdf) (24/10/13)]

389 Ibid

390 Case study provided by England's Illegal Money Lending Team

Around 18,000 people have been saved from being driven into a cycle of never-ending debt worth £38.8 million and from suffering both mental and physical harm.<sup>391</sup> What is worrying though is that this may just represent the tip of the iceberg due to the lack of reporting of this crime. The majority of victims are unwilling to report the crime, with 70 per cent of victims saying it is too dangerous.<sup>392</sup>

### Victim Quotes – in evidence to the CSJ<sup>393</sup>

'I have had to move from my home, have lost my job and am suffering from depression. I have lost everything'

'Ultimate stress and disruption to whole life. Had to relocate, change kid's schools and start afresh. The experience has led me to depression and I now have to take medication (anti-depressants) to help and support my sleep. It has led to breakdowns in relationships, living in poverty and disruption to all forms of life'

'From a debt of a few hundred pounds I paid back £7k and only had £5 per week to live on. Could not pay my bills only just getting back on track now. I never went out and could not eat properly. I became ill suffering from chest problems and infections'

In a modern economy and society it is shameful that such practices are allowed to persist. Not only does this problem need to be tackled but the drivers of demand for these services, primarily poverty and financial exclusion, need to be addressed. Similarly, the unintended consequences of other regulations, such as the introduction of an interest rate cap need to be considered. Research has indicated that such regulation can increase the number of people who then have to resort to illegal money lenders as they are unable to borrow through mainstream or non-mainstream financial institutions yet still have a need for credit.<sup>394</sup>

### Anne's Story – in evidence to the CSJ<sup>395</sup>

It was coming up to Christmas, and Anne was worrying about affording presents for her two young children. Spotting an advert in her local paper for unsecured loans, she decided to call the number:

A man answered, and told her he would be able to lend her £150, but it would need to be secured on something. He came to her home and took her passport, explaining that this would be returned once she had repaid in full. He explained that she would need to repay £15 each week plus an extra £10 a week in interest. She knew this was steep but she was desperate and believed she would be able to pay back within a few months with her wages from working in a shop.

391 Ibid

392 Ibid

393 Case study provided by England's Illegal Money Lending Team

394 Policis, *The effect of interest rate controls in other countries*, London: Policis, 2004 [accessed via: <http://www.policis.com/pdf/credit/Effect%20of%20interest%20rate%20controls.pdf> (24/10/13)]

395 Case study provided by England's Illegal Money Lending Team

In January, Anne fell ill and was unable to work. As a result of this she defaulted on a couple of payments. She was resting at home with her six year old daughter, when the loan shark barged in with two other men, demanding to know why she had not paid. They pulled electrical items out of her living room, claiming the loan was secured against these.

Anne was terrified. 'There was nowhere to go' she said 'I was not even safe in my own house. I was screaming, crying, pleading with him not take my stuff. To think, that my little girl had to see that.'

A few days later she received a note from the loan shark through her door, to tell her that an extra £100 had been added to the debt for the 'bailiff' visit. From that point onwards, she paid the loan shark religiously retaining the post office slips as proof of payment. However the loan shark still appeared at her door, alleging she'd missed payments. He would turn up late at night and on once occasion Anne had to hide, as he tried to climb in through her kitchen window. For every visit he would add an extra charge of £80 to £100.

This continued for 5 years, with Anne paying back around £5,000 on the loan of £150.

The England Illegal Money Lending Team caught the loan shark, and discovered Anne was not alone in her experience. The loan shark had around 900 'customers' who he was harassing for payments he believed to be due. He was given a lengthy custodial sentence and stripped of £270,000, money he had made illegally.

Anne said 'It was such a weight of my shoulders. It had got to the point where my nerves were shot and I was too frightened to answer the door. I'd realised he was never ever going to go away. If he had not been arrested I'd probably still be paying him now'

## Conclusion

Low-income households are bearing the brunt of Britain's problem debt because their low-income can force them to make financial choices that put them at a significant disadvantage. The psychology of how they perceive and manage their debts can then cause them to spiral out of control.

As people incur increasing levels of debt they tend to engage in a series of denial, underestimation and rationalisation of their problems. This can result in further borrowing and other ineffective debt remedies that can ultimately delay and worsen their problem debt. Issues surrounding this psychology of debt management are not unique to low-income households. However, due to their increased vulnerability and lack of financial resilience, their decisions can have a greater impact on their health and debt problem.

The decisions of low-income households are often significantly influenced by aspects of their financial position including: irregular income, low savings, job insecurity, increased cost of borrowing, and less disposable income. A combination of these factors can mean they incur additional costs and penalties when accessing financial services and purchasing goods and services. Commonly known as the poverty premium, the cumulative effect of these costs can be to push people into problem debt.

A large part of the poverty premium results from the increased cost and frequency of borrowing that often becomes part of life for low-income households. Due to reductions in mainstream lending many households can now only access credit from high-cost lenders. Not only is this form of borrowing expensive, but also the short-term nature of the loan and some aspects of current business practice can trap some people in a cycle of borrowing, leading to problem debt.

However, the costs of problem debt can extend far beyond the financial implications. In the next chapter we will examine the negative impacts related to problem debt, such as mental health difficulties, family breakdown and addiction, many of which can also contribute to worsening problem debt. Life in problem debt can be hard, with many of the negative impacts serving as a barrier to resolving the problem debt that caused them.

# chapter three

## Causes and effects of problem debt

Problem debt is rarely an isolated financial problem without additional consequence. The stress of managing tight finances, dealing with creditors, as well as the stigma associated with problem debt can lead to mental health difficulties, family breakdown, addiction, worklessness and crime.

Whether pre-existing or a direct effect of problem debt, these issues can escalate into different crises. For instance, problem debt can lead to or exacerbate mental health difficulties, which in turn can have knock-on effects including, for example, addiction or family breakdown. The interrelated nature of these factors, whether cause or effect, highlights how problem debt can take over multiple aspects of a person's life, making it increasingly hard to recover.

### 3.1 Mental Health

The link between problem debt and an increased risk of suffering from a wide range of mental health conditions is well established. These include anxiety, stress, and depression.<sup>396</sup>

These mental health conditions are not only harmful for those affected, but the treatment of these illnesses has significant cost implications for the state and the NHS. Worse still, deteriorating mental health can be a driver of problem debt and prevent people from addressing their financial issues.

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396 Mind, *In the red: Debt and mental health*, London: Mind, 2008 [accessed via: [http://www.mind.org.uk/assets/0000/9121/in\\_the\\_red.pdf](http://www.mind.org.uk/assets/0000/9121/in_the_red.pdf) (15/10/13)]

‘We know there is a cyclical relationship between debt and mental health: people with mental health problems are around three times more likely to be living with debts, and people living with debts often experience worsening mental health because of anxiety about their finances. As such, it is important to ensure both that people with mental health problems have access to good financial advice and support, and that those people experiencing debt can access emotional support to help them deal with their situation.’

Vicki Nash, Head of Policy and Campaigns, Mind – in evidence to the CSJ

### 3.1.1 The impact of debt on mental health

Research shows that individuals who initially have no mental health problems but then find themselves struggling with unmanageable debts have a 33 per cent higher risk of developing depression and anxiety-related problems compared to the general population who do not experience financial problems.<sup>397</sup> Given that 2.6 million households are estimated to be suffering from severe financial stress, this indicates a high level of potential mental health difficulties related to problem debt.<sup>398</sup>

Self-reporting of mental health is subjective, but surveys indicate that problem debt has a significant impact on mental health conditions. Almost half of people burdened by problem debt report it having a great impact on their health.<sup>399</sup> For those with pre-existing mental health conditions, almost 90 per cent report that their problem debt has worsened their mental health condition.<sup>400</sup> Similarly around three in five debt advice clients reported having received medical treatment or counselling for a mental health issue as a result of their debt.<sup>401</sup> A 2012 survey of debt advice clients found that seven out of ten (68 per cent) had been prescribed medication by their GP to help them cope with mental health difficulties related to their debt.<sup>402</sup> Such evidence highlights that support services for people with problem debt should also take regard of the possible impact it is having on their mental health.

397 Skapinakis P;Weich S, et al., ‘Socio-economic position and common mental disorders. Longitudinal study in the general population in the UK’, *British Journal of Psychiatry* 2006, 18, pp109–117

398 Department for Business, Innovation and Skills, *Credit, Debit and Financial Difficulty in Britain, 2012*, London: Department for Business, Innovation and Skills, 2013 [accessed via: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/208075/bis-13-p187-a-report-using-data-from-the-yougov-debttrack-survey.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/208075/bis-13-p187-a-report-using-data-from-the-yougov-debttrack-survey.pdf) (21/10/13)]. Estimate based on 26.4 million UK households, of which 11% of households are experiencing ‘severe financial stress’

399 Legal Services Research Centre, *Helping Hand: The Impact of Debt Advice on People’s Lives*, London: Legal Services Research Centre, 2007 [accessed via: <http://www.justice.gov.uk/downloads/publications/research-and-analysis/lsrc/2007/Impact.pdf> (16/10/13)]

400 Mind, *Still in the red: Update on debt and mental health*, London: Mind, 2011 [accessed via: <http://www.mind.org.uk/assets/0001/6203/Still-in-the-Red.pdf> (16/10/13)]

401 Legal Services Research Centre, *Helping Hand: The Impact of Debt Advice on People’s Lives*, London: Legal Services Research Centre, 2007 [accessed via: <http://www.justice.gov.uk/downloads/publications/research-and-analysis/lsrc/2007/Impact.pdf> (16/10/13)]

402 Moneysavingexpert.com, *Guide to mental health and debt*, Moneysavingexpert.com, 2013 [accessed via: [http://images.moneysavingexpert.com/attachment/mentalhealthguide\\_2013\\_2.pdf](http://images.moneysavingexpert.com/attachment/mentalhealthguide_2013_2.pdf) (16/10/13)]



### Janie (50) – in evidence to the CSJ<sup>403</sup>

In 2006 Janie and her husband found themselves over-budgeting after a change in their monthly wage packet led to an increased use of their credit cards. They went to their bank for advice, which gave them a £2,500 overdraft.

They were then caught out when the debt on their credit cards was sold and the interest rates went up. Their debts then spiralled out of control, and soon what they were paying out in card payments exceeded what they needed to live on.

They tried getting help from fee-charging debt management companies but ended up feeling 'terrified' after a two-hour face-to-face consultation and when they were bombarded with cold calls. Her husband was then hit with a £300 reduction in wages.

As a result of the debt, Janie was suffering from severe stress and anxiety. She sought medical help for depression and was not able to sleep at night. Unable to find any respite from the calls or the debt her health further deteriorated.

*'I was down my doctor every week with stress-related problems. I have been previously agoraphobic, and I was beginning to go down that road again because I was so stressed...not even going home would give me peace of mind because the phones were just going all the time. It really got to my husband in the end, and he's quite a strong person. It made us very, very ill.'*

There is a highly concerning correlation between problem debt and an increased risk of suicide, as people are faced with financial problems that often seem insurmountable.<sup>404</sup> Recent news stories have highlighted some tragic cases where people appear to have been driven to suicide by their spiralling debts and the harassment of creditors.<sup>405</sup>

Research has found that people who are struggling with debt are twice as likely to have suicidal thoughts as the general population after controlling for other factors.<sup>406</sup> Similarly, client surveys of those receiving debt advice found that one in three had either attempted or contemplated suicide as a result of their problem debt.<sup>407</sup>

Given the potential impact of problem debt on mental health conditions it is vital that debt advice agencies and creditors take mental health conditions into account when providing services and attempting to collect debts.

403 Case study provided by StepChange

404 Meltzer I H, Bebbington P, Brugha I T, Jenkins R, McManus S, Dennis M S, 'Personal debt and suicidal ideation' *Psychological Medicine*, 41(4), April 771-778, 2012 [accessed via: [http://www.hurlstons.com/magdalene2012/3\\_Howard\\_Meltzer\\_Article\\_Personal\\_Debt\\_and\\_Suicidal\\_Ideation.pdf](http://www.hurlstons.com/magdalene2012/3_Howard_Meltzer_Article_Personal_Debt_and_Suicidal_Ideation.pdf) (16/10/13)]

405 Daily Mail, *Father dies in a fireball after being hounded by payday loan companies over £1,600 debt*, 16 May 2013, [accessed via: <http://www.dailymail.co.uk/news/article-2324769/Antony-Breeze-set-hounded-payday-loan-firms.html> (16/10/13)]; Daily Mirror, *Payday loan leeches: Suicide dad hounded for cash as he lies in hospital*, 23 December 2013, [accessed via: <http://www.mirror.co.uk/news/uk-news/suicide-dad-hounded-for-cash-by-payday-1502853> (16/10/13)]; Daily Mail, *Overdrawn student killed himself over just £8,000 of debt and left a suicide note written on the back of a letter from his bank* [accessed via: <http://www.dailymail.co.uk/news/article-2242259/Student-Toby-Thorn-killed-just-8-000-debt-wrote-suicide-note-BANK-letter.html> (16/10/13)]

406 Meltzer I H, Bebbington P, Brugha I T, Jenkins R, McManus S, Dennis M S, 'Personal debt and suicidal ideation', *Psychological Medicine*, 41(4), April 771-778, 2012 [accessed via: [http://www.hurlstons.com/magdalene2012/3\\_Howard\\_Meltzer\\_Article\\_Personal\\_Debt\\_and\\_Suicidal\\_Ideation.pdf](http://www.hurlstons.com/magdalene2012/3_Howard_Meltzer_Article_Personal_Debt_and_Suicidal_Ideation.pdf) (16/10/13)]

407 World Suicide Prevention Day, Press Release, *Thousands of suicidal people each year saved each year – by tackling their debt problems*, World Suicide Prevention Day, 2013 [accessed via: <https://capuk.org/downloads/press/suicideprevention2013.pdf> (16/10/13)]

'I was in a right state with everything. I had already attempted suicide and felt there was no reason left to live. I was so anxious and depressed I would not go out to speak to people.'

Emma – in evidence to the CSJ<sup>408</sup>

'I was suicidal, bad tempered, and argued with my partner. I would go out and spend money on other things before paying bills.'

James – in evidence to the CSJ

'Before Christians Against Poverty became involved in my affairs I felt I was drowning in a sea of despair and could see no way out I was just getting deeper and deeper into debt and could see no way out. I felt so much relief from Christians Against Poverty when they took over and felt that at last someone was helping me by showing me that there was a way out.'

Chris – in evidence to the CSJ

### 3.1.2 Debt collection practices

Stress associated with problem debt can be caused or exacerbated by the practices of some creditors and debt collection agencies. For people who feel harassed by the collections efforts of creditors – via phone, text, email and letters, as well as when bailiffs are summoned – it can make their daily life extremely stressful and full of anxiety.

'We had bailiff letters, eviction notices and my partner was prescribed anti-depressants. We feared answering our own door and sometimes struggled to make meals, find bus fare etc.'

Maria – in evidence to the CSJ<sup>409</sup>

Feelings of harassment and anxiety as a result of credit collection efforts are subjective and can be over reported. However, the negative impact that actions of less scrupulous debt collection agencies can have on people's mental health should not be underestimated. Even within the same organisation there can be vast differences, as the following example makes clear:

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408 Case studies provided by Christians Against Poverty

409 Case study provided by Christians Against Poverty

### Amanda – in evidence to the CSJ<sup>410</sup>

*Amanda was left with her ex-husband's debts that she did not know about during their marriage.*

'I owed two debts, one on the mortgage and one for the hire-purchase (HP) on the car, both from the same bank. It was like night and day how they treated me.

The mortgage people were very understanding, they listened to me and I was able to work out an arrangement with them, even though the debt was more than 10 times the size of the HP debt.

The HP people were different though, they were nasty. They would regularly call me 3 or 4 times a day. The latest call was 10 minutes before 10 in the evening. Eventually I would hide and not answer the phone.

We could not afford to pay anymore, but that did not matter to them, it was still not enough. They just would not listen. A brick wall would understand better than they do.

It was very much the principle with them; they kept telling me that I was irresponsible for taking the loan out. I tried to make payment arrangements, but they just said 'we will drag you through the courts...we will get what we want'

Eventually they took us to court and got exactly what I had offered them all along, £25 a month, because that was all we could afford.

Despite everything, they never once used the words: "I understand"!

The actions taken by some private bailiffs are perhaps the most concerning and can have a severe impact on those affected. As problem debt has grown in recent years, so has the use of bailiffs by creditors, especially by local authorities in England and Wales who referred 1.8 million debts to them in a 12-month period.<sup>411</sup> Figures suggest that the five biggest private bailiff firms earn combined revenue in excess of £60 million annually.<sup>412</sup>

Between 2007/08 and 2011/12 a study by the Citizens Advice Bureau saw a 38 per cent increase in the number of complaints related to bailiff collection practices, with more than 56,000 complaints in 2011/12.<sup>413</sup> A third of these problems were related to council tax arrears.<sup>414</sup>

The study found widespread examples of illegal practice and threatening behaviour by bailiffs to gain entry. Of those who dealt with bailiffs more than three quarters experienced stress or anxiety as a result, with almost a quarter reporting that it had a negative impact on their mental health.<sup>415</sup> The fees charged by bailiffs also increased people's debts by over a third on average.<sup>416</sup>

410 Case study provided by StepChange

411 Money Advice Trust, Press release, *Local Authorities in England and Wales refer 1.8 million debts to bailiffs in 12 months* [accessed via: <http://www.moneyadvicetrust.org/media/news/Pages/Local-Authorities-and-Bailiffs0821-6215.aspx> (16/10/13)]

412 Department for Communities and Local Government, *Clampdown on councils using heavy-handed bailiffs*, 17 June 2013 [accessed via: <https://www.gov.uk/government/news/clampdown-on-councils-using-heavy-handed-bailiffs> (16/10/13)]

413 Citizens Advice, *Press release, 38% hike in bailiff problems prompts call for crackdown on bogus practices*, 23 December 2012 [accessed via: [http://www.citizensadvice.org.uk/index/pressoffice/press\\_index/press\\_20130127-2.htm](http://www.citizensadvice.org.uk/index/pressoffice/press_index/press_20130127-2.htm) (16/10/13)]

414 Ibid

415 Ibid

416 Ibid

## Fair Money Advice Debt Adviser – in evidence to the CSJ

'The clients had council tax arrears causing the bailiffs to be summoned. The bailiffs levied on (took possession of) a car that the neighbours owned. When we called the bailiffs to identify the item that was levied on, the bailiff stated that he was not sure and he would call us to update us. He did not call. We called head office and were told that they did not check who the car belonged to.

I informed them that our clients did not own a car and that the walking possession (seizure) was invalid, and the fees should be removed. They refused to remove the fees.

We then made a complaint to the council about this, at which point Equita then finally waived the fees.'

Excessive bad practice by private bailiffs, driven in part by a fee structure that rewards councils financially for the increased use of bailiffs, led to a call for greater regulation by government.<sup>417</sup> The Department for Communities and Local Government responded with new guidelines for councils aiming to cutback on aggressive bailiff enforcement.<sup>418</sup>

'It is unacceptable for councils to employ burly bailiffs with heavy-handed tactics like kicking down doors, making phantom visits or charging excessive fees – it is unfair and damages a council's standing in the community.'

Rt Hon Eric Pickles MP, Secretary of State for Communities and Local Government – 17 June 2013<sup>419</sup>

It should be noted that there are examples of good and bad practice within the debt-collection industry, with vast improvements in recent years due to voluntary reform and codes of conduct within the industry.<sup>420</sup> For example half of collection staff surveyed said there was a specialist team in their organisation to handle cases involving mental health conditions. However, one in five staff did not know if there was a specialist team or not, indicating there is still significant room for improvement, at least amongst the training for frontline staff.<sup>421</sup>

There also seems to be a discrepancy between what collection agencies think they are doing in regards to vulnerable people and what how those they are collecting from feel they are treated. A survey of frontline debt collection workers found that 80 per cent always or often

417 Department for Communities and Local Government, Press release, *Clampdown on councils using heavy-handed bailiffs*, 17 June 2013 [accessed via: <https://www.gov.uk/government/news/clampdown-on-councils-using-heavy-handed-bailiffs> (16/10/13)]

418 Ibid

419 Ibid

420 The Royal College of Psychiatrists and the Money Advice Trust, *Debt collection and mental health: an evaluation of the Debt and Mental Health Evidence Form*, London: The Royal College of Psychiatrists and the Money Advice Trust, 2011 [accessed via: [http://www.infohub.moneyadvicetrust.org/content\\_files/files/medical\\_evidence\\_and\\_mental\\_health\\_\\_\\_stage\\_2\\_report.pdf](http://www.infohub.moneyadvicetrust.org/content_files/files/medical_evidence_and_mental_health___stage_2_report.pdf) (16/10/13)]

421 Fitch C, Davey R, *Debt collection and mental health: ten steps to improve recovery*, London: The Royal College of Psychiatrists and the Money Advice Trust, 2010 [accessed via: <http://www.rcpsych.ac.uk/pdf/Debt%20collection%20and%20mental%20health%20report.pdf> (16/10/13)]

made a note about a customer's mental health issue if disclosed, with six out of ten saying it would help their collection rates if they were allowed to take mental health concerns fully into account.<sup>422</sup> This is in contrast to a survey of people with both problem debt and mental health difficulties that found 82.6 per cent felt they were being harassed, despite informing their creditors of their mental health condition.<sup>423</sup>

Similarly, less than one in five felt they were treated with sympathy and sensitivity after informing their creditors of their mental health problems.<sup>424</sup> Only one in 10 felt that debt collection agencies took mental health problems into account when making decisions about the person's financial difficulties.<sup>425</sup> These issues are exacerbated by perceived stigma that is often cited as the reason why an estimated two-thirds of people with mental health difficulties do not disclose them to their creditors.<sup>426</sup>

Much of this evidence is subjective, but it points to significant problems that still exist within the collection industry and which need to be addressed.

### 3.1.3 The cost of debt-related illness

As well as protecting people's mental health and well being, the treatment costs associated with debt-related mental health conditions provide an economic case to address the underlying issues of problem debt. While it is impossible to calculate the exact treatment costs that are associated with debt-related mental health conditions, the growing costs of treating mental health conditions mean there is a significant case for addressing any root cause such as problem debt.

Mental illness accounts for over a fifth of the total burden of ill health in the UK, more than cardiovascular disease or cancer.<sup>427</sup> The NHS currently spends 11 per cent of its annual budget on mental health services, around £10.5 billion.<sup>428</sup> The wider economic cost of mental health problems is estimated at around £105 billion, including impacts on productivity and employment of approximately £30 billion.<sup>429</sup> A recent study by the London School of Economics estimated that even a debt advice service not specifically targeted at those with mental health difficulties and funded by the NHS, would be cost effective in terms of reducing the strain on mental health treatment services.<sup>430</sup>

422 Ibid

423 Mind, *In the red: Debt and mental health*, London: Mind, 2008 [accessed via: [http://www.mind.org.uk/assets/0000/9121/in\\_the\\_red.pdf](http://www.mind.org.uk/assets/0000/9121/in_the_red.pdf) (15/10/13)]

424 Ibid

425 Ibid

426 Fitch C, Davey R, *Debt Collection and Mental Health: ten steps to improve recovery*, The Royal College of Psychiatrists and the Money Advice Trust, 2010 [accessed via: <http://www.rcpsych.ac.uk/pdf/Debt%20collection%20and%20mental%20health%20report.pdf> (16/10/13)]

427 Department of Health, *No health without mental health: A cross-Government mental health outcomes strategy for people of all ages*, London: Department of Health, 2011 [accessed via: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/213761/dh\\_124058.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/213761/dh_124058.pdf) (24/10/13)]

428 NHS, NHS allocations for 2013/14 [accessed via: <http://www.england.nhs.uk/allocations-2013-14/> (24/10/13)]. Royal College of Psychiatrists, *No health without mental health: The case for action*, London, Royal College of Psychiatrists, 2010 [accessed via: <http://www.rcpsych.ac.uk/PDF/Position%20Statement%204%20website.pdf> (24/10/13)]

429 Centre for Mental Health, *The Economic and Social Costs of Mental Health Problems in 2009/10*, London: Centre for Mental Health, 2010 [accessed via: [http://www.centreformentalhealth.org.uk/pdfs/Economic\\_and\\_social\\_costs\\_2010.pdf](http://www.centreformentalhealth.org.uk/pdfs/Economic_and_social_costs_2010.pdf) (16/10/13)]

430 Personal Social Services Research Unit, *Mental Health Promotion and Prevention*, London: Department of Health, 2011 [accessed via: <http://www.lse.ac.uk/businessAndConsultancy/LSEEnterprise/pdf/PSSRUFeb2011.pdf> (16/10/13)]

The link between NHS treatment costs and problem debt can also be estimated on a more individual level. A Civil and Social Justice survey found that 44 per cent of the debt problems reported 'led to physical or stress-related ill-health [and that] the average cost to the NHS of 'difficult-to-solve' debt problems that caused such ill-health was around £50 (£20 per debt problem in general)'.<sup>431</sup> Given the large number of people estimated to be experiencing financial stress, such estimates clearly suggest there is an economic case for intervention by policy makers to address the underlying issues behind problem debt.<sup>432</sup>

### 3.1.4 Driving debt

In *Completing the Revolution: Transforming Mental Health and Tackling Poverty*, the CSJ recognised a relationship between debt and mental health that is two-way: unmanageable debt may result in poor mental health outcomes and poor mental health can in turn undermine the ability to manage finances.<sup>433</sup> The report identified the wider implications of poor mental health for the most disadvantaged and wider cost implications for society.

It is important to note that mental health difficulties do not inherently imply an inability to handle personal finances, but there is a correlation between mental health difficulties and problem debt. Adults with a mental health disorder are three to four times more likely to have a debt problem than the general population.<sup>434</sup> Nearly three quarters of people with mental health conditions and problem debt felt their mental health problems had made their debt worse.<sup>435</sup>

#### Carl – in evidence to the CSJ<sup>436</sup>

Carl is 42 years old, married, working full time and has bipolar disorder:

*'Bipolar is a mental health condition that makes my moods swing up and down. When it's up, it can make my spending irrational so without proper financial advice I can overspend, which is what happened to me. Then, when overspending hits in, I have the negative swing which is like dropping into an abyss.'*

Carl has built up significant current account overdraft debts and credit card debts. He also has three outstanding payday loan debts. His particular mental health condition has a direct impact on his money management, though through psychological therapy he is improving his budgeting.

431 Pleasence P, Buck A, Balmer NJ, Williams K A *Helping Hand – The Impact of Debt Advice on People's Lives*, London: Legal Services Research Centre, 2006 [accessed via: [http://www.rcgp.org.uk/clinical-and-research/clinical-resources/~/\\_media/Files/CIRC/Mental%20health%20forum/Mental%20Health%20Page%20Sept%202013/PCMHF-Guidance-Debt-Mental-Health-Factsheet-2009.ashx](http://www.rcgp.org.uk/clinical-and-research/clinical-resources/~/_media/Files/CIRC/Mental%20health%20forum/Mental%20Health%20Page%20Sept%202013/PCMHF-Guidance-Debt-Mental-Health-Factsheet-2009.ashx) (18/09/2013)]

432 Department for Business, Innovation and Skills, *Credit, Debt and Financial Difficulty in Britain, 2012*, London: Department for Business, Innovation and Skills, 2013 [accessed via: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/208075/bis-13-p187-a-report-using-data-from-the-yougov-debtrack-survey.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/208075/bis-13-p187-a-report-using-data-from-the-yougov-debtrack-survey.pdf) (24/10/13)]

433 Centre for Social Justice, *Completing the Revolution: Transforming Mental Health and Tackling Poverty*, London: Centre for Social Justice, 2011

434 Government Office for Science, *Mental capability and wellbeing: Making the most of ourselves in the 21st century*, London: Government Office for Science, 2008 [accessed via: [http://www.bis.gov.uk/assets/BISCore/corporate/MigratedD/ec\\_group/113-08-FO\\_b.pdf](http://www.bis.gov.uk/assets/BISCore/corporate/MigratedD/ec_group/113-08-FO_b.pdf) (16/10/13)]

435 Mind, *Still in the red: Update on debt and mental health*, London: Mind, 2011 [accessed via: <http://www.mind.org.uk/assets/0001/6203/Still-in-the-Red.pdf> (16/10/13)]

436 Case study provided by National Debtline

Amongst debt advice clients, mental health difficulties are often cited as being the primary driver of their problem debt. Christians Against Poverty found that it was the primary cause of problem debt for one in 12 clients.<sup>437</sup> While StepChange does not distinguish between mental and physical illness, this was the driving force behind more than one in 10 of their clients' problem debt.<sup>438</sup>

One area of particular concern is the exploitation of vulnerable people who may not have the mental capacity to completely understand the financial agreements they agree to. Serious concerns exist around those with mental health problems being vulnerable to mis-selling and aggressive doorstep lending.<sup>439</sup> Only three per cent of survey respondents with mental health conditions reported that creditors had expressed concern about their ability to manage the loan, even though 30 per cent felt they were not able to make a reasonable decision about the loan.<sup>440</sup>

Similarly, those with mental health difficulties related to depression and anxiety are likely to have a harder time dealing with their problem debt meaning it can quickly spiral out of control.<sup>441</sup> The impact of debt psychology on the failure to recognise and address problem debt mentioned earlier in this chapter is likely to represent an even greater issue for vulnerable people who are already struggling with a mental health condition.

Just as with collection agencies, there seems to be mixed results in terms of how well social and health care professionals recognise the link between mental health difficulties and debt. Nearly three-fifths of people with mental health conditions and problem debt told a healthcare professional about their debt and around 30 per cent were asked unprompted by their health or social care professional about potential financial issues.<sup>442</sup> However, around one quarter reported that they felt the health or social care professional did not think their debt problems were relevant to their mental health.<sup>443</sup> It would appear there is capacity for improvement in this area to ensure people get the joined up support they need.

## 3.2 Family Breakdown

The added stresses and pressures associated with problem debt can impact on a person's personal relationships with friends, partners and family. In Breakthrough Britain the CSJ identified that the exact relationship is often unclear, but that family breakdown can both be the result of problem debt as well as an initial or contributor cause.<sup>444</sup> A 2012 survey of debt advice clients found that 75 per cent of those in a couple said their debt affected their relationship, and for more than one in four it ended it completely.<sup>445</sup>

437 Christians Against Poverty, *CAP client report 2012*, Bradford: Christians Against Poverty, 2013

438 StepChange, *Statistical Yearbook 2012*, Leeds: Foundation for Credit Counselling, 2013 [accessed via: [http://www.stepchange.org/Portals/0/Documents/media/reports/statisticsyearbooks/Statistical\\_Yearbook\\_2012.pdf](http://www.stepchange.org/Portals/0/Documents/media/reports/statisticsyearbooks/Statistical_Yearbook_2012.pdf) (16/10/13)]

439 Revolving Doors Agency, *Hand to Mouth*, London: Revolving Doors Agency, 2009 [accessed via: <http://www.revolving-doors.org.uk/documents/hand-to-mouth/> (17/10/13)]

440 Mind, *Still in the red: Update on debt and mental health*, London: Mind, 2011 [accessed via: <http://www.mind.org.uk/assets/0001/6203/Still-in-the-Red.pdf> (16/10/13)]

441 Ibid

442 Ibid

443 Ibid

444 CSJ, *Breakthrough Britain: Serious Personal Debt*, London: CSJ, 2007

445 Marriage Week, Press Release, *For Richer for Poorer – How Money Stress Wrecks Marriages*, Christians Against Poverty, 2013 [accessed via: <https://capuk.org/downloads/press/marriageweek2013.pdf> (17/10/13)]

Family breakdown is a complex issue with many, often interrelated, causes. There is rarely a single identifiable factor being responsible for the relationship breakdown. However, there are some specific aspects of problem debt that highlight how it can contribute to family breakdown.

Finances are a central part of family life and are one of the topics families most often seek help with and find most difficult to talk about.<sup>446</sup> Consequently there are often prolonged delays before people reveal their debts to their family and friends with 31 per cent of debt advice clients not having told them yet.<sup>447</sup> Similarly, it is estimated that more than one in 10 people hide debt from their partner.<sup>448</sup>

'For many couples underlying financial issues can be a constant source of tension and the root cause of many conflicts. This is especially true if couples have incurred debts without letting the other know, with some actively hiding debts from their partner. Couples find it hard to talk about money, meaning by the time they really begin to talk about their debts it can be too late, both to save their financial position and their relationship.'

Chris Sherwood, Director of Policy and External Affairs, Relate – in evidence to the CSJ

The uncertainty and lack of control associated with unmanageable debt can have a debilitating effect on an individual with knock-on effects for their family.<sup>449</sup> Debt has also been shown as a risk factor that increases the possibility of maternal depression, itself a trigger of family breakdown.<sup>450</sup>

The costs, both financial and emotional, of family breakdown are hugely significant. The CSJ has previously highlighted the damaging impact relationship breakdown can have on the well-being and mental development of children.<sup>451</sup> Similarly, the Relationships Foundation has estimated the cost of family breakdown in the UK to be rising, hitting £46 billion in 2013.<sup>452</sup> This is a wide estimate encompassing a whole range of associated and implied economic costs, yet it is still a significant figure that cannot be overlooked.

446 Relate, *How is austerity affecting our relationships?*, Relate, 2013 [accessed via: <http://www.relate.org.uk/userfiles/documents/Howisausterityaffectingourrelationships-Relate2013.pdf> (17/10/13)]. Bright Grey, Press Release, *Lets not talk about sex*, 2011 [accessed via: <http://www.brightadviser.co.uk/news-and-views/news/archive/2011/#> (16/10/13)]. Family Lives, *Families Matter: The realities of family life in Britain today*, London: 2013, Family Lives

447 StepChange, *Statistical Yearbook 2012*, London: 2013 [accessed via: [http://www.stepchange.org/Portals/0/Documents/media/reports/statisticsyearbooks/Statistical\\_Yearbook\\_2012.pdf](http://www.stepchange.org/Portals/0/Documents/media/reports/statisticsyearbooks/Statistical_Yearbook_2012.pdf) (16/10/13)]

448 The Cooperative Banking Group, Press Release, *Brits hide £41bn in debt from their partners*, 28 August 2012 [accessed via: <http://www.co-operativebankinggroup.co.uk/servlet/Satellite?c=Page&cid=1326094872357&pagename=Corp/Page/tp/Corp&currant=1346134400711&currnth=8> (27/10/13)]

449 Nettleton, S. (2000), "When a capital investment becomes an emotional loss: the health consequences of the experience of mortgage possession in England", *Housing Studies*, Vol. 15, pp. 463–79.

450 Reading R and Reynolds S, *Debt, Social Disadvantage and Maternal Depression Social Science and Medicine Volume 53*, Issue 4 2001 pp441–453 [accessed via: [http://www.4children.org.uk/Files/e5370a06-db65-4277-97ae-a0ed00b549c0/Suffering-in-Silence\\_NewCover.pdf](http://www.4children.org.uk/Files/e5370a06-db65-4277-97ae-a0ed00b549c0/Suffering-in-Silence_NewCover.pdf) (17/10/13)]

451 Centre for Social Justice, *Fractured Families: Why Stability Matters*, London: Centre for Social Justice, 2013

452 Relationships Foundation, *Counting the cost of family failure: 2013 Update*, Cambridge: Relationships Foundation, 2013 [accessed via: [http://www.relationshipsfoundation.org/Shared/Uploads/Products/61374\\_Cost%20of%20Family%20Failure%20PDF.pdf](http://www.relationshipsfoundation.org/Shared/Uploads/Products/61374_Cost%20of%20Family%20Failure%20PDF.pdf) (17/10/13)]



### 3.2.1 Driving debt

The breakdown of a family can impact almost every part of their life including the family financial situation. It is estimated that nearly seven million people in Britain suffer financial problems as a result of a failed relationship.<sup>453</sup> In 2012 debt advice clients who attributed their debt to relationship breakdown owed an average of £17,629 in unsecured debt, and had just £25 each month available to meet debt repayments.<sup>454</sup>

There are many financial implications associated with divorce or separation both direct and indirect that can lead to financial troubles. Firstly, at an average of £1,300 the cost of the divorce itself is significant, especially if lawyers are necessary or the separation is contested.<sup>455</sup> Secondly, the rapid sale and division of assets, including a family home, can result in them being sold under market value and possibly even for negative equity. Lastly, household bills often fall in arrears due to confusion or disagreement over who is responsible for paying bills.

Financial troubles relating to family breakdown can continue after the immediate separation. Joint loans, joint accounts and other joint financial agreements can be difficult to end and failure to keep up with repayments during separation can have a negative impact on credit ratings. Similarly, disagreement over childcare payments and the cessation of other financial arrangements agreed to during the relationship can place a significant financial burden on one or both of the parties, driving people into problem debt.

For such reasons family breakdown is one of the most common causes of problem debt cited by those accessing the help of debt advice charities. Separation or divorce was the primary cause of problem debt for 16 per cent of Christians Against Poverty's clients and for about one in 10 of StepChange's clients.<sup>456</sup>

Problem debt caused by relationship breakdown is often more of a concern for women. Over the past three years the percentage of women citing family breakdown as the primary cause of their debt was almost double that for men.<sup>457</sup> One possible explanation for this is greater proportion of men who are the sole earners for their families.<sup>458</sup> Similarly, given the still unequal distribution of caring responsibilities, women are more likely to have been out of the job market for some time while raising children, meaning it can be harder to find employment following divorce or separation.<sup>459</sup>

453 The Telegraph, *Failed relationships hit credit status*, 26 Feb 2013 [accessed via: <http://www.telegraph.co.uk/finance/personalfinance/consumertips/9895292/Failed-relationships-hit-credit-status.html> (17/10/13)]

454 StepChange, Press Release, *The Debt Cost of Divorce*, 11 September 2012 [accessed via: <http://www.stepchange.org/news/The-debt-cost-of-divorce.aspx> (17/10/13)]

455 Williams G, *Legal Services Benchmarking*, *Legal Services Benchmarking*, 2012, p99 [accessed via: <https://research.legalservicesboard.org.uk/wp-content/media/2012-Individual-consumers-legal-needs-report.pdf> (17/10/13)]

456 Christians Against Poverty, *CAP client report 2012*, Bradford: Christians Against Poverty, 2013. StepChange, *Statistical Yearbook 2012*, London: 2013 [accessed via: [http://www.stepchange.org/Portals/0/Documents/media/reports/statisticsyearbooks/Statistical\\_Yearbook\\_2012.pdf](http://www.stepchange.org/Portals/0/Documents/media/reports/statisticsyearbooks/Statistical_Yearbook_2012.pdf) (16/10/13)]

457 Ibid

458 ONS, *Women in the labour market*, London: ONS, 2013 [accessed via: [http://www.ons.gov.uk/ons/dcp171776\\_328352.pdf](http://www.ons.gov.uk/ons/dcp171776_328352.pdf) (24/10/13)]

459 Women & Equality Unit, *The impact of women's position in the labour market on pay and implications for UK productivity*, London: DTI, 2002 [accessed via: <http://www.lancaster.ac.uk/sociology/research/publications/papers/walby-weupayandproductivity.pdf> (24/10/13)]

Even when family breakdown is not the primary driver of debt, people who have experienced family breakdown are often more susceptible to falling into problem debt. Whereas 12 per cent of people in England and Wales are divorced or separated, 16 per cent of CAB debt advice clients were divorced or separated.<sup>460</sup> Similarly, single parents often struggling on low income seem to be much more vulnerable to problem debt and are overrepresented amongst debt advice clients.<sup>461</sup>

The CSJ has heard how personal debt has come between couples, leading to family breakdown that can have a human impact far greater than the size of the debt that caused it.

### Mandy – in evidence to the CSJ<sup>462</sup>

Mandy and her ex-husband both had unhappy childhoods. They wanted to give their children the best childhood they could provide. Unfortunately this meant that they were spending way beyond their means.

They re-mortgaged their house several times and had numerous credit cards and loans. It was an unhappy marriage but debt and money worries were 'a big reason' why it broke down.

Mandy attributes being 'in denial' about her financial situation to her depression and relationship difficulties. During her divorce, however, the full extent of her debt became clear:

As a result of the pressure of debt and divorce, Mandy attempted to take her own life.

She found StepChange online, owing £30,000 at that time. She has since remarried and is now under treatment with an outpatient mental health team, but is facing bankruptcy.

*'We re-mortgaged several times, but it was all around spending beyond our means and also a lot of it was from childhood difficulties, wanting to give our two boys the best possible childhood that myself and my ex-husband did not have.'*

*'When we started divorce proceedings [I] realised the extent of how many credit cards, how much borrowing, how many times we borrowed against the house and that's when the impact hit, when we saw the lump sum. [We were] in denial prior to that. I've had depression for a long time and my depression just got worse – so I guess my depression also meant I was in denial.'*

*'[The debt is] still in my name, [my ex-husband] paid what he felt was half his share but I decided at the start of the divorce proceedings that I was not gonna battle him and that was a decision that I made because I did not want to go through with solicitors because of my mental health...[and] I did not want to involve my children.'*

460 Citizens Advice Bureau, Debt advice statistics – in evidence to the CSJ

461 Ibid

462 Case study provided by StepChange

### 3.3 Worklessness

Living with the burden and mental stress associated with problem debt can have a significant negative impact on people's ability to be productive at work and can prevent those who are unemployed from finding work. The knock-on economic effects are borne both by the state, in terms of benefits for the unemployed and by the economy as a whole in terms of lost productivity. Being unable to work or find work can also exacerbate debt problems, keeping people trapped in debt, as they are often unable to finance their cost of living or begin to repay their debts.

The all-encompassing nature of problem debt can distract people from their job and hinder their performance. Citizens Advice found that half of people struggling with debt reported it had affected their performance at work.<sup>463</sup> For some the stress associated with debt is even more serious, with a survey finding that 19 per cent of people with problem debt (42 per cent of those currently in work) had to take time off work as a result of stress, with one in 10 giving up their job as a result of their debt problems.<sup>464</sup>

Problem debt can act as a barrier to finding work. Not only does debt serve as a distraction from searching for work, as the primary concern is often resolving debt issues, but there are practical barriers too.<sup>465</sup> Debt problems can make it difficult to afford the essentials necessary when searching for employment including transport, training and appropriate clothing and supplies.<sup>466</sup> One survey found that around one in five found it difficult to find employment as a result of their debt problems.<sup>467</sup> Part of this may be attributed to the decrease in self-confidence experienced by those struggling with problem debt.<sup>468</sup> There are also several debt resolution methods, especially the Debt Relief Order that may disincentivise work, something that will be discussed in Chapter Four.

The impact problem debt can have on worklessness is of particular concern as work is the best route out of poverty. Also, worklessness is a key driver of problem debt meaning people can become trapped in a cycle of debt and unemployment.

'I was trying to survive, struggling to fight depression everyday. I would go to local library every day on job sites looking for work. It was very hard to stay positive and motivated.'

Mervyn – in evidence to the CSJ

463 Citizens Advice, Press Release, *3 in 4 of those in debt say money worries are harming their health*, 17 December 2012 [accessed via: [http://www.citizensadvice.org.uk/index/pressoffice/press\\_index/press\\_20121217.htm](http://www.citizensadvice.org.uk/index/pressoffice/press_index/press_20121217.htm) (17/1-13)]

464 Legal Services Research Centre, *Helping Hand: The Impact of Debt Advice on People's Lives*, London: Legal Services Research Centre, 2007 [accessed via: <http://www.justice.gov.uk/downloads/publications/research-and-analysis/lsrc/2007/Impact.pdf> (16/10/13)]

465 Gibbons D, *Out of work and out of money*, Manchester: Manchester City Council, 2010 [http://www.responsible-credit.org.uk/uimages/File/out-of-work-and-out-of-money-final\(1\).pdf](http://www.responsible-credit.org.uk/uimages/File/out-of-work-and-out-of-money-final(1).pdf)

466 Ibid

467 Legal Services Research Centre, *Helping Hand: The Impact of Debt Advice on People's Lives*, London: Legal Services Research Centre, 2007 [accessed via: <http://www.justice.gov.uk/downloads/publications/research-and-analysis/lsrc/2007/Impact.pdf> (16/10/13)]

468 StepChange, *Statistical Yearbook 2012*, Leeds: Foundation for Credit Counselling, 2013 [accessed via: [http://www.stepchange.org/Portals/0/Documents/media/reports/statisticsyearbooks/Statistical\\_Yearbook\\_2012.pdf](http://www.stepchange.org/Portals/0/Documents/media/reports/statisticsyearbooks/Statistical_Yearbook_2012.pdf) (16/10/13)]

### 3.3.1 Unemployment and income shocks

Perhaps the most obvious driver of problem debt is any significant change to a person's or family's income. This can be caused by reduced hours, a salary decrease or sudden unemployment. Such a shock can quickly drive a family into problem debt as they rapidly deplete their savings and borrow heavily to try to meet their expenditures.

The demand for debt advice is therefore closely correlated with the unemployment rate. A one per cent increase in the unemployment rate is associated with an additional 60,000 debt advice enquiries per quarter.<sup>469</sup> Almost one in four debt advice clients in 2012 cited unemployment or redundancy as the primary cause of their problem debt.<sup>470</sup>

It is important to make the distinction between how unemployment and income shocks drive problem debt, as compared to the systemic issues related to being on a persistent low-income discussed in Chapter Two. Income shocks and unemployment drive debt because there is a sudden drop in income, meaning bills and debts begin to pile up immediately. This is a distinctly different issue than how low-income households incur debt gradually while struggling to keep up with living costs and unexpected expenses due in large part to their lack of financial resilience.

The psychology of debt management is particularly important in regards to unemployment. Optimism regarding the length of unemployment and a desire to maintain existing living standards can lead to people rationalising increasingly high levels of borrowing necessary to meet the shortfall in income.<sup>471</sup> In some extreme cases borrowing can be used to hide unemployment from friends and family for fear of the stigma associated with unemployment. Borrowing in this manner, especially if from high cost lenders, is risky and can easily send a household into a debt spiral.

Even when unemployment or an income shock is not the primary cause of problem debt, those who are unemployed appear to be more vulnerable and more likely to fall into problem debt. The unemployment rate in the UK currently stands at just under eight per cent, whereas 37 per cent of people seeking debt advice from the Citizens Advice Bureau were unemployed at the time.<sup>472</sup> Disproportionately high levels of unemployment were recorded amongst the clients of other debt advice charities.<sup>473</sup>

Prolonged unemployment is also associated with greater risk of developing depression and other mental health conditions that are another significant drivers of problem debt.

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469 Gathergood, J, *Demand, Capacity and Need for Debt Advice in the United Kingdom* London: Money Advice Trust 2010

470 StepChange, *Statistical Yearbook 2012*, Leeds: Foundation for Credit Counselling, 2013 [accessed via: [http://www.stepchange.org/Portals/0/Documents/media/reports/statisticsyearbooks/Statistical\\_Yearbook\\_2012.pdf](http://www.stepchange.org/Portals/0/Documents/media/reports/statisticsyearbooks/Statistical_Yearbook_2012.pdf) (16/10/13)]

471 CRSF, *Seeking direction: Men, money advice and the road to financial health seeking direction: Men, money advice and the road to financial health*, London: Money Advice Trust, 2013 [accessed via: [http://www.infohub.moneyadvicetrust.org/content\\_files/files/seeking\\_direction\\_men\\_money\\_advice\\_and\\_the\\_road\\_to\\_financial\\_health\\_final\\_160311.pdf](http://www.infohub.moneyadvicetrust.org/content_files/files/seeking_direction_men_money_advice_and_the_road_to_financial_health_final_160311.pdf) (22/10/13)]

472 CAB, *Advice Statistics – in evidence to the CSJ*

473 StepChange, *Statistical Yearbook 2012*, Leeds: Foundation for Credit Counselling, 2013 [accessed via: [http://www.stepchange.org/Portals/0/Documents/media/reports/statisticsyearbooks/Statistical\\_Yearbook\\_2012.pdf](http://www.stepchange.org/Portals/0/Documents/media/reports/statisticsyearbooks/Statistical_Yearbook_2012.pdf) (16/10/13)] (16/10/13); National Debtline, *Advice statistics – in evidence to the CSJ*

### 3.4 Addiction

A person's addiction to alcohol, drugs or gambling can become all-consuming, driving themselves and their family into problem debt as they attempt to fund their addiction. There are currently 380,000 problem drug users in the UK and 1.6 million people are classed as alcohol dependent in England.<sup>474</sup>

As a person slips further into addiction they can often borrow increasing amounts or let other bills and expenses go unpaid in order to fund their addiction.<sup>475</sup> One recovering heroin user told the CSJ 'I would never open an envelope. I'd just put it straight in the bin...', as substance users often can not face the enormity of their debts.

'My marriage of 15 years went dramatically downhill due to my drug abuse, so I left and ended up in a homeless unit. I borrowed money from a doorstep lender, but things spiralled out of control. With no money I lived on a diet of rice. After Christians Against Poverty stepped in, the lender stopped harassing me and I started to breathe again. Members from the local church brought me food parcels and I saw hope again. Now I am debt free, it's like a new beginning.'

Katrina – in evidence to the CSJ<sup>476</sup>

'Nearly all clients come into treatment with debt problems, it is almost as common a feature of addiction as health issues. The pressure of trying to overcome this, manage this, or cope with the long-term consequences is a problem that nearly all addicts suffer from.'

Unfortunately, although this is such an important barrier to long-term recovery, there are few resources either within or outside rehab that set aside time and effort to help resolve this.'

Chip Somers, Chief Executive, Focus12 – in evidence to the CSJ

However, people can also turn to drugs and alcohol in order to cope with the stress and anxiety resulting from their problem debt. Similarly, there is a more general two-way causal relationship between financial hardship and problematic drug and alcohol use.<sup>477</sup>

474 Centre for Social Justice, *No Quick Fix: Exposing the depth of Britain's drug and alcohol problem*, London: Centre for Social Justice, 2013

475 Bauld L, Hay G, McKell J and Carroll C, *Problem drug users' experiences of employment and the benefit*, London: Department for Work and Pensions [accessed via: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/214409/rrep640.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/214409/rrep640.pdf) (18/10/2013)]

476 Case study provided by Christians Against Poverty

477 Adfam, *Adfam Discussion Paper: Family Support in Times of Economic Hardship*, Adfam, 2011 [accessed via: [http://www.adfam.org.uk/docs/families\\_poverty.pdf](http://www.adfam.org.uk/docs/families_poverty.pdf) (18/10/13)]

'Before Christians Against Poverty got involved with my financial situation I felt pretty down. I started to drink quite heavily to cope with the feelings the cost of which was also contributing to our debt problems.'

Brian – in evidence to the CSJ<sup>478</sup>

The CSJ was told how the problem is also cyclical, with addiction driving debt that in turn drives the addiction and causes more debt as a result.

'The rigours and symptoms of systematic drug and/or alcohol use, combined with crime caused to gain substances, can cause significant debts for both the addict and their significant others to such an extent that the majority of clients we have had contact with have required close support with debt agencies in finding a way to resolve these issues. The availability to gain credit card access and bank loans exacerbate the debt situation for the addict who has no means in which to repay monies to credit companies as a whole. Furthermore, many clients will claim benefits fraudulently to get money for their substance of choice. The vicious circle created by the addict in borrowing/stealing and using funds to buy substances can create further stress and in many cases, heavier drug use to alleviate stress/negative feelings – thereby undermining self worth and esteem.'

Libby Reid, ANA treatment Centres – in evidence to the CSJ

The need to fund an addiction can lead to debt issues for both the addict and their family as they borrow or steal money to pay for their habit.<sup>479</sup> A study conducted by Adfam found that 80 per cent of family members of substance users experienced money related issues.<sup>480</sup> Families interviewed frequently mentioned the additional burden of attempting to repay the substance users' debts, both normal debts and those owed to drug dealers. They also experienced increased financial stress due to threats and harassment by illegal moneylenders and violent drug dealers.<sup>481</sup> Attempting to repay these debts often took priority over rent and essentials such as food, causing severe stress and potentially driving the family member into debt too.<sup>482</sup>

478 Case study provided by Christians Against Poverty

479 UKDPC, *Adult family members and carers of dependent drug users: prevalence, social cost, resource savings and treatment responses*, London: UKDPC, 2009. Adfam, *Adfam Discussion Paper: Family Support in Times of Economic Hardship*, Adfam, 2011 [accessed via: [http://www.adfam.org.uk/docs/families\\_poverty.pdf](http://www.adfam.org.uk/docs/families_poverty.pdf) (18/10/13)]

480 Adfam, *Adfam Discussion Paper: Family Support in Times of Economic Hardship*, Adfam, 2011 [accessed via: [http://www.adfam.org.uk/docs/families\\_poverty.pdf](http://www.adfam.org.uk/docs/families_poverty.pdf) (18/10/13)]

481 Ibid

482 Ibid. UKDPC, *Adult family members and carers of dependent drug users: prevalence, social cost, resource savings and treatment responses*, London: UKDPC, 2009

‘Substance users can run up large debts from both legal and illegal money lenders as a result of their drug use, and often their family steps in to repay them. The substantial impact these debts can have on family members’ mental health and financial wellbeing cannot be understated. Ultimately, the burden of these debts can place a significant strain on the relationships between family members and impact on the recovery of both the substance user and their family.’

Joss Gaynor, Policy Director, Adfam – in evidence to the CSJ

Addiction can push people to commit crimes for several reasons, for example in order to get money or pay back drug dealers. In turn, court fines associated with drug related convictions can further drive problem debt. If drug use results in a prison sentence then the debt issues that had accumulated prior to the sentence can become even more problematic for the substance user’s family. This is especially true of debts owed to dealers and illegal moneylenders who often will increasingly try to collect money from the family as the substance user is no longer able to repay.<sup>483</sup>

This is a vicious cycle as substance abuse can allow people to ignore their spiralling debts and also cause their problem debt to worsen. Dealing with problem debt issues is often an important part of recovery from addiction, as taking care of these issues reduces stress and improves the chances of recovery and preventing relapse.<sup>484</sup> The CSJ was told by an addiction support service how serious personal debt can represent a significant barrier for those in recovery.

‘The additional stress of debts, especially when significant others are involved, (such as dependents or spouses etc), is a large factor to relapse and continual use. Even in early recovery, whilst attending a programme to address addiction, the addict can struggle to maintain sobriety as inevitable consequences catch up with them – such as debt repayment. Much support is required for the slow process of repayment to take place.’

Libby Reid, Chief Executive, ANA Treatment Centres – in evidence to the CSJ

483 Adfam, Adfam Discussion Paper: Family Support in Times of Economic Hardship, Adfam, 2011 [accessed via: [http://www.adfam.org.uk/docs/families\\_poverty.pdf](http://www.adfam.org.uk/docs/families_poverty.pdf) (18/10/13)]

484 Health Strategy Board for Scotland, Health Technology Assessment of Prevention of Relapse in Alcohol Dependence, NHS Scotland, 2002 [accessed via: <http://www.dldocs.stir.ac.uk/documents/alcrelapse.pdf> (18/10/13)]. Neale J, Nettleton S and Pickering L, The everyday lives of recovering heroin users, London: RSA, 2012 [accessed via: [http://www.thersa.org/\\_data/assets/pdf\\_file/0007/635353/RSA\\_Recovery-Everyday\\_lives\\_of\\_recovery\\_users.PDF](http://www.thersa.org/_data/assets/pdf_file/0007/635353/RSA_Recovery-Everyday_lives_of_recovery_users.PDF) (16/10/13)]

Addiction to drugs and alcohol incurs significant costs both in terms of human lives affected and financial cost to the state. Therefore, helping to address problem debt for this vulnerable group can not only aid in their recovery, but also reduce the burden on state services as their recovery is more likely to be successful.

### 3.5 Prisoners, debt and crime

Problem debt can be a motivating factor for criminal activity, especially amongst ex-offenders who are more vulnerable to debt. This can often include acquisitive crimes conducted in order to fund drug habits or repay illegal moneylenders.<sup>485</sup> There are an estimated 23,000 offenders with financial problems linked to their offending for whom reducing their debt-related issues can significantly help to reduce re-offending.<sup>486</sup>

The prevalence of debt amongst the prison population is significantly higher than the national average, a situation that worsens as a result of being incarcerated. It is estimated that around half of people in prison have debt problems.<sup>487</sup> For those prisoners with debts, 40 per cent felt that their time in prison worsened their debt problems, with an even higher level of former prisoners (64 per cent) reporting the issue.<sup>488</sup> Being in prison also can have a negative impact on the financial situation for the families of prisoners. For the families of prisoners in debt, two-thirds said their debt had worsened as a result of their relative's imprisonment.<sup>489</sup>

The type of debts owed by prisoners and former prisoners contribute significantly to debt problems amongst this group. One in three reported owing money for housing, a particularly concerning debt as it makes it harder to secure stable accommodation upon release, an essential factor in preventing reoffending.<sup>490</sup> Debts can be exacerbated during prison sentences as housing tenancies and direct debits are often hard to end correctly before entering custody.<sup>491</sup> Similarly, prisoners are over ten times more likely to have tried to borrow from an illegal moneylender than the average UK household, a type of debt for which there are no rules and which can grow exponentially.<sup>492</sup> Credit related debts are likely to worsen during time in prison as there are no guidelines to freeze interest for those entering prison.<sup>493</sup>

Upon release from prison the debt accumulated both before and during the prison sentence can keep people trapped in debt. Following imprisonment two-thirds of prisoners lose their

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485 Prison Reform Trust and Unlock, *Time is money*, London: 2010, Provident Foundation [accessed via: <http://www.prisonreformtrust.org.uk/Portals/0/Time%20is%20Moneysmall.pdf> (16/10/13)]

486 Consumer Financial Education Body, *Improving the financial capability of offenders*, London: Consumer Financial Education Body, 2010

487 Prison Reform Trust and Unlock, *Time is money*, London: 2010, Provident Foundation [accessed via: <http://www.prisonreformtrust.org.uk/Portals/0/Time%20is%20Moneysmall.pdf> (16/10/13)]. DWP, *Investigating the prisoner finance gap across four prisons in the North East*, London: DWP, 2010 [accessed via: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/214490/rrep715.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/214490/rrep715.pdf) (24/10/13)]

488 Prison Reform Trust and Unlock, *Time is money*, London: 2010, Provident Foundation [accessed via: <http://www.prisonreformtrust.org.uk/Portals/0/Time%20is%20Moneysmall.pdf> (16/10/13)]

489 Ibid

490 Ibid

491 DWP, *Investigating the prisoner finance gap across four prisons in the North East*, London: DWP, 2010 [accessed via: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/214490/rrep715.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/214490/rrep715.pdf) (24/10/13)]

492 Prison Reform Trust and Unlock, *Time is money*, London: 2010, Provident Foundation [accessed via: <http://www.prisonreformtrust.org.uk/Portals/0/Time%20is%20Moneysmall.pdf> (16/10/13)]

493 Citizens Advice, *Locked out: CAB evidence on prisoners and ex-offenders*, London: 2007, Citizens Advice



job and one-fifth face increased financial difficulties.<sup>494</sup> The inability to find work upon release makes it harder to service debts and can mean their debt problems rapidly worsen. Former prisoners are often financially excluded as a result of being in prison and are unable to open a bank account or access credit upon release.<sup>495</sup> This serves as both a barrier to work and drives people towards high cost credit and illegal moneylenders that will in turn keep them trapped in debt.

Re-offending and the provision of benefits to former prisoners who are unable to find work as a result of their debts all represent a significant cost to state services. Similarly, the prevalence of mental health conditions is significantly higher amongst the prison population than the general population and therefore they are more likely to be at risk of suffering mental health difficulties as a result of their problem debt<sup>496</sup>. As was detailed earlier in this chapter, mental health difficulties are not only a tragic circumstance for those affected, but also represent a significant cost to the NHS and state services.

## Conclusion

While debt is by definition a monetary concern, problem debt in Britain today has a far greater impact on people's lives than can be represented in monetary terms. Largely flowing from the stress and stigma surrounding problem debt, the associated consequences of problem debt in Britain are extensive, diverse and severe.

Many of the impacts of problem debt are cyclical and self-reinforcing. Problem debt can lead to mental health difficulties or exacerbate existing ones, but mental health difficulties can also make people considerably more vulnerable to problem debt. Similarly, debt problems can destroy the trust between family members leading to their separation, but also the breakdown of relationships can lead to financial problems.

It is important that support services do not look at the results of problem debt in isolation, but consider wider and potentially contributory factors such as mental health difficulties, family breakdown and addiction issues. These must be tackled together.

494 DWP, *Investigating the prisoner finance gap across four prisons in the North East*, London: DWP, 2010 [accessed via: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/214490/rrep715.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/214490/rrep715.pdf) (24/10/13)]. Civitas, *Factsheet – Education in prisons*, London: Civitas, 2010 [accessed via: <http://www.civitas.org.uk/crime/factsheet-EducationinPrisons.pdf> (24/10/13)]

495 Prison Reform Trust and Unlock, *Time is money*, London: 2010, Provident Foundation [accessed via: <http://www.prisonreformtrust.org.uk/Portals/0/Time%20is%20Moneysmall.pdf> (16/10/13)]

496 Prison Reform Trust, *Mental health care in prisons* [accessed via: <http://www.prisonreformtrust.org.uk/ProjectsResearch/Mentalhealth> (24/10/13)]



# chapter four

## Avoiding and addressing debt

The high cost, both in financial terms and in the number of lives impacted, means that there is a pressing social obligation to help people avoid, manage and escape from their problem debt. This chapter will outline some of the financial institutions that are available to help people access affordable financial services, a key factor in avoiding and managing problem debt. We will also look at the organisations that work to support people in developing their financial skills, rebuilding their finances and their lives when things do spin out of control.

Just as there is no one root cause of problem debt, or one effect, there is no one solution. In this chapter we will examine four key areas and services that help people to avoid, manage and resolve their problem debt:

- Financial education and capability designed to help people develop the skills, knowledge, attitudes and behaviours they need to manage money and debt well, and to build personal and financial resilience;
- Debt advice including preventative debt advice;
- Debt relief solutions to help people recover from high levels of problem debt;
- Alternative financial services, such as credit unions, which are potentially better suited to service the needs of some communities than current mainstream financial providers.

In each of these areas we will examine what is currently being provided and why it is helpful, identify any problems or deficiencies, and look at recent improvements.

While there are many examples of successful organisations and people working with Britain's poorest communities, the scale of problem debt in Britain means that more help is urgently needed to help people who are at risk or already burdened by problem debt.

## 4.1 Avoiding problem debt – financial capability and education

The lack of financial education and as a consequence, financial capability in the UK, can be both a driver of problem debt and can negatively impact on an individual's ability to recover from problem debt. This can manifest itself in many ways, including through an individual not understanding the terms and conditions of the debt they are taking on, not shopping around for the best credit deals or products available, not having any savings to rely on and therefore having to turn to credit, or by not understanding when or how to ask for help. More broadly, not being financially capable also has negative impacts on an individual's ability to make financial decisions that are right for themselves and their families. Given the complexity of some financial products and their increasing prevalence, it is more important than ever that people are equipped with the right skills to manage their money, engage with the financial services market, avoid falling into debt and recover from any problem debt they acquire.

Traditionally financial education broadly revolved around the following topics:

- Budgeting;
- Understanding financial products including bank accounts, credit cards etc;
- The importance of saving;
- Understanding the options and costs of borrowing.

However it is clear that education in these areas alone is not enough. Financial capability, which is a broader concept, generally defined as 'having the knowledge, understanding, skills, motivation and confidence to make financial decisions which are appropriate to one's personal circumstances,' is a much more powerful ability than just knowledge.<sup>497</sup> Empowering people to make the right choices with regards to their own financial situation, such as living within their means, saving, and understanding what levels of debt they can afford to take on, can ultimately have significant implications not only for their financial situation, but on their wider wellbeing also as we highlighted before.

Increasingly, therefore most financial education programmes in the UK concentrate not only on imparting knowledge and information, but also on developing attitudes, motivations and behaviours which will equip individuals to make informed choices on their finances throughout their lives.

However changing such attitudes is a huge challenge. A recent survey found that one in four people prefer to 'live for today than plan for tomorrow' and that one in six would go out for the evening even if they could not afford it.<sup>498</sup> Furthermore, one in five said they lacked confidence when managing money and a third found it uncomfortable to talk about money.<sup>499</sup>

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497 CFBT, *Financial capability: Why is it important and how can it be improved?*, Reading: CFBT, 2011 [accessed via: <http://cdn.cfbt.com/~media/cfbtcorporate/files/research/2011/r-financial-capability-2011.pdf> (24/10/13)]

498 Money Advice Service, *Financial capability of the UK*, London: Money Advice Service, 2013 [accessed via: <https://www.moneyadviceservice.org.uk/en/static/the-financial-capability-of-the-uk> (24/10/13)]

499 Ibid

These issues are much more to do with people's attitudes towards money rather than their actual financial skills, and they play a considerable role in how and whether people feel able to manage their money.

For the sizeable portion of the population that are not financially capable, dealing with finances can be an extremely confusing and stressful experience, meaning that they are much more susceptible to choosing unsuitable products or making choices that can eventually lead to problem debt. Therefore helping people overcome these difficulties and become financially capable can be empowering and incredibly beneficial for this group and help them to take control of their finances and avoid unnecessary debt.

#### 4.1.1 The scale and cost of the lack of financial education

It is estimated that the lack of financial education costs the UK £3.4 billion each year, of which £716 million is directly attributable to debt.<sup>500</sup> Other costs are related to, consumer detriment from mis-selling and increased welfare payments resulting from unemployment and poor retirement planning. Financially uneducated households generally tend to have lower net worth, use higher cost credit and are more likely to report credit arrears or difficulty paying their debts.<sup>501</sup> Clearly there is both a moral and financial imperative to improve financial education in the UK.

The lack of financial capability is particularly pronounced among younger and older age groups. A recent survey found that two-fifths of young people 14–25 were unable to differentiate between being in credit and being overdrawn on a bank statement, while one in eight did not know what an overdraft was.<sup>502</sup> Similarly, more than a quarter of people over 55 failed to identify the available balance on a bank statement.<sup>503</sup> This lack of such basic skills is a concern, especially given the other multiple risk factors younger and older age groups are exposed to in regards to incurring problem debt as outlined in Chapters One and Two.

500 Centre for Economics and Business Research, *Potential benefits of implementing financial education*, London: CEBR, 2012 [accessed via: [http://static.moneysavingexpert.com/documents/MSE\\_Cebr\\_Financial\\_Education\\_report.pdf](http://static.moneysavingexpert.com/documents/MSE_Cebr_Financial_Education_report.pdf) (24/10/13)]

501 Disney R and Gathergood J, *Financial Literacy and Indebtedness: New Evidence for UK Consumers*, University of Nottingham: Centre for Finance, Credit and Macroeconomics (CFCM), 2011 [accessed via: <http://www.nottingham.ac.uk/cfm/documents/papers/11-05.pdf> (24/10/13)]

502 Press Association, *Young people have 'dangerous gaps' in money knowledge, charity says*. 23 June 2013 [accessed via: <http://www.moneysavingexpert.com/news/family/2013/06/young-people-have-dangerous-gaps-in-money-knowledge-charity-says> (24/10/13)]

503 Money Advice Service, *The Financial Capability of the UK*, 2013 [accessed via: <https://www.moneyadvice.org.uk/files/the-financial-capability-of-the-uk.pdf> (12/10/13)]

## Financial education and young people

*Andy Cook – Co-Found and Operations Manager of TwentyTwenty, a CSJ Alliance Member that works with disadvantaged young people to help them learn life skills and attitudes and help them find work, told the CSJ about his experiences with young people:*

'Hardly any of the young people I speak to have ever learned about managing money. Not from parents, not from school, and only in fits and spurts from support agencies. Whilst I do not think that this would be uncommon across a spectrum of young people, the disadvantage our young people face means that the consequences within their lives seem far more severe.

Many young people (aged 16–21) that TwentyTwenty work with do not have a bank account, with many citing the reason as to why not as the cost of obtaining the necessary identification. As a result, they often have someone else manage their money for them and exclusively use cash, even though they know it is not best for them in the long run.

We often hear comments like: 'It goes in five minute flat – as soon as I have it, I get what I want' and 'saving – what's that?!'

One young lad Josh, seemed to sum the situation up perfectly by saying how he knows he is not learning to handle money by his step-dad looking after it, but is happy with the setup as he knows as soon as he gets money, he'll spend it. Short-term necessity trumps long-term learning.

Often what is role modelled to young people about managing money is overwhelmingly poor. Comments like 'My mum is the worst with money' are common.

There are stories where parents will buy the latest stuff – iPads/iPhones etc – as soon as they come out just so that they have them to look cool. 'Its all about looking cool' said one girl. This is continually teaching them that going after what you want is far more crucial than thinking about what you need.

Many have parents/older siblings who are therefore in debt – with the main thing this causes being stress. 'It is always on my mum's mind' said one girl, meaning they never quite relax. Living in such an environment, permanently on guard, must be tiring.

A number who have since improved their money-management said that it took something extreme for them to change how they thought about money – having children (where suddenly they were responsible for someone else), or having a loan shark or other person demanding payment. Sadly, it seemed to me like many young people I speak to would have to go through something bad or utterly life-changing, to change their current disposition.

Our young people seemed to be in agreement that schools could try to teach financial education, but it probably would not make a difference. This is because at 14, 15, or 16 they were 'too young', with those kinds of Personal, Social, and Health Education lessons seen for 'chilling out', not learning. They did all think though that at 16, 17, or 18 it should be compulsory for colleges/alternative education providers to do lessons on managing money – with the teaching being focused on real life things like bills, setting up bank accounts etc. They want the practical stuff on this – i.e. what bills are likely, how to pay them etc. This is the kind of education that can make a real life changing difference for these young people as they have simply never learned it.'

## 4.1.2 Financial education and young people

There is increasing evidence to suggest that whilst young people would like to receive their financial education from their parents, most parents do not feel equipped to have these conversations with their children.

Studies have indicated that parental education on financial skills is lacking across the board with 49 per cent of respondents saying that their parents did not adequately teach them money management skills and only one in eight adults recalling having financial education in school.<sup>504</sup> Similarly, a survey by Magnified Learning found that 39 per cent of parents do not feel competent to advise their children on bank accounts, with lower income groups being much less likely to feel 'very competent'.<sup>505</sup>

As some parents do not feel comfortable or are not capable of providing the necessary financial education it is important that young people's financial education is supplemented in schools. The Government has announced plans to include financial education in the curriculum beginning in 2014. This is a great achievement for campaigners, and should help ensure that children are better prepared to handle their finances.



'Financial education is an essential part of a broad and balanced curriculum. It is an entitlement for all young people and crucial in preparing them for life. While many parents want to give their children the best possible start when it comes to managing money, they often lack the knowledge and confidence to deliver financial education.'

Personal Financial Education Group – in evidence to the CSJ

504 AXA, *Big Money Index Report March 2013*, London: AXA, 2013 [accessed via: <http://www.axa.co.uk/WorkArea/DownloadAsset.aspx?id=10737419339> (24/10/13)]. Ipsos/ING Survey September 2013 [accessed via: <http://www.ipsos-mori.com/newsevents/blogs/thefinancialstatement/1483/Back-to-school.aspx> (24/10/13)]

505 Legal & General, Press release, *Parents feel incompetent advising children on finances*, 21 June 2012 [accessed via: <http://www.legalandgeneralgroup.com/media-centre/press-releases/2012/group-news-release-magnifiedlearningjune2012.html> (24/10/13)]

However, simply including something in the curriculum is no guarantee that the education will be effective, or that it will have the desired impact on people's behavioural and financial choices. Many of those involved in the campaign to get financial education on the curriculum are now expressing concerns about the way in which it is being implemented.

#### Michelle Highman CEO, The Money Charity – in evidence to the CSJ

'Ensuring that the next generation grow up financially capable, able to make the most of their money and take informed decisions about their futures is crucial. It is vital that we take a two-pronged approach to this. We need to equip parents with the skills and confidence they need to start breaking money taboos and openly talk to their children about managing money in the home. We also need to ensure that financial education is taught professionally and engagingly in schools throughout the country.

The recent announcement on the curriculum is a big step forward, but it is vital that we do not see this development as 'job done'. Teachers and schools will need outside help to deliver lessons on this subject. Most do not feel qualified or confident to start talking to children about money. Children themselves have also indicated that they would prefer to hear from outside experts rather than their teachers. All this means that those, such as ourselves, who provide these free lessons to schools, are expecting demand for our services to rise dramatically from October 2014 and more needs to be done to support and fund these outside organisations.'

One particular concern is that there is no requirement for school-based education past the age of 16, which is the point at which many young people enter the job market and begin to take on more financial independence.

#### Lily Lapenna, CEO MyBnk – in evidence to the CSJ

'The argument for financial education in the UK has been rightly won, however; the battle for effective and impactful money lessons in a crowded curriculum has just begun. Everyone who has fought for financial education to be accessible to all young people can celebrate. The priority is now to support teachers in providing quality and focus on reaching all young people including those not in formal education and post 16.

We can not forget the many young people who will not benefit from such initiatives in need of help with things like budgeting and responsible borrowing. If anything, it is here where the demand for financial education needs now to be loudest.'

It needs to be recognised that financial education and increased financial capability are necessary for all age groups, not just those in school. Therefore, programmes that reach other demographics need to be supported. While the need for pupils to be educated in schools is paramount in our next report we will be looking more closely at the need to empower people throughout their lives.





#### 4.1.2 The benefits of financial education

Being financially capable has positive impacts outside of just being better able to manage personal finances. The positive impact financial education can have on people's self-confidence, employment opportunities and mental health provides wider benefits than just avoiding problem debt.

Financial education can reduce the risk of unemployment by ten per cent, which in turn can reduce the risk of falling into problem debt.<sup>506</sup> A study commissioned by the UK's Financial Services Authority has suggested that strengthening financial capability can also improve psychological wellbeing.<sup>507</sup> The wider impact of financial education reflects that people's psychology and behaviour is tied into their management of money and susceptibility to problem debt.

I did not know that money had anything to do with psychology. And it does affect our daily life, anything we are doing money is there to affect our daily behaviour. The way we feel, the clothes we are wearing, our shoes, sometimes we go somewhere and we feel bad, thinking oh this place is not for me because of my clothes or shoes. From the courses I came out of all these barriers, the course teaches you to tackle all these judgements you put on yourself or you believe that people are putting on you.

Anonymous participant in Made of Money programme – in evidence to the CSJ<sup>508</sup>

506 Centre for Economics and Business Research, *Potential benefits of implementing financial education*, London: CEBR, 2012 [accessed via: [http://static.moneysavingexpert.com/documents/MSE\\_Cebr\\_Financial\\_Education\\_report.pdf](http://static.moneysavingexpert.com/documents/MSE_Cebr_Financial_Education_report.pdf) (24/10/13)]

507 CFBT, *Financial capability: Why is it important and how can it be improved?*, Reading: CFBT, 2011 [accessed via: <http://cdn.cfbt.com/~media/cfbtcorporate/files/research/2011/r-financial-capability-2011.pdf> (24/10/13)]

508 Case study provided by Quaker Social Action

As mentioned before, financial education should not just revolve around young people in school, as there are many adults who can benefit substantially from a course tailored to their needs. This is especially true in disadvantaged communities where so much of life revolves around money, or the lack of it. It is often harder to engage with adults, however, there are examples of organisations that are providing financial education courses designed to promote long-term financial empowerment.

### Case study: Quaker Social Action

Quaker Social Action is a CSJ Alliance member based in east London that offers financial education to both children and parents through its Made of Money programme. They utilise a holistic approach that is not patronising and gets families to talk about larger issues surrounding money, such as financial planning, budgeting, saving etc. This preventative approach to financial capability goes beyond the basics of budgeting and money management, by examining the psychological and emotional impact of financial difficulties.

Made of Money recognises that poverty and financial exclusion do not just affect wallets: they also affect relationships, health and dignity. Confidence and attitude are just as important as knowledge and skills, and addressing these side by side means that change is much more likely to take root in people's lives.

When Dainhea first came to a Made of Money workshop she was in arrears with her rent but was too ashamed and embarrassed to admit it. *'Not having the money to pay is quite shameful, such a dark place. I'd been unwell for years with it, but since doing Made of Money I'm sleeping and dreaming again.'* As a result of the work she did on the six week course Dainhea says she gained the confidence to talk to her landlord and as a result arranged for utilities and service charges to be paid first leaving a small amount in her weekly income to repay her debt. Working with a friend from playgroup who also attended the course, she now budgets, plans her expenditure and saves money by bulk buying essentials.

### 4.1.3 Curbing mis-selling and clarifying financial products

While it is important that people are given the skills to be financially capable, the onus should not be entirely on the consumer as often they are interacting with financial providers from a position of disadvantage. Increasingly complex financial products and the associated terms and conditions have gotten to a level in some cases where a sophisticated financial background is required to understand what is being agreed to. There is a clear case to be made for greater clarity and a drive towards consumer protection in both the design and selling of financial products to ensure consumers fully understand and want the products they are buying.

In the last few years there have been numerous examples of widespread practice in the financial industry that has not been in the consumer's best interests. Examples of mis-selling include:<sup>509</sup>

509 Consumer Focus, *Response to HMT consultation on Financial Services Bill*, London: Consumer Focus, 2011 [accessed via: <http://www.consumerfocus.org.uk/files/2009/06/Consumer-Focus-response-to-HMT-consultation-on-bill.pdf> (24/10/13)]. The Telegraph, *Rise in customers winning compensation from banks that mis-sold paid-for accounts*, 07 August 2013 [accessed via: <http://www.telegraph.co.uk/finance/personalfinance/consumertips/banking/10228479/Rise-in-customers-winning-compensation-from-banks-that-mis-sold-paid-for-accounts.html> (24/10/13)]

- Payment Protection Insurance;
- Pensions;
- Packaged current accounts;
- Endowment mortgages.

Much of this has to do with the increasing complexity of financial products and contracts. For example, the documentation for a personal loan from a mainstream bank requires degree level education to understand while the standard policy for Payment Protection Insurance (PPI) product requires PhD level education to comprehend.<sup>510</sup> Although consumers in the UK describe themselves as knowledgeable, survey results that indicate that 5.2 million adults lack day-to-day functional literacy and 6.8 million lack functional numeracy seem to suggest otherwise.<sup>511</sup>

There appears to be a clear case for greater clarity in the market for financial products and services to ensure that consumers are able to make the best decision and avoid debt. It is widely acknowledged that the market is failing in this regard and key stakeholders at a listening event led by Toynbee Hall issued the following recommendations to the FCA amongst others:<sup>512</sup>

- Financial products need to be transparent and tailored to needs, particularly when illness or disability is an issue;
- Terms and conditions should be 'jargon free' and always presented at the right time;
- Service providers need to take responsibility for ensuring that advertising, marketing and selling practices are clear;
- Service providers need to be understanding and offer forbearance and signposting to trusted advice organisations.

These measures are not designed to take responsibility away from consumers, but rather to level the playing field and ensure people know what they are signing up for. This is especially important for low-income households and vulnerable groups, including older people and those with mental health conditions, as they are particularly at a disadvantage as was set out in Chapter Two. It remains to be seen to what degree these reforms will be implemented, but hopefully these along with other FCA measures and a nationwide push towards greater financial capability, both for adults and young people, will help to prevent problem debt where possible.

#### 4.1.4 Budgeting and the introduction of Universal Credit

Effective household budgeting is a necessary skill if people are to avoid problem debt. Ensuring that all people are able to budget adequately will be a key part of the roll out of Universal Credit, which began in April 2013. This major welfare reform, with origins at the CSJ,

<sup>510</sup> Ibid

<sup>511</sup> Ibid

<sup>512</sup> Toynbee Hall, *Listening Event for Financial Conduct Authority on 'may have regard to access': Report on Key Issues and Recommendations*, London: Toynbee Hall, 2013 [accessed via: [http://www.infohub.moneyadvicetrust.org/content\\_files/files/fca\\_listening\\_event\\_on\\_access\\_to\\_financial\\_services.pdf](http://www.infohub.moneyadvicetrust.org/content_files/files/fca_listening_event_on_access_to_financial_services.pdf) (24/10/13)]

simplifies the benefit system by combining six separate benefits into one monthly household payment designed to simulate the earning schedule that 75 per cent of the British workforce experience.<sup>513</sup> An essential feature is the gradual withdrawal, or tapering, of benefits upon a claimant entering work so that people are always better off in work.

Payments for the package of benefits being combined into Universal Credit will normally be made to one member of the household as a lump sum including Housing Benefit. It will then be the responsibility of the household to manage the finances for the month. For this it is necessary that all Universal Credit claimants have a transactional bank account or Post Office Card Account to receive this monthly payment.

As was outlined in Chapter Two, there is a lack of financial products truly designed with the interests and needs of low-income households in mind, with 1.4 million people still lacking a transactional bank account. The DWP has responded to this market failure by openly calling for providers to offer a better range of products to help with budgeting and which will meet the needs of Universal Credit claimants.<sup>514</sup> Other options are being pursued by the DWP to help people budget and manage their money.

Universal Credit is currently being trialled in several pilot areas before being fully rolled out. These pilots and the independent evaluations commissioned by the DWP are crucial to allow for continued learning and feedback to ensure that the correct systems are in place to support the most vulnerable people during the transition to Universal Credit.

The monthly payment of benefits, including Housing Benefit – currently paid directly to landlords for 95 per cent of claimants in social housing and for 20 per cent of those in private accommodation – has been the focus of a particular trial to assess the impact on claimants' financial situation and levels of rent arrears.<sup>515</sup> As has been stated before low-income households are often very good at money management. Survey results of claimants in these pilot areas seem to reflect this: two-thirds expressed they were very organised in the managing of money and around 80 per cent said they preferred to wait and save for things rather than buy on credit.<sup>516</sup>

Tenants in the pilot areas were initially concerned about incurring rent arrears, which is understandable given that almost half already owed rent arrears or other debts prior to the pilot.<sup>517</sup> However, this may be more indicative of the general concern held by low-income households about money and debt stemming in part from their lack of savings and financial resilience that put them at risk as discussed in Chapter Two.

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513 HM Government, Guide: Universal Credit [accessed via: <https://www.gov.uk/universal-credit> (24/10/13)]; DWP, *Government response to the House of Commons Work and Pensions Select Committee's third report of Session 2012–13*, London: DWP, 2013 [accessed via: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/221715/uc-wpsc-response.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/221715/uc-wpsc-response.pdf) (24/10/13)]

514 DWP, Press release, *New financial products to help Universal Credit claimants manage*, 17 September 2012 [accessed via: <https://www.gov.uk/government/news/new-financial-products-to-help-universal-credit-claimants-manage-money> (24/10/13)]

515 Hansard, House of Lords, Lord Freud, Column 1347, 14 Dec 2011 [accessed via: <http://www.publications.parliament.uk/pa/ld201011/ldhansrd/text/111214-0002.htm#11121494000008> (24/10/13)]

516 DWP, *Direct Payments Demonstration Projects: Learning the lessons, six months in*, London: DWP, 2013 [accessed via: <http://www.shu.ac.uk/research/cresr/sites/shu.ac.uk/files/direct-payments-learning-lessons.pdf> (24/10/13)]

517 Ibid

The pilot trials will conclude in December 2013 with the full analysis to be published afterwards, however the initial results from the first nine months of the pilot have already been made available. These show that between 91 and 97 per cent of the total rent owed was paid to landlords by tenants in receipt of Housing Benefit, with an average collection rate of 94 per cent.<sup>518</sup> The vast majority of tenants had no problem managing to pay their rent and budget accordingly, however, around 17 per cent had the payment of rent switched back to their landlord after incurring arrears. The range in collection rates reflects different engagement strategies utilised by landlords, such as text message reminders, letters, phone calls as well as the availability of dedicated teams to help with budgeting and explain the changes to tenants.<sup>519</sup>

In response to concerns raised by those working with the most vulnerable, the DWP has already set out provisions to ensure that those with disabilities, mental health or addiction problems will be given extra support. For some this may involve retaining bi-weekly payments of benefits and for others rent payments will still be made directly to landlords. The CSJ will monitor whether this commitment is delivered upon during the rollout and it is essential that any gaps in the system be quickly addressed.

The initial survey results at the beginning of the pilot trials found that 31 per cent of tenants thought they would not be able to cope with paying their rent directly, however, the collection rates indicate many people underestimated their own abilities.<sup>520</sup>

It is vital that the financial capability of benefit claimants is built up both to prepare them for the switch to Universal Credit and to give them the best chance to return to work and avoid problem debt. Landlords have a crucial role to play in this process as their profits now depend on their ability to engage with tenants to deliver appropriate support and budgeting services necessary to improve rent collection rates. This is an overlooked benefit of the switch to direct payment of Housing Benefit, and hopefully will further incentivise Housing Associations to offer a range of services including debt advice, financial planning and credit union accounts.

While the pilot trials have shown that the majority of people will be able to budget under Universal Credit, the 17 per cent who had to revert to their rent being paid directly to the landlord after nine months is of natural concern. During the first four months of the pilot trial only five per cent of households had experienced levels of arrears that required them to be switched back, indicating that the support period for some groups may be longer than others.<sup>521</sup>

Given the pressures and risks engulfing the group most vulnerable to the transition under Universal Credit, it is vital that local authorities, housing providers and the DWP maintain razor like focus and an open mind to the support people may need. In the longer-term the

518 DWP, *Direct payment demonstration: Learning and payment figures – May 2013*, London, DWP, 2013 [accessed via: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/228925/direct-payment-demo-figures-may-2013.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/228925/direct-payment-demo-figures-may-2013.pdf) (24/10/13)]

519 DWP, *Direct Payments Demonstration Projects: Learning the lessons, six months in*, London: DWP, 2013 [accessed via: <http://www.shu.ac.uk/research/cresr/sites/shu.ac.uk/files/direct-payments-learning-lessons.pdf> (24/10/13)]

520 Ibid

521 Ibid

benefits of a more realistic system are clear, but great care must be taken on behalf of those who have understandable challenges in reaching a functioning level within such a new system. Unnecessary and unmanageable debt would severely undermine the important principle behind this welfare change.

## 4.2 Debt advice and debt management

A key component in any government strategy aimed at reversing the growing trend of problem debt in Britain must be the expansion and provision of free debt advice services to those in need. Debt advice can help people both avoid their debt spiralling out of control as well as help people recover from their debt and start a fresh life.

It is impossible to measure exactly the total demand for debt advice due in part to the stigma that inhibits people from self-reporting. However, evidence suggests that there is significant demand above what is currently being provided. A 2012 report estimated that 2.6 million individuals in slightly more than one million households sought some form of debt advice in 2011 and that 1.7 million people would seek help from a free debt advice provider in 2012.<sup>522</sup> In contrast, the same report estimated total 'potential demand,' meaning those who could benefit from some form of debt advice, as being closer to 5.5 million households, based on the levels of financial stress observed in the population.<sup>523</sup> Given the current economic climate these levels are not forecast to decrease soon.

Part of the discrepancy between actual demand and potential demand can be explained by a lack of awareness in the population about the availability of free debt advice services and also general attitudes towards receiving advice. A survey found that a quarter of respondents do not think it is clear where someone can go to receive free impartial debt advice.<sup>524</sup> Another study of people who demonstrated financial problems, defined as a result of missing at least one payment, found that more than half did not seek debt advice, and that almost one quarter (23 per cent) did not feel they needed advice.<sup>525</sup> Young people (17–24) are the least likely group to seek debt advice despite being the age group most likely to be struggling with problem debt.<sup>526</sup> Often people will not seek advice until their debt problem is very serious, with a combination of factors such as creditor behaviour or deteriorating family relationships that make not dealing with the problem untenable.<sup>527</sup> It is important that more is done to help people access suitable debt advice services, as it can provide a lifeline for people struggling with problem debt.

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522 Money Advice Trust, *Demand capacity and need for debt advice in the United Kingdom – 2012*, Nottingham: Money Advice Trust, 2010 [accessed via: [http://www.infohub.moneyadvicetrust.org/resource.asp?cat\\_id=260&rPath=cat&r\\_id=770](http://www.infohub.moneyadvicetrust.org/resource.asp?cat_id=260&rPath=cat&r_id=770) (14/10/13)]

523 Ibid

524 R3, *Personal debt snapshot wave 7*, London: R3, 2012 [accessed via: [http://www.r3.org.uk/media/documents/policy/research\\_reports/personal\\_debt\\_snap/R3-Personal-Debt-Snapshot-Wave-7-2012.pdf](http://www.r3.org.uk/media/documents/policy/research_reports/personal_debt_snap/R3-Personal-Debt-Snapshot-Wave-7-2012.pdf) (24/10/13)]

525 CRSP and Money Advice Trust, *Sustaining debt repayments*, London: Money Advice Trust, 2012 [accessed via: [http://www.infohub.moneyadvicetrust.org/content\\_files/files/sustainable\\_debt\\_repayments\\_\\_\\_lbg\\_\\_mat\\_november\\_2012\\_2.pdf](http://www.infohub.moneyadvicetrust.org/content_files/files/sustainable_debt_repayments___lbg__mat_november_2012_2.pdf) (24/10/13)]

526 London Economics, *Debt advice in the UK*, London: London Economics, 2012

527 CRSP and Money Advice Trust, *Sustaining debt repayments*, London: Money Advice Trust, 2012 [accessed via: [http://www.infohub.moneyadvicetrust.org/content\\_files/files/sustainable\\_debt\\_repayments\\_\\_\\_lbg\\_\\_mat\\_november\\_2012\\_2.pdf](http://www.infohub.moneyadvicetrust.org/content_files/files/sustainable_debt_repayments___lbg__mat_november_2012_2.pdf) (24/10/13)]

Clients accessing face-to-face debt advice have the lowest average income and have the most serious debt problems.<sup>528</sup> Although estimates vary, the average debt advice client has between £16,000 and £18,000 in problem debts.<sup>529</sup> The most frequently advised method of debt resolution is a Debt Management Plan (DMP), whereby arrangements are made with creditors for an affordable repayment scheme during which interest is frozen.<sup>530</sup>

Debt advice has been proved to be overwhelmingly effective in helping people to recover from problem debt issues, regardless of the method of delivery. One study found that over 90 per cent of debt advice is effective at helping the client achieve either a formal or informal resolution.<sup>531</sup> Similarly, those who sought debt advice were twice as likely to have their debts become manageable within twelve months as compared to people who do not seek advice.<sup>532</sup> Other studies have linked the amount of time taken to seek debt advice with the likelihood of the client repaying their arrears.<sup>533</sup>

There are wider benefits to debt advice outside of the repayment of debts. These include improved financial and family stability, avoiding mental health difficulties, maintaining employment, avoiding criminality and homelessness while also increasing the likelihood of improving income.<sup>534</sup> The reduction in stress and benefits to mental health is perhaps most important and noticeable, with studies finding improvements in this area anywhere from between 41 and 67 per cent.<sup>535</sup> Economic studies have also managed to put a monetary value on these benefits. A social return on investment (SROI) study conducted by Advice UK found that there was £9 of social benefit for every £1 invested in debt advice.<sup>536</sup>

Debt advice services have been doing well to keep up with the increased demand for debt advice. However, there are some questions regarding future funding. It was estimated that the total funding for 2011/2012 was £53 million. Less than one fifth of this was considered to be 'certain' to be continued for the next year, with more than one fifth of funding classed as 'very uncertain'.<sup>537</sup> Overall, about a quarter of funding is expected to disappear by 2013/2014, which could lead to a drop in the capacity to serve over 100,000 clients.<sup>538</sup> Also from April 2013 cuts in legal aid will have decreased the availability of free debt advice to some of the most vulnerable groups, which will have a particular impact on the core funding of the Money Advice Service.<sup>539</sup>

528 Friends Provident Foundation, *Clients' perspectives on how they access debt advice*, Surrey: Friends Provident Foundation, 2012 [accessed via: [http://www.infohub.moneyadvicetrust.org/content\\_files/files/fpf\\_summary\\_may\\_2012\\_clients\\_perspectives\\_on\\_debt\\_advice.pdf](http://www.infohub.moneyadvicetrust.org/content_files/files/fpf_summary_may_2012_clients_perspectives_on_debt_advice.pdf) (24/10/13)]

529 London Economics, *Debt Advice in the UK*, London: London Economics, 2012

530 The Money Advice Service, Press Release, *Debt advice delivers improved outcomes for people*, 19 October 2012 [accessed via: [http://www.infohub.moneyadvicetrust.org/content\\_files/files/debt\\_advice\\_delivers\\_improved\\_outcomes\\_research\\_1901012.pdf](http://www.infohub.moneyadvicetrust.org/content_files/files/debt_advice_delivers_improved_outcomes_research_1901012.pdf) (24/10/13)]

531 Friends Provident Foundation, *Clients' perspectives on how they access debt advice*, Surrey: Friends Provident Foundation, 2012 [accessed via: [http://www.infohub.moneyadvicetrust.org/content\\_files/files/fpf\\_summary\\_may\\_2012\\_clients\\_perspectives\\_on\\_debt\\_advice.pdf](http://www.infohub.moneyadvicetrust.org/content_files/files/fpf_summary_may_2012_clients_perspectives_on_debt_advice.pdf) (24/10/13)]

532 The Money Advice Service, Press Release, *Debt Advice Delivers Improved Outcomes for People*, 19 October 2012 [accessed via: [http://www.infohub.moneyadvicetrust.org/content\\_files/files/debt\\_advice\\_delivers\\_improved\\_outcomes\\_research\\_1901012.pdf](http://www.infohub.moneyadvicetrust.org/content_files/files/debt_advice_delivers_improved_outcomes_research_1901012.pdf) (22/10/13)]

533 London Economics, *Debt advice in the UK*, London: London Economics, 2012

534 Ibid

535 Ibid

536 Ibid

537 London Economics, *Audit of the supply of debt advice services in the UK*, London: London Economics, 2012

538 Ibid

539 Citizens Advice Bureau, *Out of scope, out of mind*, London: Citizens Advice Bureau, 2012 [accessed via: [http://www.infohub.moneyadvicetrust.org/content\\_files/files/out\\_of\\_scope\\_final\\_web1.pdf](http://www.infohub.moneyadvicetrust.org/content_files/files/out_of_scope_final_web1.pdf) (24/10/13)]



The biggest shortfall in the debt advice sector is in the provision of face-to-face debt advice as it is the most expensive to provide and yet, for some particularly vulnerable groups, it is the most effective and most accessible form of debt advice.<sup>540</sup> Local authority budget cuts and reductions in legal aid have hit Citizens Advice Bureau especially in regards to providing specialist face-to-face debt advice.<sup>541</sup>

As funding dries up for free-to-client debt advice services, there may be an expansion in the fee-paying sector to absorb the extra demand.

#### 4.2.1 'For free' vs 'for fee' debt advice

Debt advice is currently provided both on a free and commercial basis in the UK. While there are arguments for and against both models, it is essential that there are free debt advice services available to those on the lowest incomes so they are not put at risk of increasing their debt through service charges.

A recent study found that users of free debt advice services were more likely to be successful than for those clients who paid a fee. Similarly, failure rates for those who paid for debt advice was twice as high. Part of this can be attributed to the more detailed budget and realistic budget given to clients by free-debt advice services as well as the level of contact they maintain during the process with the client.<sup>542</sup>

Fee charging debt management companies have a variety of pricing structures but normally require an initial setup fee and take a percentage of monthly repayments made to creditors. In contrast, free debt advice services pass on 100 per cent of monthly repayments to creditors, with the only fees being those that are paid directly to the courts in the event of insolvency proceedings. Many free debt advice charities are funded through charitable donations from the creditors they negotiate with on behalf of their clients, as there is a recognised business case in terms of increased recovery rates for the creditor.<sup>543</sup> Debt advice services are also funded by charitable donations; for instance, funds provided by creditors make up only a maximum of eight per cent of Christians Against Poverty's budget.

While both commercial and free debt advice services provide essentially the same range of debt solutions, the profile of their clients differs considerably. The proportion of individuals engaged in a DMP earning under £10,000 per year was twice as large for free debt advice services as for commercial providers.<sup>544</sup> This is perhaps unsurprising but highlights the importance of free debt advice for Britain's poorest and most vulnerable.

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540 Ibid

541 Citizens Advice Bureau, *2013/14 Quarter 1*, London: Citizens Advice, 2013 [accessed via: [http://www.citizensadvice.org.uk/advice\\_trends\\_q1\\_2013-14.pdf](http://www.citizensadvice.org.uk/advice_trends_q1_2013-14.pdf) (24/10/13)]. Citizens Advice Bureau, Press Release, *Cuts in CAB funding leaving thousands with nowhere to turn for help*, 6 September 2011 [accessed via: [http://www.citizensadvice.org.uk/index/pressoffice/press\\_index/press\\_20110906.htm](http://www.citizensadvice.org.uk/index/pressoffice/press_index/press_20110906.htm) (24/10/13)]

542 CRSP and Money Advice Trust, *Sustaining debt repayments*, London: Money Advice Trust, 2012 [accessed via: [http://www.infohub.moneyadvicetrust.org/content\\_files/files/sustainable\\_debt\\_repayments\\_\\_\\_lbg\\_\\_mat\\_november\\_2012\\_2.pdf](http://www.infohub.moneyadvicetrust.org/content_files/files/sustainable_debt_repayments___lbg__mat_november_2012_2.pdf) (24/10/13)]

543 London Economics, *Debt advice in the UK*, London: London Economics, 2012

544 Zero Credit Debt resolution in the UK, Timperly: Debt Resolution Forum, 2012 [accessed via: <http://www.debtresolutionforum.org.uk/resources/df-research-18th-june-2012.pdf> (24/10/13)]



Although there is clearly a market for commercial debt advice providers, many of whom are well established and well respected, there are several issues regarding the transparency of their service and the advice they give.<sup>545</sup> An estimated one in 10 individuals in a fee-charging DMP are not told about the fees associated with their debt solution until after they have already agreed to it, with a further 15 per cent not being told until just before signing up.<sup>546</sup> Independent reviews of the commercial debt advice sector have highlighted that some smaller newer providers may push clients towards debt solutions that maximise their profits, rather than the solution that is in the best interests of the client.<sup>547</sup> Similarly several providers, who were not members of the industry's voluntary code of conduct, were found not to be passing on payments to creditors, leaving the client worse off.<sup>548</sup> In 2011, the Citizens Advice Bureau dealt with 3,000 complaints regarding rogue commercial debt management companies' exploitative practices.<sup>549</sup>

The Office for Fair Trading (OFT) launched a compliance review of the industry in 2010 that found widespread problems and led to warnings being issued to 129 firms. Two main problems identified were firms misrepresenting themselves as being a free debt advice service and front-loading fees so that the firm's risk was minimised, but meaning the repayment of the client's actual debt was delayed. The OFT has since refused to renew the licences of several firms for their failure to improve standards.<sup>550</sup>

Several attempts have been made by the Government to bring greater regulation to the industry.

'The government is determined to drive up standards in this industry and ensure that people seeking paid-for advice are not disadvantaged by debt management companies that do not offer value for money'

Jo Swinson, Minister for Consumer Affairs, February 2013<sup>551</sup>

545 Collard S, *An independent review of the fee-charging debt management industry*, University of Bristol: Personal Finance Research Centre, 2009 [accessed via: <http://www.bristol.ac.uk/geography/research/pfrc/themes/advice/pfrc0906.pdf> (24/10/13)]

546 R3, *Debt and Insolvency: The Full Picture*, R3, 2010 [accessed via: [http://www.r3.org.uk/media/documents/policy/policy\\_papers/personal\\_insolvency/R3\\_Debt\\_Insolvency\\_Paper\\_D4\\_March\\_15th.pdf](http://www.r3.org.uk/media/documents/policy/policy_papers/personal_insolvency/R3_Debt_Insolvency_Paper_D4_March_15th.pdf) (24/10/13)]

547 Collard S, *An independent review of the fee-charging debt management industry*, University of Bristol: Personal Finance Research Centre, 2009 [accessed via: <http://www.bristol.ac.uk/geography/research/pfrc/themes/advice/pfrc0906.pdf> (24/10/13)]

548 Ibid

549 Citizens Advice Bureau, Press Release, *Tougher action needed on fee charging debt management companies says Citizens Advice*, 16 September 2011 [accessed via: [http://www.citizensadvice.org.uk/index/pressoffice/press\\_index/press\\_20110915.htm](http://www.citizensadvice.org.uk/index/pressoffice/press_index/press_20110915.htm) (24/10/13)]

550 OFT, Press Release, *OFT refuses to licence three debt management companies in ongoing drive to push up standards*, 31 January 2013 [accessed via: <http://www.offt.gov.uk/news-and-updates/press/2013/13-13#.Ui8EwdKsiSo> (24/10/13)]

551 The Insolvency Service, Press Release, *New Protections To Help Consumers Paying for Debt Management Advice*, 7 February 2013 [accessed via: <http://news-insolvencybis.gov.uk/Press-Releases/NEW-PROTECTIONS-TO-HELP-CONSUMERS-PAYING-FOR-DEBT-MANAGEMENT-ADVICE-68758.aspx> (24/10/13)]. The Insolvency Service, *DMP Protocol – August 2013* [accessed via: <http://www.insolvencydirect.bis.gov.uk/insolvencyprofessionandlegislation/policychange/DMP/Debt%20Management%20Plan%20Protocol.doc> (24/10/13)]

A Private Member's Bill in 2011 would have required commercial firms to inform potential clients about free alternatives; however the Bill failed to proceed further than the first reading.<sup>552</sup> A debt management plan protocol to regulate the provision of DMPs by commercial bodies was launched in February 2013 with the main stated aims being to increase transparency regarding terms and fees and to regulate advertising practices.<sup>553</sup> The Insolvency Service began the approval process in October 2013 with five companies gaining approval.<sup>554</sup> This protocol will hopefully bring significantly greater protection and clarity for clients, but if this industry standard fails there is always the opportunity for the FCA to bring in greater regulation once it assumes responsibility for consumer credit in April 2014.<sup>555</sup> It is a positive sign that the FCA has already included some aspects of the DMP protocol in their draft proposal for the regulation of consumer credit.<sup>556</sup>

The availability of free debt advice services for low-income households is essential as it provides one of the best ways to help struggling individuals and families face their debt problems and begin their recovery, as quickly and effectively as possible.

#### 4.2.2 Value of early intervention

Free debt advice is essential for those who are struggling with problem debt, but there is also a case to be made for the promotion of early intervention and greater integration of debt advice services through lenders who are often the first to notice signs of financial difficulties. Early intervention, involving working with a borrower pre-emptively, can not only save the borrower money by preventing their debt from spinning out of control, but can also save the creditor money in terms of long or extended collection processes.<sup>557</sup>

The early intervention programme at Barclays has had remarkably positive results. The bank contacted some of the 28,000 customers involved, while others contacted the bank directly. These individuals tended to be male and were more likely to be unemployed.<sup>558</sup> Customers were generally happy to be contacted by the bank and overwhelmingly expressed both increased financial stability and a sense of relief.<sup>559</sup> Lenders benefit from such intervention as it maintains a good relationship with the customer and decreases the cost of collections later.

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552 Parliament, *Fee Charging Debt Management Companies (Promotion of Free Debt Management Advice) Bill 2010–12* [accessed via: <http://services.parliament.uk/bills/2010-12/feechargingdebtmanagementcompaniespromotionoffreedebtmanagementadvice.html> (24/10/13)]

553 The Insolvency Service, Press Release, *New Protections To Help Consumers Paying for Debt Management Advice*, 7 February 2013 [accessed via: <http://news-insolvency.bis.gov.uk/Press-Releases/NEW-PROTECTIONS-TO-HELP-CONSUMERS-PAYING-FOR-DEBT-MANAGEMENT-ADVICE-68758.aspx> (24/10/13)]

554 Insolvency Service, *Protocol update – October 1*, London: Insolvency Service, 2013 [accessed via: <http://www.insolvencydirect.bis.gov.uk/insolvencyprofessionandlegislation/policychange/DMP/DMP-Protocol-update-1October2013.doc> (24/10/13)]

555 The Insolvency Service, Press Release, *New Protections To Help Consumers Paying for Debt Management Advice*, 7 February 2013 [accessed via: <http://news-insolvency.bis.gov.uk/Press-Releases/NEW-PROTECTIONS-TO-HELP-CONSUMERS-PAYING-FOR-DEBT-MANAGEMENT-ADVICE-68758.aspx> (24/10/13)]

556 FCA, *CPI 3/10 – Detailed proposals for the FCA regime for consumer credit*, London: FCA [accessed via: <http://www.fca.org.uk/your-fca/documents/consultation-papers/cp13-10> (24/10/13)]

557 Money Advice Trust, *Understanding financial difficulty*, Money Advice Trust, Bristol University: Money Advice Trust, 2011 [accessed via: <http://www.bristol.ac.uk/geography/research/pfrc/themes/credit-debt/pfrc1113.pdf> (24/10/13)]

558 Ibid

559 Ibid

The Social return on investment (SROI) conducted by Advice UK found that the cost of providing early intervention advice is significantly cheaper than crisis intervention.<sup>560</sup> Early intervention also has the obvious benefit of avoiding many of the negative impacts associated with problem debt that were discussed in Chapter Three. For social landlords specifically it has been estimated that there is a 22 per cent return on investment through both decreased rent arrears and decreased evictions, which can be expensive.<sup>561</sup>

There is a clear case for funding debt advice, yet for services to be effective the barriers to debt advice and the stigma surrounding it need to be addressed too.

### 4.2.3 Debt advice stigma

Despite the overwhelming evidence that people struggling with debt benefit from debt advice and the wide variety of charities offering free debt advice services, only a small fraction of people in need access them.

A recent survey found that only one in 13 people who were concerned about their levels of debt were planning on seeking debt advice in the next six months.<sup>562</sup> One in 10 people feel there is a stigma attached to receiving debt advice.<sup>563</sup> This is reinforced by survey results that found that two of the top three concerns people had when choosing a debt advice service was that it was confidential and that the service was not judgemental.<sup>564</sup>

It would appear the perception of the stigma is higher amongst those who are actually struggling with debt. It is estimated that more than four out of ten people struggling with serious debt issues worry about the stigma attached to seeking debt advice.<sup>565</sup> This is particularly worrying as the delay in recognising problem debt and seeking advice can lead to it spiralling out of control and more drastic remedies, such as bankruptcy, being required.

## 4.3 Debt solutions

For those whose debt has become uncontrollable some form of debt solution is crucial to help them recover. In 2011 more than 460,000 people entered a new debt solution, which represented just under half of the 1.1 million people involved in an ongoing debt solution.<sup>566</sup> The number of debt solutions in progress has increased by 60 per cent since 2007, again highlighting that the number of people struggling with problem debt is continuing to grow despite economic recovery.<sup>567</sup>

560 London Economics, *Debt advice in the UK*, London: London Economics, 2012

561 The Financial Inclusion Centre, *Does debt advice pay, Tameside: The Hyde Group*, 2011 [accessed via: [http://www.hyde-housing.co.uk/client\\_files/library/special/Does\\_Debt%20Advice\\_Pay\\_A%20Business\\_Case\\_for\\_Social\\_Landlords\\_Final\\_Report.pdf](http://www.hyde-housing.co.uk/client_files/library/special/Does_Debt%20Advice_Pay_A%20Business_Case_for_Social_Landlords_Final_Report.pdf) (24/10/13)]

562 R3, *Personal debt snapshot wave 7*, London: R3, 2012 [accessed via: [http://www.r3.org.uk/media/documents/policy/research\\_reports/personal\\_debt\\_snap/R3-Personal-Debt-Snapshot-Wave-7-2012.pdf](http://www.r3.org.uk/media/documents/policy/research_reports/personal_debt_snap/R3-Personal-Debt-Snapshot-Wave-7-2012.pdf) (24/10/13)]

563 Ibid

564 London Economics, *Debt advice in the UK*, London: London Economics, 2012

565 Pressitt, Press Release, *Social Stigma Stops People Seeking Debt Solutions*, 14 August 2009 [accessed via: <http://pressitt.com/smnr/social-stigma-stops-people-seeking-debt-solutions/301/> (24/10/13)]

566 The Debt Resolution Forum, *Debt Resolution in the UK*, Cheshire: The Debt Resolution Forum, 2012 [accessed via: <http://www.debtresolutionforum.org.uk/resources/market-size.pdf> (25/10/13)]

567 Zero Credit *Debt resolution in the UK*, Timperly: Debt Resolution Forum, 2012 [accessed via: <http://www.debtresolutionforum.org.uk/resources/df-research-18th-june-2012.pdf> (24/10/13)]

The term 'debt solutions' encompasses a wide range of formal and informal solutions as detailed in the table below.<sup>568</sup>

Formal solutions	Informal solutions
<ul style="list-style-type: none"> <li>■ Debt Relief Order (DRO)</li> <li>■ Individual Voluntary Arrangement (IVA)</li> <li>■ Bankruptcy</li> <li>■ Administration Orders</li> </ul>	<ul style="list-style-type: none"> <li>■ Debt Management Plan (DMP)</li> <li>■ Negotiations with creditors</li> <li>■ Direct token repayments</li> <li>■ Full and final settlement</li> <li>■ Consolidation loan</li> </ul>

Informal solutions are arranged directly with creditors, often with the help of a debt advice agency. In the case of a DMP the debt advice service will handle all negotiations and payments to creditors, with the client just making one monthly payment to the advice service. Formal solutions are applications made either to a court, the Insolvency Service or a licenced practitioner to have all or a portion of an applicant's debts wiped off without full repayment. There are advantages and disadvantages to each debt solution depending on a person's particular circumstance, highlighting the necessity of free debt advice services to ensure people make an informed decision.

The following sections will detail some of the specifics of each debt solution to draw attention to some of the negative implications for those who are driven to resort to them. In certain circumstances these can weaken a person's future financial situation, exposing them to the risk of problem debt again.

#### 4.3.1 Debt Relief Orders

A Debt Relief Order (DRO) is a relatively new form of insolvency brought in by the government in 2007 to help those on low incomes with debt issues.<sup>569</sup> This was recommended by the CSJ in *Breakthrough Britain*, as research indicated the costs and procedures of insolvency were acting as a barrier to debt resolutions for many of the poorest and most indebted, keeping them from ever escaping poverty.<sup>570</sup> However, there are implementation issues with the DRO that can make it difficult for some people rebuild their lives.

To be eligible applicants must have less than £50 a month in disposable income, debts of under £15,000, assets of under £300 and not own a home.<sup>571</sup> If approved by the Insolvency Service then a moratorium is placed on all debts for a period of 12 months after which they will be written off.<sup>572</sup>

568 For the sake of simplicity, the terms for legal instruments in England and Wales are used in this table and subsequent section. Figures represent the aggregates for the entire UK including the equivalent debt solutions in Northern Ireland and Scotland as while there are minor legal differences, the principals mentioned here are still applicable across them all.

569 StepChange, *DRO Guide*, StepChange, 2012 [accessed via: <http://www.stepchange.org/Portals/0/documents/info/stepchange-DRO-guide.pdf> (25/10/13)]

570 Centre for Social Justice, *Breakthrough Britain: Serious Personal Debt*, London: Centre for Social Justice, 2007

571 StepChange, *DRO Guide*, StepChange, 2012 [accessed via: <http://www.stepchange.org/Portals/0/documents/info/stepchange-DRO-guide.pdf> (25/10/13)]

572 Ibid

Since its introduction in 2009 the number of people filing for a DRO has increased year on year, with more than 31,000 people filing for a DRO in 2012.<sup>573</sup> This huge demand reflects the disproportionate levels of problem debt held by the poorest people.

In order for a DRO to be successful applicants must not exceed the £50 disposable income threshold during the 12-month period following their application. This can potentially have an unintended consequence for those who are unemployed or underemployed, as they must take care when returning to employment or seeking additional hours, not exceed the £50 disposable income threshold, as this would invalidate the DRO and make them liable for all of their debts again.

Most applicants are in receipt of some form of state benefit, meaning that upon returning to employment or gaining additional hours, their disposable income may not rise significantly due to the parallel reduction in benefits. The introduction of Universal Credit, which tapers benefit withdrawal, will help in this area, but it still appears that at this very low threshold some people may be disincentivised from seeking increased employment, especially if it would exceed the levels at which benefits can be claimed. This is a concern as people should not be discouraged from working to improve their financial situation through employment, which the CSJ has always argued is the most effective route out of poverty.

A DRO is registered on the insolvency register and remains on an applicant's credit file for a period of six years.<sup>574</sup> It will still severely impact an applicant's ability to get credit, some banks will not provide an account and there are restrictions on setting up businesses. These can all also act indirectly as barriers to work.

### 4.3.2 Individual Voluntary Arrangement (IVA)

An Individual Voluntary Arrangement is a legally binding arrangement with creditors organised by an insolvency practitioner that allows for manageable debt repayments to be made over a set period (normally five or six years) after which all remaining debts are written off. This is by far the most popular form of formal debt solution with more than 55,000 people entering an IVA in the past year, an increase of over 500 per cent in just the last ten years.<sup>575</sup> Over the past 20 years more than one in four IVAs has failed, mostly because of an inability to keep up with repayments, indicating that it may not have been the appropriate debt remedy or was not flexible enough to accommodate people's changing circumstances.<sup>576</sup>

When the IVA is approved repayments are based on an applicant's income at that time. Any increase in income must be reported to the insolvency practitioner and will result in a modification of the IVA. Any increase above the standard rise in living costs will be taken away

573 The Insolvency Service, *Statistics release: insolvencies in the first quarter 2013*, London: The Insolvency Service, 2013 [accessed via: <http://www.insolvencydirect.bis.gov.uk/otherinformation/statistics/201305/alltables.xls> (25/10/13)]

574 StepChange, *DRO Guide*, StepChange, 2012 [accessed via: <http://www.stepchange.org/Portals/0/documents/info/stepchange-DRO-guide.pdf> (25/10/13)]

575 Insolvency Service, *Statistics release: Insolvencies in the second quarter 2013*, London: ONS, 2013 [accessed via: <http://www.insolvencydirect.bis.gov.uk/otherinformation/statistics/201308/index.htm> (28/08/13)]

576 The Insolvency Service, *Individual voluntary arrangements: outcome status of new cases registered between 1990 and 2011*, England and Wales, London: The Insolvency Service, 2012 [accessed via: <http://www.insolvencydirect.bis.gov.uk/otherinformation/statistics/IVAs/ivas.htm> (25/10/13)]

and applied to the applicant's debts. Again, the unintended consequence of the IVA is that people are potentially disincentivised from seeking better-paid employment for several years, as it may not provide them with significant financial gain. Worse still, people may be encouraged to take on black market labour which will not be reported and which no taxes can be claimed from.

In effect, the current debt solutions may discourage people from seeking new employment opportunities that might help to alleviate the income shortfall that caused their problem debt in the first place.

### 4.3.3 Bankruptcy

Bankruptcy is the most extreme debt solution and also carries the most extreme restrictions that potentially could drive someone back into debt. In the past year more than 31,000 people declared bankruptcy, around a quarter (23 per cent) of whom were self employed.<sup>577</sup>

Following a bankruptcy petition the applicant can be required to make repayments to creditors for up to three years from any remaining disposable income after living costs. Any windfall of funds or increases in earnings will likely result in an increase in the repayments, which could potentially disincentivise work. Due to the high costs of applying for bankruptcy, a £525 deposit plus a £175 court application fee, some people may be unable to raise the funds necessary to apply. If their assets are too high for a DRO and they do not have sufficient disposable income for an IVA some people may be left in a situation where they are unable to apply for any form of insolvency and have no way to escape from their problem debt.

The situation is worse for the self employed who will usually have to close their business, are unable to serve as a director if they are a limited company and are required to inform all future business partners and business creditors they have previously been declared bankrupt. If they were to carry on trading as a self-employed person it is also virtually impossible to open a business bank account. This can make conducting business difficult, potentially decreasing the individual's income and exposing them to future problem debt.

Bankruptcy remains on an individual's credit file for six years, severely limiting the applicant's ability to obtain mainstream credit and open a bank account. This can potentially restart the cycle of debt as people may resort to high cost credit due to their financial exclusion.

### 4.3.4 The stigma of debt solutions

For many people bankruptcy and other debt solutions represent the only realistic way of resolving debt issues and recovering from debt, however significant social stigma regarding debt solutions can prevent people from seeking help. A survey by the insolvency service found that around three quarters of businesses and more than half of individuals (the general public) recognise there is a stigma attached to bankruptcy.<sup>578</sup>

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577 The Insolvency Service, *Statistics release: insolvencies in the first quarter 2013*, London: The Insolvency Service, 2013 [accessed via: <http://www.insolvencydirect.bis.gov.uk/otherinformation/statistics/201305/alltables.xls> (25/10/13)]

578 The Insolvency Service, *Attitudes to Bankruptcy*, London: The Insolvency Service, [accessed via: <http://webarchive.nationalarchives.gov.uk/+http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/policychange/attitudes/report-attitudetobankruptcy.pdf> (25/10/13)]

People who declare bankruptcy appear to overestimate the negative stigma held by others. An overwhelming 85 per cent of bankrupts thought people viewed them as a personal failure in comparison to just over 20 per cent of the public. Similarly, more than 60 per cent of bankrupts felt they were viewed as being, guilty of wrong-doing, dishonest and untrustworthy. This is greatly exaggerated as in reality only around 20 per cent of individuals hold these views regarding bankrupts.<sup>579</sup>

That bankrupts, and presumably those considering bankruptcy, perceive the public and businesses negative attitudes towards them as worse than it really is represents a significant concern. This report has set out that the delay in recognising problem debt, telling friends and family and seeking debt advice all contribute to a worsening of the problem. Therefore, the stigma surrounding bankruptcy is worrying as it could potentially increase the delay in people accessing vital debt relief services.

Stigma around conducting business with bankrupts also has worrying implications. Less than half of businesses said they would conduct business with a discharged bankrupt on normal terms, while more than one in 10 said they would not even conduct business with them if terms of the contract were modified. For undischarged bankrupts – those in the 12-month period following their application – the opportunities to conduct business were even more limited due to stigma. Only one in 10 businesses would agree to deal with them on normal terms, while less than 40 per cent would do business with them on modified terms.<sup>580</sup>

The implications of such stigma when combined with the other restrictions placed on bankrupts can represent a significant barrier returning to financial independence and place them at risk immediately of falling back into problem debt.

## 4.4 Alternative finance: credit unions

As credit is an essential part of our modern economy it is essential that people on low incomes have access to affordable credit from responsible lenders when they need it. Credit union loans are not inherently devoid of problems, however their low cost and the increased forbearance shown by credit unions mean they are less likely to cause problem debt.

Britain's network of credit unions is currently very small, but over time with the correct support and development it could play a much larger role in Britain's financial system. Credit unions not only provide affordable loans, but also mortgages, current accounts and savings products. They are not a direct replacement for banks or payday lenders, but rather offer a new system of community finance. However, there are significant hurdles that need to be addressed if this is to become reality.

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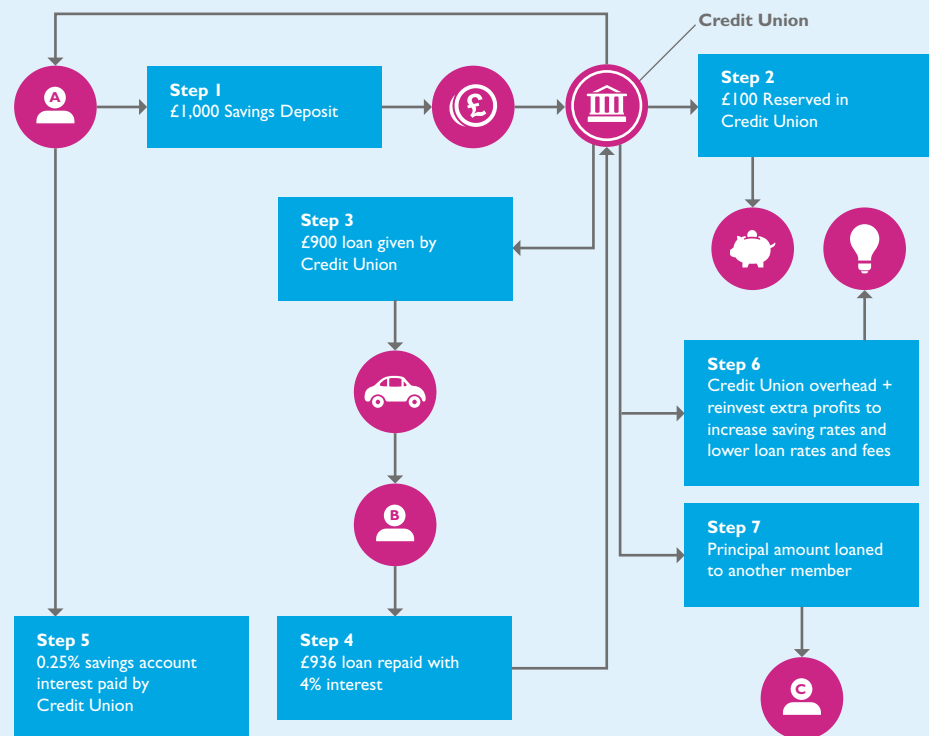
579 Ibid

580 Ibid

## 4.4.1 Credit unions in the UK

### What is a credit union?

A credit union is a community-based financial co-operative that takes deposits from its members and also allows them to take out affordable loans funded from the communal deposits of other members. Services are only available to members and all members must meet the requirement of a 'common bond' in order to join. Common bonds include membership in a particular organisation, working for a particular employer or living in a certain area. In this way credit unions are embedded in the local community to which they provide a benefit and are often staffed by volunteers from that community.



Because of their unique co-operative structure and ethical aims, credit unions are able to offer affordable loans to people who would often be rejected by mainstream banks. Interest rates on loans are capped by law at two per cent per month, or 26.8 per cent APR. These affordable loans can be used effectively to help people on the edge of financial ruin take control of their lives.

Perhaps the most troubling aspect of the development of credit unions as a provider of low-cost credit is simply the scale of expansion necessary in order to become an established alternative to banks and high-cost lenders. Membership in credit unions is significantly lower in the UK than in other developed countries. There are now 390 credit unions in the UK offering services to just over a million members, around two per cent of the adult population.<sup>581</sup> In contrast in Ireland 70 per cent of the population are members of credit

581 Bank of England, *Introduction to credit union Statistics*, London: Bank of England, 2013 [accessed via: <http://www.bankofengland.co.uk/statistics/Documents/ms/articles/art1jul13.pdf> (24/10/13)]. ONS, *Population estimates for UK, England and Wales, Scotland and Northern Ireland, mid-2011 and mid-2012* [accessed via: <http://www.ons.gov.uk/ons/publications/re-reference-tables.html?edition=tc%3A77-319259> (24/10/13)]

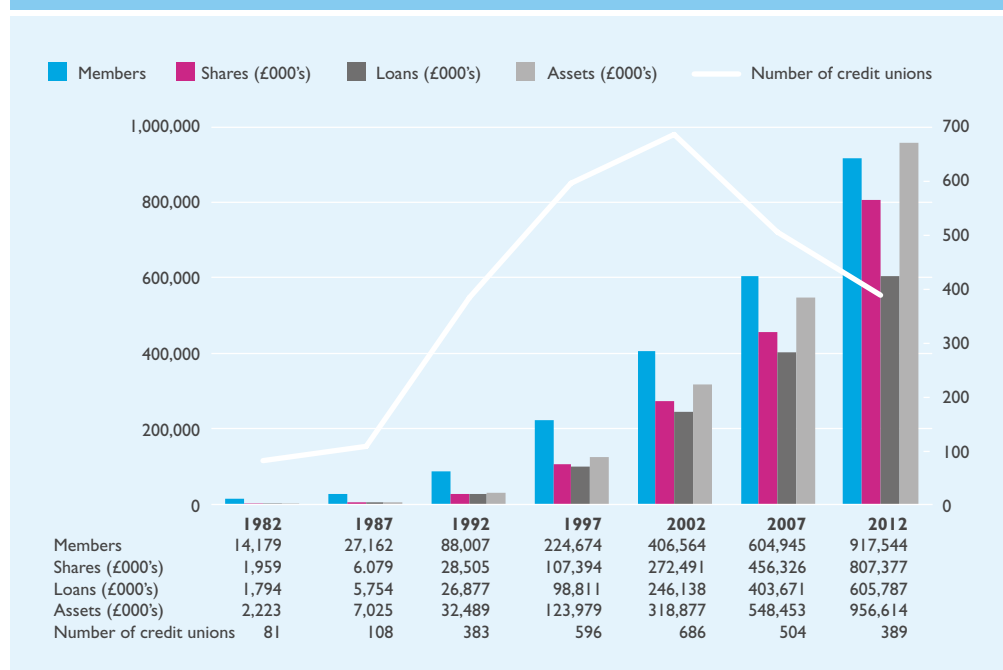


unions, in Canada and the USA around 43 per cent of the population are members.<sup>582</sup> Even within the UK the figures vary widely, with significantly higher membership rates in Scotland and Northern Ireland.<sup>583</sup>

'In Britain the credit union sector lags far behind that of other countries, in terms of size, professionalisation and integration within the financial system. In order to expand the sector we need to ensure that the services offered by credit unions are professional and competitive, specifically in regards to IT infrastructure and offering innovative products. Most importantly though, credit unions need to be run in a sustainable manner, which will negate the need for long-term subsidy from the government.

Mark Lyonette, Chief Executive, ABCUL – in evidence to the CSJ

Figure 11: Credit union growth in the UK<sup>584</sup>



Credit unions have been growing in terms of membership and loans provided since 2004, however, not all have been successful. Almost 300 credit unions, 43 per cent of the total, have

582 Ibid

583 Bank of England, *Introduction to credit union Statistics*, London: Bank of England, 2013 [accessed via: <http://www.bankofengland.co.uk/statistics/Documents/ms/articles/art1jul13.pdf> (24/10/13)]. ABCUL, *An international movement* [accessed via: <http://abc.ul.org/credit-unions/international-movement> (24/10/13)]

584 ABCUL – in evidence to the CSJ

ceased to operate since 2002, however this has slowed considerably with only 18 closures since the beginning of 2011.<sup>585</sup> It has been suggested that the majority of these closures were smaller credit unions, some with under 100 members, and that this therefore represents a consolidation and professionalisation of the sector.<sup>586</sup>

'The recent drop in the number of credit unions is mostly due to a rapid professionalisation of the sector as larger credit unions have been created from smaller ones which have less chance of reaching sustainability. There have also been a small number of closures.'

Mark Lyonette, ABCUL CEO – in evidence to the CSJ

#### 4.4.2 Changing the image of credit unions and expanding membership

Unlike in other countries credit unions in the UK are often seen as a niche provider run by philanthropists who lend money to the poor and financially excluded. This reputation does not reflect the goals of the industry and is counterproductive to gaining membership and creating a sustainable business.

'Credit unions are growing – but we want them to be a mainstream option for savers and borrowers just as they are in other countries and to ditch the image of a 'poor man's bank.'

Lord Freud, Parliamentary Under Secretary of State for Welfare Reform, 27 June 2012<sup>587</sup>

A recent survey found that fewer than one in 10 people thought a credit union would be able to help them, a figure that rose to 60 per cent upon learning more about credit unions.<sup>588</sup> The CSJ has heard that the current reputation of credit unions does not represent their ambitions and is hindering their development.

585 Civitas, *Credit unions: A solution to poor bank lending*, London: Civitas, 2013 [accessed via: <http://civitas.org.uk/pdf/CreditUnions.pdf> (24/10/13)]

586 Ibid

587 DWP, Press release, *Credit union £38 million expansion deal signed*, 16 April 2013 [accessed via: <https://www.gov.uk/government/news/credit-union-38-million-expansion-deal-signed> (24/10/13)]

588 DWP, *Credit Union Expansion Project: Feasibility Study Report*, London: DWP, 2012 [accessed via: <http://www.dwp.gov.uk/docs/credit-union-feasibility-study-report.pdf> (16/10/13)]

‘The major barrier to growing our business is a lack of public recognition and understanding of the Credit Union concept that is key to our financial survival. Unlike in other countries, we are not yet an accepted part of mainstream banking. By the time we explain that we are a mutual cooperative owned by our customers and not a Trade Union, most of our natural client base has gone elsewhere or lost interest. Our streamlined website helps to overcome this but we need to become a natural choice for all who need an alternative to the high street banks.’

David Wright, Chairman, SurreySave Credit Union – in evidence to the CSJ

‘Credit unions need to be run as sustainable, ethical businesses. This means offering competitive products that meet the needs of members, investing in IT infrastructure, and training staff to ensure excellent, consistent customer service.

We need to get rid of the ‘lender of last resort’ image and replace it with the message that members choose credit unions above other financial providers because of our member-centric products, customer service and community roots.’

June Walker, Chief Executive, Glasgow Credit Union – in evidence to the CSJ

Credit unions, led by their largest trade body ABCUL, recognise that they need to change their image and diversify their membership base if they are going to expand and become a major force in the financial industry.

‘In order for credit unions to become sustainable and grow there needs to be a growth in membership across all income brackets. In other countries there is much greater involvement of employers with credit unions and options for automatic enrolment and savings. We need to look at expanding partnerships with employers in order to help the sector grow into a viable alternative to high street banks.’

Mark Lyonette, CEO of ABCUL – in evidence to the CSJ

In Glasgow there are 34 credit unions providing services to 120,000 members, just over one in five residents.<sup>589</sup> There are a variety of credit unions, ranging from large to small and with varying common bonds that tie their members together through their employers, community associations or where they live. The local government supports credit unions through offering cheap rents and a tax incentive, while also funding a recent programme to give every 16-year-old student a credit union account.<sup>590</sup> The success of credit unions in Glasgow is an anomaly in the UK, but it provides an example of how they can serve large sections of the population when public attitudes about credit unions are slightly changed.

'Glaswegians just seem to 'get' the credit union ethos and are happy to tell others of their positive experiences. There are several credit unions in the city offering their services directly to staff of large employers via payroll deduction (such as Glasgow Credit Union and Glasgow City Council) and this has definitely helped increase penetration within the city.'

June Walker, Chief Executive, Glasgow Credit Union – in evidence to the CSJ

Most importantly, the availability of credit unions can have a real impact on people's lives and save them from problem debt.

#### Jane, 48 and mum of two, Glasgow – in evidence to the CSJ

'I started using payday loans when my husband was made redundant and we reached the limit on our credit cards. We were struggling to pay the mortgage and buy food. It was really simple to get the loans but things quickly spiralled out of control.'

When the interest was added, we were deeper in debt than before. Between the payday loans and credit cards, I borrowed £5,500 but owed £10,000 in total including the interest. When my husband got another job, the crippling interest meant all our money was going out on that and the balance was not reducing.

I did not know where to turn. I'd read about Glasgow credit union online but did not know if they'd be able to help us. Rather than just looking at the debt we had they looked at everything and told us we could apply for a Consolidation Loan. We were able to borrow enough to clear all the high cost debt at a much lower rate of interest, which made the monthly repayments much more affordable.

We can now see our debt reducing monthly thankfully. It still makes me feel nervous how depressed and stressed I was from the payday loans. It was the worst decision we ever made and nearly cost us everything.'

589 ABCUL, Press release, *Credit union account for every high school pupil in Glasgow*, 14 June 2013 [accessed via: <http://www.abc.ul.coop/media-and-research/news/view/349> (29/10/13)]

590 Glasgow City Council, Press release, *Credit Union account for every young Glaswegian to combat payday loans*, June 2013 [accessed via: <http://www.glasgow.gov.uk/index.aspx?articleid=10084> (24/10/13)]

#### 4.4.3 The drive to modernise and expand credit unions

The coalition Government has taken significant steps to facilitate and support the expansion of credit unions. New legislation has implemented many of the CSJ recommendations from 2007 including the relaxation of membership requirements, allowing interest to be paid on savings, allowing lending to organisations, and raising the monthly interest rate cap from two to three per cent, effective from April 2014.<sup>591</sup>

The Association of British Credit Unions Limited (ABCUL) was awarded the contract to deliver the Department of Work and Pensions (DWP) credit union Expansion Project (CUEP) in June 2012.<sup>592</sup> The aim of this project is to double credit union membership to two million people by 2017 and save low-income households up to a billion pounds in interest payments. The DWP has allocated £38 million over the three-year life of the project, a continuation of the £113 million paid by the DWP to support credit unions between 2006 and 2012.<sup>593</sup>

The specific goals of modernisation set out by the DWP are:

- Achieve cost reductions of 40 per cent;
- Automate loan decision-making to improve speed of decisions and reduce costs;
- Introduce IT systems to provide online banking and a wider range of account features such as automated saving and jam-jar accounts;
- Work with landlords and community businesses in order to increase membership.

Results from the similar DWP Growth Fund programme, which ran between 2006 and 2009, are positive and indicate that many credit unions could be ready to expand and develop their business. In the three-year trial the credit unions involved more than doubled their membership and tripled the number of loans given out to low-income members.<sup>594</sup>

However, independent evaluation found that despite the expansion, a gap still existed between their operating costs and income that needs to be addressed if the credit union model is to be sustainable in the long term.<sup>595</sup> A significant number of credit unions were also found to be completely unsustainable and dropped from the programme.<sup>596</sup> It is too soon to tell, but it is to be hoped that credit unions and politicians have learned from the DWP Growth Fund and there will be a regulatory environment, political support and necessary industry expertise to allow the sector to develop into a widespread sustainable provider of community finance.

591 Centre for Social Justice, *Breakthrough Britain: Serious Personal Debt*, London: Centre for Social Justice, 2007. ABCUL, *Legislative change for credit unions* [accessed via: <http://www.abc.ul.org/media-and-research/briefings/legislativechange> (08/09/130)]. HM Treasury, Press release, *Government to increase access to affordable credit*, 12 June 2013 [accessed via: <https://www.gov.uk/government/news/government-to-increase-access-to-affordable-credit> (08/09/13)]

592 DWP, Press release, *ABCUL to deliver credit union expansion project*, 16 April 2013 [accessed via: <http://www.dwp.gov.uk/other-specialists/credit-union-expansion/latest-news/> (08/09/13)]

593 Speech by Lord Freud to the All-Party Parliamentary Group on Credit, 22 April 2013 [accessed via: <https://www.gov.uk/government/speeches/speech-to-the-all-party-parliamentary-group-on-credit-unions> (25/10/13)]. DWP, Press release, *Credit union £38 million expansion deal signed*, 16 April 2013 [accessed via: <https://www.gov.uk/government/news/credit-union-38-million-expansion-deal-signed> (24/10/13)]

594 Ibid

595 Ibid

596 Ibid

#### 4.4.4 Competing with payday lenders

Most recently, credit unions received endorsement from the Archbishop of Canterbury, Justin Welby and the Church of England, which has founded a credit union for clergy and pledged to offer their support to other credit unions.

'We've got to have credit unions that are both engaged in their communities and much more professional, and... people have got to know about them.'

Archbishop Welby – Total Politics Interview, July 2013<sup>597</sup>

Specifically, the Archbishop has taken the position that promoting credit unions as a viable business alternative to payday lending will be far more successful in limiting the spread of high-cost credit than attempts to restrict them through legislation.

'I've met the head of Wonga and we had a very good conversation and I said to him quite bluntly 'we're not in the business of trying to legislate you out of existence, we're trying to compete you out of existence.'

Archbishop Welby – Total Politics Interview, July 2013<sup>598</sup>

However, there is a long way to go before the Archbishop's ambition is fulfilled: UK credit unions have just over a million members and made loans of £662 million in 2012, of which more than a third was in Northern Ireland despite it having just six per cent of the total population.<sup>599</sup> In comparison an estimated seven million people use high-cost credit and borrowed an estimated £4.68 billion in 2012, more than seven times the amount lent by credit unions.<sup>600</sup> Similarly, the five largest payday-lending firms spent almost as much as the entire DWP funding for credit unions (£36.3 million) in 2012 just on advertising.<sup>601</sup>

Archbishop Welby has admitted that they are not ready to take over the reins just yet and that the development of a nationwide network of professional, sustainable credit unions 'is a decade-long process.'<sup>602</sup>

597 Total Politics, *Archbishop's move: Can Welby restore faith in the church*, 24 July 2013 [accessed via: <http://www.totalpolitics.com/articles/384457/archbishopand39s-move-can-welby-restore-faith-in-the-church.shtml>] (24/10/13)]

598 Ibid

599 Bank of England, *Introduction to credit union Statistics*, London: Bank of England, 2013

600 Apex Insight, *High-cost Credit: UK market profile and forecasts*, London: Apex Insight, 2012. DWP, *Credit Union Expansion Project: Feasibility Study Report*, London: DWP [accessed via: <http://www.dwp.gov.uk/docs/credit-union-feasibility-study-report.pdf>] (16/10/13)]. Office of Fair Trading, *Payday Lending: Compliant Review Final Report*, London: Office of Fair Trading, 2013 [accessed via: [http://www.offt.gov.uk/shared\\_offt/Credit/oft1481.pdf](http://www.offt.gov.uk/shared_offt/Credit/oft1481.pdf)] (22/10/13)]

601 Hansard, Commons Debates, *Backbench business – High cost credit*, Column 502, 5 September 2013 [accessed via: <http://www.publications.parliament.uk/pa/cm201314/cmhansrd/cm130905/debtext/130905-0002.htm>] (24/10/13)]

602

Within the industry competing directly with payday lenders is generally not seen as practical or a sustainable business model. Because the loan is short term and there is a maximum interest rate cap, it is almost impossible for credit unions to make a profit on this type of loan. This does not even take into account the initial start up costs related to the necessary IT required to give instant decisions, which can be prohibitively expensive. Even for credit unions that do have the scale to offer such loans there are other ethical and business concerns.

‘Payday style loans do not benefit member’s real needs as they do not address their underlying financial problems. Credit unions should concentrate on helping members understand their finances and developing products that empower them.’

June, Chief Executive, Glasgow Credit Union – in evidence to the CSJ

However, through modernisation and incorporating parts of the payday lending model credit unions can become a well-developed alternative provider of finance on their own terms.

‘We believe it is speed and convenience which attracts people to payday lenders, not the short-term nature of the loans – the amount of loans which are rolled over demonstrates how the short term nature of the product is a problem in itself, even before the high interest charges are added on. It is by making their services as efficient, convenient, and accessible as possible that credit unions can help steer many more people away from high cost lenders. By helping more people access credit unions through their employers and improving systems to ensure people can apply online and get quick decisions on loans, the sector can become the financial services provider of choice for many more people.’

Mark Lyonette, Chief Executive, ABCUL – in evidence to the CSJ

Despite the challenges a few credit unions have begun to offer products designed to directly compete with payday loans in sophistication and ease of access.<sup>603</sup> The product designed by London Mutual credit union can broadly compete with a loan from a payday lender in many regards, but at a fraction of the cost.

603 Information sourced from London Mutual credit union and a representative loan from Wonga

CUOK Pay Day Loan from London Mutual credit union	Typical Payday Loan
<b>Term:</b> Between 30–90 days	<b>Term:</b> Between 1–31 days
<b>Cost:</b> £19 for a £400 loan (26.8% APR)	<b>Cost:</b> £127 for a £400 loan (5853% APR)
<b>Fees:</b> No late fees	<b>Fees:</b> £30 missed payment fee
<b>Application:</b> Completed online, instant decision	<b>Application:</b> Completed online or in store with instant decision
<b>Funds:</b> Same day delivery	<b>Funds:</b> Delivered within 15 minutes
<b>Eligibility:</b> Membership required at a cost of £7 which can be deducted from the loan and applied for with the loan	<b>Eligibility:</b> No pre-requirements

Although most credit unions are not trying to compete directly with payday lenders, the Archbishop’s comments and the resultant media coverage have been a huge positive for the credit union sector in terms of raising awareness about credit unions.

‘Given our business margins we cannot afford expensive advertising, so free national publicity is essential. After Archbishop Justin Welby’s public intervention in June, we hit, for the first time, our 35% loan growth targets in July and August. We need many more such high profile endorsements to stimulate general awareness of our services, rather than being referred to just as a niche provider of loans for the poorest and most financially excluded.’

David Wright, Chairman of SurreySave – in evidence to the CSJ

It is important that people and politicians realise that the expansion of credit unions will not mean that payday lenders disappear as they serve different markets. However, with the right support and well-balanced sustainable development in the long term, credit unions have the opportunity to establish themselves as a major provider of alternative finance for households across the income spectrum.

## 4.5 Alternative finance: community development financial institutions and the social fund

Similar in ethos to credit unions, Community Development Financial Institutions (CDFIs) are community based not-for-profit lenders who aim to support low-income households and the development of businesses within Britain’s poorest communities. Specifically, they attempt to serve the needs of those individuals and communities who are excluded from accessing mainstream credit and financial services. Unlike credit unions CDFIs do not take deposits and money for loans comes solely from their income from other loans and outside investment through grants and partnerships.



CDFIs have received significantly less recognition than credit unions, but the Coalition Government has still aimed to support their development. CDFIs have been selected as delivery partners for part of the Government's £30 million fund to support small business loans for young entrepreneurs.<sup>604</sup>

There are currently 53 CDFIs in the UK, down from a peak of 80 in 2005, although the number of loans offered has increased despite the reduction in CDFIs.<sup>605</sup> In 2012 nine CDFIs made loans worth £11.4 million to almost 30,000 individuals. These loans saved over 10,000 people from a debt spiral, 17,000 from high cost creditors and 1,740 from illegal moneylenders.<sup>606</sup>

As CDFIs are not regulated in the same way as credit unions they are better placed to offer innovative business models and provide a new form of alternative finance to some of Britain's most deprived communities. As one example, CDFIs can charge higher interest rates on their loans – with typical rates of 39 per cent APR, still 100 times cheaper than payday lenders – meaning they have more flexibility when offering loans as the profit margins are not quite so tight.

While significantly smaller than credit unions, CDFIs are uniquely placed to help alleviate problem debt in Britain's poorest communities. Firstly, as there are no membership requirements or savings requirements they are better situated to handle 'walk-in' trade, a key factor when dealing with people who are often in a crisis and need immediate financial help. The CSJ was told that establishing their presence on British high streets and through marketing is a key part of the business model and helps alert people to the alternatives to high-cost lenders.

#### Muna Yassin, Managing Director, Fair Finance – in evidence to the CSJ

'I think we offer something different as a CDFI – and can sit alongside both banks and credit unions – that allows greater choice to a section of the population with very limited options when it comes to financial products and services. Our services can be accessed by all (as opposed to banks and most credit unions) and in that sense we are a universal financial services provider. We fully focus on the client's financial wellbeing (often telling clients that credit is not the answer and exploring advice options) and provide a 'high street' presence to normalise and reduce any stigma attached from using alternative service providers. Moreover, Fair Finance and CDFI's often help the clients and sections of our communities that other services have already rejected.'

Marketing and social media initiatives may seem insignificant, however they are key to establishing the profile of alternative lenders. It is important that these lenders are seen as professional alternatives to banks and high cost lenders, rather than as a charity. This echoes the views expressed by credit unions about the need to shift away from the image of being a 'poor-man's bank.' Through raised awareness and involvement in a community, CDFIs are situated to bring substantial change beyond just the impact of individual loans.

604 Prime Minister's Office, Press release, *£30 million boost as start-up loans for young entrepreneurs scheme expanded*, 3 January 2013 [accessed via: <https://www.gov.uk/government/news/30-million-boost-as-start-up-loans-for-young-entrepreneurs-scheme-expanded> (09/09/13)]

605 CDFA, *Inside community finance: The CDFI industry in 2012*, London: CDFA, 2013 [accessed via: <http://www.cdfa.org.uk/wp-content/uploads/2010/02/ICF-full-report-web1.pdf> (09/09/13)]

606 Ibid

The greater emphasis on loans to local small businesses and social enterprises by CDFIs, accounting for 88 per cent of their total loan value, also enables them to promote sustainable development within communities.<sup>607</sup> Many of these small business loans are for initial start up supplies for sole traders who would otherwise have no access to finance, something that can be a significant barrier to employment in these situations. While this does not directly work to combat problem debt, it provides long-term benefits for Britain's poorest communities in terms of employment and infrastructure development, which can help combat some of the root causes of problem debt discussed in Chapter Two.

As a result of these marginally higher interest loans and other funding opportunities unavailable to credit unions, half of all CDFIs were able to cover all of their operating costs in 2012.<sup>608</sup> While the industry is small and has a long way to go, there are several extremely encouraging examples of how CDFIs can provide affordable, sustainable credit to Britain's poorest communities.

### Case study: Fair Finance

This East London-based CDFI, winner of a Big Society Award, is a leading example of how ethical lending can be combined with sustainable development to help turn around the fortunes of both people and communities. Over the past eight years Fair Finance has lent out £4 million in loans to around 5,000 households and businesses through its five branches, saving the poor and financially excluded over £2 million in interest payments. It has also provided help to more than 5,000 people deal with over £20 million worth of debts through its sister charity, Fair Advice.

The key ethos behind Fair Finance is to provide loans to some of the most deprived people in London who have nowhere else to turn. Loans are typically given out to help people fund the unexpected costs of life, often incurred as a result of incredibly stressful situations. Examples include funeral costs, or the replacement or repair of household goods. Increasingly they are also used simply to help keep up with the rising cost of living or unexpected income shocks. These are all situations where many people turn to the payday lenders that crowd the high streets near all of the Fair Finance locations.

While operating under a philanthropic banner, the emphasis on professionalism and sustainability mean Fair Finance is able to help far more people with the same amount of money than they could through charity alone. Their intensive approach to lending, which includes detailed interviews with all potential borrowers matches the processes of any bank and takes into account aspects of their life and finances that mainstream banks would never even consider:

The results are impressive: the default rate of their loans is just 10 per cent despite over half of all their accepted applicants having average incomes far below the national average.

This model proves that affordable credit can be sustainable when provided by innovative lenders who are in touch with the communities they serve.



607 Ibid

608 Ibid

As they do not take deposits CDFIs are not a direct replacement for credit unions, but rather represent a complementary piece, able to provide affordable finance to financially excluded people who often have no choice but to borrow from high-cost lenders which can lead to problem debt. Moreover, investment in CDFIs can help to tackle the issue of financial exclusion in Britain's poorest communities that can place a significant financial burden on people and put them at risk of problem debt.

CDFIs are currently unable to meet the demand for their services and estimate that if given sufficient capital they could provide around £6bn annually in loans to over eight million clients.<sup>609</sup> Such an expansion would have a significant impact on the number of people and communities struggling with problem debt, providing substantial savings to people and the state as people become more financially stable.

#### 4.5.2 Localisation of the Social Fund

The Social Fund offered financial assistance to some of the most financially excluded people through grants and loans and for some of the very poorest was often their primary source of borrowing.<sup>610</sup> As part of the Government's wider drive towards localism the budgets previously used to deliver part of the Discretionary Social Fund (Crisis Loans and Community Care Grants (CCG)) have now been devolved to upper tier local authorities in England<sup>611</sup>. This switch provides an opportunity to involve local organisations – CDFIs, credit unions, financial planning services and even private providers – as well as local government departments, in delivering new local welfare schemes to meet the needs of vulnerable groups who are struggling financially.

Crisis loans and CCGs were used to fund emergency expenses and provide financial assistance for some of the poorest people. In 2010/11 DWP spent a total of £368.4 million on community care grants and crisis loans, with Crisis Loans accounting for 61 per cent of this expenditure.<sup>612</sup> However, expenditure on Crisis Loans fell by 41 per cent the following year (2011/12), to £274.3 million, as a result of a number of administrative measures taken by DWP, including reductions in the maximum amount and the number of permissible awards in any 12-month period.<sup>613</sup> Disregarding expenditure on crisis loans made that year for 'alignment purposes' to bridge the gap between new benefit claims being made and the receipt of payment, the level of spend on community care grant and crisis loans in 2011/12 was just over £215 million.<sup>614</sup> This compares to the 2013/14 programme budget of £178 million, which was devolved to support local welfare provision.<sup>615</sup>

609 CDFA, *Mind the finance gap*, London: CDFA, 2013

610 Collard S and Kempson E, *Affordable credit: the way forward*, Bristol: The policy press, 2005 [accessed via: <http://www.bristol.ac.uk/geography/research/pfrc/themes/finexc/pfrc0506.pdf> (24/10/13)]

611 In Scotland and Wales the budgets have been localised to the devolved administrations

612 DWP, *Annual Report by the Secretary of State for Work and Pensions on the Social Fund 2011/2011*, London: DWP, 2013 [accessed via: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/214336/2011-annual-report-social-fund.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/214336/2011-annual-report-social-fund.pdf) (24/10/13)]

613 DWP, *Annual Report by the Secretary of State for Work and Pensions on the Social Fund 2012/2013*, London: DWP, 2013 [accessed via: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/209379/DWP\\_Annual\\_Report\\_on\\_the\\_Social\\_fund.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/209379/DWP_Annual_Report_on_the_Social_fund.pdf) (24/10/13)]

614 Ibid. Crisis loan 'alignment payments' were made in order to help bridge the gap between a new benefit claim being made and receipt of payment. These have been replaced with a new national system of Short Term Advances on benefit and the budget for these was not devolved to local areas.

615 Centre for Responsible Credit, *Local welfare provision, low-income households, and third sector financial services provision*, London: CfRC, 2013 [accessed via: <http://www.responsible-credit.org.uk/uimages/File/local%20welfare%20provision%20low-income%20households%20and%20third%20sector%20financial%20services%20final.pdf> (24/10/13)]

The Government has stated that this decrease in funding, pegged to the 2005/06 budget, reflects the true demand for these funds which had become inflated since the introduction of telephone applications which removed a large part of the bureaucracy associated with the Social Fund and saw increased levels of take-up.<sup>616</sup>

The Government hopes that local authorities will be able to develop new local welfare schemes which will ensure the poorest and most vulnerable continue to receive financial assistance, while also helping reduce the cost to the state by redirecting applicants to more suitable service provision, when appropriate, and in order to meet 'underlying needs' that can drive demand for funds.<sup>617</sup> Funding has not been 'ring fenced' meaning local authorities are free to utilise the money as they see fit so long as it is put towards these broad goals.<sup>618</sup>

However, the implementation of local welfare schemes in England has seen several key restrictions put in place in comparison with the previous Social Fund scheme. In particular, many local authorities have restricted eligibility to people in receipt of means-tested benefits.<sup>619</sup> This was not previously the case for Crisis Loans, and there are concerns that assistance is no longer available to the working poor in many areas as a result.

Likewise, some local schemes are only providing assistance when all other forms of help – including Budgeting Advances from DWP – have been exhausted.<sup>620</sup> This runs the risk that people who cannot realistically afford the repayments for these advances will be denied access to grant payments that would otherwise have saved the taxpayer from bearing the costs of people using local social services or moving into some form of institutional care.

In addition, most local authorities have put in place residence conditions – for example by requiring that applicants must have lived in the area for a period of up to 12 months prior to qualifying for help.<sup>621</sup> This can lead to people being passed from one local authority to another even though the need for assistance is an urgent one.

Finally, the vast majority (87 per cent) of local authorities are only issuing grants or in-kind assistance (such as the direct provision of 'white goods') rather than providing loans.<sup>622</sup> Under the previous system these loans were interest free and were normally repaid through weekly deductions from benefits. This allowed funds to be recycled. Under the old system 50 per cent of the budget for crisis loans was funded through these repayments. Although there were criticisms that the loan repayments were often high because these were recovered

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616 Child Poverty Action Group, *The Social Fund at a local level: notes for and from practitioners*, London: CPAG, 2012 [accessed via: <http://www.cpag.org.uk/sites/default/files/CPAG-practice-note-social-fund-0812.pdf> (24/10/13)]. DWP, *Annual Report by the Secretary of State for Work and Pensions on the Social Fund 2010/2011*, London: DWP, 2013 [accessed via: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/214336/2011-annual-report-social-fund.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/214336/2011-annual-report-social-fund.pdf) (24/10/13)]

617 Centre for Responsible Credit, *Local welfare provision, low-income households, and third sector financial services provision*, London: CRC, 2013 [accessed via: <http://www.responsible-credit.org.uk/uimages/File/local%20welfare%20provision%20low-income%20households%20and%20third%20sector%20financial%20services%20final.pdf> (24/10/13)]

618 Ibid

619 Ibid

620 Ibid

621 Ibid

622 CSJ analysis of new local welfare provision programmes

over relatively short lengths of time, the move to primarily grant or in-kind assistance may put budgets under further pressure.<sup>623</sup>

A possible mechanism for providing loan schemes would be for local authorities to partner with providers of affordable credit in their area, such as credit unions and CDFIs. However, a survey of credit unions found that while almost all were aware of the changes to the social fund, only around half had been approached to actively engage in creating the local replacement scheme.<sup>624</sup> This may represent a missed opportunity to boost affordable credit provision and provide an alternative to high-cost credit. An estimated 20 per cent of people previously refused, wholly or in part, by the Social Fund ended up borrowing from a high-cost lender to meet the shortfall.<sup>625</sup>

The debate about the relative value of providing loans as opposed to grants and in-kind assistance is a live one, as small loans are often expensive to administer and, in the absence of a mechanism to recover payments directly from benefits, could be subject to much higher levels of default than was the case under the previous Social Fund scheme. In addition, there may be there savings that can be realised through bulk purchasing of furniture or 'white goods'<sup>626</sup> which offsets the effect of no longer recycling funds through the provision of loans.

As only six months have passed since the budgets for Crisis Loans and Community Care Grants have been devolved, it is too early to assess the impact of this policy. However, it will clearly be important for the new local schemes to be properly evaluated to ensure that vulnerable groups of people, including those leaving institutional care or at risk of entering into it, are provided with appropriate financial and 'wrap around' support to meet their needs. In addition, any evaluation will need to look at the long-term financial viability of provision and identify best practice in this regard.

Finally, it is important to look at how local schemes will interact with new national provision, including Universal Credit. For example, it is possible that some applicants to local welfare schemes may have financial problems which warrant at least a short-term exception from the normal payment arrangements: such as having their benefits paid on a fortnightly rather than monthly basis. This type of issue will need to be picked up in discussions with DWP as part of the Local Support Services Framework being developed for Universal Credit.

## Conclusion

In order to tackle problem debt it is necessary that there are services to help people avoid, manage and resolve their debt. Financial literacy and capability continue to be an issue in Britain despite being one of the most financially developed countries in the world. Part of

623 Centre for Responsible Credit, *Local welfare provision, low-income households, and third sector financial services provision*, London: CfRC, 2013 [accessed via: <http://www.responsible-credit.org.uk/uimages/File/local%20welfare%20provision%20low-income%20households%20and%20third%20sector%20financial%20services%20final.pdf> (24/10/13)]

624 Ibid

625 Centre for Responsible Credit, *Intelligence on financial inclusion*, London, Friends Provident Foundation 2013 [accessed via: <http://www.responsible-credit.org.uk/uimages/File/FPF%20Social%20Fund%20summary%20April%202013.pdf> (24/10/13)]

626 Ibid

this is due to the increasing complexity of modern financial products that place a significant barrier to access and can often lead to people choosing inappropriate products that they do not need or cannot afford. The burden in this area should be shared, with a national drive to improve financial capability and literacy, however, financial institutions also need to work to make their products more transparent and accessible.

For those that struggle with their debt it is crucial that there is sufficient support for the 'free to client' debt advice services, including face-to-face services for some of the most vulnerable clients. These services are essential to help people resolve their debt problems and current levels of awareness about free services are still worryingly low. It is also essential that the punitive component of insolvency solutions, especially the DRO, do not limit people from returning to work and leave them trapped in unemployment and vulnerable to more debt problems. This is obviously a balancing act as the complete removal of any punitive measures would mean there was no incentive to avoid debt in the first place.

Lastly, in the long run it is essential that there are affordable and ethical financial services available for the poorest and most financial excluded. Developing credit unions and CDFIs cannot happen overnight, but the Government's support is a valuable first step towards greater sustainability and expansion within this sector. The development of a truly sustainable alternative financial system embedded in communities could potentially alleviate much of Britain's debt problem by bringing about a culture change to encourage savings and financial responsibility.

# Conclusion

Rising personal debt levels represent a significant problem for people in Britain. While most personal debt is healthy and manageable, such as an affordable mortgage, student loan or low-interest credit card used to bridge income gaps, for many people their debt has become unhealthy and unmanageable.

While people of all income levels can end up seeking debt advice or declaring bankruptcy, the problem of debt seems to be more of an issue for low-income and vulnerable households. A perfect storm of rising living costs, decreasing real wages, low savings and expensive credit seems to have pushed many to the edge and over a financial cliff edge.

There is no one cause and problem debt affects everyone differently, but many of those who are struggling often share similar challenges. There are recurring risk factors such as unemployment, social tenant, single parenthood, older and younger age groups, financial exclusion as well as persistent low and irregular income. Similarly, issues such as family breakdown, poor mental health and addiction are not only more prevalent amongst these groups, but can cause, and be worsened by problem debt.

Not everyone in this group is in debt by any means, but the interrelated nature of many risk factors and the severity of the impact mean there is no question but that action is needed. This 'state of the nation' has set out the scale of the problem but provided no solutions. In the follow-up report as part of the CSJ's Breakthrough Britain II project we will be looking at ways to alleviate or reverse the trends identified here.

- Based on the findings of this report we will be looking at the following areas:
- Access to affordable credit for low-income and financial excluded households;
- The development of alternative financial providers through the promotion of mainstream membership, savings and partnerships with employers;
- Ensuring lenders are responsible, transparent and that debt collection practices do not inflict harm on people;
- Helping develop financial literacy, education and capability so people can avoid debt.

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