

---

# Breakthrough Britain

*Briefing Paper 5*

## SERIOUS PERSONAL DEBT

Chairman of the Serious Personal Debt Working Group:  
*Lord Griffiths of Fforestfach*

This is the Executive Summary of the Serious Personal Debt volume of the Social Justice Policy Group's *Breakthrough Britain* report. For further information, or to download the full report please visit [www.poverty.debate.com](http://www.poverty.debate.com)

### *Introduction and state of the nation*

The number of people who admit to having debt problems, the many indicators which provide evidence on the scale of the problem and the contrast of UK indebtedness with that of Europe, all confirm the conclusion that 'personal debt is the most serious social problem facing the UK today'. Furthermore, this problem is getting worse. In fact, the fear of what this fast growing debt problem might do to the whole economy has now become so great that the Governor of the Bank of England has spoken out publicly to warn us of its danger.



### *Consumer debt is at record levels*

- Personal lending has now reached £1,318 billion.
- British consumers are on average twice as indebted as those in Continental Europe.
- Between 7 and 9 million people in Britain claim to have had a serious debt problem.

### *Many more are in danger of being plunged in a severe debt crisis*

- Few have adequate savings for unexpected expenditure, and
- less than 50% of the population have made provisions for a drop in income or a deterioration of financial circumstances.

### *A considerable number of people in this country suffer from serious stress and worry because of debt*

- 74% of British couples find money the most difficult subject to talk about.
- 32% lie to their partners about how much they spend on credit cards.
- 35% are kept awake at night worrying about their finances.

### ***Low income families are among the most vulnerable***

- The Bank of England has estimated that around half the people who describe debt as being a “serious burden” are from a low income group.
- People living in housing provided by local authorities or housing associations are more than twice as likely to have been in debt as the average person.

### ***Debt should not be viewed in isolation***

- Debt and a number of other serious social problems are interdependent on each other both in terms of cause and effect.
- Those out of work are more likely to have experienced serious personal debt problems.
- Those who left school early, or came from single parent families, or whose parents were unemployed are more likely to have been in debt.



## ***Why has government policy failed?***

Why there are so many people in serious debt in this country is clearly a complex question that has many different facets to its answer. However, through our research we have identified five factors that help to explain why many people become seriously indebted.

### ***1. “It’s too easy to get into debt.”***

Respondents in our YouGov poll believed the prime reason for people getting into debt was that credit was easily available. This is true. In recent years, interest rates, inflation, and unemployment have all been low. Against this background, the demand for credit has been high, and its cost low. At the same time, the retail financial industry has been extremely innovative and competitive. Today over 400 mainstream financial institutions compete fiercely to satisfy consumer demand.

### ***2. “Lenders target vulnerable people.”***

Clearly, banks do not explicitly target vulnerable people, but their lending practices have been criticised for: Aggressive marketing; a lack of transparency in calculating the cost of borrowing; undue care in lending and a lack of data-sharing.

Although we do not believe that lenders set out to target vulnerable people, customers are often enticed into over-borrowing with disastrous consequences; research evidence suggests there is a strong correlation between serious indebtedness, drug and alcohol addictions and family breakdown. And accordingly, vulnerable people are arguably far more likely to get into serious debt problems.

### ***3. Financial Capability is low.***

According to MORI poll in 2004, 33% of people in the UK lack any confidence in handling money, and only 30% could calculate correctly the interest on £2000 at 4% over two years.

If people lack a basic level of financial capability then they are not in a position to make informed decisions, and it is arguably only natural that they will find themselves in a situation of serious debt, without really being aware of how they got there.

**4. Britain has little to no discernable savings culture.**

In the last few decades we have witnessed the disturbing decline of a savings culture. Whereas we once used to save money in order to buy an asset, it is now case that most of us 'buy now and pay later'.

Currently half of Britain's pensioners are said to be cutting back on other things to pay annual fuel bills, and the situation does not look set to improve. In fact, with the rate of debt growing everyday, unless there is a considerable change in this country's attitude to saving, the situation is likely to get worse as each year goes by.

**5. "Modern society is increasingly materialistic."**

Society's attitude to borrowing has changed as radically over the past 60 years as its attitude to saving, and perhaps even more so. Credit has moved from being perceived as dangerous, to morally neutral, to beneficial; and with this has arguably come an excessively materialistic society.

**What are the objectives of policy?**

In view of our findings, we believe policy recommendations must aim to address not just the scale of serious personal debt, but also its crippling nature. A body of policies which can fulfill this aim must have the following objectives, and would:

- **Enable consumers to take on credit without taking on unmanageable debt.**  
A balance needs to be achieved whereby consumers, and especially those on a low income, have access to the type of credit they need at a competitive and affordable price, but are not encouraged to take on more credit than they can realistically manage.
- **Allow debtors access to the type of debt advice right for them.**  
We believe that the needs of those in debt are massively diverse, and that a blanket approach to debt advice does not provide the best solution. Our aim is that smaller local debt agencies are given the same kind of support and funding as the larger agencies, so that are able to provide the services often desperately needed by their communities (and sometimes not offered by the larger agencies).
- **Give every consumer the opportunity to learn how to manage their money effectively.**  
Through the simplification of financial language, community based financial education, and a greatly improved approach to money education in schools, we aim to provide every consumer with the opportunity to be empowered to a position where they feel capable and confident to make informed decisions about how best to manage their money
- **Encourage Britain to develop a savings culture again.**  
A long term goal is to develop a culture of saving in this country. Although much can be done to improve the services offered and the regulations surrounding the credit industry, the bottom line is that if more people saved rather than borrowed - less people would be in debt.

**YouGov polling**

- 86% of people agreed that more time and resources should be dedicated to teaching secondary school students how to manage their money.
- 88% of people agreed that information on people's credit history should be checked before credit cards and store cards are offered and cards only made available to only those who can afford them.

- 92% of people agreed that debt advice should be mandatory for people considering bankruptcy or similar courses of action.
- 89% of people agreed that door step lenders should be held to a professional standard of conduct, prices should be publicised clearly and full information provided readily.
- 87% of those who expressed an opinion agreed that credit unions should be supported and expanded nationwide.

### *Policy recommendations*

Given the scale of debt in this country, a great deal needs to be done in order to stop the problem growing further. This is true across the spectrum of socio-economic status, however we believe that most can be achieved in helping the lowest economic quintile of the population deal with the problems of serious personal debt. Therefore, we have aimed to produce a number of reasoned and practical recommendations designed to address the scale and nature of serious debt, and in particular to protect the poorest and most financially vulnerable in society.

Our recommendations are that:

#### ***1. Door step lenders should compete more actively and accordingly offer more competitive interest rates.***

Home credit has been criticised for charging extortionate interest rates, taking advantage of the poor, and even actively keeping people in poverty. However, many have also defended the industry, warning that alternatives could be far worse. We believe that a balance must be sought, whereby market practices are more transparent and services improved, without destabilising the market to the detriment of customers (who are often among the poorest and most financially vulnerable in society).

In accordance with the Competition Commission's analysis, we recommend increasing transparency, data sharing and compliance procedures within the home credit market. In addition, we also feel it is necessary to *ensure* effective compliance by home credit companies. We therefore also propose that government strengthens agents' guidelines. We recommend appointing the audit or governance committees of the main board to oversee compliance issues. We also recommend that this process be supervised by the Financial Services Authority.

Ultimately, because the cause of high interest rates is the lack of competition, with these proposals we aim to increase competition by increasing the number of companies supplying credit within the industry. If, however, the barriers to competition continue to exist and the market continues to be dominated by one large company, then competition must be enforced from the outside. Perhaps the only obvious measure that could ensure this would be a break up of existing companies. This is a drastic measure and one we are loathe to recommend. We believe that it should only be undertaken if the industry fails at its duty to put its own house in order.

#### ***2. Interest rate caps in the sub prime market should be prohibited.***

Capping interest rates is a popular proposal often put forward as a method to combat extortion within the sub prime market, and in particular the home credit market. However, we believe that is argument is flawed, and that there is strong evidence to show that the capping of interest rates would not result in a healthier, fairer or more competitive market, but would in fact encourage the opposite.

For decades in the UK, rent control killed the private rented sector in housing. But it did not kill off housing demand. In fact the opposite was true: because rents were held down demand increased. Exactly the same would be true in this market. If ceilings were introduced, they would reduce the supply of home credit and in principle kill the home credit industry, and in fact the whole of the sub prime market. Furthermore, because

of an excess demand for sub-prime consumer credit, illegal lenders would step in to fill the gap.

Therefore, we believe that interest rate caps would damage sub prime credit consumers (many of whom are among the most financially vulnerable in society) by forcing them to turn to illegal lenders who, research tells us are, unlike regulated sub prime lenders, extremely damaging, both to individuals and entire communities.

### ***3. UK credit unions should be strengthened, supported and expanded.***

In the UK, credit unions provide credit for only 1% of the population. And yet, there are more than 42,000 credit unions worldwide, with over 160 million members. In the United States, there are 86 million credit union members (43% of the population); in Canada, 5 million (22% of the population); and in Australia 3.5 million (25% of the population). Britain's position is clearly anomalous.

Credit unions are a safe source of credit for customers who cannot, or choose not to, access mainstream credit. They offer credit at reasonable rates of interest and in a form that suites many low income consumers. They are also a valuable tool to encourage saving and responsible money management.

In view of this, we believe credit unions need to be strengthened and liberated from the excess regulation that is largely responsible for the diminutive size of the credit union network in this country, and for their struggles to become financially viable. We do, of course, welcome the recent move towards a degree of liberalisation in this sector. Nevertheless, the government could do much more, and we recommend learning from New Zealand's excellent model. We therefore propose the UK government take steps to strengthen and expand its movement by allowing credit unions to:



- Determine their own common bond
- Abolish the minimum age restriction
- Provide services to organisations and not just individuals
- Form a Central Shared Services Organisation
- Pay interest on savings
- Charge for auxiliary services

In addition, we believe that if credit unions are to be successful then the commercial banks, as part of their social responsibility, need, as in other countries, to support their development.

### ***4. Banks should be held accountable to a customers' charter with the full force of law behind it.***

We recommend that the voluntary Banking Code be replaced by a statutory Bank Customers' Charter. The Banking Code is voluntary and sets out standards of good practice for financial institutions to follow when they deal with personal customers. The code applies to current accounts, card products, loans and overdrafts, savings and deposit accounts and payment services. Therefore, given the tens of millions of people who are affected by these services and products, we have to question, 'Why banking is the only area of self-regulation still surviving in the financial sector?'

There appears to be no legitimate answer to this question and in view of this we strongly recommend that the voluntary Banking Code be replaced by a Customers' Charter that has the full authority of the law behind it and is overseen by the Office of Fair Trading.

The Commission feels very strongly that mainstream banking is an area which has escaped formal regula-

tion for too long, and that given recent revelations of 'unfair' bank charges, it is an appropriate time to alter this situation.

***5. Local community based debt advice should be supported.***

Public funding for debt advice should represent the diversity of the need by being distributed across the full diversity of service providers. A more level playing field must be established so that smaller organisations are not overlooked and the government does not concentrate their funds on only the largest service providers in this area.

We recommend that a fixed proportion of public support be given to these smaller organisations, and that small independent advice agencies be exempted from unnecessary regulations, so that voluntary effort is not deterred. Funding from central and local government should be distributed on a pro rata basis between separate advice organisations according to the contribution they make in their locality. And a clear and simple mechanism should be formulated and put in place to ensure fairness between different agencies.

***6. The benefits system and Social Fund should be reviewed in detail.***

Currently the debt problem in this country is greatly exacerbated by the inefficiency and inaccessibility of the benefits system. However, if the benefits system were managed more efficiently, it could be extremely valuable in tackling the problems of financial exclusion. We believe the same could be said of the Social Fund, which is currently too much of an untapped resource.

We welcome the fact that the economic dependency sub-group of the Social Justice Policy Group has been looking at a means of simplifying the various credits, benefits, allowances and entitlements, as well emphasising the need to enhance their uptake, and to improve use of direct payment schemes, through benefits and salary deduction.

In line with the economic dependency sub-group's recommendations, we recommend a full review of the benefits system, with the additional and specific aim of reversing the detrimental effect it is currently having upon many of those in debt, or on the edge of debt.



Similarly, we believe that the potential exists for the Social Fund to become an extremely effective source of affordable credit, reducing both social and financial exclusion. It is not possible to explore this in sufficient depth within the context of this paper, however, and we therefore recommend a full and detailed review of the Social Fund.

***7. Individual Voluntary Agreements (IVAs) should only be approved following independent advice.***

In view of the disastrous consequences IVAs can have on a debtor's future ability to raise credit (up to a period of 12 years), and the fact that the number of IVAs being voluntarily opted for has increased at an unprecedented rate in recent years, our recommendation is that IVAs should only be made available following independent debt advice, through recognised debt advice agencies. Ensuring debtors know the full extent of what it is they are considering and the alternatives, before entering any official and legally binding agreement.

***8. IVAs should be made available to a further category of debtor.***

We recommend that a new category of IVA should be made available for those with smaller consumer debts. Thus enabling debtors who meet certain criteria, for example, those with less than £20,000 of liabilities and

£1,000 of assets and a surplus income per month of less than £75, to apply (after independent debt advice) for a debt relief order to the Official Receiver.

***9. Education in personal finance should be improved***

In order to be effective, education in personal finance needs to be made much more relevant and stimulating so as to better capture the attention and imagination of those trying to learn. The value of private sector expertise and enthusiasm to communicate the importance of financial capability and to indeed teach the practical skills involved needs to be realised and utilised. Therefore, we recommend that private sector initiatives to educate both children and adults in personal finance should be encouraged, strengthened and expanded.

***Conclusions***

We believe that the onerous burden that serious personal debt currently has on people in this country can be broken but that action must be taken now. Our policies are designed to redress the balance between lenders and borrowers, and to give every consumer the opportunity to learn how to manage their money effectively, and the space and freedom to do so. It is not merely about getting people out of debt, but also providing people with the knowledge and skills they need to stay free of serious debt and the social problems so entwined with it, for the rest of their lives.

## SERIOUS PERSONAL DEBT WORKING GROUP

**Lord Griffiths of Fforestfach** (Chairman) Vice Chairman of Goldman Sachs International, and Chairman of the Debt Commission, which published 'What Price Credit?'

**Manish Chande**, Chief Executive of Mountgrange Capital plc and formerly Chief Executive of Land Securities Trillium plc

**Professor Iwan Davies**, Head of School of Law, University of Wales, Swansea

**Tom Jackson**, 'Fellow of the Centre for Social Justice' and Secretary of "What Price Credit?"

**Rt Revd James Jones**, Bishop of Liverpool

**Heather Keates**, Chief Executive of Community Money Advice

**Juliet Johnson**, Senior Researcher

## ABOUT THE SJPG

The Social Justice Policy Group was commissioned by Rt Hon David Cameron MP, Leader of Her Majesty's Opposition, in January 2006 to make policy recommendations to the Conservative Party on issues of social justice.

The Policy Group is chaired by the Rt Hon Iain Duncan Smith MP, former leader of the Conservative Party and Chairman of the Centre for Social Justice, and its Deputy Chairman is Debbie Scott, Chief Executive of Tomorrow's People. The Policy Group's Secretariat is hosted by the Centre for Social Justice.

The work has been done through six working groups, which have examined key "pathways to poverty": family breakdown, educational failure, economic dependency, indebtedness and addictions. A sixth group has studied how the third sector might be supported to do more to give vulnerable people second chances and help them escape poverty.

For further information, or to download the full report of the Social Justice Policy Group, *Breakthrough Britain*, please visit [www.poverty.debate.com](http://www.poverty.debate.com)

All media enquiries, please contact Nick Wood, Media Intelligence Partners, on 07889 617 003.