Financial Conduct Authority

Consumer credit and consumers in vulnerable circumstances

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Contents

Executive summary

Consumer credit is an important part of UK financial services and the UK economy, helping people smooth their income and providing them with greater flexibility over their spending. However, we know that many millions of people across the UK get into problems paying back debt, overstretching themselves and suffering both financial and non-financial detriment. A recent study from the Money Advice Service found almost 9 million people over-indebted, with over-indebtedness shown across the income spectrum.

The most important factors contributing to unmanageable debt are a change in circumstances and high levels of accumulated debt. Low savings, income volatility and high debt/income ratios, can all reduce people's resilience to income shocks and increase the likelihood of problem debt occurring. Problems can be further compounded by individual skills, knowledge, confidence and biases, and through a lack of access to credit.

To understand more about the experiences of consumers most at risk of unmanageable debt, we have conducted primary research looking at the attitudes towards, and use of, credit for people on the lowest incomes.[1] This builds on our segmentation.

This research identifies three distinct borrower groups:

- survival borrowers;
- lifestyle borrowers; and
- reluctant borrowers.

Survival borrowers tend to use credit often to meet day to day expenses, and it tends to be less mainstream. Lifestyle borrowers also tend to use less mainstream credit, but mainly for one-off expenses. Reluctant borrowers tend to be struggling with mainstream credit acquired when they had more disposable income, and are likely to be reluctant to take on more borrowing.

Because of these characteristics, groups use different credit products, for different reasons:

- Survival borrowers, due to very tight finances, often feel they have 'no option' but to borrow due to lack of income. Catalogue credit and home credit are very popular forms of credit with this group due to ease of access and low weekly payments.
- Lifestyle borrowers also use catalogue and home credit, but for different reasons. These borrowers generally have sufficient income for day-to-day expenses but use credit for larger purchases or one-off events, and feel in control when minimum payments are being met.

1 'Consumer Credit Research: Low income Consumers', Optimisa, 2014, at www.fca.org.uk/news/consumers/consumer-credit-research

- Reluctant borrowers, who tend to limit their use of credit, focus on paying back existing debts, often from more mainstream sources such as bank loans and credit cards.

These groups are not static, and our research shows that people can move between groups through a change of circumstances, further accumulation of debt, or by getting help.

Across all borrowing groups, we found that choice is heavily influenced by behavioural biases and preferences – with many prioritising flexibility, control, and familiarity over absolute cost – and by a lack of access to alternative forms of credit, perceived or otherwise. Consumers' circumstances and behaviours in all groups can mean high costs associated with credit use.

Our research explores the main reasons why debt becomes unmanageable, and the strategies people use to cope with spiralling debts, showing how unmanageable debt triggers both financial detriment and affects health and wellbeing. While many of the people we interviewed had low awareness of the help and support available to them, debt advice is effective in helping people get out of unmanageable debt. Helping people get the right advice and solution they need, before debt gets out of control, is therefore vital.

This work will help us as we engage in discussions with stakeholders, including firms, about consumer outcomes for this market. This includes the work we have already announced in our business plan on: tackling risks in high-cost short-term credit; addressing issues with credit cards, overdrafts, and log book lending; improving financial promotions; and improving debt management.

Our research shows the vital role that debt advice can play. As we take over the regulation of this sector, we welcome a broader debate with stakeholders to encourage more people to get access to good quality advice earlier, before they reach crisis point.

CHAPTER 1 – Consumers in vulnerable circumstances and unmanageable debt

Summary:

- Consumers in vulnerable circumstances are those who are especially susceptible to detriment.
- Almost nine million people in the UK are over-indebted.
- Low income is the most common single feature exhibited by consumers in vulnerable circumstances.
- Low income consumers can be particularly vulnerable for a variety of reasons but most significantly they tend to be very vulnerable to income or expenditure shocks.

Definition of 'consumers in vulnerable circumstances'

Vulnerability is such a subjective term that it is hard to define. Indeed, most users of consumer credit may be regarded as 'vulnerable' to some degree because of their financial circumstance. **We consider a vulnerable consumer to be someone who, due to their personal circumstances, is especially susceptible to detriment.**

When looking at people's use of consumer credit, detriment can manifest itself in many ways. For example, people can choose the wrong product, pay a high price, fail to get the right product that serves their needs, or be treated unfairly by their chosen provider. **However, the most significant detriment occurs when people, through the use of consumer credit, get into unmanageable or problem debt.** This can often lead to spiralling problems, leading to both financial and non-financial costs.

Scale of over indebtedness

There are many ways of defining over-indebtedness – objectively by looking at levels of debt repayments relative to someone's income or instances of falling behind on credit commitments, or subjectively by asking people how much of a burden their debt is.

Our consumer research shows that perceptions of what people consider to be debt can vary. For example, while the people we interviewed considered bank loans, mortgages and payday loans as 'undisputed borrowing', many did not consider catalogues, 'buy now pay later' credit or overdrafts as debt.[2]

2 'Consumer Credit Research: Low Income Consumers', Optimisa, 2014

Much of the existing research excludes student loans or mortgages or focused on unsecured credit, so may underestimate the scale of the problem.

Objective figures such as those from the 2012 YouGov Debt Track survey suggest that 6% of the UK population are falling behind with their credit commitments.[3] Subjective measures suggest that the figures are higher. In one research paper, 12% cite debt as a heavy burden[4] while another reports 25% saying they feel burdened by debt.[5]

The Money Advice Service recently published the conclusions from research into the over-indebted population, which combined both the objective measures – being at least three months behind with a bill or credit commitment– and subjective measures – feeling debt is a heavy burden. It estimates that 8.8 million individuals (18% of the adult population) are over-indebted in the UK,[6] with over-indebtedness being shown across the income spectrum.

We detail below the factors that can increase the likelihood of over-indebtedness becoming unmanageable debt.

What makes consumers in vulnerable circumstances susceptible to unmanageable debt?

There are two key factors that increase the likelihood of unmanageable debt occurring: **a change in circumstances** and **high levels of accumulated debt**.

There is extensive evidence showing that **people are particularly susceptible to detriment when they experience changes in their circumstances.**[7] Consequently, vulnerability can be long-term or it can be a dynamic state that affects some consumers at different times.[8]

People can be spending a high percentage of their income servicing debt either because they have taken on large absolute levels of debt (which may have been affected by rising costs of living) or because they are on low incomes. While these high debt levels are not necessarily a problem so long as households have the means to continue servicing and repaying them, **highly-indebted households may be more likely to face to financial difficulties** if affected by adverse economic shocks, such as unemployment.[9]

Other external factors can leave people less resilient to an unexpected change in circumstance or getting into problems with high levels of debt.

High levels of debt are particularly worrying when combined with high repayment ratios. As we show in Chapter 2, there is a strong correlation between income and both high debt to income proportions and high repayment to income ratios. According to data published by the Department for Business, Innovation and Skills, almost 30% of households that had borrowed money and had an income of less than £13,500 per year reported spending

3 'Credit, Debt and Financial Difficulty in Britain', Department for Business, Innovation and Skills, 2013

4 Ibid.

5 'Tomorrow's Borrowers', The Smith Institute, 2013

6 'Personalising the debt sector', Money Advice Service, 2013

7 For example Optimisa, 2014; 'Credit and Debt in Low Income Families', Joseph Rowntree Foundation, 2010; 2013 Client Survey Provider KPIs, Debt Resolution Forum, 2013

8 'Tackling consumer vulnerability. An action plan for empowerment', Consumer Focus, 2012

9 'Overindebtedness in Great Britain', ISER, 2010

more than 30% of their income on servicing debts (compared to only 10% of households on incomes between £25,000 and £50,000).[10]

Greater levels of income volatility can decrease resilience to income shocks. Some people have an irregular income due to being employed in jobs based on hours worked, rather than a monthly salary, or through 'zero-hours' contracts, which provide less stability of work and income.[11] Stable employment is important – both to facilitate access to many financial products and to secure best value from those that are purchased.

Low levels of savings can also make people less resilient. As we would expect given pressures on day-to-day incomes, levels of savings are correlated with income. Around 8.4 million households in the UK have no savings at all, which rises to 70% of people in the lowest income quintile.[12] 3.9 million lower-income families would be unable to pay their rent or mortgage for more than a month if they lost their job.[13]

Lack of access to financial products and services can drive people to higher cost forms of credit, which can increase the risk of unmanageable debt. 1.4 million people in the UK do not have a transactional bank account (more than 33% of whom are in the lowest income decile).[14] Many, particularly those on low incomes, do not have access to a range of mainstream, often lower cost, credit options. Friends Provident research found 1.1 million people on low incomes need credit but are unable to borrow.[15] Other research also supports this.[16]

Individual and behavioural factors increasing vulnerability

While people's attitudes towards credit are generally positive, as we explore further in Chapter 3, many people have **specific behaviours, preferences and biases** that can lead them to prioritise factors such as certainty of approval, flexibility and familiarity, over the absolute cost of credit. These preferences can also lead to **increased costs when using mainstream products**, such as incurring fees for unauthorised overdrafts or paying minimum balances on credit cards.

Knowledge of consumer credit products varies. Our qualitative research found a lack of shopping around both within a particular product type and between products. This was often due to assumptions around credit options, convenience or lack of understanding.[17]

There is some more worrying evidence that **people lack confidence when engaging with financial products and debt solutions**. Our research found that many borrowers lacked the confidence to be able to budget and manage their money effectively, often stemming from negative experiences in the past.[18] Lack of confidence can undermine choices, with many people assuming they would not get mainstream credit, therefore self-restricting choice. The Money Advice Service found that 41% of the over-indebted population lack the skills and confidence to deal with their creditors, and 44% do not know about the debt solutions

10 'Credit, Debt and Financial Difficulty in Britain', Department for Business, Innovation and Skills, 2013
11 'Maxed Out', Centre for Social Justice, 2013
12 Ibid.
13 Ibid.
14 Ibid.
15 'Credit and low income consumers', Friends Provident, 2011
16 Such as 'Financial Inclusion in the UK', Joseph Rowntree Foundation, 2009; 'Financial Exclusion', Resolution Foundation
17 'Consumer Credit Research: Low Income Consumers', Optimisa, 2014
18 Ibid.

available to them when they get into trouble.[19] Lack of confidence can also manifest itself in not seeking help, or recognising a problem, at the right time. Only 17% of the over-indebted population are currently accessing debt advice and 16% of people report that they would never consider getting advice.[20]

Some research shows a correlation between attitudes towards money and credit and problem debt. This includes a **correlation between self-control, financial literacy, and over-indebtedness,**[21] with a lack of 'self-control' towards spending increasing the likelihood of problem debt occurring.

All of these factors, both externally influenced and individual behaviour, can combine in various ways to make certain groups of people more at risk of getting into problem debt. We explore these groups below.

Who are consumers in vulnerable circumstances?

While all consumers can be vulnerable to over-indebtedness, the risk factors outlined above combine around those people on low incomes. The relationship between low income and unmanagable debt is articulated in a wide range of literature.[22] People on low incomes are far more likely to have high levels of debt and income gearing, have little or no savings, have greater levels of income volatility, and often lack access to financial products and services.

While low levels of product knowledge or confidence are by no means exclusive to those on low incomes, they can compound these external factors, which can be further influenced by particular behavioural factors that can increase problems with credit usage.

It comes as no surprise, therefore, that our analysis of who is in debt finds that those on low incomes are the common denominator. But there are other factors that characterise people in unmanageable debt, which we explore briefly below.

Our quantitative research exploring consumer drivers and influences when making financial decisions shows four particular segments that are more likely to find themselves in financial difficulty (see Figure 1): hard pressed, starting out, striving and supporting, and living for now. Common factors for these four segments appear to be **low income** and **lack of savings**. Other similarities, in common with other research,[23] include **younger adults**, those in **receipt of benefits** and those **living in rented accomodation**.

19 'Indebted Lives', Money Advice Service, 2013

20 Ibid

21 'Self-Control, Financial Literacy and Consumer Over-Indebtedness', Centre for Finance and Credit Markets, 2012

22 Such as 'Maxed Out', Centre for Social Justice, 2013; 'Regulating Consumer Credit', NAO, 2012; 'Credit and low income consumers', Friends Provident, 2011

23 Such as 'Indebted Lives', Money Advice Service, 2013; 'Credit, Debt and Financial Difficulty in Britain', BIS, 2013

Figure 1

Segment	% found themselves in financial difficulties over the past five years (UK average across all population segments – 15%)	Key statistics
Hard pressed	28%	10% of the population 45% aged between 15 and 35 52% have a household income below £10,000 64% live in social housing 31% are unemployed 49% are on benefits 72% have less than £500 in savings 59% have no savings or investments
Starting out	25%	9% of the population 60% aged between 15 and 34 57% have a household income below £20,000 66% do not save or invest 25% have pension provision 58% live in privately rented accomodation
Striving and supporting	22%	8% of the population 49% aged between 25 and 44 58% have dependent children 46% receive child benefits 50% rent privately or are in social housing 57% have a household income below £20,000 38% have less than £500 in savings 34% have pension provision
Living for now	20%	14% of the population 28% aged between 15 and 24 43% have a household income below £20,000 55% rent privatly or are in social housing 53% have savings less than £2,500

Consumers with **mental health problems** are also particularly at risk of over-indebtedness. While the 'triggers' for getting into unmanageable debt appear consistent with other groups, recent research found that mental health conditions were the primary driver of debt for one in 12 of Christians Against Poverty's debt advice clients.[24]

> *'I was forced to give up my job a few months ago due to my mental health problems. I have had to move to a smaller property as a result of this. I am now doing some work at home but this doesn't cover the bills and I don't feel emotionally strong enough to return to work.'*[25]

Despite **people over the age of 65** being less likely to be over-indebted, with 1% of the over-indebted population comprising of over 65s[26], there are still particular risk factors. These include lower than expected returns on savings, decreasing annuity rates, increase in energy and food costs, and increased job and income insecurity. As with other vulnerable groups, low income is associated with an increased risk of falling into problem debt, and can create greater hardship in the elderly due to lack of potential for higher earnings in the future, vulnerability to interest rate fluctuations and health problems leading to additional pressures on spending.

24 Christians Against Poverty, 2013

25 'Working together: understanding motivations and barriers to engagement in the consumer debt marketplace', Arrow/Bristol, 2013

26 'Indebted Lives', Money Advice Service, 2013

CHAPTER 2 – The wider landscape

Summary:
- Debt levels are high in absolute terms. More recently, levels of unsecured debt have started increasing again and this is likely to continue, including for low income consumers.
- The number of people seeking debt advice is going up but is still very low at only 17% of the over-indebted population.
- Those on low incomes have high debt to income ratios.
- Savings are low and are likely to continue to stay low. Inadequate savings leads to vulnerability.
- The use of high cost credit has recently increased for the lowest income households.

To evaluate the impact and likely trends associated with consumers in vulnerable circumstances in the consumer credit market it is important to consider the backdrop and some wider economic issues and trends which impact vulnerability.

Credit for the UK population overall

Absolute debt levels are high. The UK population had become considerably more indebted over the past two decades, primarily driven by the huge increase in mortgage debt. We now owe £1,476 billion, an average of nearly £56,000 per household, £6,000 of which is consumer credit.[27]

Figure 2 illustrates the slight decrease in consumer credit from its peak in 2008. However, this was due to a combination of consumers deleveraging in 2009, 2010 and 2011 and banks writing off debt. As Figure 3 shows, the net lending figures for 2012 and 2013 show a return to positive growth.

27 Our calculation based on Bank of England data as at 31st March 2013 (not inflation adjusted)

Figure 2 – Total UK Household debt 1993-2013[28]

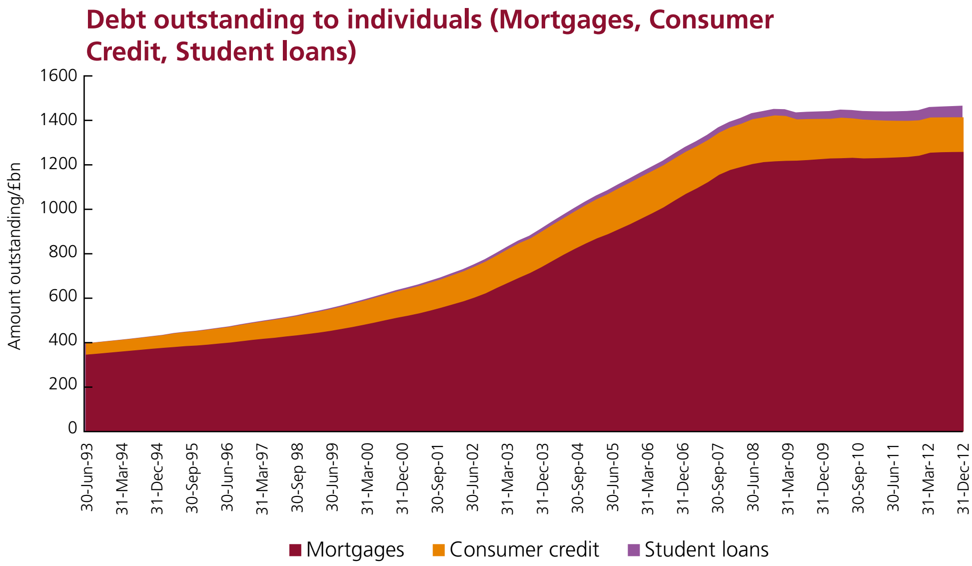
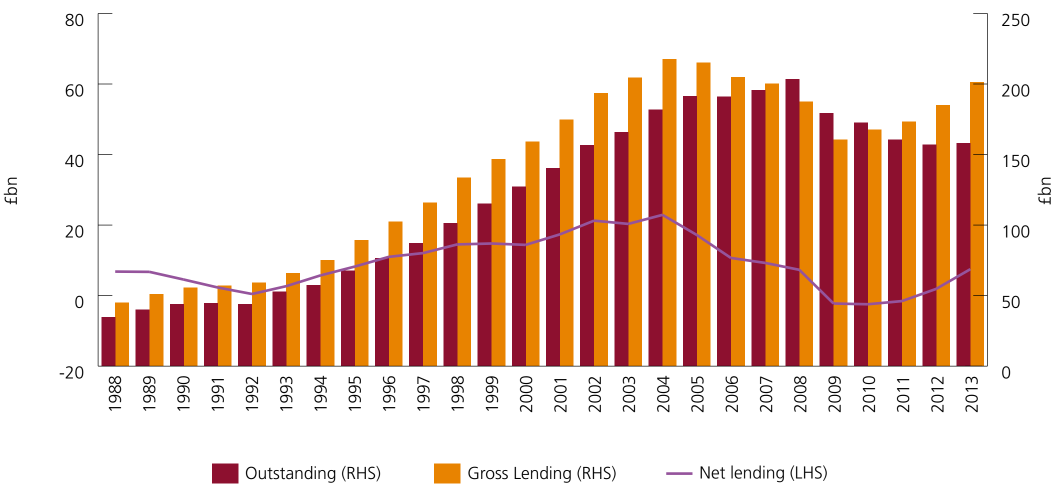


Figure 3 – Consumer credit lending 1988-2013[29]



Pressures on increasing credit usage are likely to remain in the medium term. The Smith Institute projected likely patterns of behaviour, and predicts that consumer debt will increase over the next 10 years due to a variety of factors, including current 'overhang' of unmanageable debt from pre-recession, the impact of welfare reform and sluggish wage growth.[30]

More people are seeking help with debt. Research by Zero-credit (data in figure 4) shows that total new debt solutions starting each year have increased by almost 40% since 2007, although it is still low compared to the amount of people who could benefit.[31] The increase since 2007 could be due to a number of factors, including greater awareness of debt solutions,

28 Bank of England data

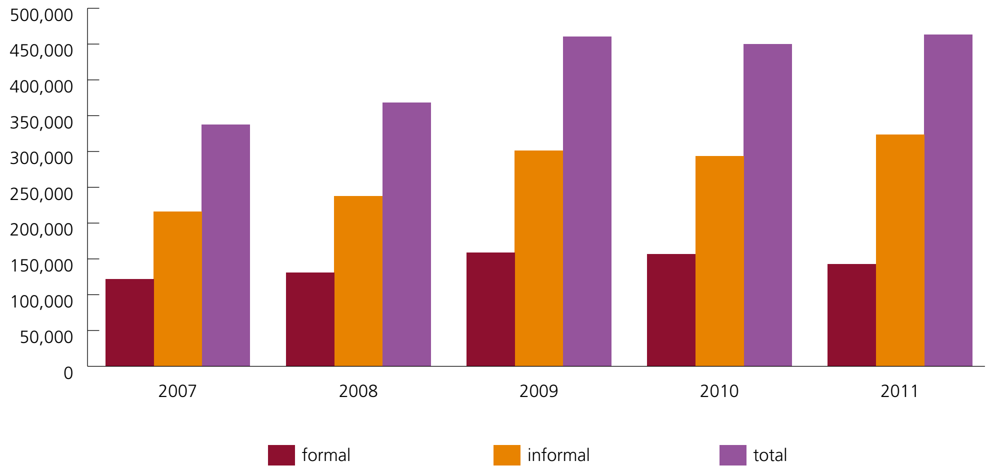
29 Bank of England data

30 'Tomorrow's Borrowers', The Smith Institute, 2013

31 'Debt Resolution in the UK', Zero-credit research and report commissioned by The Debt Resolution Forum, 2012

improved referrals from firms, or more entrenched problem debt. More recent figures from the Money Advice Service cite that the number of people who now access debt advice has risen to 1.5 million but that this still represents only 17% of the over-indebted population.[32]

Figure 4 – UK Debt Solutions Starting in 2007 – June 2011[33]



Consumer credit market – Product factors and trends

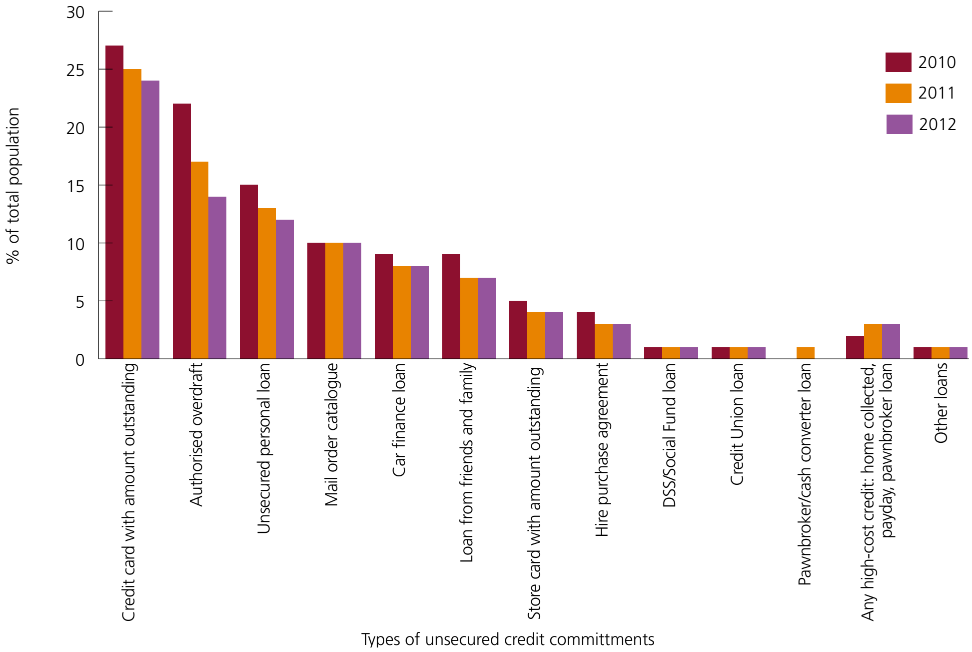
After a long period of sustained consumer credit growth, consumer credit lending fell after the financial crisis, only more recently showing signs of an upward trend. As Figure 5 shows, the decrease between 2010 and 2012 is most evident in the use of overdrafts, consistent with the tightening availability of credit post-financial crisis. The exception to the downward trend has been an increase in people using high-cost credit, although this remains small.

This chart also shows that debt on credit cards is significantly more prevalent than other forms of credit, 24% of people have credit cards with debt outstanding on them, compared to just 14% using authorised overdrafts and 12% using unsecured personal loans.

32 'Indebted Lives', Money Advice Service, 2013

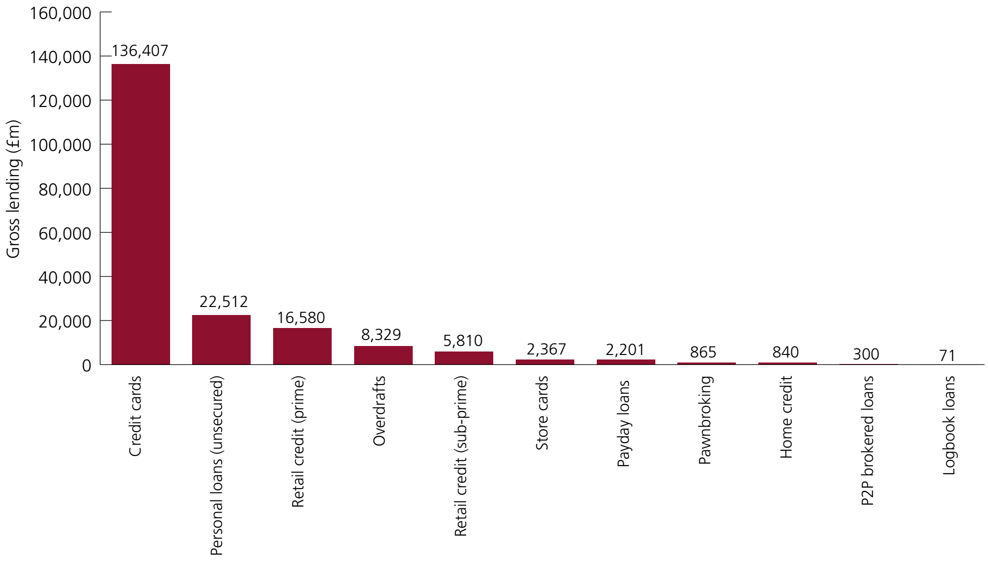
33 'Debt Resolution in the UK', Zero-credit research and report commissioned by The Debt Resolution Forum, 2012

Figure 5 – Types of unsecured credit commitments[34]



Looking at **gross lending**, credit cards are by far the biggest source of unsecured credit. There were 63 million credit cards in circulation in 2013, an increase of 50% since 1998.[35]

Figure 6 – Gross lending by credit product (June 2012 – June 2013)[36]



34 Data from 'Credit, Debt and Financial Difficulty in Britain', 2011 – 2013
35 Market Trends, UK, Card Association, Q1 2013
36 Sources: Datamonitor, FLA, Mintel, BIS, NPA, CCA

Economic and market context

Consumer savings are low and may fall further. We know that savings are an important factor protecting consumers from getting into problem debt.

Unsurprisingly, at the same time as consumers took on more credit, their savings fell quite substantially. The household savings ratio fell to historically low levels between 2000 and 2008. Despite a more recent rise, some research has predicted that the savings ratio may fall from 7.2% in 2010 to 5% in 2017,[37] a level well below that of 20 years ago.

Currently, around 8.4 million UK households (one in three) have no savings at all and in households with income under £15,600 half have no savings.[38]

Interest rates are likely to rise and this will negatively affect borrowers. Low interest rates have cushioned many households with mortgages and debts, but it is likely that rates will rise eventually and this will increase the servicing costs for debt laden households. In particular it is likely to have a substantial impact on people with mortgages.

Employment levels are improving and this should increase general levels of resilience. However, the increased use of zero hour contracts and non-voluntary part-time workers is still a concern in terms of its likely effect on consumer vulnerability.

There is a cost of living squeeze where household income is likely to continue to come under pressure as earnings growth continues to lag behind price inflation.[39] There is also evidence to suggest that, on average, lower income households can experience higher inflation rates compared to higher income households, so although headline inflation fell to 2% in December 2013[40] and the Monetary Policy Committee expects inflation to remain at, or slightly below, the target over the forecast period, the impact of this on stretched consumers is unlikely to be positive.

We have highlighted in the previous chapter that it can be more difficult for certain groups like the sick or elderly to rely on increased earnings to get out of debt. Therefore it is **expected that the retired will have higher debts than the current generation of retirees** due to a decline in the savings culture, pressures on incomes and the greater normalisation of debt from student loans and other sources of credit. This is likely to lead to an increase in the numbers of consumers in vulnerable circumstances over the longer term.

The consumer credit market for low income consumers

The modest recent decline post crisis in the overall consumer credit market is reflected in decreasing demand among consumers in vulnerable circumstances. Overall, applications for unsecured credit from those on lower incomes declined by around 5% in the two years from 2010.

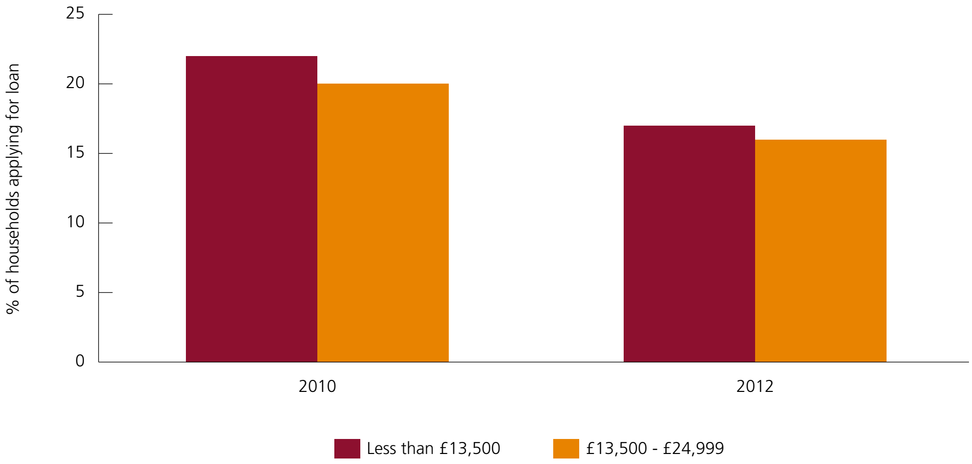
37 'Maxed Out', Centre for Social Justice, 2013

38 Ibid

39 ONS data, 2014

40 Inflation report, Bank of England, 2013

Figure 7 – Households applying for unsecured credit/loan in last 6 months by household income[41]

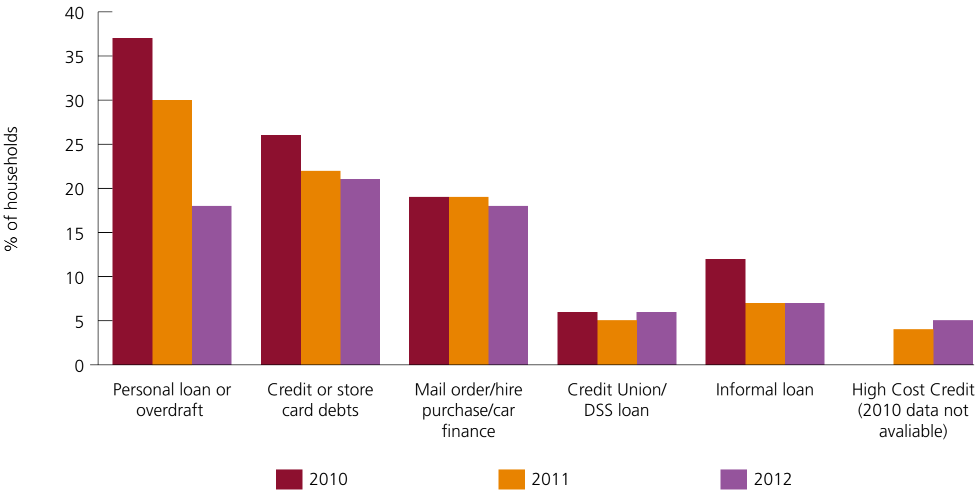


As figure 8 shows credit and store cards, personal loans, and overdrafts are the most common types of credit product for households with income less than £25,000. The use of personal loans and overdrafts have declined as forms of credit used by those on low incomes since 2010.

There is some evidence of an increase in the use of high-cost credit by those on the lowest incomes. High-Cost credit includes home credit, payday loans, and pawnbrokers. This has many drivers, such as increasingly tight budgets of those on low incomes and the greater prevalence of high-cost short-term credit available in recent years.

41 Data from 'Credit, Debt and Financial Difficulty in Britain', 2011 – 2013

Figure 8 – Types of credit used by households with income below £13,500 (2010 – 2012)[42]



Significantly more people with household earnings between £13,500 and £24,999 are using personal loans, overdrafts and credit cards, than those on the very lowest incomes.

Figure 9 – Types of credit used by households with income below £13,500 – £24,999 (2010 – 2012)[43]

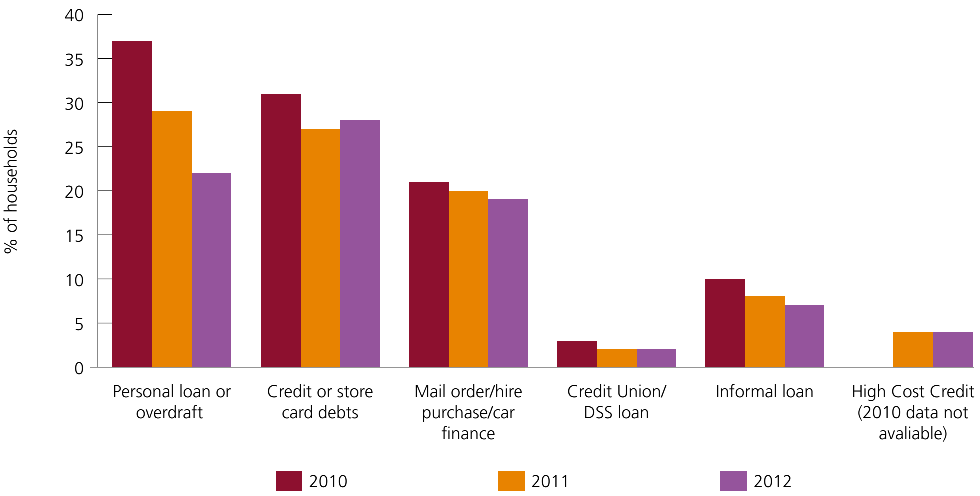
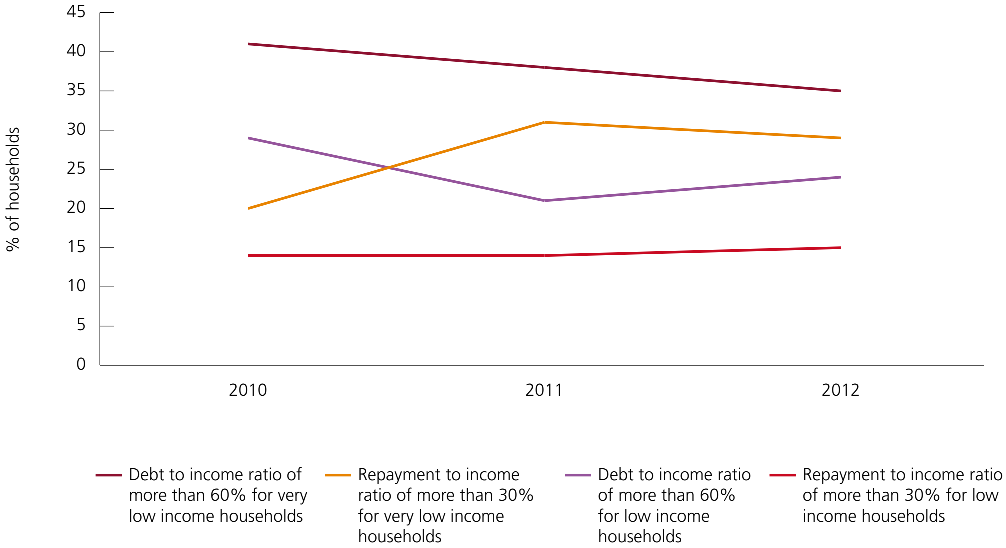


Figure 10 shows that those **on low incomes appear to be have higher debt/income ratios** increasing the likelihood of affordability problems and getting into unmanageable debt.

42 Data from 'Credit, Debt and Financial Difficulty in Britain', 2011 – 2013 using data from YouGov DebtTrack self-completion survey administered online

43 Ibid

Figure 10 – Measures of indebtedness for low income (£13,500 – £25,000) and very low income (<£13,500) households[44]



44 Data from 'Credit, Debt and Financial Difficulty in Britain', BIS, 2011 – 2013

CHAPTER 3 – Consumer journey

Summary:

- There are particular behavioural biases and access issues that influence product choices for consumers in vulnerable circumstances.
- We have identified three borrower groups – survival borrowers, lifestyle borrowers and reluctant borrowers – and explored their attitudes and uses of credit.
- The types of credit used by consumers in vulnerable circumstances are similar to wider consumers, such as overdrafts and credit cards. However, our research found those on very low incomes make greater use of other forms of credit, such as home credit and catalogue credit.

Specific behavioural factors and preferences influencing choice of credit

We commissioned new qualitative research to understand the reasons why consumers in vulnerable circumstances use credit and the reasons why particular products are chosen. The research involved 33 in-depth interviews of individuals with a household income in the bottom 10-15% of household incomes in the UK who have had or currently have difficulties with debt, and enabled us to gain further insight into the experiences of low income credit users, including the different uses for credit, how different credit products work for them and the trade-offs they make, as well as the understanding how consumer credit can lead to unmanageable debt.

Low income households, similarly to those on higher incomes, use credit to manage peaks of income and expenditure across a month or a year. However, there is evidence that some of those on the lowest incomes use credit to survive, paying for everyday essentials, such as food, rent and bills.[45]

Our research found several behavioural factors and preferences that influenced choice of credit:[46]

- **Flexibility:** users prefer flexible repayments and prefer to use lenders that recognise the difficultly of maintaining regular payments, and allow people to be 'let off' missed payments. Aligned to this is the importance of **control** and the feeling that more 'traditional' lenders gave little control around what people could borrow and no bargaining power to influence the terms and conditions.

45 Various sources, such as 'Making Ends Meet', Consumer Focus, 2011; Friends Provident, 2011, Optimisa, 2014

46 'Consumer Credit Research: Low Income Consumers', Optimisa, 2014

- **Certainty of approval and repayments:** those on low incomes wanted to be certain that they would get the money they needed before they applied. Many did not use banks and credit cards due to a 'fear of rejection'. While some had experiences in the past of being turned down by providers, for some this was a perception of what would happen if they applied for mainstream credit.

- **Familiarity and trust:** our research found that people lacked familiarity with some forms of lending and were more likely to use lenders that they (and often their friends and family) had previously used. This preference for familiarity is also shown in being receptive to face to face contact from lenders, valuing 'personal service' and often seeing mainstream lenders as remote and impersonal.

These factors are also reflected in other research. For example, Consumer Focus identified control, convenience and clarity as the main influences on borrowing decisions.[47]

> *'Just a letter with my name and address on, that was it. Date of birth, name, letter to prove that's where you lived… You borrow £100, pay £140 back, that was it, there was no this is the interest rate, this is, you know, the APR or whatever. All you needed was a couple of people to say they know you, you are a good payer and not a risk and that's what they're looking for.'*[48]

FCA research

Our research identified three distinct borrower 'typologies' – survival borrowers, lifestyle borrowers and reluctant borrowers.[49] These categories are not static and we have also gathered some evidence that borrowers can move between these typologies due to external influences on attitudes and behaviours, as we explore in Chapter 4.

Survival borrowers borrow to supplement their income for day-to-day expenses. This group tend to be on benefits or very low income and potentially face the highest risk of detriment. They are more comfortable using home credit, catalogue credit and rent to own than mainstream forms of lending, which they perceive they do not have access to. The majority focus on the affordability of repayments, which are usually low weekly amounts.

The most prevalent credit products used for this group were:

- Home credit – seen as friendly, flexible and non-judgemental.

- DSS loans – perceived as 'free money' from Government.

- Catalogues – used mostly for white goods as well as clothing, many did not consider this a form of borrowing.

- Rent to own – used because they were seen to be likely to get approval, they were primarily used to buy white goods.

- Payday loans – less common but used by some of this group who were in employment.

47 'Making ends meet', Consumer Focus, 2012
48 'Consumer Credit Research: Low Income Consumers', Optimisa, 2014
49 Ibid

- Unlicensed lender – advantages of familiarity of relationship.

- Credit unions – often referred by support service, aimed at their situation, high likelihood of approval.

This group are much less likely to use more mainstream forms of credit – bank loans, overdrafts, mortgages, credit cards, store cards – due to the perception that they would be unlikely to be approved. They were also less likely to use online credit as it was seen as impersonal and inflexible. They had limited awareness of other forms of credit, such as logbook loans.

Case study – survival borrower (woman, 24)
Single, unemployed, left home at 14, left school at 15, returned aged 16 to complete GCSEs, moved into a hostel at 17.

Current borrowing and debts
2 payday loans for £200 – does not know the repayment total, Social Department (maximum) – does not know the amount.

'They could take my stuff, it's not a bad thing, I'd just go to another catalogue and buy everything back, obviously I'd be working that would clear my debt and I could restart.'

Relies solely on benefits, which never entirely cover the bills and food, repaying a Social Department loan has reduced her benefit for £113 to £73 every two weeks.

She has previously been in full-time employment, but spent most of adult life unemployed and on benefits. She is completely self-reliant, with little support from family members. She occasionally gets help from friends for items such as clothes. However, when they have been unable to help she has turned to shoplifting to get by.

When she has taken out credit, she has no way of repaying and is fully aware of this at the time of application. However, she has little fear of the consequences as she believes she has little they could take away. She was interested to hear about services provided by debt advice organisations and has aspirations to be in full-time work.

Implications of debt
Financial: She has no disposable income to be able to pay off debts or take out credit.

Psychological: She suffers from severe anxiety, stopping her leaving home, exacerbating her debts.

Lifestyle borrowers use credit for 'one off' purchases. This group tends to have many small borrowings and are likely to have seen some recent reduction of their income. As with survival borrowers, they tend to feel most comfortable with home credit, store cards, catalogues and online credit, rather than more mainstream lending.

The most prevalent credit products used for this group were:

- Catalogues – attractive as seen as little pressure to pay as long as make minimum payments and commonly used for clothes and home furnishings.

- Home credit – seen as friendly, convenient, flexible and commonly used to supplement income.
- Online credit – less common and tended to be attractive due to small payments.
- Buy now pay later – less common but used for larger purchases if approved.
- Store cards – some people were likely to use these if offered by a retailer.
- Rent to own – most people recognised the high costs but were willing to use for emergency (i.e. white goods) if other options were unavailable.

This group is also less likely to use more mainstream forms of credit – mortgages, bank loans, credit cards or overdrafts – due to the assumption that they are ineligible due to credit score or have had previous problems paying back in the past. Similarly, this group had a low awareness of credit unions and logbook loans.

Case study – lifestyle borrower (man, 26)

Lives with partner in privately rented accommodation, partner is pregnant with their first child.

Current borrowing and debts

Second home credit loan – borrowed £200, to pay back £320.

'It's good – they come to the house every week to get the money… it is only £10 a week… I asked her [agent] about paying more quickly if I have a bit extra one week but she said no, we have to build up a history.'

He has been in and out of employment since leaving school, but has been unemployed for two years now. He applies for jobs but usually hears nothing back. He said that he feels 'skint' and anxious about needing more money when the baby arrives. He manages money entirely by cash, with all benefits withdrawn and sorted into 'pots' for bills, food, loan repayment etc. Any small change gets saved into a money box. He seems neither confident nor engaged with banks, with his partner only using a current account to receive benefits.

He had no money for home improvements when they moved into their house over a year ago. He once asked a bank for a loan but was told that he needed a job. He tried to apply to payday lender but was not accepted. He was given a premium rate number to call to discuss the reasons why, but he could not afford to call. He took out an initial £100 loan from a home credit provider after hearing about them locally and through friends. He immediately took another £200 loan to pay for home improvements, as he was told that he was now eligible to borrow more. He finds the home collection convenient and the agent to be friendly, flexible and helpful.

Implications of debt

Financial: potentially may become a serial home credit user.

Psychological: feeling anxious about needing more money when the baby arrives, but otherwise comfortable with weekly affordable repayments.

Reluctant borrowers are people who have seen their income fall and struggle to manage credit acquired when they had more disposable income. They are very reluctant to take on new borrowings and many are likely to be struggling with repayments. They tend to have more mainstream forms of credit such as mortgages, bank loans and credit cards.

The most prevalent credit products used for this group were:

- Mortgages – taken out when their disposable income was higher.
- Bank loans – mostly taken out when income was higher and now focused on paying them off.
- Credit cards – many still have them having taken them out in the past, but are now hesitant to use them.
- Hire Purchase Agreement (at 0%) – some limited use as an enabler to improve financial circumstances.
- Friends and family – to help out in an emergency.
- This group is much less likely to take on new credit commitments. They commonly perceive store cards, catalogue cards, rent to own and buy now pay later as spending beyond their means and consider overdrafts to be an expensive way to borrow.

Case study – reluctant borrower (woman, 62)

Lives with husband in rented accommodation following house repossession, son and daughter moved out, lost their family business five years ago, husband suffers from depression due to loss of business and she finds it difficult to cope.

Current borrowing and debts

£120,000 of debt, in a repayment plan with a debt management company, repaying £40 per month.

'I look back now and wonder were we on the ball enough… it was awful when they were relentlessly harassing me… different debt management companies calling me up… I didn't know who I owed money to.'

For the last few years she and her husband have received a state pension of £195 a week, before that she worked on and off. She cannot afford to heat all of the rooms in their home and cuts out or juggles essentials such as food, cleaning and utilities week by week. She is very careful with money and knows exactly how much cash she has in her purse and what she can afford to spend.

She took out her first loan 20 years ago (a hire purchase agreement from car dealership), not shopping around. They took out various personal and big business loans from a bank (£50,000 max loan) for cars, holidays and vans. She always went to the bank as she knew they would lend her the money and she trusted them, wanting to keep all money in one place. She took out a credit card, which was sold to her when she went into the branch. She then took out credit cards for her children to buy essentials at school (her daughter and boyfriend spent thousands of pounds in some years).

After they lost their business they had accumulated approximately £120,000 debt. She initially sold jewellery (£900) and personal pensions and borrowed money from her sister. She 'cracked' and googled debt help and found a debt management company, who put her on a debt management plan. She took out a credit card with a few years ago to pay for emergencies and help with her credit rating.

Implications of debt

Financial: Credit taken when times were good, with no shopping around and limited consideration of interest rates. Very wary about taking out new credit and overspending.

Psychological: Struggling to come to terms with the loss and adapt to living on little money. Anxious about the debt and considers that she has little hope of getting out of debt 'in her lifetime'.

Types of credit used by low income groups

As shown in Chapter 2, credit use by consumers on low incomes is broadly similar to consumers in higher income brackets, with mainstream products such as overdrafts, credit cards and bank loans being the most popular sources of credit.

Our research has found that people on the lowest incomes have a distinct pattern of credit use and are more likely to use small sum, short term credit products, such as mail order credit, home credit, and loans from government.

Some consumers may have less access (or perceive they have less access) to mainstream forms of credit due to a number of factors, which we explore below.

Mainstream credit

Around a quarter of people on low incomes have **credit or store card debts**.[50]

The research we commissioned from Optimisa found that many consumers with credit cards did not actively use them, but still had credit card debts from when they were in a better financial position, but were now reluctant to use credit cards due to a change in circumstance. Consumers using credit to make ends meet and for emergency/discretionary spending tended not to use credit cards. The reasons for this included that they expected that they would not be approved, due to previous problems or assumptions about their credit score.[51]

Some quantitative research shows that **overdrafts** are a popular form of credit for those on low incomes.[52]

However, our research found few respondents saying they had used overdrafts. We found overdrafts as a common example of 'hidden borrowing', more likely to be overlooked as debt by respondents until prompted. As with credit cards, our research suggests that those using credit to make ends meet or for emergency/discretionary spending do not often use overdrafts. Reasons for this include not holding a current account or, if they do, assuming they would not be allowed an overdraft. Those in the sample who did have an overdraft considered them to be a 'good buffer' and had often had them in the past when in a better financial situation. However, they were also considered to be costly and difficult to access.[53]

Bank loans are used by some people on lower incomes, as seen in some qualitative research, although most studies show they are often a residual commitment for people when they were in better financial positions.

The Optimisa research reflects this, with those with bank loans focused on paying off a loan taken out when they had a higher income or using them to consolidate debts that they had. Bank loans were generally regarded as a reliable and safer credit. However, many considered that they could not get a bank loan, with some trying and failing. They are also seen as more formal so the implications of missing payments were more official. Related to this, they were perceived by participants as inflexible and impersonal.[54]

Non-mainstream credit

Non-mainstream forms of lending are often preferred by people on lower incomes because they are often seen as more flexible, more convenient and more accessible.

Home credit (i.e. borrowing from doorstep lending companies) is far more popular with people on lower incomes than other groups. According to the Competition Commission study in 2006, only 10% of home credit users had an income greater than £13,500.[55]

50 'Credit, Debt and Financial Difficulty in Britain', 2011 – 2013
51 'Consumer Credit Research: Low Income Consumers', Optimisa, 2014
52 Such as 'Credit, Debt and Financial Difficulty in Britain', 2011 – 2013
53 'Consumer Credit Research: Low Income Consumers', Optimisa, 2014
54 Ibid
55 Competition Commission review of Home Credit, 2006

Our research found that home credit has many features liked by users, such as providers being friendly and approachable, flexibility in terms of missing payments and offering manageable weekly repayments. Research has found that most users tend to use home credit repeatedly, developing friendly and long standing relationships with the collection agent[56]

> *'It plays a very big role in my life. The relationship I have with the lady who comes is, I've known her for a year and a half now and she's really nice. She doesn't just come to collect our money, she actually comes, sometimes she comes and has a cup of tea with my mum.'*[57]

However, it should also be noted that our research also indicated that some consumers in vulnerable circumstances had negative views of home credit, believing that agents target those who are particularly vulnerable.[58]

> *'I did try to pay them off and as soon as I got close to paying them off, they kind of stand there with money saying 'go on take it', and it's just too tempting, especially when they're saying 'rather than paying £15 a week, you can pay £10 a week and get £200, £300 in your hand tonight'. It's hard to say no.'*[59]

We have seen that **Catalogue credit** is one of the most important sources of credit for low income borrowers, used to purchase larger household items and other 'one off' purchases. Catalogues are often available locally through family and friends, or by direct postal application, with credit application procedures often seen as straightforward and easy to understand.

Our research found that catalogue credit was used for buying clothes, home furnishings, white goods, gifts, and emergency purchases, with our respondents valuing the flexibility and low weekly payments.[60]

Social fund budgeting loans are interest-free loans made by the Government and repaid by regular direct deduction from benefits. They are calculated according to fixed formulas dependent on the benefit received, on any outstanding Social Fund debts and on the level of any other continuing financial commitments. Loans are generally for amounts between £100 and £600 and paid back within 104 weeks. As shown in the Debt Track Data, these are predominantly used by those on very low incomes.[61] However our research found these were not widely used by our interviewees. While they were sometimes seen as 'free money', there were concerns about the decreasing benefit payments to finance them and not having enough left to live on.[62]

Our research found that people would borrow from **friends or family**, although we found that disadvantages such as emotional discomfort and friends and family being in equally difficult circumstances making them reluctant. And as we explore later, many borrowers seek help from friends and family when debt becomes unmanageable, often as a 'last resort' having attempted other solutions.[63]

56 'Consumer Credit Research: Low Income Consumers', Optimisa, 2014; Competition Commission review of Home Credit, 2006
57 'Consumer Credit Research: Low Income Consumers', Optimisa, 2014
58 Ibid
59 Ibid
60 Ibid
61 Data from 'Credit, Debt and Financial Difficulty in Britain', BIS, 2011 – 2013
62 'Consumer Credit Research: Low Income Consumers', Optimisa, 2014
63 Ibid

This is supported by other qualitative research, showing that between a quarter and half of participants on the lowest incomes use loans from friends and family.[64] Other research focusing on credit across Europe has found a heavy reliance on loans from friends and family due to a lack of access to other sources of credit.[65]

Hire purchase (or 'rent to own') is where a customer spreads the costs of a purchase by paying in instalments, with the goods only 'hired' until the final instalment, at which point the customer is usually given the option to buy the goods.[66]

Although there was some use of hire purchase for large or emergency purchases, our research found that people often discounted this as an option due to expectations that they will not be approved, unfamiliarity with hire purchase agreements, and a lack of clarity around repayment terms and conditions.[67]

Payday loans are significantly less popular than other forms of credit for those on the very lowest incomes. Many people on the very lowest incomes lack access to these loans. Recent DebtTrack research (with data up to 2012) shows that people on the very lowest incomes (less than £13,500) were less likely to use payday loans than other forms of credit. Only 13% of payday loan users had an annual income less than £13,500. This is borne out in qualitative studies.

Our research found that some 'survival borrowers' used payday loans, seeing the speed, convenience and small amount of paperwork needed as the main advantages of these loans. However, many participants in the Optimisa research did not use payday loans, particularly lifestyle and reluctant borrowers. These borrowers considered that payday loans were inappropriate for low income borrowers as they may not be able to repay easily, therefore rolling over loans. They also considered the interest rates to be very high.[68]

> *'Online loans are the easiest loans to get because they are quick and easy. Two seconds filling in the application form and 10 minutes waiting on the money. If you can get the application then that's the best one.'*[69]

Behavioural biases and industry practice

Some financial costs may be incurred by consumers in vulnerable circumstances due to the way they interact with credit products. For mainstream credit products, additional costs would include penalty charges for missed payments or failed direct debits, over-limit fees on overdrafts and raising cash or making extended minimum payments on credit cards. For non-standard products such as payday loans and home credit, additional costs are imposed through the re-financing of loans.

Research has shown that 67% of low income credit users are subject to additional costs relating to the way they interact with a product – 3.6 million people pay credit-related charges for missed payments or over-limit fees. These costs total around £630 million per year for low income users, averaging £174 per head per year.[70]

64 Such as Joseph Rowntree Foundation 2010, Debt on Teeside, 2013
65 'Road to Inclusion', IPSOS Mori, 2013
66 'Credit and low-income consumers', Friends Provident, 2011
67 'Consumer Credit Research: Low Income Consumers', Optimisa, 2014
68 Ibid
69 Ibid
70 'Credit and low income consumers', Friends Provident Foundation, 2011

58% of low income borrowers using overdrafts as a credit facility have incurred over-limit fees and 44% of those using credit cards have missed payments. For those incurring charges, the average number of overdraft fees is 6.2 per year and average number of missed payments on credit cards is 3.4 per year.[71]

Our research has shown that charging structures for the use of unauthorised overdrafts varies widely among providers and points to a lack of transparency around how charges are levied. Given behavioural biases, this lack of transparency is likely to particularly affect consumers in vulnerable circumstances. OFT research found that almost 18% of people with a household income less than £20,000 are permanently overdrawn and so may be more at risk of unaffordable use of overdrafts. For borrowers becoming over indebted, overdrafts are a frequently relied on source of credit, with 67% of StepChange clients having overdraft debts.[72] Our analysis found that many borrowers did not consider overdrafts as a form of debt.

Recent Which? research demonstrates that the cost of using an arranged overdraft to borrow £100 for a month varies between £30 and £0 depending on the current account selected.[73] This research also displays that the difference is more stark for borrowing £100 through unarranged overdrafts for a month, which can cost between £100 and £1 across different providers.[74] Our research has also pointed to a lack of flexibility using overdrafts, including instances of overdraft facilities being removed unexpectedly. This can disproportionately affect consumers in vulnerable circumstances, making it harder for them to manage their usage.[75]

The cost of non-standard products are less influenced by behaviour driven elements although a minority of users do 'roll over' existing loans. For example, some 28% of all new payday loans issued in 2011/12 were rolled over or refinanced at least once.[76]

71 Ibid.

72 Statistical Yearbook, Step Change, 2012

73 http://www.thisismoney.co.uk/money/saving/article-2458568/Bank-overdrafts-just-expensive-payday-loans-claims-Which.html

74 http://www.thisismoney.co.uk/money/saving/article-2458568/Bank-overdrafts-just-expensive-payday-loans-claims-Which.html

75 ICF/GFK (from FOS data]

76 'Payday Loan compliance review', Office of Fair Trading, 2013

CHAPTER 4 – The causes and effects of unmanageable debt

Summary:

- Changes in circumstances and high levels of debt are the main reasons people get into unmanageable debt.
- Debt can quickly spiral, and unmanageable debt can cause financial and non-financial problems.
- Debt advice is effective but many people do not get help soon enough.

What triggers consumers in vulnerable circumstances into debt problems?

As we have highlighted in Chapter 1, changes in circumstances, coupled with high levels of debt, are the overwhelming reason why people get into unmanageable debt. Figure 12 shows the main reasons the Debt Resolution Forum found for seeking help. This is supported by other research:[77]

Figure 12 - Main reason for seeking help in 2013

a drop in income	32.50%
a change in circumstances	28.50%
increased outgoings	19.70%
overspending	15.00%

[78]

77 Such as 'The effectiveness of debt advice in the UK', Money Advice Service, 2012
78 2013 Client Survey Provider KPIs, Debt Resolution Forum, 2013

Our research shows that survival borrowers are often in a highly vulnerable state due to taking on very high levels of debt, and being particularly susceptible to getting trapped in a debt cycle and missing payments. Lifestyle borrowers were susceptible to a change in circumstances, usually through a loss of income or increasing pressures on expenditure, and we observed a tendency for them to make minimum payments wherever possible to get through difficult periods. Reluctant borrowers, due to often having high levels of existing debts, were at risk of changing circumstances where meeting financial obligations became unmanageable.[79]

Bad consumer outcomes

The debt trap and debt spiral

Over-borrowing and the debt trap

Our research found that many people exhibit behaviours that can both increase the level of interest they need to pay and risk over-borrowing, increasing the likelihood of unmanageable debt occurring.

Many of the people we interviewed were able to service borrowing through meeting minimum payments, with some believing that meeting minimum payments only meant paying the debt for longer, rather than also paying more interest.

Other risk factors observed in our research included people missing payments, particularly on products such as home credit and payday loans, whom respondents felt were more accommodating to missed payments than more mainstream providers. Similarly to making minimum payments, our interviewees believed that missing payments would mean they were paying back their loan for longer, rather than paying back more overall.

This behaviour can lead to a 'debt trap', servicing existing debts but unable to pay down any principle. This can lead to incurring very high credit costs. This trap is prevalent among those on low incomes, as shown in other research. The Centre for Social Justice estimated there are 790,000 low-income credit card holders habitually making minimum payments on their cards, with 121,000 making minimum payments for more than three years.[80]

Our research found that these factors are often combined with low visibility of total borrowings, leading to 'fragmented borrowing', with people often having numerous (often small) credit commitments. Respondents often did not consider or recognise certain forms of credit as borrowing, and therefore did not have full appreciation of the total level of their credit commitments, potentially leading to over-borrowing and unmanageable debt occurring.[81]

Debt spiral

For those people in unmanageable debt, there is significant evidence that they can easily be tipped into a 'debt spiral', magnifying problems and leading to financial and non-financial detriment. While this spiral is not limited to those on low incomes, for reasons explored above, people on low incomes are less able to cope with income shocks or mounting debts and so are more likely to enter into this spiral. Those people who are in 'debt traps', servicing but unable to pay off existing debts, are highly likely to be triggered into this sequence of events.

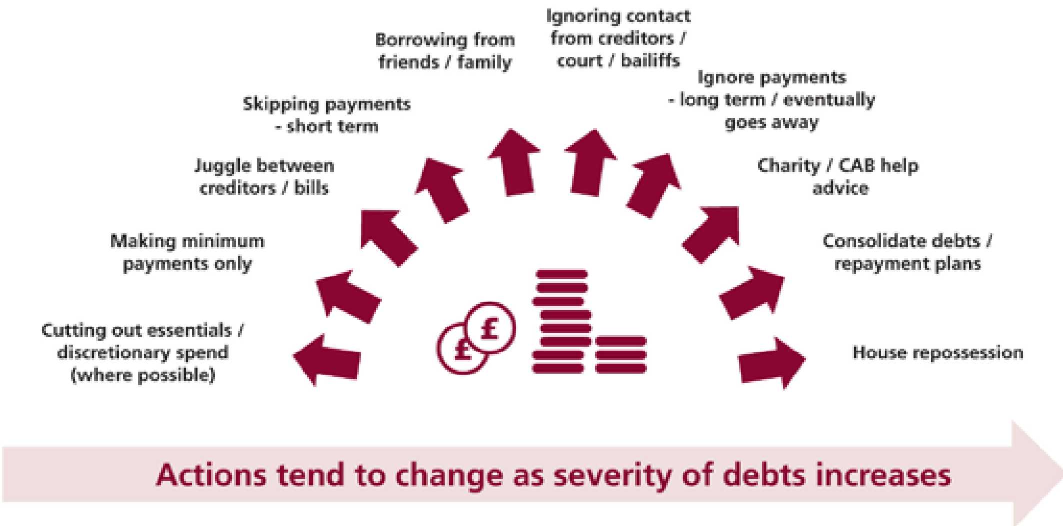
This problem was highlighted by our own research. This research outlined various 'coping strategies' that people use when their debts become problematic, beginning with cutting out

79 'Consumer Credit Research: Low Income Consumers', Optimisa, 2014

80 'Maxed Out', Centre for Social Justice, 2013

81 'Consumer Credit Research: Low Income Consumers', Optimisa, 2014

essentials and juggling between creditors/bills, to ignoring contact from creditors and ignoring payments, to eventually getting help and advice or taking action to consolidate debts.[82] As the diagram below shows, actions tend to change as the severity of debts increase, and people often only get debt advice when other options have failed.



'It first started with an overdraft when I was 16, 17. Like I got a £200 overdraft off the bank and then I lost my job and I wasn't able to pay it back. I started going into town and I didn't want to face them, that I couldn't pay the money back, so rather than going I just hid from it. I lost my job and went abroad, so went abroad and just put it all to the back of my head and didn't think about it till I came back. When I came back there was letters, obviously from the bank, saying that I owed them money, but I'd spiralled out of control. I was not paying the bills, the bill kept going up and up and up. And, basically, I didn't know what to do of how to sort it out. I think it was because I was young and naïve, that I just forgot about it all or wanted to forget about it.'[83]

The spiral suggests that intervening early can limit the problems caused by unmanageable debt. Indeed, the research we commissioned suggests that people can move between different borrower typologies – survival, lifestyle, reluctant – through changes in income or receiving advice sooner. For example, it suggests that people can move from being a survival borrower to a reluctant borrower after getting help from debt advice services.[84]

Financial costs of unmanageable debt

Financial costs can vary widely due to the particular product used and someone's behavioural preferences and biases. Case studies below show the potential financial impact of mounting and compounding financial costs for consumers in vulnerable circumstances.

'I got a letter about a brilliant new credit card, that you can choose any design on – balloons, leopard print. £200 limit and they'd even give you a pin number so you could make cash withdrawals for a charge of about £30 a day every time you took money out. So, then I increased it and increased it and ended up with about a £800 total on it that cost me about two grand to pay back.'[85]

'A CAB…reported seeing a man who had taken out three logbook loans but was struggling making repayments…when he went to the bureau the man had three loans of £500 each, totalling £1,500. The loan company had continued to offer him loans even though he was struggling to make the repayments. He thought

82 'Consumer Credit Research: Low Income Consumers', Optimisa, 2014
83 Ibid
84 Ibid
85 Ibid

he had paid back £3,270 but still owed £2,200. The man was expected to make repayments of £120 a week, which he could not manage.'[86]

'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.'[87]

Non-financial effects of unmanageable debt

Money Advice Service research found that 74% of those people with unmanageable debts are unhappy, 70% often feel anxious about their debts, and 56% report a negative impact on their family life.[88] Three effects of problem debt stand out from the literature reviewed: the impact on mental health, on people's relationships, and on people's ability to work.

Our own research found interviewees often feeling anxious, depressed and losing confidence, and some reporting relationship difficulties.[89]

Mental health

There is a large body of research exploring the link between problem debt and the risk of suffering from anxiety, stress and depression. People are 33% more likely to develop a mental health issue if they find themselves struggling with debt, 70% of debt advice clients were prescribed medication from their GP to help them cope with debt-related mental health difficulty, and 33% have attempted or contemplated suicide as a result of their debt.[90]

John Gathergood explores the link between psychological health and debt, arguing there is 'well documented statistical association between problem debt and poor psychological health at the individual level'.[91] Analysis of the BHPS shows clear association between the onset of problem debt and the worsening of psychological health at the household level.

'On my good day, with my anxiety, it doesn't really affect me because, like, I could just go out there and face the world. But on my bad days I, like, feel like the whole world is just like falling down and I feel, like, a bit panic-y and that. So I try not to remember, I try and forget obviously the debt and that.'[92]

Relationship breakdown

As well as affecting mental health, debt can have a significant influence on relationships. The stigma of being over-indebted can mean that people delay talking to their family about the problems. Indeed, it is estimated that 10% of people hide debt from their partner.

'I don't even see my friends no more because I just can't be bothered and they've all got good jobs and everything … I can't tell them what my situation is, I just find it…I wouldn't like to use the word embarrassing, but it's more frightening and you don't want them to think less of you.'[93]

Debt can also lead to relationship breakdown. 75% of debt advice clients in a relationship said their debt had negatively affected it, and 25% said it caused them to end their relationship.

86 'A Credit to the Nation', Citizens Advice Bureau, 2012
87 Step Change case study
88 'Indebted Lives', Money Advice Service, 2013
89 'Consumer Credit Research: Low Income Consumers', Optimisa, 2014
90 'Maxed Out', Centre for Social Justice, 2013
91 'Debt and Depression: Causal links and social norm effects', Gathergood, 2012
92 'Consumer Credit Research: Low Income Consumers', Optimisa, 2014
93 Stepchange, 2012

Unemployment
Debt can also contribute to increased unemployment. 10% of people over-indebted reported giving up a job as a result of their debt problems, and 20% found it difficult to find employment as a result of a debt problem.

There is a close correlation between unemployment and debt, with a 1% increase in employment rate accounting for an additional 60,000 debt advice enquiries per quarter.[94]

The Impact of debt advice and debt solutions

Debt advice
Numerous studies have shown the benefits of getting help and advice, both in terms of helping to avoid debts spiralling out of control, and to help people recover from existing debt burdens. Research from the Money Advice Service in 2012 showed that around 75% of those that had received debt advice have reduced or eliminated their debt as a result.[95] Other research from the Money Advice Service, looking at the impact of their funded debt advice work, showed that just over two-thirds (68%) of debt advice clients feel that their situation is better than before they sought advice from the debt advice centre.[96]

> *'You know what, I said 'if you're doing this to me, I'll just, you'll get nothing, because I'll tell you now, I'll go home and I'll just end it.' And basically, they weren't that bothered. And when I spoke to debt advice provider on the phone, and I told them, she says, 'look', she says, 'you don't have to talk like that and think like that.' She says, 'we will help you and we will get you out of this mess.'*[97]

However, not everyone accesses advice, and those that do often leave it too late and wait until their debt has spiralled out of control. According to Money Advice Service research, only 17% of the over-indebted population access debt advice,[98] and around 20% of the over-indebted population don't recognise they are in debt. According to BIS research, only 7% of respondents to a survey who said they had some difficulties keeping up with bills and payments in 2009/10 sought professional debt advice in the preceding six months. For those who said they were constantly struggling or were falling behind with payments the figure was 13%.[99] As the 'debt spiral' shows, often people will only seek advice when their situation becomes untenable, such as being continually chased by creditors.

Our research showed that awareness of sources of help was generally low and in most cases, where help had been received, it was a result of the person being referred to help, rather than self-directed. Friends and family were sometimes used for help initially. Some respondents mentioned that they had received help and advice from debt advice charities such as Citizens Advice and StepChange.[100]

Free debt advice is available in various ways – face to face, telephone, and online. Evidence suggests that advice has the potential to be equally effective across each of these channels.[101] The Money Advice Service have done work to assess the current supply and demand of debt

94 'Maxed Out', Centre for Social Justice, 2013
95 'The Effectiveness of Debt Advice in the UK', Money Advice Service, 2012
96 '360 Degree Evaluation of Money Advice Service Funded Face to Face Debt Advice', Optimisa, 2013
97 'Consumer Credit Research: Low Income Consumers', Optimisa, 2014
98 'Indebted Lives', Money Advice Service, 2013
99 'Debt and household incomes', Financial Inclusion Centre, 2011
100 'Consumer Credit Research: Low Income Consumers', Optimisa, 2014
101 'Debt Advice in the UK', Money Advice Service, 2012

advice, and while it concluded that the supply of face to face advice was generally in line with the demand from those actively seeking advice, it is also clear that demand would outstrip supply if more people who could benefit from advice were encouraged to seek it.[102] Working with the Money Advice Service, the industry, and consumers groups to design effective triage and interventions is key.

Debt solutions

The outcome of debt advice for many people is to enter into a debt solution. For those most severely over indebted, these solutions can be formal – such as Debt Relief Orders (DRO), Individual Voluntary Agreements (IVA) or Bankruptcy – or informal, such as debt management plans (DMPs), negotiations with creditors and consolidation loans.

In 2011 almost 500,000 people entered a new debt solution, and the overall number of debt solutions in progress has increased by 60% since 2007. Demand for formal DROs has increased significantly since 2009, with around 31,000 filing for a DRO in 2012. IVAs have also increased significantly, with 55,000 taking an IVA in 2012.[103]

The most common means of addressing unmanageable debt is a DMP. This is an agreement between someone and their creditors to pay their outstanding debts by making regular payments to a licensed debt management company. The company will then share this money out between creditors. Research by Zero-credit shows that the number of new DMPs increased from over 80,000 in 2007 to over 160,000 in 2011.[104] In 2012 there were between 520,000 and 645,000 ongoing DMPs, over half of which were provided by fee-paying debt management firms.[105]

Qualitative evidence from the Money Advice Trust has shown that those people who had free DMPs expressed a high level of satisfaction with the ongoing level of repayment, informed by a detailed and thorough budgeting and review process. These people reported that both initial and longer term repayments were set at an appropriate level, taking into account reasonable levels of household expenditure and other financial commitments.[106] There were others with self-negotiated arrangements for whom negotiations with creditors had resulted in repayment levels being set at an unsustainable level. In some instances this had resulted in people being unable to sustain repayments and as a result declaring themselves bankrupt as unmanageable debts continued to grow.[107]

Fee-charging debt management firms

Our qualitative research found that awareness of debt management companies was very low.[108] We have also seen that consumers lack awareness of all the solutions available to them and so do not shop around and are more likely to make 'distress' purchases.[109]

While research has found that debt management firms can be effective in helping resolve unmanageable debt, we have undertaken work to understand the fee-charging sector in-depth to identify potential consumer detriment, particularly around incentive structures that may not always act in the interests of consumers, and a lack of awareness from clients of the costs and terms they had signed up for.

102 Ibid

103 Analysis of statistics from the Insolvency Service

104 'Debt Resolution in the UK', Zero-credit research and report commissioned by The Debt Resolution Forum, 2012

105 Fee Charging Debt Management Market Assessment, DEMSA, 2012

106 'Sustaining Debt Repayments', Money Advice Trust, 2012

107 Ibid

108 'Consumer Credit Research: Low Income Consumers', Optimisa, 2014

109 'Debt Management Guidance Compliance Review', Office of Fair Trading, 2010

As the OFT review into debt management firms in 2010 found, fees can lack transparency and can be disproportionately high. The opaqueness of fee structures from many debt management firms increase the likelihood of customers not shopping around. The OFT also found evidence of misleading advertising (including implying all services were free or impartial), poor quality of front line advice and incentive structures based on completions of a particular DMP, which may not be in the customer's best interests.[110]

In terms of understanding debt management solutions, research has found a substantial variation in understanding the detail of what had been signed up for. People who used a free-to-client debt management company generally had a greater understanding of what their arrangements entailed, knew how long the arrangement would last and felt that the level of repayment had been reached following a realistic and thorough assessment of what was affordable.[111]

According to Money Advice Trust research, people using fee-charging debt management companies were far less clear in their understanding of what they had signed up for, particularly in terms of the length of arrangements and the level of fees and charges applied by debt management firms. Those paying a fee often lacked knowledge, at least at the start, of how much they were paying in monthly fees to the debt management firm. There was, however, a greater knowledge of the amount of upfront fees being charged.[112] The majority of survey respondents had found it easy to maintain debt repayments and had not missed a payment, but around a quarter had found it difficult to keep up with their repayments.[113]

Lead generators are commonly used in this sector, they are firms that gather data from potential customers. Many lead generators then sell this data to debt management firms (as well as claim management companies and payday lenders), who then contact the customer to sell them their services. There is concern that some lead generators may be causing significant consumer detriment, including channelling products or services that are unsuitable for them, or from the unsafe management of consumers' personal data, which may put them at risk of fraud or identify theft.

110 'Debt Management Guidance Compliance Review', OFT, 2010

111 'Sustaining debt repayments', Money Advice Trust, 2012

112 Ibid.

113 Ibid.

CHAPTER 5 – Next steps

This work will help us as we engage in discussions with the industry about consumer outcomes for this market. This includes the specific work we have announced in our business plan on tackling risks in high-cost short-term credit, addressing issues with credit cards, overdrafts and logbook lending, improving financial promotions and improving debt management. We also want firms to look at what we have found and consider if they are treating consumers in vulnerable circumstances fairly.

This paper has been written in the context of a wider work stream focusing on consumer vulnerability more generally. We have considerable evidence that it is an issue which cuts across both industry sectors and consumer segments. Although the focus here has been on consumer vulnerability correlated with low-income in the consumer credit market, there is a wide variety of manifestations of vulnerability and its associated outcomes.

We intend to publish an occasional paper later this year that will explore the concept further, which will be supported by substantial qualitative research with consumers in vulnerable circumstances and suggest ways in which the industry and the regulator can move forward on this together.

This paper shows the value of debt advice for those who are struggling with unmanageable debt, but it also shows that many people do not know where to get advice, or seek advice too late.

Our recent proposals for the regulation of payday loan providers will include a 'risk warning', signposting to the Money Advice Service for help and advice, and we will also require firms to provide an information sheet when consumers refinance and roll over a loan, signposting to free debt advice providers.

But we want to understand what more we can do in signposting people to help and advice sooner, and we will engage with consumer groups and the industry to explore other ways to get people the right help and support at the right time. We also acknowledge that future regulation may have an impact on the supply of debt advice. Given this, we have agreed with the Money Advice Service to set up three year funding arrangements with free debt providers in England and Wales, to improve the quality, consistency and availability of debt advice. Following a review of the supply and demand of debt advice, we have also agreed to increase debt advice funding to the Money Advice Service for 2014/15 to ensure more people are able to access good quality, free, debt advice.

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