Breakthrough Britain

Ending the costs of social breakdown

Volume 5:

Serious Personal Debt

Chairman: Lord Griffiths of Fforestfach

Policy recommendations to the Conservative Party

Social Justice Policy Group

Chairman, Rt Hon Iain Duncan Smith MP

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Executive Summary

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 competi-

tion, 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 regulation 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 for-

mulated 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 imagi-

nation 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, strenthened 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.

Section 1
The State of the Nation

Financial health is as desirable as physical health. And yet, personal debt in the UK is an enormous and growing problem, both on an absolute basis, and relative to Western Europe. Since our Interim Report, published in December 2006[1], every month has seen a new record level of consumer indebtedness being hit:

- Personal lending in this country has now reached £1,318 billion.[2]
- Total secured lending on homes has increased by 11.5% in the last 12 months and now stands at £1,104 billion.[3]
- The average household debt in the UK is £54,452.[4]
- Unsecured lending had risen to an average of £4,550 per adult in the UK.[5]
- Clients of Citizens Advice[6] (CitA) have an average of £13,000 of debt equating to nearly 17.5 times their monthly income. On average, it would take these clients 77 years to pay back their debts in full.[7]
- The UK's Personal Debt to Income ratio has tripled, from below 50% in the '70's to over 140% in 2007.[8]
- The UK is responsible for a third of all unsecured debt in Western Europe, and British consumers are, on average, twice as indebted as those in Continental Europe.[9]

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1 Social Justice Policy Group. Breakdown Britain, Consumer Indebtedness. SJPG, December 2006.

2 When our interim report was published, personal lending in this country was estimated at £1.25 trillion. According to figures compiled by Credit Action this number is now estimated to have risen to this new figure. http://www.creditaction.org.uk/debtstats.htm

3 Figures researched, compiled and provided courtesy of Credit Action http://www.creditaction.org.uk/debtstats.htm

4 When our interim report was published the average household debt was estimated at £50,000. According to figures compiled by Credit Action this number is now estimated to have risen to this new figure. http://www.creditaction.org.uk/debtstats.htm

5 Figures researched, compiled and provided courtesy of Credit Action http://www.creditaction.org.uk/debtstats.htm

6 Previously known as Citizen's Advice Bureau (CAB).

7 Figures researched, compiled and provided courtesy of Credit Action http://www.creditaction.org.uk/debtstats.htm

8 Breakdown Britain, Consumer Indebtedness, Part A: The Scale of Personal Indebtedness. Page 11, (a) point 2.

9 Breakdown Britain, Consumer Indebtedness, Part A: The Scale of Personal Indebtedness. Page 11 (b) point 4.

The UK consumer credit industry has been remarkably resourceful in devising new products to meet changing consumer needs. The enormous growth of consumer credit has clearly benefited most consumers. Personal loans have allowed some people to access cash at times when it is needed. Credit cards have proved a great convenience by reducing the use of cheques and cash, and are a secure, convenient method of payment accepted all around the world. Store cards are attractive because they provide extra services and personalised accounts. And most important, access to mortgages and loans enables individuals and families to even out expenditure over the course of their lifetime.

However, the number of adults who are finding personal debt a severe problem is continuing to rise. While it is difficult to measure the scale of the personal debt problem precisely, all the available evidence suggests that the problem is far worse than most people imagine:

- Our own polling exercise suggests that between 7 and 9 million adults have had a serious debt problem. If we include the children of these adults, then the number of those affected by serious debt problems rises to between 9 and 12 million.[10]
- The Consumer Credit Counselling Service received 33% more calls in the first quarter of 2007 compared with the same period in 2006. A total of 86, 990 calls were made to its helpline in the first three months of this year.[11]
- Bankruptcies and IVAs have increased on an unprecedented scale in the last few years, with the number of IVAs increasing by 118% from 2005 to 2006.[12]
- Citizens Advice dealt with 1.4 million new debt problems in 2006, this is 11% more than 2005, and double the number of just 8 years ago equating to 5,300 new debt problems a day.[13]
- The number of missed payments of bills, tax, credit cards and mortgages, and the demand for the services of debt agencies, have both increased dramatically.[14]

The debt time bomb

It is clear that debt is already a serious problem for millions of people. However the number of people for whom debt could easily become a serious problem is

10 YouGov Survey, for the Social Justice Policy Group, November 2006. Detailed in Breakdown Britain, Consumer Indebtedness, Part A: The Scale of Personal Indebtedness. Page 13, C. 'YouGov Poll on Personal Debt'.

11 Figures researched, compiled and provided courtesy of Credit Action http://www.creditaction.org.uk/debtstats.htm

12 Figures courtesy of the Insolvency service.

13 Figures researched, compiled and provided courtesy of Credit Action http://www.creditaction.org.uk/debtstats.htm

14 Breakdown Britain, Consumer Indebtedness, Part A: The Scale of Personal Indebtedness. Page 11, (d) point 1-4.

even greater. The potential for the debt crisis to worsen is a grave concern. The mains reasons for this are:

- **Lack of Savings**: Many people have inadequate savings for unexpected expenditure and less than 50% of the population has made any provision for a drop in income, or for a deterioration in financial circumstances.
- **Rising Interest Rates**: Interest rates have risen from a low of 3.5% in July 2003, to 5.5% now, and economists expect them to rise further this year.
- **Rising Unemployment**: Unemployment stands at its highest level for 6 years, and has risen from 4.8% to 5.5% in the past year.

With so many people possessing such little security for unexpected changes, and with rising interest rates and rising unemployment, any kind of change to the economic climate could plunge many more people into a severe debt crisis. As the governor of the Bsank of England recently warned: “some of the important risks thsat can effect [financial] instruments - from terrorist attacks, invasion of computer systems, or even consequences of a flu pandemic - are almost imposible to quantify, and past experience offers little guide.”[15]

Low income families are among the most vulnerable

Many low income families are excluded from the mainstream financial sector. For example, one in twelve households, or 2.8 million adults, in Great Britain have no bank account[15]. Despite being excluded from mainstream sources, many still need access to credit and therefore tend to receive it through sources such as:

- Doorstep lending
- Pawnbrokers (cash converters)
- Sale-and-buyback shops
- Mail order catalogues

The Treasury estimates that there may be 3 million regular users of these types of credit, and that the size of the doorstep lending market may vary from two to three million people. One problem with these markets is that lenders charge considerable rates of interest often between 100%-400% or even greater.

The Bank of England has estimated that around 50% of those who describe debt as a “serious burden” are from a low income group. This was confirmed by our polling analysis which showed that people living in housing provided by local authorities or housing associations were more than twice as likely to have been in debt as the average person. The survey also found that 37% of

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15 Speech by Mervyn King, Governor of the Bank of England, at the Lord Mayor’s Banquet for Bankers and Merchants of the City of London at the Mansion House on Wednesday 20 June, 2007. Page 5, paragraph 3.

15 Department for Work and Pensions, Family Resources Survey of 2202-03, 2004.

respondents living in such accommodation had experienced serious personal debt problems compared to an average of 20% for all respondents.

We have concluded that debt is a particular problem for low income families; with little savings to fall back on and little or no access to mainstream banking and savings facilities, they are clearly vulnerable to unexpected changes in their circumstances.

Debt and social problems

Breakdown Britain[16], highlighted the correlation between debt, unemployment, alcohol and drug addiction, criminality, educational failure and family breakdown. 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.

Our YouGov Poll[17] found that:

- Respondents who were out of work were more likely to have experienced serious personal debt problems.
- Respondents with a history of drug or alcohol addiction, or with a criminal record, were more than twice as likely as the average respondent to have experienced serious personal debt problems.
- Respondents who left school early; or who had come from single parent families; or whose parents were unemployed were more likely to have been in debt.
- Respondents cited debt as the number one cause of family breakdown.

The effect of debt

The YouGov poll also found that large numbers of people in this country suffer from significant stress and worry because of debt:

- 74% of British couples find money the most difficult subject to discuss.[18]
- 32% lie to their partners about how much they spend on credit cards.[19]
- 35% are kept awake at night worrying about their finances.[20]

Furthermore, according to AXA:[21]

- 3.8 million people admit to money worries causing them time off work.[22]

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16 Social Justice Policy Group. Breakdown Britain, Consumer Indebtedness. SJPG, December, 2006.
17 YouGov Survey for the Social Justice Policy Group, November 2006.Detailed in Breakdown Britain, Consumer Indebtedness, Part A: The Scale of Personal Indebtedness. Page 13, C. 'YouGov Poll on Personal Debt'.
18 Ibid.
19 Ibid.
20 Ibid.
21 AXA. Avenue First Quarter Review: Debt. January, 2006.
22 YouGov Survey, for the Social Justice Policy Group, November 2006. Detailed in Breakdown Britain, Consumer Indebtedness, Part A: The Scale of Personal Indebtedness. Page 13, C. 'YouGov Poll on Personal Debt'.

- More than 10.7 million people suffer relationship problems because of money worries.[23]
- 43% of people have suffered from symptoms of stress arising from anxiety generated because of poor understanding of their finances or poor controls over their personal financial situation.[24]

In addition:

- 1 in 4 of Christians Against Poverty's (CAP) clients had seriously contemplated suicide before asking for help.[25]

The debt spiral

People in serious personal debt typically experience a debt spiral involving ten steps:

1 ***Initial Trigger***
Unexpected changes are the most common trigger of debt spirals as well as delays in entitlements to benefit payments, changes in family circumstances, family breakdown and over-borrowing and over-lending.

2 ***Missed payments***
The first symptom of a debt spiral is usually a missed payment, after which interest charges are incurred.

3 ***Escalating Penalty Charge***
Once a payment is late or missed, penalty charges are often imposed, thus causing debt to escalate.

4 ***Juggling of finances***
Following late payments, the debtor prioritises the payment of one debt over another. This juggling act becomes gets even more complex as the debtor takes out new loans in order to pay off old ones.

5 ***Pressure from Creditors***
The methods used by various creditors and debt collection agencies can add tremendous pressure to a person caught in a debt spiral.

6 ***Personal and Financial Chaos***
Many people become so overwhelmed by the pressure that they lose the ability to take control of the situation.

7 ***Unrealistic Promises***
Contact with repayment agencies generally results in the setting up of a repayment schedule, but often the level of repayment is set at too high a rate to be sustainable.

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23 Ibid.
24 Ibid.
25 Data courtesy of Christians Against Poverty.

8 ***Legal Proceedings***

If repayments are not forthcoming on a regular basis, creditors will ultimately make a claim against the debtor in court, in order to obtain a judgement against them.

9 ***Enforcement Orders, Bankruptcy and Eviction***

If a debtor defaults on a Court judgment, then Enforcement Orders such as the attachment of Earning Orders, Charging Orders and Bankruptcy Orders can be sought.

10 ***Total Loss***

Section 2
What are the Causes?

Why people get into severe personal debt is clearly a complex question that is likely to be answered differently by each individual according to their situation. However, through our research we have identified five factors that help us to explain why so many people become seriously indebted.

1. "It's too easy to get into debt."

Respondents in the YouGov poll[26] believed the prime reason for people getting into debt was that credit was easily available. This is true. For the last five years interest rates have been at low levels and credit has been cheap. Over ten years inflation has been low, the stop-go cycle has given way to continued economic growth and there has been low unemployment. Against this background the demand for credit has been high.

At the same time the retail financial industry has been extremely innovative and competitive, with new products being brought to the market at historically low rates of interest. Before the liberalisation of credit markets in the early 1970's, credit was rationed. Today over 400 mainstream financial institutions compete fiercely to satisfy consumer demand. Since the 1980s, credit card and mortgage markets have grown rapidly and the increase in unsecured lending has been accompanied by risk-based credit pricing in which interest charged to customers depends on the perceived risk of default.

2. "Lenders target vulnerable people"

Clearly, banks do not explicitly target vulnerable people, but their lending practices have been criticised for:

26 YouGov Survey for the Social Justice Policy Group, November 2006. Detailed in Breakdown Britain, Consumer Indebtedness, Part A: The Scale of Personal Indebtedness. Page 13, C. 'YouGov Poll on Personal Debt'.

- Aggressive marketing, such as; misleading marketing in supermarkets; unsolicited increases in credit limits; inappropriate selling of payment protection insurance; and the introduction of credit card cheques.
- A lack of transparency in calculating the cost of borrowing. There is currently no consistent method for comparing different banks' interest rates; and many customers simply do not understand either APRs, or their variety.
- Undue care in lending. The liberalisation of financial markets, and the changes in technology and credit scoring, have made banking more impersonal. Responsible lending requires adequate credit rating systems, and high standards in assessing credit applications.
- A lack of data-sharing. This has significantly contributed to debt problems, and hampered responsible lending. With over 20% of people now holding at least four credit cards, there is insufficient communication between lenders on default data such as arrears, missed payments and bankruptcies.

Lenders do not set out to target vulnerable people. However, customers are often enticed into over-borrowing with disastrous consequences; research evidence suggests there is a strong correlation between serious indebtedness and drug and alcohol addictions and family breakdown. And accordingly, vulnerable people are arguably far more likely to get into serious debt problems. Nevertheless, if banks did target vulnerable people this would be categorised by the Office of Fair Trading (OFT) as irresponsible lending and would be an unfair practice, and therefore relevant to that institution holding a consumer credit license.

3. Financial Capability is low

According to a 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.

Evidence compiled by Credit Action and the Consumer Credit Counselling Service has also shown that many people in Britain have a severe lack of understanding of their financial situation, with 25% of having "no idea" how much they spend in a week; and an even higher percentage possesing no idea as to their monthly cash flow. Indeed, their evidence shows this lack of knowledge to extend further, with only 50% of adults knowing the balance on their credit cards, and 46% having no idea what interest rates they either receive on their savings, or pay on their debts.

In this context, the fact that approximately 15% of those aged between 18 and 24 years olds think an ISA (Individual Savings Account) is an ipod accessory, and another 10% believe it to be an energy drink[27] is just one more illustration of the extreme nature of the debt problem.

27 Figures researched, compiled and provided courtesy of Credit Action http://www.creditaction.org.uk/debtstats.htm

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. In order to prevent people entering debt too easily, more clearly needs to be done to educate people in financial capability, both in schools and in the wider community.

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'.

This is especially sobering when thinking of the future: The Pensions Commission says that 11.7 million workers do not make any contribution to a private pension[29]. Currently 25% of those aged over 60 years still have outstanding mortgage debts, and half of Britain's pensioners are said to be cutting back on other things to pay annual fuel bills[30], 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. In the past 60 years, credit has moved from being perceived as dangerous, to morally neutral, to beneficial; and with this has arguably come an excessively materialistic society.

Many world religions have traditionally been very critical of charging interest due to the power relationship created between borrower and lender that is often unequal and constraining. When giving evidence to our debt commission, one Anglican Bishop, for example, stated that, "the people who need to be addressed about debt are the creditors, not principally the debtors" and was clear that the fundamental issue about debt for him, was that of justice.

Similar points have been made by sociologists concerned about the impact of materialism, and its inaffordability. Professor Holman underlined three social changes that have made low income families more vulnerable to the problems of debt: the decline in working class collective organisations with

29 Data courtesy of Credit Action http://www.creditaction.org.uk/debtstats.htm
30 Ibid.

hardship funds; the fragmentation of families; and the advent of the drug culture. The fact that these developments occurred just as there was a major structural change in the financial system, making consumer credit available to all, has clearly resulted in some extremely damaging consequences.

Conclusions

Debt is a serious problem for millions of families in the UK. Debt problems are triggered by a number of different factors and are strongly linked with family breakdown, economic dependency, alcohol and drug addiction and educational failure. The current debt crisis could get even worse if the economic cycle should turn, and any significant change in the economic climate will plunge millions more into a desperate problems repaying debt. Debt particularly affects low-income families, many of whose lives are characterised by a constant struggle to meet repayments. Any attempt to identify solutions must recognise that severe indebtedness cannot be treated as an isolated problem, strongly linked as it usually is with other social problems.

Section 3
The Objectives of Policy Recommendations

Policy recommendations must aim to address not just the scale of over-indebtedness but also its crippling nature. This is no easy task and there is no single 'silver bullet' solution to such an entrenched social problem. We have, however, aimed to produce a number of reasoned and practical recommendations designed to address the scale and nature of serious debt, with a particular view to protecting the poorest and most financially vulnerable in society.

In terms of the sub prime market our objective is to increase competition so that prices are lower and services are of a higher quality. The pattern which has developed so that the poorest pay the highest borrowing rate needs to be broken. We believe that society has a responsibility to protect the poor and vulnerable and we have formulated our recommendations with this in mind.

We aim to tackle the following problems:

- *The ease with which credit is extended without the full terms, conditions and implications of the loans being known by the borrowers.*
  A balance needs to be achieved whereby borrowers 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.
- *The lack of available and competitive credit and consequently high interest rates in the sub prime market, and in particular in the home credit market.*
  One of our fundamental objectives is that low income consumers have access to competitively priced credit with the freedom to choose between a variety of credit products without being exploited.
- *The concentration of public funding that is driven into only a few larger debt advice agencies, thereby financially discouraging smaller agencies to develop.*
  A wide range of debt advice and other debt services need to be made available to the public, to this end, all agencies should experience a more level playing field when it comes to funding and support. We believe that the needs of those in debt are massively diverse, and that a blanket approach does not provide the best solution. Our recommendations should ensure many smaller local debt agencies are properly funded and thus able to run

the services desperately needed by each of their communities.

- *The number of young people leaving school with little to no financial capability.* Financial education in schools needs to be greatly improved. It is our aim that all young people should leave school with a thorough understanding of personal finance and the skills that they need to go on to manage their money effectively.
- *The number of adults who are disadvantaged by a lack of understanding and a fear of financial language.*
  Through the simplification of financial language and community based financial education, every consumer should be empowered to a position where they feel capable and confident to make informed decisions about how best to manage their money
- *The decline of a savings culture, and the disturbingly large proportion of the population possessing little to fall back on to face "a rainy day".*
  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.

Ultimately our objective is to see serious personal debt and its crippling effects, significantly reduced in this country.

Section 4
Policy Recommendations

4.1. The Home Credit Market

Home credit is an extremely controversial industry and has attracted a great deal of comment. It 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 regulated and services improved, without destabilising the market to the detriment of customers (who are often among the poorest and most financially vulnerable in society).

The home credit market is especially relevant to the poorest quintile of the population. Therefore, the way, or perceived way, the home credit market works, has created a great deal of controversy. This controversy culminated in the super-complaint made by the National Consumer Council (NCC) in 2004. As a consequence the Competition Commission launched an investigation into the alleged anti-competitiveness in this market and reported its findings in November of last year.

The Competition Commission concluded its report with a number of recommendations. Before discussing these recommendations though, the home credit market should be put into context, in order to understand its importance for lower income borrowers.

By its very nature the home credit industry provides credit to many of those excluded from the mainstream sources, and offers services sometimes desperately needed by customers who would otherwise have little or no alternative but to turn to illegal money lenders. As the National Consumer Council itself acknowledged:

> *"It is important to reaffirm that the home credit industry provides a valuable source of credit to consumers on low incomes. Our findings are that the characteristics of the home credit market meet the needs of the customer base well… It follows that to remove home credit from the market or to drive it underground could be to the detriment of low-income consumers".*[31]

The Committee therefore wishes to stress that it does not desire to damage or

31 Whyley C. and Brooker S. Home Credit: an investigation into the UK home credit market, National Consumer Council, July 2004. Page 67.

destabilise the home credit market, and is indeed very aware that if the industry were seriously de-stabilised the very people the Committee is aiming to protect, namely the poor and financially vulnerable, would be those most harmed. However, we do believe its standards need to be raised substantially, and this is reflected in our recommendations.

Returning to the Competition Commission's report, we believe two conclusions in particular stand out:

1. Competition in this market is limited and therefore the cost of borrowing is higher than in a competitive market.

The Commission reached this conclusion based on the evidence that; prices are higher in the UK market compared to the Republic of Ireland; profits made in this market considerably exceed the cost of capital; levels of switching between lenders is only modest, and there is little variation in market shares over time. They found that the two most fundamental reasons for the lack of competition in this market were the lack of appropriate alternative credit products to home credit, and the significant barriers to large-scale entry to that market.

The argument that the home credit industry has traditionally used to defend high interest rates is the high risk they take when lending to this market. Some argue that, because the default rate is low this argument does not stand up. We reject this. Providing doorstep credit in a tough inner city estate in which shops and houses are boarded up, and in which there is active drug dealing and alcohol abuse, is hardly an environment to attract credit lent at the finest rates and clearly involves higher costs than other forms of credit. Not only that, but the home credit industry makes great use of its flexibility in handling late payments: Default may be low in the sense that customers fail to pay back the loan, nevertheless there seems to be a significant amount of default when measured by the loan being paid back over a longer period of time than was initially agreed. However this would not fully justify the rates charged in this market.

The Competition Commission correctly concluded that the reason for high prices is first and foremost a lack of competition. They also acknowledged that the provision of a home collection service does involve higher costs than other forms of credit, but that this service does not account for the excess profits the largest lenders in this market generate. We agree with the Competition Commission's conclusion that: 'profits have been persistently and substantially in excess of the cost of capital for firms that represented a substantial part of the market.' And with their estimate 'that profits in excess of the cost of capital of at least £75 million each year had been earned in the industry over the period 2000 to 2005.[32]'

32 Competition Commission: Home Credit Market Investigation, November 2006. Summary, page 7, paragraph 10.

We can only conclude that if competition in this market were increased, companies could still make a healthy profit by providing the same service at lower rates.

2. There is no consistent evidence to prove the charge that doorstep lending makes customers vulnerable to being exploited by the agent in their own home. The Competition Commission found no evidence of exploitation. It concluded that:

> *"There may be risks associated with the agent relationship, (but) on balance we consider that the evidence is consistent with a general picture of agents seeking to establish and maintain a good relationship with customers by meeting their expectations."*[33]

Whilst we believe we must accept the judgment of the Commission who have carried out an extensive investigation into this issue, we still wish to report that we have continued to receive anecdotal evidence which questions this conclusion.

Policy Recommendations

Increasing Transparency, Data Sharing and Compliance

Given the Competition Commission's investigation and the evidence our Commission has received it is essential to look at the specific charges made against the home credit market and the policy recommendations we feel are needed to address these.

The specific charges against the home credit market include;

- High APRs
- Little evidence of customers switching between home credit companies
- Significant costs incurred by switching, and strengthened by 'step up' loans and 'rollover' loans
- Exploitation of low financial literacy among consumers

All of these, it is alleged, give rise to an unfair relationship between the provider and the customer. Furthermore, the National Consumer Council also claim that the home credit market is characterised by significant barriers to entry which prevent the prospect of large new entrants entering on a sufficient scale to challenge the present market concentration.[34] There are a number of ways in which competition could be increased in the home credit market. One of

33 Competition Commission: Home Credit Market Investigation November 2006, Section 6.123.

34 C Whyley and S Brooker, 'Home Credit: an investigation into the UK home credit market', National Consumer Council, July 2004. Page 5.

which is increasing transparency and data sharing, and in this we strongly endorse the four remedies recommended by the Competition Commission:

- **Data Sharing**
  Home Credit lenders with over 60 agents or £2 million in annual turnover will be required to provide data on all of its customers' new home credit loan, voucher agreements, and all existing loans and voucher agreements (which they have consent to share) to at least two Credit Reference Agencies. (Information on home credit loans and vouchers will be recognisable as distinct from information on other credit products, and any search made by any alternative home credit lender will be recognisable as such.)[35]
- **Publication of Prices**
  All home credit lenders are to be required to provide specified information on the price and other terms of their loans to an independent website operator appointed by the Competition Commission. The information will be published on this website to enable users to compare the prices of loans in a certain geographical area, and provide information regarding customer rights. The costs of this website are to be met by the largest home credit lenders. Home credit lenders should also be required to provide information, mirroring that on the website, on request, either orally or in writing, to the customer within one week of the request.[56]
- **Better Information to Customers**
  The Competition Commission will ensure that statements of loan accounts provide information relevant to home credit customers. The Consumer Credit Act 2006 ensures that home credit loan statements are made each quarter and include the total cost of credit for the loan, the terms of early settlement rebates, reference to the price information website and details of how to request additional statements.

  All home credit lenders will be required by the Competition Commission to provide one free statement per quarter or one per loan (whichever allows for more requests). These requested statements will have to be posted or given to the customer within one week of the request being made (orally or in writing) and will have to comply with the same requirements about form and content as periodic statements provided by home credit lenders. Each loan will be presented separately, and a summary page of the customer's current position will also be provided.[37]
- **Early Settlement Rebates**
  The Competition Commission should ensure that any rebates on the early settlement of loans are fair to both home credit borrowers and lenders. All

35 Competition Commission: Home Credit Market Investigation. CC, 30 November 2006. Summary, Remedies, page 10, point 26.

36 Competition Commission: Home Credit Market Investigation. CC, 30 November 2006. Summary, Remedies, page 10, point 27.

37 Competition Commission: Home Credit Market Investigation. CC, 30 November 2006. Summary, Remedies, page 10, point 28.

home credit lenders will be required to give an Early Settlement Rebate at least as generous as one based on the actuarial formula set out in The Consumer Credit (Early Settlement) Regulations 2004. In calculating a minimum rebate, no home credit lender will be allowed to defer the settlement date for more than 13 days or to use actual repayments rather than contractual repayments as the basis for the calculation.[38]

The Need for Further Measures

While we accept the Competition Commission's findings about excessive pressure in connection with doorstep selling, given some of the evidence received, we remain concerned about this area. Major companies in the home credit industry have an opportunity to show greater leadership by further increasing transparency and creating much greater public confidence in their marketing practices. We are frankly dismayed that the industry is doing less than it should to respond to criticisms. It seems as if it has succumbed to a culture of complacency in which it is unable to understand the frustration which many sympathetic observers feel. There is a feeling that from a public policy perspective the industry is in, to put it crudely, the last chance saloon.

In addition to supporting the Competition Commission recommendations we also feel it is necessary to *ensure* effective compliance by home credit companies in order to protect its customers, many of whom are in a vulnerable position. At present the industry has guidelines for agents regarding this issue, and we strongly support these. However, given the customer base, we propose that government should strengthen these guidelines and their implementation by appointing the audit or governance committees of the main board to oversee compliance issues. This would mean that the main boards would receive regular reports from board committees on these issues, and that independent directors who were members of the relevant committees would play an enhanced role in governance. We also recommend that this process be supervised by the Financial Services Authority (FSA).

Furthermore, owing to the nature of the home credit market we believe more accountability is needed in regard to agents' responsibilities. The YouGov survey for the Social Justice Policy Group of April/May 2007 showed that 89% of people think doorstep lenders should be held to a professional standard of conduct, and to this end we recommend that there should be additional regulation in relation to an agent's first contact with potential new customers. We propose that there should be a requirement upon agents to inform the potential customer up front regarding the full cost of the service by comparison with other forms of credit. The agent

38 Competition Commission: Home Credit Market Investigation. CC, 30 November 2006. Summary, Remedies, page 11, point 29.

should give a clear and simple example of how much a typical loan would cost e.g. 'If I were to lend you £100 I would expect you to pay me back £250 over 15 weeks'. We feel that this sort of information needs to be given to prospective customers up-front and before any specific agreement is discussed. This measure, if observed correctly, should enable consumers to make a more informed choice and realise the financial impact of what they are considering, before entering negotiations.

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.

4.2 The Case Against Capping Interest Rates

A popular proposal to combat the high rates of interest that often occur in the sub-prime market, and in particular the home credit market, is to cap interest rates. We believe that this argument is severely flawed and that the capping of interest rates would not result in a healthier or more competitive market, but would in fact encourage the opposite.

The APR of sub prime credit is high and has led to charges of exploitation and abuse. For example, in the home credit industry, rates in excess of 150% p.a. are typical and often higher. In comparison, it is claimed that APR rates in the main-stream lending industry rarely exceed 30%. We believe that these comparisons are misleading as the APR excludes penalty charges with APRs for overdrafts never published. The accusations that the prices charged in these markets are high is not just limited to Home Credit but to the sub prime sector as a whole. Because APRs introduce great distortions when used to measure the cost of credit for short term loans of small amounts, credit providers should not be required to publish APRs on sub prime loans of less than 6 months, but instead be required to publish the total amount repayable far more explicitly within the documentation. This requirement encourages a more accurate measurement of cost that is considerably simpler to understand, and therefore much better suited to the 'typical borrower's' level of financial literacy.[39]

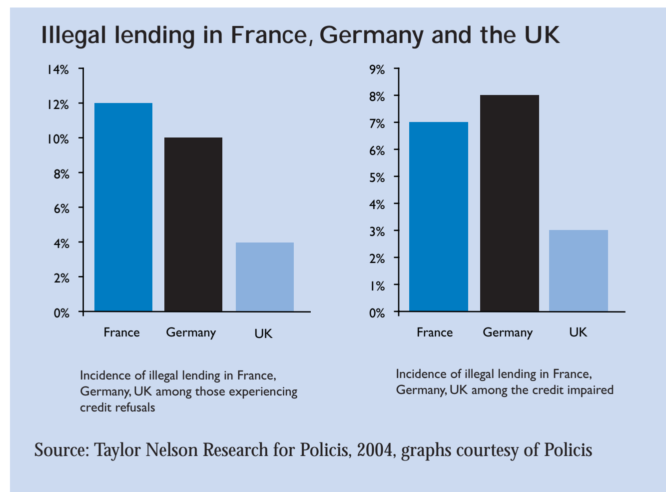
An alternative measure sometimes suggested to deal with the higher interest rates which result from the lack of competition in doorstep lending is to cap interest rates. This was confirmed in our polling[40]. When asked "A cap on interest rates would put an end to some of the most obscene and extreme interest

39 See section 4.8 ' Money Education' page 44, for MORI statistics on adult financial literacy and capability
40 YouGov Survey for the Social Justice Policy Group, April-May 2007

charges and make doorstep lenders offer fairer rates" 75% of those polled agreed. However, we are strongly opposed to interest rate ceilings for the following reasons:

1. It is far from easy to specify in precise detail what should and should not be included in an APR calculation. In Germany for example, transaction costs for purchases are included in the APR, but a range of other routine costs (cash withdrawals, statement fees, correspondence fees) are not included. In the US, exemptions are typically provided for pawnbrokers and auto loans but not for others. Making these details precise would invite the home credit industry to develop ingenious devices to get around the official restrictions.
2. 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, which, as we explained in the previous section[41], would damage many of the most financially vulnerable in our society. 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. Research conducted for the Dti concluded that: 'In markets where rate ceilings are introduced….if the business model and pricing structures cannot be adapted to fit within the new framework, lenders tend to withdraw from the market.'[42] They gave the following example: In 2000 the State of Florida imposed rate ceilings on Auto Title lenders, who provided high cost short-term cash credit to largely unbanked car owners. Twelve months later the number of lenders had dropped from 600 to 58.
3. Because of an excess demand for sub-prime consumer credit, illegal lenders would step in to fill the gap. Evidence suggests that the illegal lending market is significantly smaller in the UK than in other comparable economies. In the UK, 3% of those who are on low incomes and who are credit-impaired are prepared to admit they have borrowed from an illegal lender. In France this figure is 7% and in Germany 8%.[43]

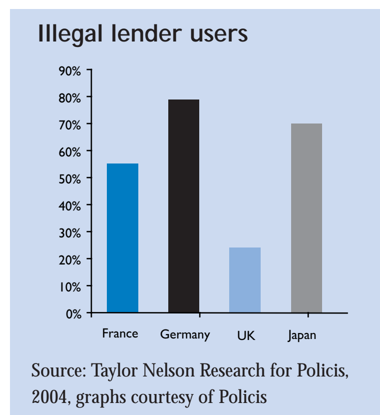


Source: Taylor Nelson Research for Policis, 2004, graphs courtesy of Policis

41 See Section 4.1 'Home Credit Market'.
42 Policis for the Department of Trade and Industry. 'The effect of interest rate controls in other countries, July 2004. Page 16, paragraph 2. Point 2.2 (iv).
43 The Griffiths Commission 'What Price Credit', March 2005. Page 59.

Recent research for the Dti, found that unlike home credit, illegal lending is deeply damaging to its customers and the communities in which they live: reinforcing social and financial exclusion and stimulating crime and anti-social behaviour[44]. Policis, who carried out this research, affirm that the UK has some very high cost credit models but minimal credit exclusion and thus a lower incidence of illegal lending than other advanced economies.[45]

4 The consumers most affected by a shortage of credit would be the most financially vulnerable namely the unbanked, credit impaired, low income individuals and families in the country. Those on low incomes who have been refused loans in the UK are estimated to be roughly 4%. The Competition Commission rejected a price cap as a remedy for the same reason: "that there was a risk that price caps would contribute to a reduction in access to credit for some customers and thus to a possible increase in financial exclusion."[46]



Source: Taylor Nelson Research for Policis, 2004, graphs courtesy of Policis

4.3. Strengthening Credit Unions

Third sector organisations already offer valuable services in the sub prime market and some mainstream banks are becoming involved in this area. However, both have the potential to do much more. We believe that credit unions in particular have huge potential to reach many more customers, as well as competing with home credit by providing a quality sub prime service. Yougov polling for the Social Justice Policy Group in April/May 2007 showed that many agree, and 87% of those expressing an opinion feel credit unions should be supported and expanded. For credit unions to flourish on a much larger scale Nationwide, time will be needed as well as support from the private sector. 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.

The expansion and improvement of the Credit Union network is a key recommendation of this paper. The main issues are:

1 At present, credit unions play a relatively small part in provision of credit in the UK so there is more than ample scope for growth. In the UK, credit unions provide credit for only 1% of the population. And yet, there are more

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44 Anna Ellison, Managing director, Policis. Giving evidence to the Committee in March 2007.

45 Policis/Personal Finance Research Centre for the Department of Trade and Industry. 'Illegal Lending in the UK', Research Report. November 2006. Page 26.

46 Competition Commission: Home Credit Market Investigation, November, 2006. Summary. Page 11, point 30.

Janice, a lone parent with two children. When her marriage broke down she had a low income and very little support. The family had a considerable debt with a hire purchase store for household goods and furniture. She struggled to find the money to provide for her family on a daily basis. Like many of her neighbours in Glasgow, she was excluded from all sources of mainstream financial services and was forced to take recurring small loans from doorstep lenders to cope with Christmas gifts for the children and necessities such as school uniforms. She would have had to repay nearly £900 on a small loan of £500 – an APR of nearly 200%. She joined Cranhill Credit Union and in her own words – 'it changed my life.' For the first time in her life she has built up some small savings and knows that the credit union is there for her at any time of financial need. In Cranhill Credit Union, a loan of £500 will only require repayment of £530 – nearly £400 less than she was charged by her friendly doorstep agent. Cranhill Credit Union has given her confidence and raised the self-esteem of her and the children who are now grown up and are also members of the credit union.[47]

than 42,000 such 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 as clearly anomalous.

2 Any growth in the UK sector, however, has to recognise that many credit unions which started in the 1980's and '90's have an unsustainable business model. We suggest that new credit unions should be established solely in accordance with the best practice developed in recent years by the Association of British Credit Unions Ltd. Their approach has resulted in a significant number of credit unions having a level of growth and income that obviates any reliance on external capital or public grants. We are also greatly encouraged by the evidence in countries such as the USA and Ireland, where credit unions are a significant provider of credit at the lower end of the market, that these movements can be viable without continuing assistance from government.

3 Credit unions in the UK have been over-regulated compared to other countries. Regulations and restrictions such as; geographical and occupational restrictions; imposing low ceilings on interest rates, are largely responsible for the diminutive size of the credit union network in this country, and for their struggles to become financially viable. Despite such interference, the sector has started to show how innovative it can be, and how positively this can affect its growth. One example of this is the introduction of the Credit Union Current Account. This gives customers full ATM access, a VISA debit card, and the ability to set-up direct debits. Any charges are completely transparent to the customer, and the account has been designed to overcome many of the difficulties currently associated with basic bank accounts.

We do, of course, welcome the recent move towards a degree of liberalisation in this sector, which has allowed:

47 Anecdotal evidence courtesy of John Patton, Scottish Union of Credit Unions, Glasgow.

- The credit union interest rate cap to be increased from 12.7% to 26.8% APR. This has allowed them to compete in the home credit market, and thus offer better services to their customers, who (even at this higher interest rate) still pay radically less than they would to any private sector creditor.
- Benefits to be paid directly into a credit union. This enables credit to be extended more responsibly and simply.
- The Credit Union Current Account to be developed and implemented, as seen above.
- The introduction of the PEARLS financial monitoring initiative, designed to improve credit unions financial health.

Nevertheless, the government could do much more, and we recommend learning from New Zealand's excellent model. New Zealand's government recognised the need for credit unions to have more freedom and flexibility if they were to grow and flourish, and legislated accordingly. Only a few years later, and their credit unions have already grown to cater for 6% of the population, and are continuing to grow steadily. We therefore propose the UK government take steps to strengthen and expand its movement by allowing credit unions:

- To determine their own common bond, with faith-based institutions, housing associations, schools, supermarkets, football clubs and debt advice agencies all potentially playing a major role. This would allow credit unions to help many more people; and to encourage commercial providers such as the Post Office and PayPoint to come into partnership with them.
- To abolish the minimum age restriction, so that young people are encouraged to save, and to become financially capable. Credit unions already provide financial education and saving facilities to over 500 schools nationwide: this measure would turn theory into practice.[48]
- To provide services not just to individuals, but to organisations (for example, local businesses and community groups) which could provide new sources of capital for lending.
- To form a Central Shared Services Organisation. This would provide economies of scale and marketing support, and has had a major impact on the efficiency and development of credit unions in other countries.
- To pay interest on savings, and not just dividends, which should encourage more sophisticated savers to use credit unions.
- To charge for auxiliary services. Currently, credit unions' charges are only allowed to 'cover the cost of providing the service', which limits their ability to offer additional services to their members.

We also believe that credit unions can help the UK to develop a wider savings culture. This is an area of huge potential, although it would be essential for the credit

48 See Money Education, Section 4.8. for more details and proposals of money education in school and in the community.

unions to remain true to their savings ethos, and to protect themselves from becoming just another retail financial institution.

Justine fled from Zaire to the UK with her two children when her husband was killed by Government supporters. She applied for asylum for all three of them and for almost a year she was housed in a transit camp before being re-housed in Glasgow. Her ability to save and repay loans was very restricted; nevertheless she has found a welcome and support in the credit union which helped her and her family to make friends and integrate with the local community. Justine believes that the credit union has been of immense importance to her and her children as they try to renew their lives and face the future.[49]

Finally we recommend that the number of Community Development Finance Institutions (CDFIs) which handle personal consumer loans should form an alliance with credit unions. There are only a small number of CDFIs in this category and therefore an alliance would strengthen both parties enabling them to become more effective in meeting the needs of the low income consumers whom they both aim to serve.

Laura is registered blind and is currently studying to be a social worker. When Laura came along to South Coast Money Line she owed over £1000 to a country wide organisation that offers access to household goods and luxury items, but at a cost.

Lin Fisher – Outreach Officer says: Goods work out much more expensive at such companies because on top of the interest rates charged for credit to buy these goods, 'optional extras' - taken out in most cases - mean that the customer can pay double or even treble the original price.

Laura purchased a second hand television and stand for her family for £544, but realised that she would end up paying £1044 – almost double the amount the set was worth.

South Coast Money Line provided a loan to re-pay the loan company. Laura reduced her monthly re- payments by £120 and shortened the length of the loan agreement.

Lin states: "At South Coast Money Line we don't believe that those on a low income should have to pay so much more for basic things – getting overpriced goods with high repayment costs when least able to afford it". [50]

4.4. The Wider Market

Whilst much of this report has concentrated on the issues facing the lowest quintile of the population and thus has primarily looked at the sub-prime market, we also wish to highlight the need for appropriate regulation in the prime market. The prime market needs to show greater leadership in safeguarding its customers from acquiring unmanageable debt.

49 Anecdotal evidence courtesy of John Patton, Scottish Union of Credit Unions, Glasgow.
50 Anecdotal evidence courtesy of Community Development Finance Association.

As our interim report, Breakdown Britain[51], highlighted, it is not merely the low-income consumers who may be adversely affected by debt. The prime market, and especially the mainstream banks, provide credit to millions of people, and it is therefore crucial that there is transparency and accountability in this part of the market.

As previously stated, the number of adults who claim to have had a serious debt problem is between 7 and 9 million, yet, with less than 50% of the population possessing provisions for a drop in income or a deterioration of financial circumstances, the number of people in danger of being plunged into a severe debt crisis is a grave concern. Given this very real concern, the need for the distribution of this credit to be responsible is vital. Although responsibility for borrowing should ultimately lie with the borrower, lenders have a duty to offer credit in a responsible manner and safeguard consumers from being able to take on more credit than they can realistically afford.

We therefore wish to make two recommendations:

First, that all lending institutions introduce a 'traffic light' system in partnership with the credit rating agencies. Under this system, satisfactory and unsatisfactory credit ratings should be given 'green' and 'red' lights respectively; marginal decisions should be given an 'amber light'. This indication of the likely presence of financial stress should require the lender to conduct a more personal and thorough discussion with the applicant, prior to any decision.

Second, we recommend that the Voluntary Banking Code should be replaced by a statutory Bank Customers' Charter. Until the FSA was set-up in 1998, the financial sector (with the exceptions of hire purchase, leasing companies and insurance) was regulated by the Bank of England. Since then, the FSA has been responsible for prudential supervision, but an important form of self-regulation within the banking industry is the Banking Code. The Banking Code is voluntary and sets out standards of good practice for financial institutions (banks, building societies, credit card companies) 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. Yet whilst it is has been hailed 'an exemplar of self regulation'[53], it has also been accused of 'lacking teeth'[54]. In addition to this criticism, the Treasury Select Committee has also issued two critical reports raising questions on the issues such as:

Tony, Community Money Advice Volunteer giving some friendly debt advice to a client[52]

51 Social Justice Policy Group. Breakdown Britain, Consumer Indebtedness. SJPG, December, 2006.
52 Photo courtesy of Community Money Advice.
53 DeAnne Julius.
54 Banking Standards Board, 1999.

- A lack of transparency on the interest rates and the penalty charge of credit cards
- Over aggressive marketing techniques
- Automatic raising of credit limits
- Consolidation loans
- Inadequate checking of credit references
- Irresponsible issue of credit card cheques
- Inadequate sharing of data

All of which raise concerns as to the validity of the voluntary Banking Code as a means of regulation, as well as the 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 OFT. This Charter should, among other things, set standards on:

- Transparency of charging
- Techniques of marketing
- Methods of debt collection and
- Compulsory data sharing

Specifically we believe the Charter should:

- Prohibit unsolicited increases in credit limits either for loans, credit cards or other forms of finance
- Prohibit automatic issuance of credit card cheques. Customers who wish to take advantage of credit cards should be required to opt in to the system. Receiving them should not be the default position
- Introduce of a code of practice for responsible debt collection. If lenders sub-contract debt collection to another agency or sell on the debt, the original lenders should still bear the responsibility to ensure these standards of debt collection are maintained
- Require the clear identification by lending institutions, not just credit card companies, of all charges or default penalties as part of the original granting of the loan or credit card. Summary boxes need greater clarity and consistency, and should clearly spell out in plain English the impact of making minimum repayments for prolonged periods
- Require consistency in the calculation of APRs
- Introduce proper regulation for the selling of Payment Protection Insurance
- Require the production of standardised, clear and transparent policies regarding penalty charges.

The Commission feels very strongly that mainstream banking is an area which has escaped formal regulation for too long, and that given recent revelations of 'unfair' bank charges, it is an appropriate time to alter this situation.

4.5. Strengthening Local Community Based Debt Advice

There are a number of different services available to help people who find themselves in unmanageable debt, a number of which offer an excellent standard of practical help and support. However, given the diversity of the market and the demand for these services, more needs to be done. Among other things the Government needs to ensure better regulation, sufficient availability of the right services for the individual debtor, and fairer funding for debt agencies, and in particular for smaller community based services.

Debt Advice Training Session

The approach taken to getting people out of debt will vary according to the particular circumstances of each case, various options may be used, namely; help with credit management, recourse to debt advice, increasing income, especially looking at benefit entitlements, reducing outgoings, refinancing, improving debt management systems and pursuing legal remedies such as IVAs and bankruptcy.

We should highlight the following issues:

1 The demand for all types of debt advice outstrips the existing provision.
2 The growth in telephone and web based debt advice, although very necessary, does not replace the ongoing need for the provision of face to face advice.
3 Although small independent advisory organisations provide a personal and professional service which responds to local needs, they seldom experience a level playing field when it comes to local government funding.
4 The growing regulatory environment and 'professionalisation' of the sector is hampering the viability and effectiveness of voluntary and civil society debt advice organisations.

Additionally the debt collection systems of many companies and public agencies are significantly below best practice; they fail to use customer segmentation and data analysis to develop less confrontational and more collaborative collection practices. In this context the innovative approach to debt management and debt prevention pioneered by companies such as British Gas provides a model of best practice.

There is also a need for wider recognition that refinancing through advertised consolidation loans often fails to address the root causes of people's indebtedness and therefore rarely succeeds in getting people out of debt, and in fact frequently makes matters worse.

Margaret had run up debts of £28,000. She went to a debt management firm two years ago and had paid them over £4,000 over the following 24 months which she had assumed was being used to repay her creditors. She asked for a statement of how much was still outstanding to her creditors and was told she still owed her creditors just over £27,000[55]

To help address these issues, we propose the following policy recommendations:

1 Small independent advice agencies should be exempted from unnecessary regulations, so that voluntary effort is not deterred[56]. These smaller organisations often offer more personal community based services, and while for many customers web and telephone based advice is perfectly adequate, there is a significant minority for whom personal, face to face advice is vital.

Clayton, a husband and father of two, severely in debt, found himself on Loughour Bridge seriously thinking about getting in his car and driving off the bridge. "I remember thinking, 'How am I going to pay this? How am I going to pay that?' " says Clayton. "You just think how easy it would be to end it all. You wouldn't have all the worries. The only thing that stopped me was the fact that I had children to think about and a family. Soon afterwards I bumped into Byron, who mentioned he was working for his local church as a Christians Against Poverty (CAP) debt counsellor. He said that CAP helped people for free, and it didn't matter how much debt they're in. I remember saying 'Perhaps you could help us – I've got one or two debts.' Byron didn't know the extent of our problem until he came to our house to go through things. That's when I told him the full story, and the effect it was having on us as a family. Byron was really helpful. He was sympathetic and very, very knowledgeable. He knew what he was talking about. When you've got a lot of problems and you actually talk to someone about it, it's a huge weight off your shoulders. You get it all out. You cry a lot. A week later, Bryon came back with a financial statement, a reasonable monthly budget and an affordable repayment plan." Clayton concludes, "I was so relieved that finally help was here. We've now got food in the cupboard, and I can concentrate on loving the children and my wife. Home has become a much happier place."[58]

Clayton on the spot where he contemplated suicide because of the pressure of being in serious personal debt[57]

55 Anecdotal evidence courtesy of Community Money Advice.
56 See Volume 6, Section 3.5 'Safeguarding the independence and vibrancy of the sector'.
57 Anecdotal evidence courtesy of Christians Against Poverty.
58 Photograph courtesy of Christians Against Poverty.

2. Information particularly focusing on what borrowers should do especially when they hit crisis point should be provided in places such as doctor's surgery and supermarkets; in other words places where low income consumers, and particularly families, visit frequently and are unlikely to feel threatened. This kind of information should be made accessible to those with little in the way of education or literacy skills, and should be presented in a suitably direct yet non-threatening way. One idea would be to produce a series of pamphlets entitled "What if we have a baby" or "What if I lose my job" concentrating on the key crisis points in people's lives when they are most likely to want help, and furthermore are willing to seek it.
3. 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[59]. A clear and simple mechanism should be formulated and put in place to ensure fairness between different agencies. We wish to acknowledge that sometimes the smallest third sector organisations can make the biggest differences[60].
4. The Financial Inclusion Fund that has recently been extended, should be distributed more equally across the debt advice services than it has been over the last two years. The funding should represent the diversity of the need by being distributed across the full diversity of service providers. Smaller organisations should not be overlooked and the government should not concentrate their funds on only the largest service providers in this area[61].
5. Lending institutions, utility companies and local councils should develop a more sophisticated debt management system, such as that, pioneered by companies such as British Gas. Their innovative approach has provided an excellent example of how to prioritise debt management and prevention, so that fewer customers fall into arrears and more debts are collected more successfully.

4.6. Reviewing the Benefits System and Social Fund

The debt problem in this country is greatly exacerbated by the inefficiency and inaccessibility of the benefits system. Low income consumers can spend years struggling to live on insufficient funds because they are unaware of their benefit rights or they can be thrown into debt as a result of a delayed benefit pay-

59 See Volume 6, Section 4.3 'Statutory Funding'.

60 See Volume 6, Section 3.1.1 'Smaller poverty-fighting TSO website - the trustmarking site' for a description of our proposal for one mechanism by which small third sector organisations can gain recognition and funding.

61 See Volume 6, Section 4.3 'Statutory Funding'.

ment. And yet, 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.

Firstly, a particular concern that emerged during our evidence-taking is the extent of benefit entitlement that is unclaimed. British Gas for example told us of their programme to help clients experiencing payment difficulties by checking their benefit entitlements. On average they found people were entitled to £1400 per annum more than they were claiming. Jill Harrison from British Gas said, 'the best you can do for someone who is on a low income is to try and help them realise their benefits. This requires closer government attention.'[62]

This lack of awareness of entitlement to benefit payments prevents people from repaying their debts and frequently increases their over-indebtedness.

Stacey, a single mum with a 9 month old baby and had been referred to her local debt advice centre by her council because she was in danger of being made homeless. When Stacey came to see us in October 2005, she was in a desperate state because she was being threatened with eviction by her landlord for getting behind with her rent payments.

Stacey was struggling to live on her income from a small part-time job and state benefits and the added burden of half a dozen debts was making her life extremely miserable. She often responded to threatening phone calls from her creditors by agreeing to pay them what they demanded and then found that she couldn't make her rent payments to her landlord. Her finances were out of control and Stacey was extremely depressed.

Thankfully the situation was caught just in time and it was discovered that she was entitled to a significant increase in her benefits. The arrears of Housing Benefit that were paid to her almost covered her rent arrears and reduced monthly payments were negotiated with all her creditors. The increase in her income combined with the decrease in her expenditure meant that she was able to meet her monthly rent, remain in her flat and meet all her financial commitments.

The relief for Stacey was enormous. She had no family in the area to support her and had made several friends in her neighbourhood so desperately wanted to remain in her accommodation. Once the threat of eviction was lifted and her finances were back under control Stacey's depression lifted and she felt much more able to deal with her finances every month and cope with the stresses of looking after a tiny baby. Her landlord was so pleased with the result that he even asked if he could refer future clients to the debt advice centre if they were having problems paying their rent![63]

Secondly, we should look at how the benefits system also contributes to debt problems when payments are delayed. A number of witnesses cited the complexity of benefit applications, and it is also clear that the inefficiency of cer-

62 Jill Harrison giving evidence to the Griffiths Commission, 2005.
63 Anecdotal evidence courtesy Community Money Advice.

tain benefit agency offices[64] only worsens the misery. One former chief executive of a large city local housing department stated that in his opinion, most low income families with whom he had dealt did not want to get into debt but found themselves being in debt because of delayed benefits.[65]

In view of these two issues, we believe that there needs to be an independent review of the benefits system, with the full co-operation of all the relevant departments. We welcome the fact that the economic dependency sub-group of the Social Justice Policy Group has been looking at means of simplifying the various credits, benefits, allowances and entitlements, so that they are easier to understand, and more straightforward to administer.[66] In addition, we welcome their emphasis on a system that regularly identifies the amount of any unpaid benefit entitlements, and looks at the best way of enhancing their uptake,[67] and on an improved use of direct payment schemes, through benefits and salary deduction.[68]

These measures could make the benefits system part of the solution, not part of the problem, of indebtedness.

Finally, we should consider the Social Fund, which was set up in 1988 and revised in 1998 to make it more accessible and effective. Part of the payments from the Social Fund are loans which charge no interest. They are an alternative to home credit, are available to people on Income Support and Job Seekers Allowance and are meant to help with one off, lump sum expenses. Applications for loans are complex and lengthy. The scheme is cash limited and repayment terms are set by the DWP and are typically more inflexible than those of home credit. Many campaigning organisations claim that the social fund is not tackling social exclusion.

Nevertheless, we believe that the potential exists for it 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. Again, this would require the co-operation of all the relevant Departments.

64 See Volume 2, Section 4 'Reforming the Benefits System' for more detailed evidence and proposals in this area.

65 The Griffiths Commission, 'What Price Credit', March 2005. Page 27.

66 See Volume 1, Section 8.5.2. 'Reform of the current system of housing benefit' for detail on one proposal regarding thes benefits system. See also, Volume 2, Section 4 'Reforming the Benefits System' for more detailed evidence and proposals in this area.

67 Ibid.

68 Ibid.

4.7: Bankruptcies and IVAs

The number of people opting for personal bankruptcies and IVAs has increased significantly over the last few years. Whilst there may be a variety of reasons for this, the bottom line is that more people are getting into serious personal debt that they cannot afford to pay back. Although bankruptcies and IVAs are by no means the ultimate solution to the whole country's debt problems, for some individuals they can provide a solution and therefore a desperately needed fresh start from the entrapment of serious personal debt. In view of this, personal bankruptcies and IVAs must be marketed and regulated responsibly.

The number of individual insolvencies has increased dramatically over the period 1998-2006 as set out in the table below. Every day, another 300 people are registering themselves as insolvent.

Individual Insolvencies

Year	Total	Bankruptcy orders	IVAs
1998	24,549	19,647	4,902
1999	28,806	21,611	7,195
2000	29,528	21,550	7,978
2001	29,775	23,477	6,298
2002	30,587	24,292	6,295
2003	35,604	28,021	7,583
2004	46,650	35,898	10,752
2005	67,584	47,291	20,293
2006	107,288	62,956	44,332

Source: The Insolvency Service

In 2006, more than 44,000 people opted for Individual Voluntary Agreements – dubbed "bankruptcy lite" – which were double the previous year's level. IVAs are agreements between banks and borrowers in which the borrower agrees to a reduced schedule of repayments over 5 years. IVA firms typically charge £3,000 plus £900-£1000 a year taken out of the debt repayment, leaving the creditors with sometimes only 10p or 20p in the £1. Because of this some creditors have become loathe to agree to IVAs and some are reported as saying they will decline IVAs should the charges levied be £4,500 or greater.

The high street banks wrote off approximately £1.4 billion as a result of IVAs last year. They have been concerned that IVAs are irresponsibly market-

ed by insolvency companies which downplay the drawbacks and wrongly claim that debtors can walk away from as much as 90% of their debts. In fact, people taking out IVAs are rarely forgiven more than 70%, and IVAs are only suitable for people on higher annual incomes with very substantial debts, usually £30,000 or more. In January, the OFT censured 17 IVA firms for misleading advertising.

There is a common misconception that the rise in IVAs in the last few years is the result of the Enterprise Act 2002. In fact, the Enterprise Act is only responsible for allowing a tiny minority of cases being granted IVAs where they would have previously been denied. We believe there is very little evidence to suggest that changes brought in by the Enterprise Act 2002 have caused the continuing increase in personal insolvencies and that these have occurred as a result of factors far removed from the legislation. We believe the recent rapid increase in IVAs is due primarily to; the rapid growth of debt itself; the fact that the debt management industry has recognised the value of IVAs as a new product, and the industry has started aggressively marketing IVAs.

IVA companies have recently been criticised for this aggressive marketing and in particular, for the amount of money they have spent on this marketing. While we feel strongly advertising must not be misleading, and we support the OFT in its action to combat this, we also feel the criticism these companies have received in terms of the monies they spend on this advertising is unproductive, given the bigger picture. In April 2004 the FSA reported that the credit industry in 2003 alone spent £1 billion on advertising mortgages, loans and credit cards. In view of this, the few tens of millions spent advertising a potential solution to people's debt is in actual fact a small amount in relation to the amount spent on encouraging people to enter greater debt. IVA companies should not be criticised too heavily, especially as their advertisements ultimately encourage people to seek help, and even if an IVA is not appropriate and so rejected, the original advertisement may well encourage them to find an alternative solution to their debt that is appropriate.

When the 55 year old man who had recently taken out an IVA was asked whether he felt much worse off now than before the IVA, he answered: "No. In fact it feels better, because, as I say, we've only got the one main bill apart from the normal household things. And I can go around and not worry about phone calls, letters or anything like that popping through. That in itself was an immense relief."[69]

IVAs are a useful tool to help people in severe debt situations face up to their problems. We do however have three recommendations aimed at improving provision, and a further recommendation addressing bankruptcy more generally.

69 Anecdotal Evidence courtesy of Antony Elliot, taken from interviews with IVA clients.

Firstly, we recommend that IVAs should only be approved following independent debt advice through recognised agencies. PricewaterhouseCoopers state in their 2006 report, 'Living on Tick: The 21st Century Debtor' that:

> *"Both bankruptcy and IVAs offer relief from debt, but both can lead to hardship in terms of employment, property purchase and rental, as well as less obvious areas such as personal relationships: with credit and debit cards being essential for online shopping, and often for holidays, airfares, car hire or even cinema tickets, insolvency can have an adverse effect beyond the obvious."*[70]

In view of both this, and the fact that the number of bankruptcies and IVAs being voluntarily opted for has increased at an unprecedented rate in recent years, we feel that it is essential that debtors know the full extent of what it is they are considering before entering any official and legally binding agreement.

Our recommendation is that IVAs should only be made available following independent debt advice, through recognised debt advice agencies. The YouGov survey for the Social Justice Policy Group in April/May 2007 showed that 92% of people stated that they felt debt advice should be mandatory for people considering bankruptcy or similar courses of action. In line with public opinion, we believe it is essential that debtors are aware of the disastrous consequences IVAs can have on their future ability to raise credit (up to a period of 12 years). Independent debt advice agencies are best placed to advise on this, and to suggest the other viable alternatives such as debt management plans.

Secondly, if an IVAs proposal is judged by an independent adviser to be a fair and viable alternative to insolvency, and yet creditors thereafter decline an IVA, there should be a rebuttal presumption in law. This would deem the credit originally provided as unfair under the Consumer Credit Act 2006.

Thirdly, we recommend that a new category of IVA should be made available to those with smaller consumer debts, so that a debtor who meets 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, would be able (after independent debt advice) to apply for a debt relief order to the Official Receiver. This would be a non-court-based scheme which would place a moratorium on any debt payments for a period of twelve months.

Finally, and on the more general subject of bankruptcies, we recommend bankruptcy fees should be acutely graduated (based on the size of the bankruptcy settlement), so that debtors are effectively rehabilitated into more responsible economic activity.

70 PricewaterhouseCoopers, "Living on Tick: The 21st Debtor", 2006. Executive Summary, page 2, paragraph 7. PricewaterhouseCoopers, 2006.

4.8. Money Education

A lack of money education, or rather of basic financial capability, is now being recognised as the reason why many people find themselves in a position of serious personal debt without fully understanding how and why they got there. Money education that focuses on teaching people financial capability enabling them to handle their money independently and effectively is vital if the pattern of falling into excessive debt is to be avoided in the future.

In our March 2005 report, *What Price Credit*, we emphasised that ultimate responsibility for borrowing must remain with the borrower, who is best placed to assess their own ability to repay. We therefore called for strategies to better enable individuals to make informed and prudent borrowing decisions.

This is particularly important given the competitive environment which has led to the relentless marketing of consumer credit products as well as the evidence of 'information asymmetries' between borrowers and lenders over the increasingly sophisticated nature of these products. According to a MORI poll in 2004, nearly 80% of UK adults do not know that APR refers to the interest rate; 33% lack any confidence in handling money, and only 30% could correctly calculate what the interest would be on £2000 at 4% over two years. The evidence we received suggests that people who would otherwise be impressively capable of managing their finances, become negatively inhibited when they feel out of their sphere and depth of financial understanding.

Nearly everyone we spoke with emphasised the need for better personal money education, and that the most immediate and obvious point of delivery for money education was through schools. In fact, in our Yougov survey, 86% of people agreed that more time and resources should be dedicated to teaching secondary school students how to manage their money.

A 25 year old woman on a salary of £36, 000 p.a., who had recently taken out an IVA, was asked: "Even if you hadn't got a credit card, do you think you would have had some problems along the way?" She answered: "I think I would have. I've never been taught this is what money management is. It's not something that you get taught when you're still at school and when you're at college. Then you're out in the real world and you're earning money. You're spending your money and everyone else around you is buying new cars and that and you think I can do that now. I've never been taught, you know, there's only so much you can do with the money you've got."[71]

Schools offer the potential for a uniform strategy to be implemented across the whole of the country. The goal should be that pupils should leave school competent in basic money management skills such as budgeting and the sensible use of credit. The reality seems to be that this is not happening, and despite forming part of the citizenship and Personal, Social and Health

71 Anecdotal Evidence courtesy of Antony Elliot, taken from interviews with IVA clients.

Education curriculum (PSHE) in England, money education is not being delivered in a consistent or strategic way in most schools.

Recent research shows that budgeting is the last thing on many students' minds

- The vast majority (80%) of 16-24 year olds admit they don't keep track of their finances.
- Despite the likelihood of being on a tight budget, 20% do not know within £100 what their financial state might be.

The FSA reports that:

- 29% of 16-24 year olds said they would not know how to prepare and manage a weekly budget;
- 19% of 22-24 year olds have short-term debts over £5,000;
- 62% of young people said if they got into money trouble or debt they would not be able to name any advice or support services they could turn to for advice

- Of undergraduates who considered dropping out of college, financial difficulty was a strong factor for 34.4%.
- 94% of 16 year olds believe it is important to know how to manage money; but only 53% have been taught how to.

According to the Institute of Public Policy Research, if children attended classes on personal finance and budgeting in schools they could be up to £32,000 richer between the ages of 35-49 than they would otherwise be.[72]

We therefore support the proposal made by the Tomlinson Report that financial education should be incorporated into the new core element of the post-fourteen school curriculum.

However, we do not believe this recommendation on its own goes far enough. We believe that in order to be effective, money education needs to be made much more relevant and stimulating so as to better capture the attention and imagination of pupils[73]. Furthermore we recognise the value of private sector expertise and enthusiasm to communicate the importance of financial capability, and to indeed teach the practical skills involved. We have been impressed by the progress made in the teaching of earth sciences through the involvement of the UK Offshore Operators Association (UKOOA), the offshore oil and gas industry's representative body. In this model, the UK Offshore Operators Association (UKOOA), the offshore oil and gas industry's representative body fund a scheme aimed at developing teachers' skills and understanding in teaching core earth science topics. This in-service education and training is provided in short modular workshops, built around the earth science content of the English, Welsh and Scottish national curricula and is

72 Data courtesy of Community Money Advice.

73 See Volume 3, Section 3.3. 'Creating a Culture of Learning', for proposals on making education more effective across the board.

delivered within schools by a nationwide team of 49 centrally trained facilitators. These workshops are activity-based, stress the importance of enquiry in science and address pedagogical issues as well as subject content. All of which has the aim of Earth Sciences being taught in a more interesting, exciting and engaging manner. We wish to invite representatives of the finance industry to consider funding the creation and delivery of a similarly engaging model for teaching money education.

We do of course, acknowledge and applaud the few private finance industry volunteers who are already pioneering similar money education models in schools, a few of which are using private sector financial experts to actually teach the students directly, which from research appears to be particularly effective. We believe that a good start is perhaps being developed through such programmes, but that much more can, and indeed needs to be done to increase the appeal and impact of money education in schools.

In addition to the involvement of private finance sector teaching *in* schools, we feel a different but complimentary model of financial education could be pioneered. The private financial sector could also look to arrange and host a series of regional events expounding the virtue of good money skills in the more inspirational context of wealth creation and management, which are aimed specifically at pupils. Fundamental to this concept is the involvement of at least one high profile 'entrepreneurial role model' with whom the young people can relate and aspire to. The central idea is the empowering of young people, providing them with useful tools, and inspiring them that good money management can enable them to be as successful as their role models, who also started with very little. These events should be informative, interactive and exciting; utilising different learning formats such as seminars, workshops and presentations, with the aim of making money education an inspiring topic and positive virtue, far removed from dull and abstract classroom lessons on, for example, compound interest.

We believe these two different approaches could be run in conjunction or merely alongside one another. Ultimately however, money education needs more funding and resources to be made available in order for it to have impact on the current debt crisis, or indeed to prevent the next generation from repeating the same mistakes of the current generation.

In addition to the importance of money education in schools, we are also aware that there is a great need to provide an opportunity for the current generation of consumers to be educated in personal finance. Many adults, as the statistics above demonstrate, are disempowered by a lack of financial capability. Although we can educate the next generation through the formal education system we also need to create a culture whereby the current adult population can learn practical money management skills. Therefore, in addition to information about how to handle one's finances

being made available in accessible places, we would also like to encourage the financial sector to partner with third sector organisations, such as those already providing debt advice, to begin pioneering progressive and practical financial education in the wider community.

Many debt advice centres provide an excellent level of money education to those already in financial hardship or crisis, but we would like to see an increase in the availability of money education services to those who seek prevention rather than rescue. Once again we do acknowledge that on a very small scale this is already being done. However the demand for such services, and indeed the genuine need for them, as the MORI statistics above demonstrate, far outstrips its provision, and thus significantly more needs to be done.

Section 5
Conclusions

We believe that, given the scale of the personal debt problem 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, and have formulated our recommendations with this in mind.

In summary our recommendations are that:

1. Measures should be taken to increase transparency, data sharing and compliance procedures in the home credit market, and if competition is not forthcoming it must be enforced from the outside.
2. Interest rates caps would neither benefit customers in sub prime markets, nor encourage competition, and should not therefore be introduced.
3. The Government should undertake a major initiative to increase and strengthen credit unions so that they can play a comparably beneficial role to those in other developed countries.
4. The Voluntary Banking Code should be replaced by a Statutory Customers' Charter. Ending self regulation and holding banks accountable by law.
5. Local community based debt management and advice should be strengthened and a fixed proportion of public support should be given to these organisations.
6. The benefits system should be reviewed in detail and with specific regard to the adverse effect its complexity and inefficiency is currently having on those in debt, or on the edge of debt.
7. The Social Fund should be reviewed in-detail and with the specific mandate of making it far more accessible to those struggling against social and financial exclusion.
8. IVAs should be made marketed more carefully, and should only be approved following independent advice.
9. IVAs should be made available to a new catagory of debtors with smaller consumer debts.
10. Private sector initiatives to educate both children and adults in personal finances should be encouraged, strengthened and expanded.

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