

# Not waving but drowning:

Over-indebtedness by  
misjudgement

Antony Elliott



**CSFI**  
Centre for the Study of  
Financial Innovation



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## Not waving but drowning: Over-indebtedness by misjudgement Antony Elliott

### Preface

For the CSFI, this is not just a big report, it is a Big Idea.

The idea was to take someone who had built his (extremely successful) career at the top end of the banking market, dealing routinely in billions as group risk director of one of our major High St. banks, and have him look at what goes on at the other end – at the interface with clients of much more modest means, where £100 means food for a week, not a middling seat at Covent Garden. What will someone who has spent almost 20 years on Megabank's top floor make of what goes on in the basement? It is rather like asking Gordon Ramsay to have a look at how chicken-pluckers make a living.

Of course, Antony Elliott is not entirely typical. He is, for instance, a man of deep religious conviction. But if that gives him an interest, he is also unusual in having had both the time and the perseverance to follow through.

It is obviously up to the reader to judge whether Antony's insights have real value – but I have no doubt. When he castigates his own industry for its unconscionable lending practices, when he is genuinely shocked at the way the temptation of ever-increasing debt is dangled in front of those who clearly cannot afford it, his peers behind the big desks in the big offices should take notice. So too should the regulators; this is not a whinging leftie from *The Guardian* or *Which?* who is complaining, but a true-blue banker who has read all 800-odd pages of the revised Basel Accord (and probably laughed at the jokes).

I think it is important to emphasise (as Antony does) that this is not a study of poverty. It is a study of *over-indebtedness* – which, though it is obviously a bigger problem for those on low incomes, is equally corrosive of middle-class lifestyles and values. It is a major problem, potentially on a par (in terms of the damage it does to families and to society) with alcohol. And yet it gets virtually no attention from the chattering classes, or even politicians, and outrageous and misleading advertisements for credit are a staple of television and the press. At the least, Antony's report ought to stir a few hacks to anger.

To me (as, I think, to him) the most egregious problem is the practice of the consumer credit industry to go on giving automatic and unsolicited credit line increases on credit and store cards so long as even a minimum payment is made. For those who are already having difficulty coping, this just pours oil on the fire. I can see no reason why written confirmation that a borrower has accepted a credit line increase should not be required.

Much more contentious is Antony's recommendation that, in cases where a lender lent to a customer who was clearly in no position to service the debt, that debt should be legally unenforceable. Still, one has to say that it would focus a lender's mind on each lending decision in a way that doesn't happen today, when the mock-

science of credit scoring means the lender is oblivious of damage that his decisions can do at an individual or family level.

Most of Antony's recommendations fall somewhere between these two extremes. They include:

- mandatory help desks for customers who show signs of getting into debt trouble;
- an obligation on the lender to make the consequences of default clear at the time a loan or credit line is granted;
- more effective debt education in colleges and schools (who could argue?);
- more information-sharing among lenders so that (as in many other countries) they have a more complete picture of each borrower's total indebtedness; and
- a central body charged with coordinating action to reduce over-indebtedness.

Readers will have their own reactions to Antony's recommendations (God preserve us from yet another regulator), but it is hard to dispute the general lines of his analysis. And he certainly makes a good case that this is an area we cannot afford to ignore.

Andrew Hilton  
Director, CSFI

## 1. Summary and recommendations

This paper evolved from the suggestion that experience gained in over 10 years as Group Risk Director for a major retail bank (dealing routinely with billions of pounds) could be used to look at the responsibility of retail financial institutions at the other end of the market – lending relatively small amounts to less advantaged individuals. At the end of 2003, when I first considered this, there was increasing publicity about over-indebtedness – and that set me thinking about the decision-making process which leads to over-borrowing. My initial objective was to identify what happens as a person takes on too much consumer credit, and whether there is a ‘tipping point’ – an identifiable moment when an individual commits to what would consensually be regarded as too much debt. The idea was that this might lead to specific recommendations for more responsible lending and borrowing.

The technique that I have used is what is known as “grounded theory” – an approach developed by Dr. Barney Glaser and Anselm Strauss, which uses case studies to identify common patterns and categories. As it emerged, the data led me to develop a theory of “over-indebtedness by misjudgement” for those with multiple debts.

My research involved 36 case studies of individuals who had become over-indebted, analysis of what actually happened to them, and the thoughts and feelings that the process of increasing over-indebtedness created. My interviews covered how decisions were taken and what happened during the period of debt acquisition. The interviewees were dispersed by age, home tenure, family type and location; the gross annual household income range was between £8,000 and £40,000. The debt involved included unsecured personal loans, credit cards, store cards and catalogue debts; it did not include mortgage payments. The cases came to me through the good offices of the Consumer Credit Counselling Service; in all cases, those I interviewed were in a debt management plan and had volunteered to take part in research related to debt. As a result, they could not be said to be a truly random sample of the over-indebted. My research did not consider financial problems in general, and it did not include consideration of issues relating to non-consumer credit arrears (such as rent, utility and other bills).

All of the 36 borrowers (except one) accepted that they had misjudged the amount of debt they should take on. This was true even when significant changes had occurred in their lives, such as a temporary or permanent reduction in income. This leads me to think that in the current environment, contrary to conventional thinking, over-indebtedness with consumer credit is not primarily caused by a change in circumstance beyond the control of the borrower, such as redundancy, divorce or illness (although these may well reduce available income).

### Hypothesis:

My hypothesis is that, when the three conditions described below are brought together, an individual with multiple unsecured personal debts will become unequivocally over-indebted, with all the misery that this entails:

- Internal or external pressures are not resisted: Examples of *external pressures* include:
  - furnishing a home, whether owned or rented;
  - satisfying the spending demands of children or spouse;
  - maintaining a lifestyle like that of peers or relations;
  - maintaining expenditure following a reduction of income;
  - supporting a business venture;
  - spending on Christmas; and/or
  - using debt to pay off existing debts.

*Internal pressures* refer to the spending that occurs during a period of compulsive spending. This is effectively an addiction - a psychological condition in which a borrower cannot control his or her desire to spend.



- Personal financial management is naïve or foolhardy: The way in which borrowers manage their affairs inevitably contributes to over-indebtedness. Examples of *naïve* financial management include a naively optimistic view that the situation will improve and a naïve view of the consequences of acquiring too much debt. There is also great naivety about the true cost of debt.

Examples of *foolhardy* financial management include a disregard for any budget, ignoring advice from friends or relations and using debt when friends or family would have willingly offered financial support.

- There is deliberate temptation by lenders: “It’s too easy” was an almost unanimous comment. The desire of lenders to “make a sale” of a product that can cause such misery can be overwhelming. Borrowers emphasised the impact of:
  - unrequested credit card limit increases;
  - marketing and sales tactics employed by lenders;
  - the frequently pernicious impact of so-called consolidation loans;
  - telephone solicitation of clients to increase loans;
  - the failure of credit card companies to cut limits, even after a change in circumstances; and
  - the absence of any serious checking of income or existing debts by credit firms.

Individual cases could be broken down to identify the extent of over-indebtedness using information available on the household budget and on the amount available to service debts. Individual circumstances are different; but it is possible to conclude that most individuals would need to think very carefully before allowing total unsecured debt to exceed 45 per cent of gross household income. For a household with gross income of £15,000, this would represent debt of £6,750. This should not be treated as, in any sense, a ‘correct’ level; some on the same income may only be able to afford £2,500 and others might be comfortably able to service debts of £9,000. Much depends on other commitments. Nevertheless, it is a useful benchmark.

The extent of over-borrowing in all the cases I looked at was significant, with the average borrower having borrowed over three times more than could comfortably be repaid in a five year period. Most of these borrowers also incurred significant penalties and charges; in some cases, these could account for a third or more of the total indebtedness.

It is important to appreciate that a borrower is in significant trouble as soon as he or she is unable to meet debt repayments from income or other sources. At this point, charges and penalties can be as important as interest.

I have not named any specific lenders in this study. The lenders involved are mostly household names – although it is difficult to be certain which actually made the particular loans that pushed the borrower beyond the point at which he or she was able to repay. It would appear that, in my sample, 25 separate lenders were involved. The lenders most represented were four major credit card companies and four high street banks – the latter represented with both loans and credit cards.

Information on the number of households that are over-indebted with consumer credit in the UK is not precise or conclusive. I believe it is a minimum of one million (4 per cent) – and it is more likely to be double this due to under-reporting in consumer surveys. It is likely that around four million people are currently living in over-indebted households in the UK, but I would go no further than to assert that the problem is sufficiently large to warrant action. Some of these borrowers will be *deliberately* over-indebted; for others, the sole cause will be misfortune. However, it is likely that the numbers who are over-indebted by misjudgement are substantial – and the ease with which the examples in this report were obtained suggests that this is the case.

This is not a study of poverty. It is a study of *over-indebtedness* – a condition that can affect anyone regardless of income. That said, I have adopted an income cut-off of £40,000 per household. This is fairly arbitrary, but it is defensible in that those who are over-indebted with incomes above this level are much better placed to rectify the situation.

The consequences of over-indebtedness are serious. The physical and mental health effects are terrible, and can last for



years. I found many examples where illness was brought on by indebtedness, and where there was a clear improvement once the debt position had been stabilised. In addition to the health effects, there are serious relationship issues. Some people will hide debts from a partner; for others, the financial problems will cause huge stress to the relationship. This is an issue deserving of significantly more research. There is far more work on the effects of excessive alcohol and drug use. Given that over-indebtedness causes such misery to so many people for a period of years, more work is needed.

At one time, bankers could be compared to doctors in the way they attempted to provide finance to a customer that was in his or her best interests. Now, the more appropriate analogy is with a wine bar or pub – but at least we agree that a pub/wine bar should not knowingly serve alcohol to somebody who is already drunk. The same point ought to apply to lending; the negative effects can be long-lasting and customers are prone to bingeing. There should be a duty of care to treat customers fairly – and to ensure that vulnerable customers make a good choice when deciding whether to borrow rather than save for a purchase.

Credit scoring is not a solution to over-indebtedness; it simply enables lenders to accept or decline business on a basis that will ensure a profit. A lender can still make that profit with significant numbers of defaulting customers provided the margin is sufficiently high. Default is obviously a subject of interest to lenders, but the extent to which customers are becoming over-indebted would rarely be a subject of discussion by management other than in the context of default performance.

Debt consolidation – by which a lender offers to consolidate higher rate unsecured loans into a single loan with a single repayment profile – has, at best, a mixed effect. For many borrowers, these loans simply formalise over-indebtedness. For others, consolidation looks like an invitation to take on more debt. When this type of borrower continues to spend, particularly on credit cards, a financial catastrophe is inevitable.

On the other hand, re-mortgaging is a real solution to the burden of unsecured debt for many home-owners. However, this is only possible while the borrower has equity in a property and can afford the mortgage repayments. In a similar way to debt consolidation, the creditor needs to be very aware of the point at which further borrowing cannot be sustained.

There could well be a sustained increase in personal bankruptcy thanks to recent changes in UK law, and this could become a solution of choice for some borrowers. Clearly, at the societal level, this is negative, in that the burden of debt is simply transferred to other borrowers. Moreover, even if bankruptcy is a real solution for some borrowers who have become over-indebted, action is still needed to reduce the number of borrowers getting to that point.

The recommendations that I have come up with from this research are based on the need to enable borrowers to make better choices.

I believe that it is possible to ensure that far fewer vulnerable people make decisions to borrow that, with hindsight, they themselves view as naïve or foolhardy. The pressures on households will continue; but more can be done to encourage better financial management and to reduce the temptation to over-borrow. The proposals that I am putting forward would not transfer responsibility from borrower to lender; but they do try to redress the balance so that the lender is acting more fairly towards the borrower.

## Recommendations . . .

Borrowers were asked to consider what could have made a difference to them.

The overwhelming demand was for a credit helpdesk that would have ensured they understood the repayments they were taking on in the context of their budget. Perhaps surprisingly, they would also have preferred to be turned down more frequently on the basis of their overall debt level. They also wanted to have the consequences of default explained to them, particularly what happens when they cannot afford the minimum payment. There were numerous complaints about the unnecessary temptation of unrequested credit card limit increases. Some borrowers also felt that there should be more education, particularly of younger borrowers.

The recommendations that follow are not designed to resolve all the issues relating to unsecured debt. But they are an attempt to reduce the number of people who become over-indebted from multiple creditors, and they are designed to address specifically the decision-making of both lenders and borrowers.

### . . . for lenders . . .

Any individual lender could implement any of these recommendations without further regulation or other intervention. In my view, no responsible lender should object to any of these recommendations:

1. Credit helpdesk: All lenders should provide a helpdesk that is independent or outsourced to an independent party, to provide assistance on budgeting and to ensure that borrowers understand the potential consequences of over-borrowing – including over-borrowing on credit cards.
2. Warnings/information: The industry should support dissemination of key information through lenders to the most vulnerable borrowers.
3. Debt education in colleges: Lenders should take more responsibility for ensuring that students (and other young people) are not just encouraged into debt, but also supported in how they are provided with loans.
4. No unrequested credit line increases on credit cards: Lenders should stop this practice. A credit limit increase can be offered; but it must require customer consent. (This recommendation is likely to be most successful when implemented in conjunction with the helpdesk and the information recommendations above.)
5. Total view of debt level: The industry should ensure that more is done to share data. This may involve strengthening the role of credit reference agencies. The total debt of a customer must be looked at to ensure that those showing early signs of distress are not encouraged to borrow further.
6. Review and reduce limits: Lenders should be prepared to reduce limits (with an appropriate explanation) if customers show signs of being over-indebted.
7. Active promotion of early independent help for the over-indebted: Lenders should proactively recommend that the over-indebted with multiple creditors seek independent help at an early stage.
8. Support release of grouped credit reference agency information: The quality of publicly available information on indebtedness is currently poor. Banks should encourage credit reference agencies to release information that would be in the public interest.

### . . . for government/regulators . . .

The regulatory framework in respect of unsecured lending is currently being reviewed; this should give an opportunity to see whether any of my recommendations can be incorporated. The track record of the financial services industry is such that the recommendations detailed above for lenders are unlikely to be uniformly adopted without regulatory pressure. In addition to this regulatory pressure, the following measures should be taken by government/regulators:

1. Debt education in schools/colleges: There should be a drive to ensure more effective education on the subject of debt. The focus needs to be broader than the understanding of an interest rate. It should include the importance of budgeting – as well as awareness of the consequences of not being able to repay.
2. Encouragement of employers, charities and community groups: It is clear that much more open discussion should take place on the issue of over-indebtedness, so that borrowers are more likely to seek support at an early stage.
3. Enable a total view of debt: Regulators should encourage the sharing of data on outstanding debt levels. The key role of the credit reference agencies means that there should be regulation to ensure that data is shared by all lenders and to provide public assurance that it will not be misused (eg for marketing purposes).
4. Not knowingly over-indebt: The courts should be given the power to no longer require the repayment of debt where it should have been clear to the lender that, at the time of granting the facility, the borrower could not afford to repay. Given the many examples where banks and credit card companies are over-indebting people by not asking about income or existing debt levels, this should provide an incentive for good lending practice.

5. Release of grouped information by credit reference agencies: Regulators should have a role in specifying the type of data that would be useful.
6. Research on over-indebtedness: The government should support more research – whether it is funded by the industry or the government itself. A variety of areas are suggested in the report.
7. A single body to oversee action to reduce over-indebtedness from multiple debts: Clarity of responsibility would appear to be essential.

All these recommendations are important. But, if I had to prioritise, I would pick the following for early implementation:

1. Make it illegal to increase a credit card limit without the agreement of the customer: This is a straightforward change to bring this form of lending into line with most others and to ensure that borrowers have an opportunity to consider what they are doing.
2. Oblige lenders to offer a credit helpdesk and to issue customers with public information leaflets to highlight the serious decision being taken when increasing levels of borrowing.
3. Oblige credit reference agencies to collect all information on out-standing debts – and to share the information.
4. Make it illegal to knowingly over-indebt a borrower (with the courts being allowed to determine when this has occurred): This recommendation would encourage lenders to act responsibly.

## 2. Objectives

The main objective of this paper is to look at the causes of over-indebtedness through multiple unsecured creditors – and, having understood those causes, to make recommendations that will reduce the number of people in this situation. It is targeted primarily at government, regulators and lenders; but it may also be useful to borrowers themselves.

Over-indebted borrowers, for this report, are defined as those who are in arrears with consumer credit on a structural basis – as defined in the Oxera report.<sup>1</sup> A borrower with multiple unsecured creditors is one who has borrowed from a number of different lenders. The loans will be a combination of unsecured loans, credit cards, overdrafts, store cards and mail order from more than one credit provider.

A recent report from the Department for Work and Pensions,<sup>2</sup> on the topic of families in debt, concludes that credit cards have become the most common unsecured credit commitment. However, the amounts owed on personal loans are much higher – and, for this reason, they are more important in relation to over-indebtedness than debts arising from store cards and mail order. It is the credit card and the unsecured personal loan, frequently in combination, that is the root cause of over-indebtedness from multiple unsecured credits.

It is widely acknowledged that the balance between lender and borrower is a difficult one. However, tragic cases resulting from excessive personal debt are causing the government increasingly to question whether lenders are being responsible.

There have certainly been many benefits from the increasing competitiveness of the UK consumer credit market, and it can be argued that there will always be problems at the margins. Indeed, lenders factor this in by ensuring that their margin is sufficient to provide for borrower defaults. It could, therefore, be argued that all government should do is ensure that contractual terms are clear. Indeed, this is the rationale behind the important role given to the Consumer Credit Act and the OFT.

I do not believe this position is defensible.

The loss of reputation and public confidence following the recent mis-selling of a range of retail financial products is, in my view, a clear warning to the lending industry. These products were sold using what were seen as accepted practices at the time – but it has since become clear that the firms’ behaviour was unacceptable. In my opinion, the consumer lending market is suffering from a similar pursuit of short-term gain at the expense of longer-term customer interest.

The lenders are by no means entirely to blame for this situation; indeed, it is a natural outcome of a competitive market, and in my own work, very few borrowers of consumer credit blamed lenders for their predicament. Nevertheless, they need to play a part in rectifying it.

At this point, some will feel I am advocating a further extension of the ‘nanny state’. I am not. However, there are plenty of studies showing that society “tends to overestimate the pleasure that it will derive from a given purchase”.<sup>3</sup> Should we all be “free to foul up”<sup>4</sup> – or should people be enabled to make choices that will improve their well-being? One of my objectives is to demonstrate that too many borrowers are not just “free to foul up”, but that they are actively “encouraged to foul up” by current lending practices which do not treat the customer fairly.

It is hoped that this paper will contribute to the debate on over-indebtedness in three ways:

- it will highlight the difficulty of stopping vulnerable borrowers with multiple consumer loans becoming over indebted as a result of a combination of societal pressures and psychological factors;
- it will use both existing and new data to highlight where the most vulnerable sections of society are, and the scale of the problem; and
- it will make a number of recommendations (to lenders, government, regulators and others) which try to redress the balance so that both lenders and borrowers take responsibility for their actions.

Ultimately, I hope lenders will support these recommendations voluntarily, but the record of the industry is such that regulation is often required. The risk, if the recommendations are not taken up, is a further decline in reputation and the alienation of more customers.

### 3. “Over-indebtedness by misjudgement”

There is a widespread perception that, for most people who become over-indebted with multiple debts, there was some trigger event that was beyond their control which resulted in them no longer being able to service existing debts.

The implication is that most borrowers correctly assessed the maximum amount of debt that they could carry at the time, but that circumstances changed beyond their control so that they could no longer repay. This may be the case for some borrowers, but it was not the case for any of the 36 households examined for this study. They did face major events that affected their position; but it was their own behaviour and that of the lenders which was chiefly responsible for the financial catastrophe that took place.

The contribution of borrowers to their own financial problems makes this a very sensitive topic. The borrowers I interviewed were all clients of a debt counselling organisation, and most had debts that were significantly greater than their ability to service them. They were not typical of all borrowers, but they were fairly typical of a minority that has consumer debts that they are unable to service. Fortunately, their willingness to discuss, in confidence, their actions has made the following section of the report possible.

The most frequently cited reason for over-indebtedness given to other researchers is that a loss of income was the cause.

For example, this was cited by almost half the households in one study, although this was in the context of all debts (including household bills), and not just consumer credit.<sup>5</sup> This survey noted that “you would not expect people to give reasons that were critical of themselves, but rather to look for some external cause”. Equally, a study on credit cards conducted over 10 years ago showed over-commitment as the primary reason<sup>6</sup>.

I came to a different conclusion. My work examined the chronology of over-indebtedness through consumer debt, including changes in income and acquisition of debts. It examined the circumstances of each case – and it found that, in all cases I looked at, a substantial amount of debt was acquired well after a change in circumstances had occurred.

By looking in detail at the pattern of debt acquisition and at changes in circumstances, it can be seen that misjudgement on the part of the borrower is a key component in determining the eventual size of the debt burden. Some borrowers do become over-indebted as a result of a reduction in income. However, in many cases, either the borrowing is taken on well after the reduction in income has occurred, or the borrower knew that part of his or her income was vulnerable to a change in circumstances. In both cases, if the borrower had realised the consequences of over-borrowing, he or she would have managed not to borrow. With hindsight, all borrowers interviewed recognised that to borrow to the maximum was an error of judgement that they regretted.

Unfortunately, they were encouraged in this misjudgement by the behaviour of the lenders.

Clearly, there are borrowers who knowingly accumulate debt without any expectation of being able to repay. They may be acting fraudulently, or they may simply be exploiting a financial system that provides such easy credit in order to spend money that they would not otherwise have had. Whatever, this group has no intention of meeting its debt obligations, and is not covered in this study; no misjudgement is involved.

All borrowers in this study clearly demonstrated the key characteristics of over-indebtedness by misjudgement – except for one. This lady was clear that – under difficult circumstances in retirement – she and her husband had *deliberately* chosen to incur debt without a realistic prospect of repayment. She understood the position of the lenders, had no regrets and regarded this route as logical in the circumstances. In the absence of alternatives, this borrower may have been rational; but she appears to be unusual in making a deliberate choice with full knowledge.

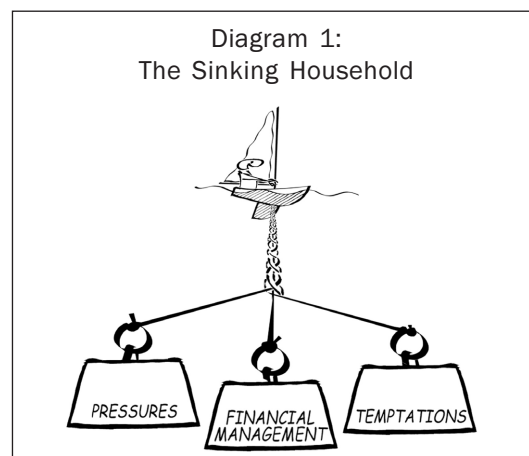
My work has looked at what people actually did, by interviewing borrowers who were able to reflect on the circumstances that led to their high debt levels. It suggests that there are three key components that contribute to being over-indebted through misjudgement:

- The borrower is under a pressure to spend that he or she does not resist: This may be related to previous expenditure levels, or there may be other factors.
- The borrower is, in some way, unable to manage his or her finances: As a result, when pressure is applied by lenders, a personal catastrophe follows.
- Lenders create a powerful temptation to borrow: Succumbing to temptation seems the easiest option.

These three components, put together, create a seemingly unstoppable process that leads to misery.

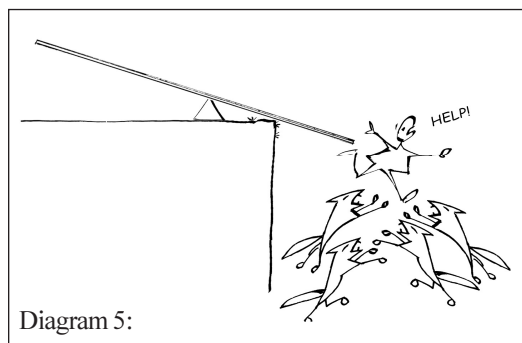
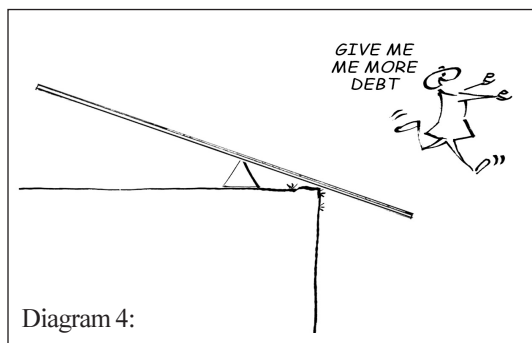
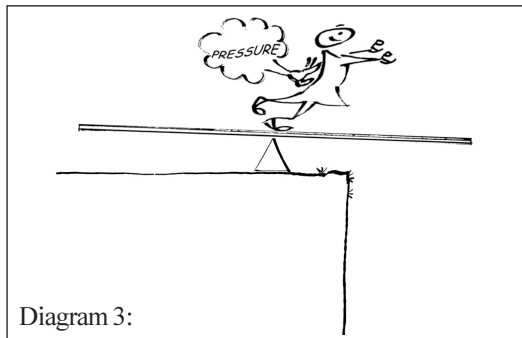
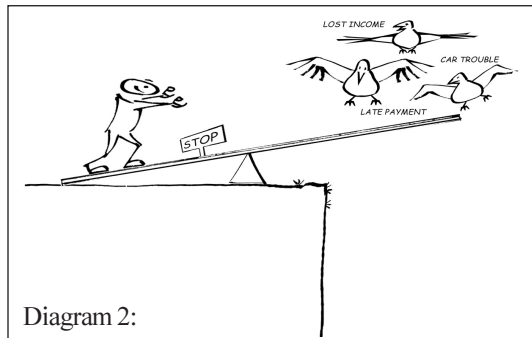
Diagram 1 shows these three factors acting together to gradually sink the boat, which in this illustration represents the household. Together, they are sufficiently strong to pull the boat under.

By examining the income and expenditure of individual borrowers, it is possible to identify a point beyond which financial risk becomes unsustainable. Nevertheless, although the borrower may become uncomfortable at this point, there is often no discernable pause in the accumulation of debt. Instead, the situation tends to deteriorate rapidly as the borrower passes some sort of “tipping point”. This process can be illustrated as a ‘debt seesaw’.



Imagine that the accumulation of debt is like walking up a seesaw, with one end over a cliff. It would be sensible to stop well before the pivot, so that an unexpected weight landing on the other end (e.g. a car breakdown or temporary loss of income) is much less likely to send one over the cliff edge. Unfortunately, the people who are prone to over-indebtedness by misjudgement appear to have some sort of pressure behind them that will keep them walking up the seesaw beyond the pivot.

Effectively, they are blind to the consequences of their actions. Even when the seesaw has fallen away, they typically manage a period of gravity-defying activity – continuing to borrow wherever capacity is available. In the end, disaster is inevitable – barring a most unlikely event such as a passing microlight (or winning the Lottery).



The questions that need to be answered are:

- what is this pressure?
- why is it that these people do not stop? and
- why is it so easy to acquire debt?

## A. What kinds of pressures do borrowers face?

Many people can enjoy long periods of managing their finances satisfactorily – but then something happens which ‘forces’ them to spend more money or to reduce their expenditure.

For some people, this ‘forced’ spending may take place without incurring debt, but the important point is that a pressure has built up – and, if the borrower chooses to spend, the money must be found. For some people, the pressure can be resisted for a considerable period, which suggests that the ‘need’ is not critical. For others, there is not even temporary resistance.

Often, there is a combination of pressures, or pressures change over time – which makes cases difficult to categorise. Nevertheless, the clearest distinction is between external and internal pressures. An *external* pressure has an identifiable source, such as children or accommodation. An *internal* pressure is a psychological phenomenon that manifests itself as compulsive spending.

In almost half the cases I looked at, a significant reduction in income had occurred at some point during the period of debt build-up – though, in some cases, this was temporary. The problems included changes in career, redundancy, business



failure, illness and loss of overtime. Occasionally, this drop of income was mentioned at the beginning of the interview as a cause of the problems. However, in all cases, either borrowers regarded themselves as having acquired too much debt prior to the drop in income, or they blamed some kind of external or internal pressure for their failure to adjust to new circumstances.

### External pressures...

The following are examples of the kinds of external pressure I found:

- Fitting out home: This can apply equally to a purchased property or unfurnished rented. The regrets expressed by borrowers suggest that they do not regard 'buy now, pay later' arrangements as having been at all good for them. In some cases, it was clear that there was pressure to buy higher-quality items that could last longer – but that only makes sense if the borrower can afford the purchase in the first place:

"I had to go and get a cooker, because when I came into the property there wasn't a cooker because it was unfurnished...I had to buy carpets and furniture to move into the property. Because I had nothing to move into the property with, you know." (Case 8)

"I'd sat there for eight months thinking 'How am I going to get this?' and 'How am I going to get that?' because it was such a big expenditure to fork out for carpets, curtains, cooker, etc. ...If I didn't need the carpets and the cooker and everything, I would have just turned round and said No. It was like perfect timing as far as I could see. And it may sound silly now, but when I was borrowing like curtains from friends and I had no carpets..." (Case 6)

A man who suffered no reduction in household income over the period of debt build-up was frank:

"...and buying things for the house. Basically, I didn't have a settee to sit on, you know. Table and chairs for the dining room. When the fridge broke down, we had to get another one. So we spent and it was excessive, but a lot of the things were things like what we needed for the house, a microwave and fridge, etc...I mean, if you're going to buy a TV, it's like the quality you actually look for. So just say we bought a piece of furniture and it were expensive. But, you know, compared to what we've gotten before, we've bought cheaper models and they've broken down in the meantime and we're finding ourselves having to go out and buy another one because it's broken down after about a year. I still don't like paying for expensive things. But I do see the value in how long they last and the quality and the workmanship." (Case 1)

In another case, a legitimate requirement to re-wire led to more expenditure using unsecured debt than could ultimately be supported:

"We were getting it re-mortgaged and we were told that it needed rewiring. So while it was getting rewired, we thought we'd do some other things with the house. So we got like double-glazing and got the loft converted. So everything really went on the house." (Case 31)

- Partner, spouse, children and other family: Finding evidence of this is not surprising. It is frequently the case that partners in a relationship have different attitudes towards money. Debt and money issues are almost always a component in serious relationship problems where counselling takes place. One man I interviewed experienced divorce, re-marriage, starting a business, a reduction in income and a child with



learning difficulties over a period of years. Although the household had a reasonable income throughout, his financial decisions were driven by a desire to please his wife:

“I’ve never been very good at saying no, as far as my wife is concerned. She’d had a pretty hard existence up until that point, and her attitude towards life became very much ‘Well if we can do it today we’ll do it and not worry about tomorrow’... I should have been stronger shouldn’t I? I was weak basically at the time, and am reaping the benefits of it now. I should have said ‘we can’t afford it’ and stuck by it, but there we go.” (Case 3)

The following is a similar situation:

“My wife will say sometimes that she did have quite a deprived childhood and, if I’ve said ‘Look you’ve spent too much’, she’ll say ‘Well look, I’m just trying to give them what I never had’. I can understand that in one way, but we shouldn’t go into debt to do it really.” (Case 20)

Children are also a pressure. One woman I talked to was made redundant. Her net income fell by 15 per cent, but she continued to borrow for the next three years:

“The money was handy for the kids, you know. But then I wish to God I’d never, because the more I was borrowing the more I was getting myself into debt. And I just couldn’t really see it; I was just trying to support my kids.” (Case 8)

Children from previous relationships frequently add a pressure to that from children of a new relationship, even when household income is substantial:

“And obviously the Child Support Agency hit home again. I’m paying nearly £500 a month now, which is a fair whack of your wages to go out. So that has a knock-on effect.” (Case 35)

A woman who started fostering explained how she felt:

“With the first foster kid that I got, I just felt – I felt I had to buy them back their childhood, you know. And that’s basically what I tried to do. It didn’t work. I know now that money doesn’t buy these kids back anything. It was a hard learning curve, but I’ve learned my lesson now, you know.” (Case 7)

Unfortunately, pressure does not necessarily end as children grow older:

“The partner I’m living with now, I’ve been with her six years. And two of her kids have set up home in this time, which I’ve helped them with without them knowing I’m in trouble. She doesn’t want them to know. So I’ve had to carry on like pretending nothing’s wrong, nothing’s happened. And if they say ‘Oh Mum we need a new washer’ and this and that, we’ve had to buy it. I know it sounds absolutely stupid really. But, you know, that’s the way I am. If I can help people I will do, but I’m not helping myself.” (Case 22)

Another couple had not appreciated the heavy toll of spending on their adult autistic son. It will take many years for them to pay back debts that he should not have incurred given his condition:

“And we’ve had to bail him out so much that – I mean the poor kid just doesn’t understand – but I think probably over the last six or seven years we’ve spent maybe £20,000 on him.” (Case 18)

- **Society and peer groups:** An over-indebted respondent experienced variable income, a problem car and a brief illness – and started his own business in a four-year period. He began with some capital, which meant that, despite all this, he did not need to be over-indebted:

“It is the keeping up with the Joneses mentality of a lad. I don’t know if it’s more prevalent with males or females, but it’s this image thing – not looking bad in front of the girls or anything like that – which is totally wrong.”

“I always feel there’s more than one thing that I need to buy. Maybe I’m a victim of the consumer society, I don’t know. Which effectively it is these days; it’s effectively keep the economy going because businesses have got to do that. They’re always trying to push you, and I’m a bit of a sucker on that in that if there’s somebody nice looking and intelligent. You do fall for the marketing ploy and you do think ‘Oh I need that’, rather than ‘it would be nice to have that’.” (Case 2)

Another man brought his wife into the discussion:

“My wife has always been conscious of the fact that she was the sort of poor relation of the family. She’s got a sister who’s a head teacher and suchlike and just seems to go through life accumulating money one way or the other – inheritances or husband and suchlike. And she always felt a pressure to sort of compete really, I suppose.” (Case 3)

The pressure from society is typified by the desire to drive a new car:

“...some of it would be if we saw other people that had a new car or something. And you perhaps think ‘Well our car’s getting quite old, it would be nice to have something a bit newer’. Things like that, you know.” (Case 20)

- **Existing debts:** Frequently, a borrower will become slightly over-indebted – and will then borrow again in order to keep the payments going on the original debt. A woman who became over-indebted in her 60s described her actions over a 10-year period:

“The main reason I took loans out was because I could not afford to pay the loan back to them. And I kept increasing, which was the most stupid thing I’ve ever done in my life. I know now, but at the time I was so desperate to pay my debts that I kept taking out more, increasing the loans so that I could then pay off the loan. And taking out second loans to pay off the first loan, and so on – and it spiralled.” (Case 19)

In a similar situation, another borrower admitted:

“I was using one to pay the other one with in the finish”. (Case 32)

This involved withdrawing cash on one card to pay off the minimum balance on another. He and his wife, both pensioners, never had a late payment charge on their eight credit cards, and were doing this for over a year. Another borrower described the typical pressure following a debt consolidation loan on which the payments were almost impossible:

“Every month, all my wages were going on bills. I had nothing left. And I was really, really panicking.” (Case 11)

This pressure was not present in all cases, but many borrowers referred to it, and it seems to be linked with denial. It applies to men, women and couples, and it can add very significantly to the level of debt – even where the original level of debt was quite low (since late-payment charges tend to be flat, and themselves incur interest).

- Setting up a business using short term credit: There were several examples in my sample where short term finance, including credit cards, was providing finance for a business:

“...the years 2001 to 2002, we (*borrower and his brother*) put together a plan to try to do this, which I now know really to be vastly undercapitalised and really put us in a difficult position, because we didn’t really have the capital to go at it... So I think things escalated to the point where we put quite a lot in. And there was always another £1,000 or £1,5000 or whatever that if we put that in, we’d be OK, we’d be up and running. But if we didn’t, we’d have to scrap the lot. So I think it ended up being a matter of putting good money after bad, if you like.” (Case 36)

- Christmas: Christmas is a time when borrowers feel under pressure to raise extra money, even when they realise it will result in becoming over-indebted:

“I probably didn’t really have a lot of option because with Christmas and that coming up, so I said all right.” (Case 14)

“Yes, the one (*credit card*) with XYZ, yes. For Christmas it was, just to buy like extras for Christmas.” (Case 27)

## Internal pressures...

These are difficult to understand if they have not been experienced personally. Nevertheless, compulsive spending is a recognised psychological condition that is growing. In her chapter in the recently published “*Handbook of Addictive Disorders*”<sup>7</sup>, Helga Dittmar of the University of Sussex has written incisively on understanding and diagnosing compulsive buying:

“Buying becomes an addiction when it takes on excessive dimensions: in terms of frequency, in terms of financial costs (credit abuse and debt), and in terms of subjective importance leading to impairment in personal, social and occupational functioning. Sufferers experience urges to buy as irresistible. The subjective experience is one where shopping takes over, having control over you, rather than you having control over your buying habits. Regardless of what they can afford, sufferers carry on despite inflicting harm on themselves and those around them.”

There is a wide range in estimates of the population affected by compulsive spending. But the *lowest* estimate translates into about 0.5 million adults in the UK, and it may be one million or more.

It is clear that compulsive shopping primarily affects women. Dittmar quotes estimates of the percentage of women among samples of compulsive buyers from 74 per cent to over 93 per cent. Her own study confirms that the overwhelming majority of sufferers were women, at 82 per cent.

Given Dittmar’s findings, it was no surprise that compulsive shoppers featured in these interviews. Indeed, they appeared to represent approximately 20 per cent of the cases I looked at – with one added wrinkle: compulsive behaviour can be

dormant for many years and then be triggered by a relatively small change in circumstances that leads to unstoppable expenditure.

In one case, a short period of excessive spending was caused by the fact that the interviewee got a job and could spend money after a number of years of imposed restraint. The expenditure was not planned, and was really extreme impulse buying:

“...and I had a son and I was unemployed and was on income support and never had any money troubles at all because I never had any credit cards, never had any loans, never had anything. So we lived actually quite well. And then, of course, I got a job and then thought ‘Oh I need a car now’. And it was great because I thought ‘Oh this is good. I’ve got a new car and a bit of extra money that I can do things with’. And so obviously it was great. I thought I can afford to pay this back really easily....Oh it was ridiculous, I was just buying anything, it didn’t matter. If it wasn’t screwed down I bought it.” (Case 5)

In another case, the unstoppable nature of the expenditure comes through clearly:

“I think it’s a female thing. I would be going out shopping and I would be going to buy a pair of trousers. But because I put the trousers on the card and I knew that I shouldn’t, just because I was choked up over it, and I would end up buying two pairs of trousers and two tops. I would overspend – it’s an emotional thing rather than a need... Girls are into spending; it’s a relationship with money. It felt like I was treating myself to a present but somebody else was paying. I never ever felt like I was spending my own money. Even when I knew that the bills were coming in and I was paying them, it’s more of an emotional thing.” (Case 7)

Compulsive spending can be triggered by very little. In this case, a small overdraft was used to cover a short period of unemployment following redundancy. This was the beginning of a compulsive spending spree:

“I had a full-time job and then I got made redundant. And the job I took after being made redundant was only part-time. And that’s when I took the overdraft. And that’s when it started. But then my hours increased at work and I ended up full-time. It all started from being made redundant, having a part-time job. I took the overdraft and it just escalated from there. I just got used to that extra money, and it just went from there...

“And I think really spending the money was a bit like an addiction. You just get used to having that money, and it’s so easy to get it.

*And you liked the things you bought?*

“No, to be honest with you, a lot of it was just thrown in the cupboard and never used.

*Right. So which bit did you enjoy?*

“The going in and purchasing.”

The same borrower took her sister’s children on holiday, admitting that it didn’t feel that she was spending her own money:

“I didn’t have any children then, and I took my sister’s children on holiday and paid for them and took them away. So it was just – I didn’t feel like it was my money. I took her children on two holidays out of this money as well.” (Case 11)

Inevitably, compulsive spending means debts are run up, and there simply isn’t enough left on which to live. The result is more debt – this time on necessities:

“I was starting to really panic because I knew I’d taken on more than I could afford to pay back. And I

got to the point where all my wages were going out on paying my debts and I hadn't anything left. And that's why I was back spending on the cards; I was paying so much out."

"Well, of course, then it was on everyday life. It wasn't on luxuries; it was just getting by." (Case 11)

Inevitably, excessive spending tends to end abruptly. Maybe it is a consolidation loan, or a lender refusing a further limit increase. The key point is that the compulsive spender receives a shock – which forces a more realistic look at his or her finances.

## B. What financial management characteristics mean that borrowers do not stop?

The dominant personal characteristics of those who become over-indebted by misjudgement tend to be naivety and/or foolhardiness. They are not "innocent" as we normally use the term.

This is not heartlessness. Consider three people who are run over crossing a busy road. If the person was blind and did not realise he was on a road, he could be described as innocent. If he genuinely thought that a quick look each way was sufficient and that fast cars would move out of his way, he was naïve. If he tried to cross the road in the full knowledge that it was very dangerous, he was foolhardy.

In each interview, the implication was that borrowers might have been able to avoid the problems in which they found themselves. Obviously, it may be that someone gets into financial trouble despite having behaved prudently. However, none of the over-indebted borrowers that I interviewed came close to falling into such a category.

### Financially naïve . . .

Naivety was the most common characteristic of those that I interviewed:

- **Naïve budgeting:** Compulsive spenders do not even consider servicing a debt when it is taken on. For most of the rest, there were clear indications of naïve budgeting:

"And if you are aware, you always think 'OK I'll pay it off, it's not a problem. I'll pay it off' ...there'll always be the good times." (Case 2)

Many of the comments made to me showed that budgeting skills were inadequate:

"...because at the end of the day, the way that I look at it is that if you can pay out what you've got to pay out to live, and at the end of the day you've still got money in your pocket... then obviously you're on a good thing. That's the way I looked at it. I still had money in my pocket at the end of it. So, realistically, I didn't have anything to worry about." (Case 34)

"Well, I just thought, you know, it would be coming out of our wages every month and we'd be able to manage. We looked at the amount of how much we were on at that moment in time and thought 'Yes, we should be able to manage this'."

After further debts were acquired:

"Yes, we thought about it. I mean, but still we thought...we'll cope again. And again, you know, it just worked out that it just did get a bit more difficult as well." (Case 1)

“I knew I could afford to pay. All I paid was less than £100 and I knew that I’d have money to spare because my DLA (*Disability Living Allowance*) goes up every year.” (Case 26)

Another example involved a borrower who was contacted by her lender to offer another loan. It is clear that, by any measure, she was already well past the point of over-indebtedness. But she decided to think about it because she needed things for her flat:

“They gave me a reference number and I said ‘Can I think about it?’ And they said Yes. And in a couple of days I started working it out, and I was thinking ‘Well I can do it’.” (Case 6)

The lack of any contingency by those who do attempt to budget is illustrated with this borrower:

“And then we took out the loans because the car just messed up on us and for other things. We just sat there and worked out what his wages were. Can we afford it? This is shopping money, rent money, all the rest of it. And whatever we were left with, if that was enough to pay off the monthly payments, then we just said ‘Yes, OK then, we’ll take out the loan’. But then there’s other things, you know, unforeseeable things that you forget about. Like the fridge breaking down.” (Case 4)

Borrowers think they can afford what appear to be small monthly repayments. Unfortunately, it takes very little to accumulate more small payments than they can afford – particularly with interest and charges:

“I think that what you think is ‘Well, if I go out now and put something on the credit card, I perhaps will only have to pay about £20 this month’. But then of course what happens is you suddenly find yourself in a position where you have to pay about £20 a month to all of them, and then you think ‘Well I can’t do that’. So I’ll pay back this one and I’ll ignore that one. And then, when you then go up to the next month and say well I didn’t pay them last month, I’ll pay them this month and I’ll give them the £20, you’ve been charged £30 for the non-payment, and then another £20 for the interest. That’s when it all went wrong really.” (Case 10)

“It’s OK, we can afford it. You pay a small amount – £5 a month or whatever – but the interest rate is so sky-high that you’re just not paying anything off at all. Most of it gets put on the interest and you’re only paying £1 off what you’ve got. So the debt’s going to be there for ages.” (Case 4)

Unfortunately, the truth is that whenever borrowers are “robbing Peter to pay Paul” financial disaster has become almost inevitable.

- **Naïve optimism:** It would not be fair to describe all the borrowers I interviewed as optimistic; however, there was a strong tendency in that direction. People tend to believe that things will improve. Unfortunately, it is rare for this to be based on anything solid – and even where it is, the optimism often continues after the hoped-for change in financial circumstances has not materialised.

Following the failure of his business, this was the thinking of one borrower with excessive credit card debt:

“I said to myself ‘Yes, I will start again’ because I was still young, I could do anything. I’m a very brave man in business; but it just sometimes doesn’t go very well.” (Case 9)

In the case of a woman whose husband had been taken ill, she continued to take on new credit card debts even after a consolidation loan. Her optimism seemed to be linked to her desire for her husband to recover – which indicates just how complex things can be:

“Because I was saying ‘Oh X’s going to get better and everything’s going to be fine, and he’s going to get a job’.

*Even after the consolidation?*

“Even after the consolidation, yes. Yes. And of course what happened was he didn’t get better; he actually got worse and ended up back in hospital again.

*But that’s not the way you were thinking, and it’s quite understandable.*

“No, and a lot of that, again, it’s all very strongly linked to my husband’s health really. But it’s very difficult for me to differentiate between one and the other. And so I had, at that time, I had to tell myself that he was going to get better. And so obviously, because I had to tell myself that, there wasn’t an option in that because that was the only way that I could keep going. So because of that, I suppose, I had to then carry on living as if he was. Does that make sense to you?” (Case 10)

Others shared this characteristic:

“I was just trying to keep the wolf from the door and, I suppose, delay the inevitable. Because at that point, of course, I kept on thinking, ‘Well, something will happen. Something will come along, and the problems will go away’.” (Case 3)

“That was probably a big period there where I wasn’t really looking at the bigger picture. I was just looking days and months ahead, just saying ‘Oh that’ll do, that’ll do’, instead of looking at the whole.” (Case 14)

“I’ll take this loan out this week. But next week, like I say, I’ll win the Lottery and put it back. And it just doesn’t happen.” (Case 22)

This woman had been hit by a cutback in overtime:

“Although the overtime stopped, I was still spending like – because I was waiting for it to come back.” (Case 7)

She built debts up, and took out a consolidation loan. Following redundancy, she paid off the debts that were not covered by insurance – but she continued to spend on the basis that she would increase her earnings. Unfortunately, since she had gone into child care work, this is very unlikely.

The most prolonged period of optimism (or denial) I came across was in the following case:

“No, I still thought all the time, until the cards were used up and there was no way to turn, I could manage somehow. All that time, I was thinking I could manage. And instead of looking ahead and realising that there was no way I could manage once I’d borrowed all that money off them, where do I get any more to go from there – I didn’t give a thought to that at the time... Because, looking back, I can see how stupid I was with it all. It should never have got to that point. If only I’d sort of sat and thought about it or somebody had said to me ‘No, you can’t have it’. And then I probably would have said ‘hold up a minute, why can’t I’ and what am I going to do from now on then. But it didn’t happen.” (Case 19)



The issue of naïve optimism and denial is a real and complex phenomenon. It stops borrowers taking a realistic view of their financial circumstances and contributes significantly to the overall debt burden.

- **Naïvety about consequences:** In many instances, borrowers have no real notion of what will happen to them if they get into difficulty. This is important because it is clear that they might well behave differently if they knew the consequences. The lack of understanding is particularly obvious in relation to fees and interest payable once a minimum payment is missed:

“I would just pay the minimum weekly payment. But then I missed one or two payments, they put interest on it, and it felt like I was giving them more than I had to begin with...Because when they charge you the loan they whack interest on you, and if you miss a couple of weeks’ payment they charge more interest. Because they didn’t say to me. They just said to me there’s one interest put on and that’s it. But they kept on putting interest on me.” (Case 8)

The comments of an immigrant are typical – if vivid. He could not believe the amount he owed (£17k) on his two credit cards once he stopped paying off the balance:

“The credit card is the most nasty, naughty, devilish idea. I know I applied for it, but he cheat on us. He give you a piece of plastic to go with it, and you don’t know what this piece of plastic could do to you in ten years time...And the interest arrears is the most devilish, naughty, nasty, barbarian idea” (Case 9)

Further examples of a lack of understanding:

“I think the bottom line is I’m no good with money; I live for today. I’m not one of them that will save for a rainy day. And I think the bottom line of why I’ve got myself into so much debt is because people will offer it, and I think they rely on people like myself that will take it and don’t think of the consequences.” (Case 13)

“...because we hadn’t really understood what we were putting ourselves into, and we were – if you like – blinded by the glossy side of things, rather than what the pitfalls may be.

*And what part of it do you feel you didn’t understand?*

“I think the consequences of just allowing it to run. And the consequences also and the temptation of the maximum allowable keep going up. I think the two of those combined almost offers a reassurance, I suppose.

*What, you felt that the fact that the limit on the card had gone up meant that you were all right for it?*

“It was safe to carry on, yes.....

*It was like rewarding you?*

“Yes, yes. That’s the way I saw it. The reward for keeping it up-to-date.” (Case 18)

“If I’d known what I was going to be getting myself into I would never have started in the first place. I mean I could have got the XYZ sorted out. I could have got them paid up and left it at that. But I would never have got myself into a mess like this if I’d known.” (Case 26)

- Naïve lack of acceptance following rejection: Although one of my findings is that many borrowers are often surprised at how easy it is to pile on more and more credit, others take the view that rejection is just another hurdle that has to be overcome – and that, if they are turned down once, they will simply try again. Three examples:

“I went to our bank, which was X bank then, and they refused us, you see. So we had to look elsewhere.” (Case 1)

“I suppose you can say that you’re trying your luck really. You know you’re in debt and you think well if I just phone up maybe I can get some more. And when someone says ‘Yes, I’ll give you this’, you think fine, I’ll take it off you. I mean I suppose it’s like gambling really, isn’t it? You don’t get carried away, but you know you’re doing wrong, You know you’ve got to sort of stop. But when it’s offered so easily...” (Case 35)

“I sent it back and initially they actually rejected me. They said that they weren’t prepared to lend the amount that I wanted. Because I can remember on that one ringing them up and getting very indignant, you know, saying at that point ‘I’ve had loans before, I’ve never missed a payment etc blah-blah-blah’, and they reversed their decision. They changed their decision on the basis of the call I made them.” (Case 3)

## Foolhardiness . . .

This category can apply to anybody who knows that something is wrong, but does not stop. It covers those who spend without any consideration of affordability, those who have been warned not to incur further debt and those who could have turned to friends or family for support.

One group are compulsive shoppers. It may seem harsh, but those who suffer from the internal pressure of compulsive spending frequently characterise themselves as foolhardy, foolish or even stupid in financial management. It seems likely that the “buzz” of compulsive spending is incompatible with any notion of affordability:

“So I’m spending and had no idea of how much. I was just spending. And then in January I done the same thing again and again – had no idea until the bills started to come in. So I wasn’t really conscious of an amount.” (Case 7)

“If I knew I had X amount on my card, I would just in and buy whatever I felt like. I wouldn’t think about it.” (Case 11)

A mature student on a grant describes her first year with a grant and overdraft:

“...you feel like a millionaire.” (Case 13)

The pressure to spend is very strong, and this borrower acknowledged the suspension of consideration for consequences:

“If I’d been using commonsense I wouldn’t have done it in the first place.” (Case 7)

Such borrowers tend not to regard the money they are spending as their own. It is as if they have been given it:

“I think really, because the money was there so easily, my whole lifestyle changed. Obviously you’ve got this money, you can go to a hole in the wall, you’re drawing out this money, and it’s like someone’s given you the money, in the stupid sense.” (Case 11)

But it isn't just compulsive shoppers who accept that they are foolhardy:

"I was warned, mind, I was warned. A friend of mine had told me, you know, don't go with them though, don't do it." (Case 8)

Many borrowers eventually receive support from friends or family – and regret not having turned to them much earlier. The problem is that it becomes more and more difficult to ask for help as debts mount:

*Interviewer: But do you think you were stupid to have done it?*

"God yes. Do I? I didn't think so at the time, but looking back on it, yes, absolutely.

*And if you look back on it and say "I was stupid", then maybe that's what it is. I don't know what you feel, but do you think that's reasonable?*

"I think that's reasonable. And I think the other thing that I would say that I felt was that I have parents that are alive and I'm sure that my parents – if I'd have gone to them cap in hand and said 'Look I desperately need some money' – would have been more than happy to have helped out. And that's perhaps what I should have done, rather than relying on credit cards. But by the same token, you also then feel you don't want to be a burden to your parents all their life, do you?" (Case 10)

Another household was coping with the husband's bankruptcy and with the wife having decided to change career, with a significant reduction in her income. The couple had a terrible five years incurring significant debts, and were now selling their house:

"Yes, in hindsight, if I was put in the same situation, I wouldn't turn to credit cards.

*What would you have done though?*

"Gone back to my Mum." (Case 33)

## Financial innocence . . .

In all cases I looked at, borrowers displayed characteristics that were clearly naïve or foolhardy. In addition, however, some also displayed a touching innocence with regard to understanding the debt and its costs – though no borrower interviewed was entirely innocent (and innocence was quickly superseded by naivety or foolhardiness):

- Understanding of the product: There are clearly instances where a borrower does not understand how a product works – or what it is suitable for. For instance, a young borrower did not understand the workings of a credit card:

"And not knowing exactly what a credit card was, I was under the understanding that the final balance would be paid off at the end of every month. I would have no choice in that matter. I look back in hindsight and think you idiot, but at 19 you're very naïve and you don't really know the way the world works. So I purchased that (DJ equipment) and then at the end of the month I realised 'Hey, it's not gone out of my account'. I thought this is great, this is brilliant. Because, of course, it was an introductory APR... And I made so sure there was £180 left in the X account. And I think I must have been having a night out or something and put the card in the machine

and thought it's still in there, right, draw the money out and put it behind the bar..."  
(Case 2)

A young couple began a business having been (ill) advised by an accountant to use credit cards:

"He (*our accountant*) told us that we should have a credit card each because it was going to be tough in the beginning to get the business going and the credit cards would help us live." (Case 17)

- Cash withdrawals, interest and charges: In the later stages of debt accumulation, interest and charges can be crucial. Most borrowers I talked to did not know that interest rates were higher on cash advances, and no borrower really appreciated the significant effect of interest and charges on the balance over time. The following are two examples of comments on cash withdrawals:

"I was quite shocked that it was higher drawing cash out than it was actually using it as a credit card. I thought the rate was the same. I actually phoned them up and said 'why is it higher?', because I did used to check my bills. And I used to think, God, I'm paying like £36 a month and nothing seems to be going down. I phoned them up and asked them why the interest was higher and they said it was to cover the cash withdrawal." (Case 6)

*"Did you realise you'd be paying quite a high interest rate on it? (cash withdrawals)"*

"No. No.

*Did you know that now?*

"I know that now – I didn't know it then.

*How quickly did you realise that you were paying such a high interest rate on withdrawing cash?*

"Never, I don't think, only when I really properly read the statements and I couldn't afford to pay it." (Case 27)

There were numerous references to the terrifying way charges and interest mount up once a borrower runs into difficulty:

"I was missing the monthly payments and of course you get sort of like a £20 charge and then another £20 charge for something else. So over the months, over the year, that soon adds up." (Case 11)

"But the thing with XYZ, you miss a payment, they cripple you. They charge you £25 or something like that. I think it's £18 and they put on another £5 for not paying the direct debit. There's a lot of hidden costs on there." (Case 2)

## C. What are the temptations that make it so easy?

Temptation is another key element in over-indebtedness.

The temptation from lenders takes a number of forms, but three categories dominate:

- the unrequested increase in credit card limits;
- the marketing approach of lenders; and
- the lack of any review, so that limits remain available even when the borrower can no longer afford to repay further loans.

It was surprising to me that only two of those I interviewed openly blamed the lenders for their situation. In most cases, they recognised that lenders are businesses and that people in their situation represent easy targets from which to make money. For the most part, borrowers accepted that lenders are not obligated to lend responsibly. However, borrowers also do not understand why lenders continue to tempt them with further loans when the most basic review of income and debt levels would show that they will struggle to repay. One borrower talked about what he had learnt:

“I’ve also learnt that you have to look ahead... Sometimes you have to say ‘It’s very tempting, I’d like to take that, I’ll have that now, I’ll solve my immediate problem.’ But all it’s doing is multiplying the long-term problems.” (Case 3)

### Automatic credit card limit increases . . .

This practice is virtually irresistible for the naïve or foolhardy borrower who is under financial pressure. Imagine sitting in a poorly furnished house and a lorry parks in the road outside with exactly the right furniture – and you can take off it whatever you like up to an agreed value. If you make one payment of three per cent, the lorry returns the following month with another load – and so on. This is the scenario facing this group. The sensible solution is to send the lorry away – but it is awfully hard to do:

“And they just kept on increasing the limit all the time, and you think to yourself ‘No I don’t want it’. And they say ‘Well if you don’t want the limit, tell us and we’ll stick to the original limit’. But I just let it get out of hand.”(Case 3)

“The credit limit is increased very, very quickly. Even if you’re on the limit and only paying the minimum, they will still increase.”(Case 7)

“Well, the typical thing was I was just merrily going along, paying my credit card bills with other credit cards in the circle that I’d got into. And then, because those cards were being paid every month, they just used to up my credit limit.” (Case 5)

A couple with *eight* credit cards available to them could look back with some regret:

“I think you sort of got to the maximum and then they stopped, you know. You stopped using the card, so they sent through a letter saying ‘Oh we’re going to give you another £700’ type thing...I would say that over the period from the time that my husband first got ill to the time that I finally said I just can’t cope with this any more, I’ve got to do something, I would think that all of them did.” (Case 10)

“I wished it had been made harder to get them in the first place. But I wish they hadn’t have put the limits up so easily. I think it should be made for you to apply for the limits to go up, because say you’ve got a card for £500 and you’ve spent £500 and you’re paying it off, and then the bill comes along and it says ‘Oh we’ve upped it to £700’. If you’re the kind of person that loves going out and spending that money and you can’t resist spending the money, you just go out – oh I’ve got £200. It’s like someone’s given me £200. ...I think that’s why I said it’s too easy to reach such high limits, because you know, I’d never had anything; there was no like bad payments or any problems. And they just gave me money very quickly.” (Case 11)

There was only one example in my sample where the limit increase was specifically requested:

“I was phoning them up and saying ‘will you increase it?’ And it was like well I almost blamed them – that it was your fault for upping my limit without even questioning how I was going to pay this money back. I suppose that is the problem with all students, that they think they’re going to get this good job and they’re going to get their money back... At one point, I think I actually thought – well probably several times – ‘God, you lot are stupid’ the ones that were giving me credit, because I think even in my heart of hearts I knew. I don’t know if I knew that I couldn’t pay it off, but I knew that I wasn’t managing. But these people kept giving me money. And I just thought well how stupid are you? (Case 13)

### Marketing and sales tactics . . .

Loans were acquired in many ways, but there were no examples among my interviewees of a borrower actively seeking best terms. Instead, borrowers incurred the debt from:

- unsolicited (junk) mail;
- approaches in public places, e.g. shopping malls;
- their own banker (mainly providing debt consolidation loans); and/or
- telephone contact.

The active role of lenders is not surprising. The advertising of credit products is a high growth area, with the FSA’s *Financial Risk Outlook* in April 2004 commenting on the 67% growth in advertising expenditure on credit cards, mortgages and personal loans over the two-year period to September 2003; approaching £1 billion was spent on advertising these products in 2003 alone. The importance to credit card companies of managing to get a card into a borrower’s hands is clear. In my sample, several borrowers intended to cut up cards following a debt consolidation loan – but soon found that an “emergency” arose, and the cycle of borrowing began again:

“And you think, no, I won’t use it, I won’t use it, and of course you do. It’s this attitude of I’ll only use it for emergencies and it doesn’t get used for a bit. And then it comes out of the wallet when you see something you really, really want.” (Case 2)

The effectiveness of the different approaches varies:

- Junk mail: This is a common method of ‘choosing’ a borrower. Typically, the initial offer will have an attractive rate – even zero per cent finance for a period. The card and its credit limit are also very easy to get:

“Most of them dropped on the front door mat and I thought ‘Yes, go for it’.” (Case 16)

“I suppose it’s because people send junk mail through the post. Well not junk mail, you open a letter, apply for this, apply for that, we’ll give you a better rate, we’ll give you a better rate.” (Case 10)

“It was one of these things that came through the door. I filled in mine and thought I’m never going to get it. And then it came through and I got it.” (Case 7)

“Well, I can remember one month, getting a credit card specifically to pay the mortgage. I was worrying about how we were going to do it and an offer came through the door, you know, and the credit card was there within about seven days or something like that...Most of them came through ‘You have been approved’; all you needed to do was sign the form and send it back.” (Case 3)

- Approaches in public places/shopping malls: This is very similar to the junk mail approach:

“In the Trafford Centre, I made the silly decision to get pulled in by some very attractive young girl to fill out an XYZ application form. You know, they just see men coming, you know – we’re so thick. If you’re blonde, gorgeous – oh come on, a bit of flirting. And bang, you fill the form out, and before you realise it you’ve got a credit card in the post.” (Case 2)

“I didn’t apply for it – they said you apply for it now here, you could get whatever interest free or whatever – I can’t remember. I said OK then we’ll have it. So I applied for it in Bluewater.” (Case 9)
- Own banker: It is a surprise to see how often a reputable High Street bank is also prepared to market loans way beyond the point where a customer can be expected to repay:

“Because when I used to go down there, I used to be really surprised to come back and say ‘Aye, that’s fine’. I knew myself I was struggling, and I knew that they must have been seeing that I was struggling as well. But I just couldn’t work out why they were still giving it. I would take it; obviously I would take it because I was looking for something. But if they’d turned me down and said ‘No, you’re not getting it’, it would probably have made me stop and think why they’re not giving it to me, sort of thing.” (Case 14)

It is clear that these loans can be a step too far:

“So I wanted another £4,000. So I walked straight in. Within half an hour or three-quarters of an hour, I had the money. It was that easy to get it in terms of there was no – we’re willing to lend £7,000 to a 20-year-old, which to me seems rather perverse in a way.” (Case 2)

“It wasn’t difficult at all. I did it in about an hour. I just went down to see them. I didn’t even know what it was for. They sent me a letter, can you call in some time? I called in and I walked out £20,000 richer – well, I weren’t richer. I’d got £20,000 off them basically in an hour.” (Case 22)

The following example typifies the lack of personal attention that is given to customers by a single main banker – and the absence of joined-up thinking:

“And I can remember going to XX local branch, sitting down with the manager, and saying ‘Look, can I borrow some money for this purpose?’ And he went through the application form and he said ‘Well no, sorry, it’s been rejected – there must be a problem here with the credit scoring or whatever’. And so I went back and thought what am I going to do? You know, we’ve got to do something with the car; it’s on its last legs. And lo and behold, within about three or four days a letter arrived from XX credit card division saying ‘In view of your excellent record blah-blah-blah... we’re increasing your credit limit’.” (Case 3)

Borrowers can easily be tempted to assume that a bank is acting in their best interests. This couple’s two bankers lent money on three or four occasions over a two year period, the unsecured debt totalling over £90,000 at the end of the period against a household net income that had gradually risen to just over £2,000 per month:

*Interviewer: So did you trust them to have worked out that it was all right for you?*  
“Yes, I should say we put quite a bit of trust in them, especially into the two banks that we’d been with all the time.



*So you felt that, because they'd lend you the money, you could afford it?*

"Yes. I'd definitely say that." (Case 20)

A similar situation with another borrower involved his bank on two occasions consolidating debts into a loan. On the second occasion, there was no possibility of being able to meet the payments:

"It was just sheer relief, because it felt like – they looked at it – kind of child-like really. But you think, well they know what they're talking about. If they say I can do it, then I'll be all right. And you kind of say all right then, we'll do that, with the genuine hope that it would fix everything, at the time." (Case 30)

- **Telephone contact:** This was not widely referred to, but there were a few examples. In particular, a lender had provided a car loan that the borrower could manage without problems. Another loan, given halfway through repaying that car loan for furniture, was, however, a major factor resulting in her becoming over-indebted:

"I think if they hadn't phoned me up, I wouldn't have been searching for a loan. Because they phoned me up and made it so easy, and it was just perfect timing because I was sitting in this house with no cooker and things. It was a case of them phoning me at what I thought was the right time to phone me. If they hadn't phoned me, I wouldn't have gone looking for a loan." (Case 6)

### 'Dormant' credit cards . . .

Lenders do not appear routinely to review credit limits with a view to a reduction – nor do they take back dormant credit cards. This is a huge temptation to borrowers since the credit card, though unused, remains available for any 'emergency'. Since "emergencies" are in the eye of the borrower, use of the credit card is well-nigh-inevitable – and can easily turn a difficult financial situation into a catastrophe.

There were numerous examples of this temptation. Many occurred following a consolidation loan that should have stabilised the borrower's finances. For instance, this borrower paid off all her credit cards with a consolidation loan that should have given her a manageable debt situation. Instead, she proceeded to over-indebt herself again with the credit cards she should have cut up:

"I kept them. I should have cut them up. Twice I've done that, and I should have cut them up. And I didn't." (Case 7)

But even cutting up a card doesn't always help:

"So I did that and cut up the X card. I basically stopped the Y one, but I kept the Z card because I thought, you know, keep it for a rainy day sort of thing. I shouldn't have done that. That should have been cut up as well, but I thought you know. Consequently the rainy day never came and more and more purchases were put on my credit card." (Case 2)

"All the cards were up to the limit, so my monthly payments were a lot higher. So I was finding it hard to make the payments. I thought if it was a one-off payment I'd pay them off that way, which I did, and paid them all off. But then the stupid thing I didn't do was cut up the cards. I kept the cards, thinking well you know if I ever need them for a rainy day – and the next minute they were all up to the limit." (Case 11)

### Does the application form matter?

For the most part, borrowers I talked to insisted that they had correctly stated their income on the application form – or that it was obvious to their main banker. However, many borrowers felt that what they put down about their income was irrelevant, and that there was no serious affordability assessment. With hindsight, they concluded that loans were being granted simply on the basis that there were no existing arrears. This meant that some borrowers were convinced that the one thing they had done wrong was to maintain a good credit record – and thus encourage further borrowing requests to be granted.

Although few borrowers admitted to overstating their income, a more common admission was not including all debts on an application form. It was clear that borrowers thought that full admission might make loan approval less likely – although, based on the evidence, it is not clear that prospective borrowers would have been declined in any case.

One borrower had an annual net income of £10,656, entirely from benefits. She was surprised at the ease of obtaining credit, and commented:

“If you add your income support up and you work it out on a yearly basis it sounds like I’m working and I’ve got a good job.” (Case 27)

Another borrower’s husband had his own business. She commented:

“The other thing I’d say is on their application form it was very easy to lie in terms of exaggerating your income.

*Yes, and obviously in your case – where your income is very (uncertain) – you could put your most optimistic income in presumably?*

“Oh yes, that’s what we went for every time. It was rather this is what we *want* to be earning, rather than this is what we are actually earning.”

When asked about her declaration of out-standing debts, she added:

“I’ve got a feeling I put down some. But I definitely wouldn’t have admitted to all of them.” (Case 17)

Another borrower commented on the declaration of out-standing debts:

“They ask on the paper, but there’s about two spaces. When you’ve got six or seven credit cards you can’t fit them into two spaces. So you just put the two down that you don’t owe so much on. You’re not telling lies; you’re just not declaring everything.” (Case 22)

### Other temptations . . .

Other temptations presented to borrowers included credit card cheques, store cards and catalogues.

There were occasional mentions of credit card cheques among those I interviewed, but they tended to have only a minor effect on total debt. Although store cards and catalogue debts do feature in many borrowers’ debts, it was rare for them to represent a sufficiently large percentage of the aggregate to be viewed as a separate cause of over-indebtedness. Nevertheless, the pressure at the point of sale to use a store card was evident – not only for compulsive shoppers:

“You don’t have time to stand there and read it or anything like that. But because the shop people don’t explain it to you as well, they just make it sound like you know ‘Here’s your card, go and spend’. You can pick up whatever you like, you know. Exactly the same with the catalogues.” (Case 4)

# 4. What are the differences between the over-indebted and other borrowers?

During my work, I interviewed nine individuals who could not be classified formally as over-indebted. Nevertheless, they all had substantial unsecured debts, and all of them had experienced financial pressures. Since the interview format was very similar to that for over-indebted borrowers, a number of useful themes emerged that reinforce my general conclusions:

- Pressure: As far as pressure is concerned, these borrowers behaved in different ways:
  - One group showed no real difference to the over-indebted – other than the level of debt. They have not become over-indebted as yet, but may well continue to borrow until the point where they do.
  - Another group was fortunate in that, although a pattern was established, a change in circumstances meant that over-indebtedness was avoided.
  - A third group of borrowers took positive action to keep expenditure to a minimum and to re-organise their financial affairs. A divorced mother at the lowest end of the income range I looked at – but with very large available credit limits in the context of her income – commented:

“On the whole, since I’ve been divorced, I’ve just managed to keep on what to me is a manageable amount, not scary...I know where I stand on a daily basis using internet banking...I’m not out of control.” (Case A)
- Personal financial management: Again, three categories emerged:
  - The first group showed no difference in behaviour compared with the over-indebted borrower when acquiring or managing debt. They were essentially naïve.
  - A second group consisted of borrowers who had an escape route – usually the eventual sale of a property.
  - A third group could be described as ‘debt cautious’. Some borrowers have a sense of consequences, which makes them cautious, particularly when it comes to fees and charges. Some actually heed advice from parents or friends. They may still fail to consider the interest rate charged, but this will not necessarily cause over-indebtedness because of their overall caution:

“I don’t like, I never have liked, borrowing money or using credit; it’s not something that I like. It’s something that I’ve done for ease.” (Case D)
- Temptation from lenders: Again, lenders invite problems, just as with the over-indebted. I identified two categories:
  - One group took the line of least resistance when acquiring debt – but has so far avoided over-indebtedness because the amounts involved have been relatively small.
  - Another group recognised debt as a temptation – but did not regard a credit limit as an invitation to use it to the maximum:

“I think it’s appalling that they just increase your credit limit without – none of my circumstances have changed whatsoever. So why do they then write to me and virtually double my credit limit?” (Case A)

One borrower agreed a reduction in his credit card limit – only to find the limit going up again:

“The bank people actually suggested it, the people running the current account side of things... we’ll get them to bring it down, which they did for a short while. And then of course, lo and behold, a short while later it was up again, which did seem strange....The Visa card people are not really working in hand with the bank are they?...They are working totally independently, and if your current account people perhaps controlled the Visa card as well it would probably be better.” (Case E)

## 5. How over-indebted are these borrowers – and who lent the money?

When interviewed, each borrower was paying creditors what he or she could afford, following a detailed budget drawn up with the debt counselling charity. Under normal circumstances, a borrower should keep a contingency, so only 75 per cent of the amount available was used to calculate the “affordable” amount of consumer debt that the individual could service. This was done by converting the affordable payment into the equivalent of a 5 year loan at a 9 per cent interest rate. For example, if the amount available to service debts was £200 per month, this would enable the borrower to service a loan of approximately £9,600.

Chart 1 shows the distribution of gearing, measured by the percentage of gross household income borrowed as unsecured debt. For example, if a person with a gross income of £25,000 borrowed £9,600, the gearing level would be almost 38pct. I worked out the “affordable” gearing (ranging from 13 to 123 pct), and then calculated the “actual” gearing (ranging from 55 to 634 pct). The chart shows gearing for both the excessive “actual” level and the “affordable” level. It shows a significant concentration for the “affordable” amount in a gearing range of 20pct to 50pct. Borrowers who could afford higher gearing tended to be pensioners, those still living in the parental home, those with a relatively high income (above £30,000) and/or a small mortgage, or those who were supported by a partner’s income.

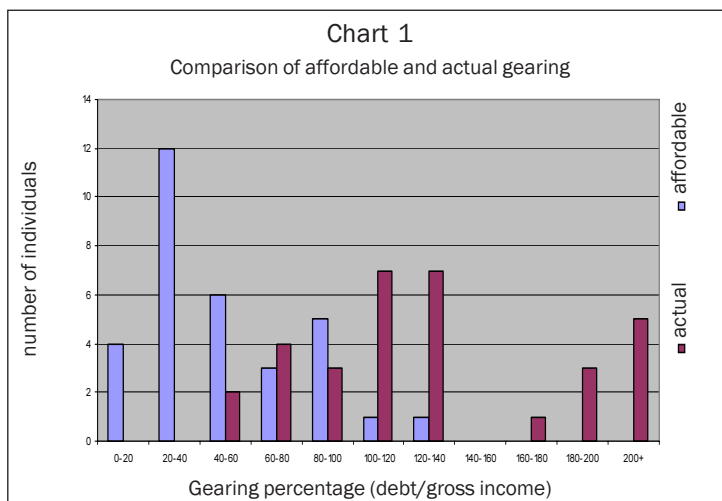


Chart 2 shows actual gearing, divided by “affordable” gearing. A ratio of 1 would indicate borrowing at the “affordable” level, with a ratio of 2 representing double the affordable amount of borrowing. The chart shows it is possible to borrow amounts far in excess of the affordable amount. The most extreme multiples seem to be caused by prolonged periods of paying the minimum and living off credit cards. Chart 3 shows that extreme examples are not necessarily caused by a loss of income; borrowers are similarly distributed whether or not they have suffered a loss of income.

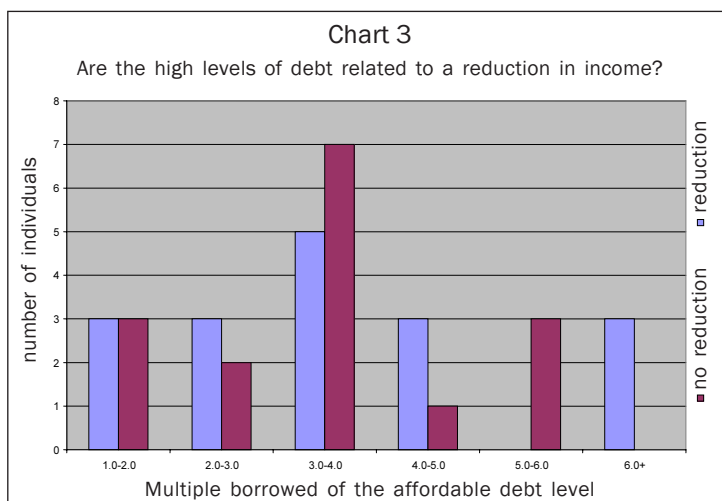
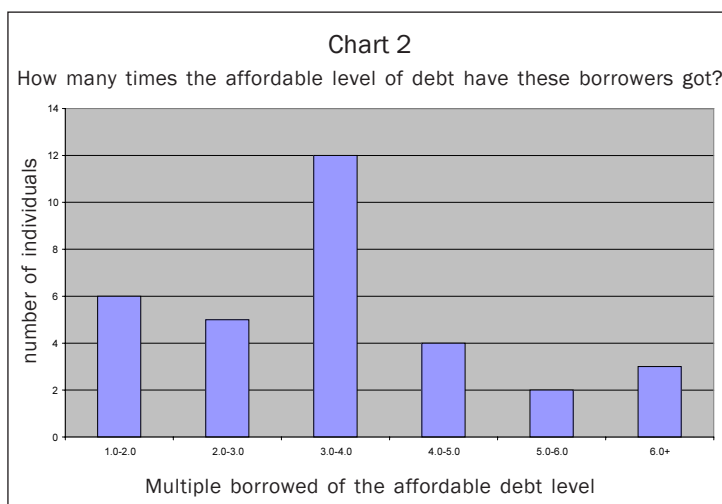
One conclusion is that there is a wide range of “affordable” gearing. However, I suggest that, if a borrower is venturing beyond gearing of 0.4/0.5 (debt equivalent to 40 or 50 per cent of gross household income), there should be a very good reason why he or she can afford to do so.

## Who were the lenders?

Thirty-two of those I interviewed were analysed to identify which lenders had lent beyond a point where the borrower was, by any standard, over-indebted. Lenders were only included if there were clear signs that the borrower was under financial pressure at the time of lending. There were 25 separate lenders represented (a bank and credit card lender of the same parent counted only once). The most frequent lenders are shown below. If this was representative, it would indicate that a few, specific credit card companies and High Street banks were most likely to have contributed to borrowers being over-indebted:

Major credit card issuer (US)	12
Major credit card issuer (US)	12
High Street bank (UK)	9 (Loans and credit cards)
High Street bank (UK)	9 (Mostly loans)
Major credit card issuer (US)	8
Major credit card issuer (US)	8
High Street bank (UK)	8 (Loans and credit cards)
High Street bank (UK)	5 (Mostly credit cards)

The number of major institutions represented is a reflection of market share and/or lending policies. There is no evidence that the lack of responsibility shown by lenders is confined to specialist or niche players serving the more risky borrower – though that may also reflect the fact that I did not focus specifically on low-income borrowers.



## 6. The Case for Action – how big is the debt problem and who is being affected?

From late 2003, there has been an exponential increase in media attention on the subject of over-indebtedness. This reflects:

- the relatively high level of debt in the UK compared with the rest of Europe;
- the continuing growth in the level of unsecured debt, which far exceeds growth in the economy;
- specific examples of over-indebted individuals who have received extensive press coverage, particularly suicide cases;
- concern over the level of student debt;
- increased demand for independent credit advice; and
- the possibility of an interest rate rise – and its consequences for the heavily indebted.

But how many people are *really* over-indebted?

The Bank of England provides information on the total amount of debt outstanding (Chart 4) – with unsecured debt of £180.5 billion (of which credit card debt was £56.5 billion) as at end-September 2004. This number is a slight under-statement as the Bank does not include unsecured debt that is held by financial institutions domiciled overseas; this includes securitised assets held by offshore companies. The dotted line, therefore, adds in all securitised assets since 1997. Given that there will have been some amortisation of securitised unsecured loan and credit card receivables, the true figure lies somewhere between the two.

Growth of consumer debt has been very high, with Chart 5 showing that growth of credit card debt is a particular issue.

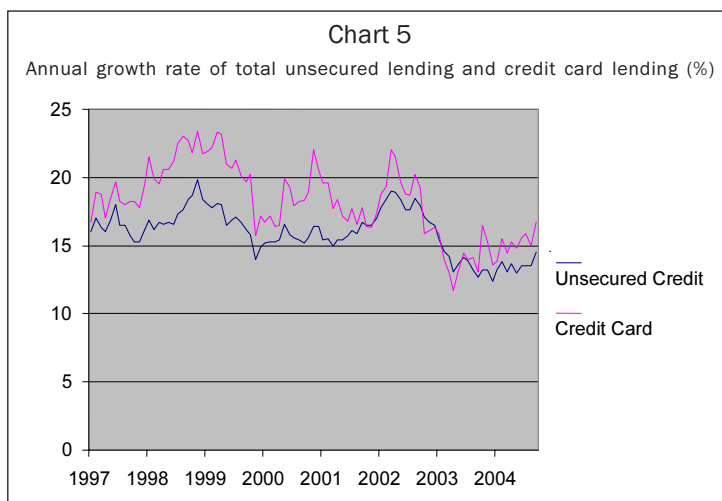
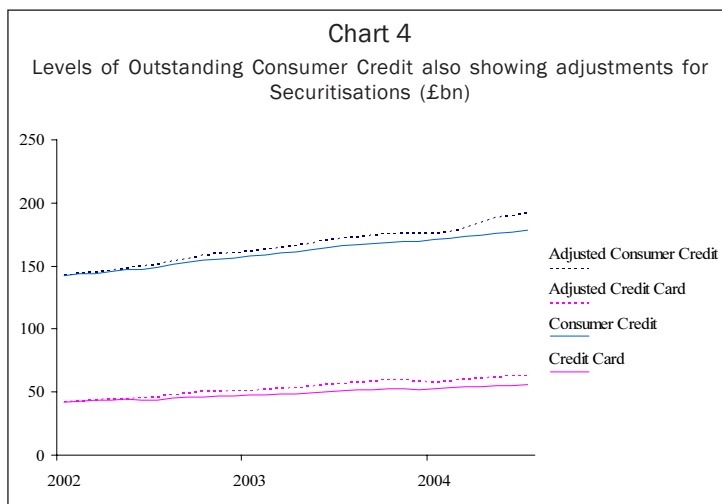
The main issue with regard to over-indebtedness relates to the concentration of debt among a small percentage of households. As Elaine Kempson put it in 2002, “most of the increase in consumer credit outstanding has arisen because the people who use credit now owe far larger sums than their counterparts in 1989”. Over the last two years, there is ample evidence that the *number* of households in debt has not increased – but the *overall amount* of debt has risen significantly.

Sir Andrew Large, deputy governor of the Bank, raised this in a speech he gave in March 2004<sup>8</sup>. Although, in his view, the financial stability and monetary policy issues are still manageable, the biggest issue is that the current generation may not be able to repay the increased debts they are taking on. He pointed to the conflict with the need for extra saving for pension provision and the issue of intergenerational fairness.

It is surprising that there is so little information on the size of the over-indebtedness problem. According to Oxera<sup>9</sup>, there are really only two surveys that are worthwhile – one carried out for the Bank of England and the other for the DTI:

- **Bank of England survey:** The survey, commissioned in October 2003<sup>10</sup>, concludes that approximately 1.6m individuals (3.4% of UK adults) find servicing their unsecured debt to be a heavy burden – of which approximately half are low income. The average unsecured debt of those finding debt to be a heavy burden is £6,900, compared with £2,900 for those who said it was not a problem. This survey also indicates that 20% of unsecured debt (c £35 bn) is concentrated among those who consider it a heavy burden. Significantly, the survey shows that all of the increase in unsecured lending over the last three years has gone to this group – pointing to a growing concentration of risk for a minority of individuals.

The BoE survey suffers from enormous under-reporting. In fact, the numbers of individuals who are over-indebted could easily be double the number reported, i.e. 3.2m. A reasonably conservative conclusion from this report would be that 2.5 million people in the UK are over-indebted using the earlier definition.



- **The Kempson (DTI) report (2002):** The most telling figure in this paper is that, in early 2002, four percent of UK households, or one million, admitted to borrowing too much. Given the propensity towards under-reporting, the actual number could be at least double this – with an effect on over four million people.

It is depressing that such a thorough survey as that produced by Oxera is forced to conclude:

“...that a more thorough understanding is required of the actual financial position of households, and of how other factors affect this position, before robust conclusions can be drawn about whether concerns relating to the possible future consequences of the current level of household unsecured debt are well founded.”

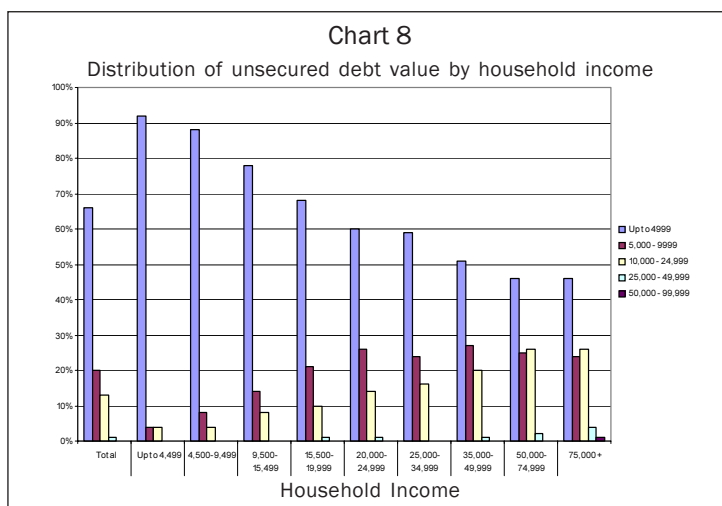
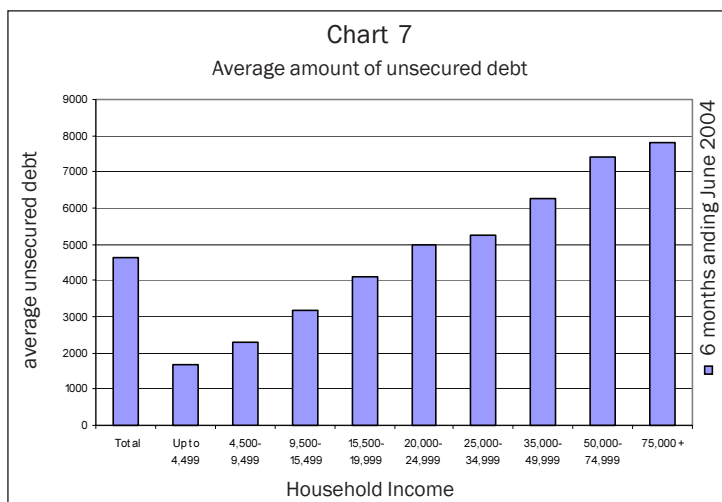
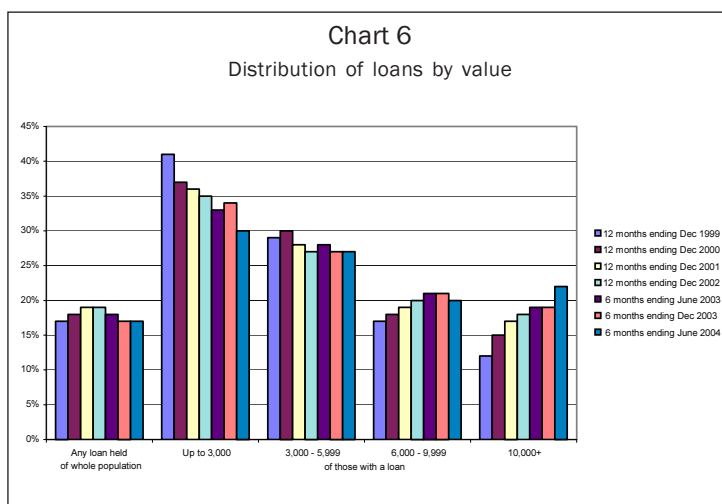
True. But it is also fairly clear that the number of UK households currently struggling with excessive debt is at a minimum one million – and is far more likely to be in excess of two million given the extent of under-reporting.

## A. NOP survey data

Information about the methodology of NOP's Financial Research Survey (FRS) is contained in Appendix 3. It has taken considerable effort to obtain the right data series given that it is the first time the data has been used for this purpose and the data feeds used in this analysis have not always been captured as part of FRS interviews.

The NOP data confirms many of the conclusions of other reports. In particular, it shows no indication of increasing numbers of households or individuals with out-standing unsecured debts. The split between credit cards, overdrafts and unsecured loans has changed through time; but the data indicates that the number of indebted households and individuals has not changed. Instead, there has been a substantial increase in the value of loans out-standing. This is clearly illustrated in Chart 6, with a significant increase in the last five years of those with unsecured loans (not including credit cards or overdrafts) exceeding £10,000:

The NOP data was analysed to see whether the number of debt *products* had increased through time. The reason for this was



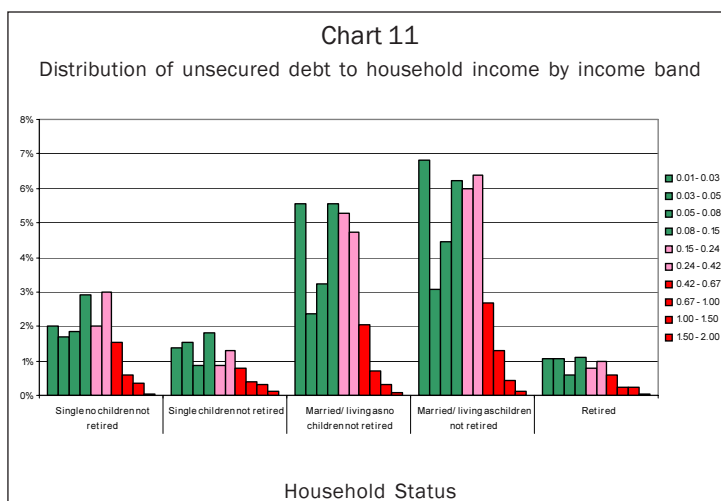
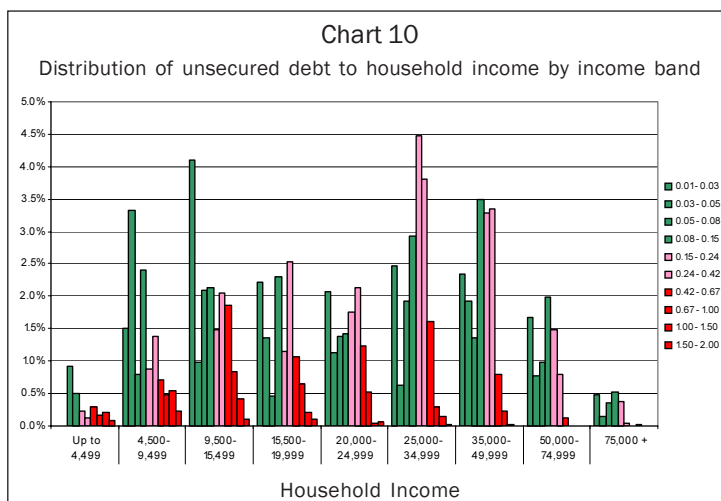
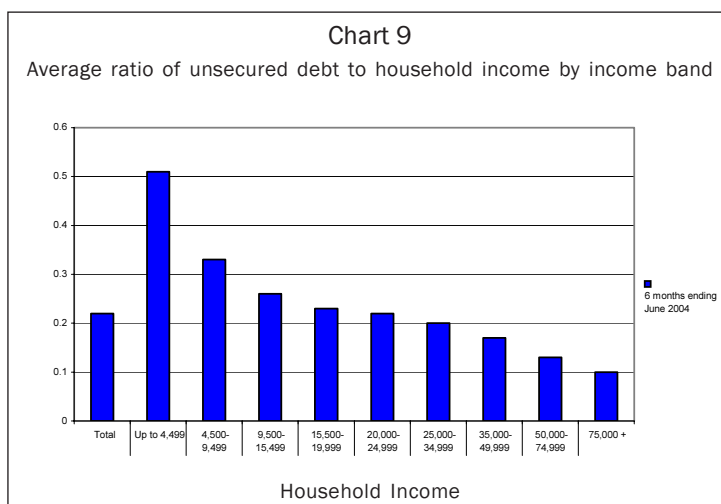


that the Kempson Report had suggested that the number of debt products is a key indicator of over-indebtedness. Unfortunately, there was no sign from the NOP data that the number of debt products is increasing significantly for any category – by age, income or household grouping. Not surprisingly, however, the average number of unsecured debt products for those aged between 25 and 55 is higher than for those younger or older. The average number of products and distribution is similar for those with gross household incomes from £4,500 to £75,000.

The amount of unsecured debt (including credit cards, but excluding overdrafts) rises with income (Chart 7); but it is the *distribution* of borrowing that is of interest with regard to over-indebtedness. Chart 8 shows the distribution of unsecured debt by income band for those households with debt. Not surprisingly, it shows that the percentage with larger loan sizes increases with higher income. Unfortunately, the chart cannot answer questions on over-indebtedness – for example, whether the 8 per cent of households with unsecured debt and an income in the range £9,500 to £15,499 can afford to service unsecured debt having a total value of between £10,000 and £25,000.

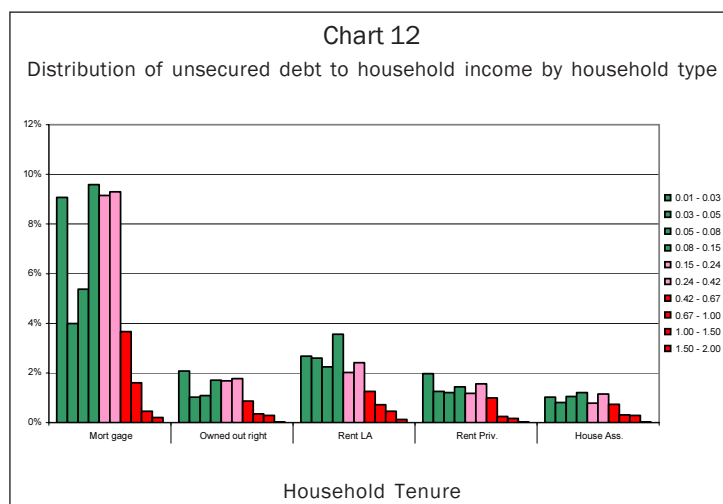
However, the ratio of household debt to household gross income (‘the gearing ratio’) does provide some insight into the sections of the population that may be under pressure. Chart 9 shows the average gearing for different income bands. The average gearing for households that have debt with an income between £9,500 and £35,000 ranges between 0.2 and 0.25. This indicates that, at a gearing level of 0.25 for a household with a gross household income of £20,000, unsecured debt of £5,000 would be a typical level. This is fairly modest – though it still requires approximately 10 pct of net household income to service it. The average household may still be able to afford a gearing double this level.

Chart 10 shows the distribution of gearing at different income bands for those households with debt. (The highest gearing levels are red, intermediate levels are pink and the lowest levels are green). It suggests that those in the income range £9,500 to £15,499 are most likely to be over-indebted, as they have the highest percentage of those with a gearing ratio of 0.42 or more. However, the chart also indicates that the vulnerable population covers a wide range of household income. My interviews indicate that there are very few people in the income band from £8,000 to £40,000 who could comfortably sustain borrowing with a gearing of 0.45 or above. Indeed, for many people, a gearing in excess of 0.15 will put them under pressure. Their



income is already committed elsewhere, either on mortgage payments or supporting a family. Chart 11 illustrates the distribution of the ratio of unsecured debt to household income for different household groupings. Not surprisingly, the highest gearing levels are for married/couples with children who are not retired.

Chart 12 illustrates the distribution by housing tenure. This indicates that those with the highest unsecured gearing are those with a mortgage. They may take the view that these debts can be incorporated into the mortgage, or that the sale of a property will be their exit route.



Source: NOP FRS

## B. What do we know?

Multiple unsecured borrowings for those earning between £7,500 and £40,000 undoubtedly can be a problem. These households represent almost 60 per cent of the UK population. The average ratio of unsecured debt to household income is manageable for the group as a whole, but the distribution indicates some very high levels of borrowing. My research shows that, even at lower levels of borrowing in relation to household income, many households in this income band cannot afford to service their debts. It is not that those on lower or higher incomes cannot become over-indebted through multiple creditors, but it is more likely that the most vulnerable section of society for this issue is that in the gross household income range of £7,500 to £40,000.

## 7. The consequences of over-indebtedness

As long ago as 1988, a research paper published by the Jubilee Centre on Families in Debt<sup>11</sup> concluded that there were five main types of problem resulting from serious debt. These are mental problems, social withdrawal, physical ailments, marital problems and family problems. I would endorse that list.

Without having experienced major debt problems, it is difficult to appreciate the anxiety that can be caused. One borrower described his situation as follows:

“Putting it into some sort of context, it’s almost like a big game to them. They dangle all these big carrots, knowing full well that vulnerable people, more so than not, are going to bite. And then the minute you’ve taken a bite out of the carrot, then they pull the choke chain on.” (Case 15)

A couple that had experienced no reduction of income in the period of stress described their situation:

“The last three or four years probably... I realised then that we were in real trouble, and it was just sort of survival then. Some weeks, we’d go to the supermarket with whatever we’d got left which was a few pounds, and try and feed a family on that. We were just trying to pay all the loans off...A lot of worry

with myself and my wife. My wife worries about it now. We both talk about it a lot more now, and we do realise where we went wrong. There was a lot of embarrassment as well – I’m very embarrassed about it.” (Case 20)

The demanding letters and phone calls, exacerbated by the difficulty of communicating with most creditors, are a real shock:

“This is the reason I wrote to them all, was to let them know that I was in this fix and that we were seeking professional help on it. And I got no replies whatsoever. And I wrote to every creditor. And then the next thing, I get letters from agencies that are taking it over, that we’re going to be sued and all the rest of it.” (Case 18)

Considering that the consequences of excessive indebtedness was not my primary objective, but it is important to highlight why action is needed. Several couples I spoke with had discussed breaking up, with their debts being a major factor. In other cases, the debtor’s partner remained unaware of the size of the problem.

Overall, the level of research into the effects of being over-indebted appears very low. In particular, health effects should be the subject of greater investigation. One study among students found that “financial problems had the strongest, most independent relationship with depression”.<sup>12</sup> Another study “found that debt did negatively impact student well-being, with depression occurring in nearly one third of graduates who anticipated owing substantial amounts of money. This compared with 8 per cent of other students who didn’t foresee debts.”<sup>13</sup>

### . . . health effects . . .

Given this, it should not be surprising that in over a third of cases I interviewed, the health consequences of indebtedness were sufficiently significant to see a doctor on several occasions. In a survey conducted by the Citizens Advice Bureau<sup>14</sup> it was discovered that “nearly half of those who had been to their GP for help had been receiving treatment for more than a year”. The health problems were not minor. For example, a woman with Crohn’s disease described the effect as follows:

“I have got something that’s called Crohn’s disease, and they say it’s stress-related. There’s something wrong with my bowel. And, of course, if I’m upset or anything, it does affect it. And I was really quite ill to the point where I can’t eat anything at all or drink anything, and then I lost a lot of weight. I was just under seven stone at one time and very, very ill. Because I just couldn’t control what I was doing.” (Case 5)

It is unlikely to be coincidence that she was able to stabilise her condition once she was established on a debt management plan.

Very serious weight changes, both up and down, were present in the men and women I spoke to, along with other stress-related conditions. In cases where debt was not the only factor, it was likely that stress was making other conditions significantly worse – particularly in cases where the individual had been unable to talk to anybody about the problem:

“I was having a lot of headaches and I was going to the doctor’s with them. I went through a spell where I was probably very depressed, very down. But I think that again was because I had to keep it to myself, I couldn’t talk about it to anyone. ...I thought this is it; I’m going to go to prison. Because I thought you’d get a default and that was it, you know. It used to scare me.” (Case 11)

A woman who became over-indebted in her 60s collapsed and was admitted to hospital. Her debts were her only source of major stress:

“...but the doctor said it was all to do with, and it had been brought on because I was so stressed and what have you, that my body just couldn’t cope with anything. And I just picked up illness, you know, as I went.” (Case 19)

The most severe cases are those that have considered suicide. The high debts for this pensioner appeared to be the only cause of her depression:

“And last year, really, if I didn’t find the CCCS, I would have done it. I was on and on ‘How do I do it so that it looks like an accident so that the children don’t get upset’, you know. I’m on tranquillisers. I had counselling and everything... I’m still a nervous wreck, you know. I think, even though this little amount what I pay – how long will they accept that?” (Case 23)

This comment came from a 24 year-old woman, following “nasty threatening letters” last summer:

“It’s just too easy. And I can well see how people get into the messes they do when you read in the papers – people just sort of ending it all. Because I think honestly, hand on heart, if I hadn’t have found the CCCS and I hadn’t been able to sort of have the friends and family around that I did, I wouldn’t have made it through this. I really wouldn’t have. No exaggeration.” (Case 30)

### . . . relationship effects . . .

It is not clear from existing research that credit arrears cause a significant increase in the likelihood of a couple splitting up, although rent and household arrears do have a link.<sup>15</sup> Indeed, in my limited sample, no one had split up permanently or divorced over debt problems. However, this is small consolation given the significant relationship and family conflict issues that over-indebtedness breeds:

“Terrible. Devastating. I mean we’ve split up over this as well before. And then obviously we’ve got back together. And it did cause a lot of arguments, and then the kids had to go without lots of things, you know. It just wasn’t a good time at all 2002-2003, just not very good years.” (Case 4)

“It’s put a big strain on my husband and myself. We came close to splitting up and that has to be quite a major factor in it. The children do get told ‘No, we can’t do that, we can’t afford it’. They’re used to going back to school and not having had a holiday – that kind of thing. It is just tough.” (Case 17)

### . . . consequences on children . . .

Most parents tried to protect their children from the effects of debt, but there were examples of having to do without holidays, clothing and school trips. It is easier with younger children, but understandably it can be particularly hard with a teenager when income is primarily directed to servicing debts:

“It causes angst, yes, because obviously when you’re a teenager you want to be just like your mates. And of course there are times when my son can’t be because there aren’t the extras to be able to just give him the cash that he would like – not that I want to give it him anyway. But even just something silly like a fiver in his pocket to go into town with, there are some weeks where I haven’t even got that, because the bills have got to be paid first. And that’s been the situation since the debts really.” (Case 15)

On a more positive note, several parents expressed the need to educate their own children in understanding how to manage money:

“...it’s made me very determined to teach them to handle money.” (Case 17)

With two younger children, the elder being seven years old, an interviewee was naturally worried:

“Well, I mean they used to hear us arguing about money a lot, and now the first thing they say – normally when you go into a shop the kids say ‘Can I have this, can I have that?’. Well my kids say ‘Have you got

enough money for...?’ That’s how they will ask. So it’s obviously had some sort of effect on them as well...I’m trying to explain to them as well – well the oldest one – money is an important thing and don’t abuse it and things like that. Because it just gets you into all sorts of trouble.” (Case 4)

My focus in this section has been on the health and family consequences of over-indebtedness. Clearly, many people find themselves having to work harder and under greater pressure. For young people, a troubling effect is the reduction in life choices at a very early age as they are driven into jobs that provide immediate income.

A review of available research on this topic suggests that nothing like as much work has been done as, say, into the consequences of drugs and alcohol. Nevertheless, the non-financial consequences of becoming over-indebted are serious and merit further study.

## 8. How responsible are lenders?

The key issue is the relationship between the borrower and the lender, given the consequences for the borrower of over-borrowing. This has altered over time, and the balance has also changed. Nowadays, the appropriate analogy is not as obvious as it used to be, but I want to put forward three:

- The lender as doctor: A doctor is required to do the best that he can for the patient. The patient trusts the doctor, while recognising that there is scope for error. In some cases, there will be choices to be made, and the doctor may present these to the patient. Inevitably, his decision will be heavily influenced by the way in which the information is presented – including the chance of success, potential side effects and the result of not treating the condition. Many patients will have a good idea of the nature of their illness. However, they are unlikely to know the exact prescription or how the drug being prescribed might interact with other drugs. Understandably, therefore, they look to the doctor to form a view on the best prescription under these circumstances. The patient’s only real choice is whether or not to take the drug prescribed.

At one time, the role of a bank manager could be seen as similar to that of a doctor – with the implication that, if he was willing to extend a loan, that was probably in the customer’s best interests.

- The lender as cigarette manufacturer: There is little doubt that smoking is likely to damage the smoker’s health – and very likely the health of others in his proximity. Unfortunately, the choice whether to smoke or not becomes very difficult once smoking has begun. Cigarettes are themselves addictive, and there can also be strong pressure to conform to a social group.

As a result, cigarette manufacturers are subject to numerous controls, and there are heavy taxes applied to recoup some of the health-related costs that fall on society as a whole.

The lender is not providing such a universally unhealthy service. However, there is a substantial minority for whom borrowing just makes a difficult situation worse. The consequences are serious, not only for the individual, but frequently for the wider family. In addition, there is a substantial minority that finds it difficult (or impossible) to control expenditure. Unfortunately, it is this vulnerable group on which the lenders rely to produce a profit. In a similar way to the addicted smoker, the unrestrained consumer is very profitable.

- The lender as wine bar or pub: The consumption of alcoholic drink is a pleasure for many, but it is a real problem for an alcoholic. Understanding this problem is straightforward – but the impact on the alcoholic and his family is far

from straightforward. The effects on the children of alcoholics, for instance, can be particularly significant, and there are wider implications for society.

One difference is that there is a legal obligation on the wine bar or pub not to knowingly supply alcohol to somebody who has drunk enough already. Lenders are not under any such obligation. For the wine bar or pub, there is also the issue of the irresponsible drinker moving from one establishment to another, which makes proper enforcement of the law difficult. The same is true of debtors – though responsible lenders can deal with this issue by sharing data on outstanding loans. That said, there are at least four reasons why the analogy with pubs and wine bars – though useful – is not perfect:

- First, credit is not the objective: It is the subsequent consumption that matters. The lender is selling ‘enabling’, and needs to be sure it is fit for purpose.
- Second, the potential to over-consume when it comes to credit is more widespread than the predisposition towards alcoholism. With only 45% of householders agreeing with the statement “I’m a saver, not a spender”<sup>5</sup>, the majority of a lender’s customers have the potential to get themselves into difficulty if there is sufficient pressure on them to spend.
- Third, any loan carries a long-term risk. The customer does not know how his or her circumstances will change – but the relationship with the lender will certainly last considerably longer than the sale of a bottle of wine or beer.
- Fourth, the economic consequences of over-spending can last for a considerable period and have serious social implications – particularly if the debt is concentrated in, say, families with children. The responsibility of the lender then becomes an issue of public policy.

Whatever the strength of these analogies, it ought to be clear that any lender has a duty of care, and should be required to treat customers fairly. Fairness must involve ensuring a customer has sufficient support to permit a sensible choice when deciding whether to borrow or save. In that sense, it is appropriate to view the lender as a pub landlord – with an obligation not to make those with too much debt further indebted. Society increasingly expects those who sell drink to act responsibly; it is reasonable to expect the same of lenders.

## 9. Consumer credit scoring – Why is it not the solution?

Over the past thirty years, the consumer credit industry has developed complex automated decision-making processes for lending portfolios. This section considers how these take account of individual circumstances and whether the use of profit drivers alone adequately addresses concerns about consumer indebtedness.

At the heart of all automated credit decision making is a statistical technique known as “scoring”. Scoring can be used through the cycle of credit decisions:

- marketing responses;
- applications;
- increasing limits;
- collections;
- debt collection; and
- write-off.

Essentially, scoring allocates points according to key borrower characteristics, e.g. 10 points for being under 25, or 20 points for being between 25 and 35 etc. All the points from each characteristic are added together to give a final total – the score.

A scorecard is built up by taking a sample of customers and looking at an outcome, e.g. did they respond to a mailing or not? Did they pay back their loan or not? All the relevant characteristics and attributes at the time that a loan is taken out are examined to see which most strongly predict the final outcome, e.g. response, or loan pay back. Once the points are added up, the final score represents the probability that a particular outcome will occur. For example, if a customer scores 200, this may represent odds of 10:1 that the customer will not pay back a loan, i.e. for every 10 paying customers with this score there will be one who will not pay back the loan. If a customer scores 220, this may represent 20:1 and so on. Any customer with a given score has the same probability of a particular outcome.

By ranking all customer scores, a portfolio can be divided up by varying probabilities of outcome. Take a very simple example of a lending portfolio. If a scorecard is built with odds of a customer not paying back his loan, it may look like this:

<b>Final Score</b>	<b>Odds</b>
100	5:1
120	10:1
140	20:1
160	40:1

Assume that every customer who does not pay back his loan costs the business £100, and that every paying customer makes the business a profit of £10. It can be seen that any group of customers scoring less than 120 (i.e. with odds of 10:1 and shorter) would make the business a loss. Therefore, the business would only offer loans to customers scoring 120 or over.

In addition to determining whether to lend, a business must decide *how much* to lend. Some organisations set the amount based purely on the score:

<b>Final Score</b>	<b>Amount up to</b>
120	£5,000
140	£10,000

Others try to take account of individual affordability by looking at characteristics such as credit turnover on a current account and using a multiplier based on the score. Still others increase limits based on usage. The modelling of how to increase limits is normally based on trial and error, i.e. on the past behaviour of customers who had their limits increased.

All of this sounds (and is) rather unsophisticated. Nowadays, much more complicated calculations are often also made to determine individual profit drivers, such as:

- interest rates;
- charges for being overdrawn, late payment, letters, telephone calls;
- the cost of mailing;
- the cost of application processing;
- the cost of collections letters, telephone calls;
- the cost of non-payment (e.g. write-off, debt collection agency); and
- the value of future interest revenue.

Unfortunately for the individual, automated decision-making is for the benefit of the lender, and the issue of affordability is essentially irrelevant.



## How is scoring used?

Predicting the ability to repay is by no means the only – or even the most important – use of scorecards. They have application right across the credit cycle:

- Marketing scorecards are used to predict response, i.e. those customers most likely to respond to an offer. They can also be used to indicate financial pressure – e.g. by identifying high use of existing credit limits, attempts to go overdrawn, a history of minimum payments etc..
- Application scorecards are used to predict customers who will not pay back (they are also known as risk scorecards). This includes, but is not restricted to, those who cannot *afford* to pay. For the most part, application scorecards are not built to identify individual affordability, and therefore are a very crude instrument for this purpose. They look for customer characteristics such as age, time at current address, behaviour characteristics (if the applicant is an existing customer) such as age of oldest account, credit turnover trends, credit reference agency characteristics, payment behaviour with other lenders, number of County Court Judgements (CCJs) etc.
- Limit scorecards try to predict when usage will increase and are similar to marketing scorecards. They have a tendency to select higher risk, more vulnerable customers who show an increasing need for credit.
- Collections scorecards are essentially risk scorecards, but look specifically at customers who have missed payments or gone overdrawn. Some of these borrowers are clearly experiencing financial difficulty; others may merely have accidentally missed a payment. The scorecards are used to target the type of action an organisation can take to recover the owed money. At this stage, the emphasis is on recovering the money and re-establishing a relationship with the customer. Typically, they concentrate on payment behaviour, and do not really cover affordability.
- Debt collection and write-off scorecards are used when customers are in severe financial difficulty. At that time, the objective is to recover as much money as possible. These scorecards look at the most effective method of recovery, i.e. whether to send the debt to an agency or to sue or just to write-off the debt. Once again, the scorecards do not really look at affordability.

Scorecards can also be used to set lending limits.

Although there are many ways in which organisations set lending limits, it is fair to say that most do not adequately reflect the ability of individuals to pay. Setting an amount based purely on score, for instance, means that two individuals with the same score but earning different salaries would be given the same amount/limit.

Equally, credit turnover misses the outgoings side of the affordability equation. Obviously, a customer may have a reasonable credit turnover, but may also have a large number of commitments such as mortgages and other lending. More perniciously, increasing limits based on usage may actually encourage people to borrow beyond their means. As a customer experiences financial pressure, the temptation is to borrow more and repay less; this is exactly the type of customer that marketing and limit increase scorecards select for guaranteed offers and limit increases.

Guaranteed offers also have their own negative impact on vulnerable customers. The fact that the lender tells the customer how much it is prepared to lend seems somehow to take away the burden of borrowing responsibly from the customer and put it onto the lender. Implicitly, the customer believes that the “bank” has calculated that he/she can borrow that much – even though, in fact, the amount on offer is not based on any ability to repay.

## Profit drivers . . .

Increased competition and “cherry picking” in the industry are putting ever-increasing pressure on profits. By using profit drivers to enhance automated decision-making, lenders have developed new techniques to squeeze extra profits out of their portfolios. These techniques include innovations such as risk-based pricing, where the price (i.e. interest rate) is increased to enable the lender to accept groups of customers with lower scores (i.e. higher odds of not paying). This has a “double whammy” impact on customers at the margin. For the borrower who manages to pay, he is paying

higher rates; there will also be more borrowers getting into difficulty. Whilst, overall, the lender makes money from this group, there is clearly an increase in the overall number of customers who get into debt.

Lenders are also increasing charges for collections activities such as unauthorised overdraft usage, telephone calls or letters, overdraft fees, missed payments, etc. The scope for charging is enormous – and by definition falls mostly on those experiencing financial hardship.

There is also a move towards developing new products particularly targeted at those customers who experience financial difficulty. These inevitably carry higher interest rates and charges.

## Data availability issues . . .

Although it is pretty clear that lenders don't take affordability routinely into account when deciding whether to lend, it is only fair to point out that there is a major issue in the industry regarding availability of data on affordability. No institution has a complete picture of an individual's financial affairs.

Historically, in the UK, financial organisations have not had to submit details of their lending portfolios to every Credit Reference Agency (CRA). Therefore, no individual CRA has details of all lending. In addition, lenders do not uniformly share all the information available. It is, therefore, currently impossible for anyone to assess an individual's total outgoings with any degree of accuracy.

Equally, details on income are notoriously difficult to establish. Banks may receive regular salary credits, but these may not represent the total picture – and they are, in any case, not applicable to the self-employed or those at home looking after relatives. Relying on customers to supply this data can also be dangerous as there is always a tendency to exaggerate income and underestimate outgoings, either deliberately or due to ignorance or misplaced optimism. Techniques to establish proof of income (such as references) are time-consuming, expensive and also not very reliable.

## Conclusion . . .

In summary, automated credit decision-making does not adequately address affordability issues. Therefore, it cannot be relied upon to encourage responsible lending. Indeed, it can easily work against the interests of vulnerable customers.

In my view, there are two major stumbling blocks that prevent organisations taking more account of affordability:

- The first is the absence of reliable and easily available data on total debt and affordability. Until this is available, it is difficult to see how lenders can address these issues without significantly increasing their overheads.
- The second – and more worrying – is that competition is putting pressure on lenders to exploit more vulnerable groups because of the profit they can make from charges, and differentiated interest rates.

# 10. Other potential solutions

## Debt consolidation . . .

There are many households in the UK that are over-indebted. The widespread practice of debt consolidation enables these households to reduce their regular payments by spreading high-rate short-term debts over a longer period, typically for five to seven years, at a lower interest rate. This practice can be sustainable – provided borrowers stop incurring high-rate short-term debt. Unfortunately, it is easy for households to utilise debt consolidation as a way of enabling them to borrow even more.

In my view, therefore, while debt consolidation can be a valuable tool for debt management, it can also be a disaster for households with spending that is not under control. Households need to understand consolidation's limitations, and ensure that they do not succumb to a continuing pressure to spend.

## Re-mortgaging . . .

Re-mortgaging also enables many households to spend in excess of their income by including high-rate short-term debt in increased secured borrowing. Very few of the over-indebted cases in my sample had done this in the later stages of their indebtedness, but it was often present in the early stages of a household becoming over-indebted. The implication is that a fall in house prices may lead to more people becoming visibly over-indebted – particularly since spending patterns will be slow to alter and those with a propensity to high-rate, short-term debt will continue to borrow.

As with debt consolidation, a household that is re-mortgaging to finance unsecured debts needs to understand its limitations.

## Home credit . . .

Home credit providers provide small loans (typically £100-500) through agents who call at customers' homes every week to collect repayments – and, when required, to supply further credit. Although they have a rather fearsome reputation, they do not feature significantly as a cause of over-indebtedness in this research – though that may be because I do not focus on low-income borrowers.

Borrowers may have had one or two of the home credit providers in their list of creditors, but they did not represent a major proportion of the overall debt of any borrower interviewed. Those who used them were aware of the high cost, but regarded a short term loan – together with home collection – as a periodic necessity, if not a benefit.

That said, home credit providers should obviously have the same duty of care as other lenders. But there is no evidence from this study that suggests they constitute a special problem on their own.

## Bankruptcy . . .

There are more and more personal bankruptcies occurring in the UK – and that seems likely to continue.

The main deterrent to individual bankruptcy is the loss of the family home if the debtor has a mortgage. If the debtor does not own a property, the main deterrent is the stigma and the loss of credit rating. These consequences are sufficient for many borrowers to enter into long-term agreements to repay what they can afford. However, for many, bankruptcy is a comparatively straightforward solution – particularly since, for most people, the period of bankruptcy is a maximum of one year.

The increasing ease of personal bankruptcy could easily make it a preferred solution to over-indebtedness. However, there would need to be a cultural shift in the UK for the stigma of bankruptcy to be removed. Such a shift could well occur among indebted young people – thanks, in no small measure, to the impact of student loans. There were no examples of personal bankruptcy in the cases I interviewed. Nevertheless, I think it would be useful to investigate the contrast between those who choose bankruptcy and those amongst the over-indebted who adopt a plan for eventual debt repayment.

I certainly believe that as more households become over-indebted, there will be more who choose to solve the problem by bankruptcy. Over time, the stigma of bankruptcy may well disappear – which will accelerate this trend. If this goes too far, the principal effect of over-indebtedness by misjudgement might well be a transfer of resources from prudent borrowers to the imprudent.

At present, if debts cannot be fully paid off in five years, a one year bankruptcy followed by a period without debt must seem preferable to spending many years using all surplus income to service debts. The situation will need to be carefully monitored to ensure that bankruptcy does not become the solution of choice. The huge rise in personal bankruptcy in the US is not a model that should be followed – and is certainly not a situation that Americans would have chosen.

# 11. What do over-indebted borrowers think would have helped them?

Some suggestions offered by borrowers are simply too intrusive for serious consideration. However, they have one thing in common: Their bad experience means that most borrowers can see why it would be in their interest to have been turned down for a loan. The overwhelming majority wished they had never borrowed any money at all, and that it would have been better if they had saved up for a few months and been patient. Most borrowers I spoke to felt they would still have had most of the things they bought without the huge debt problem.

## Help with determining affordability . . .

All borrowers I talked to would have liked the opportunity to get help *before* they reached crisis point. The advice, had it been available, might not have been enough to stop debt becoming a strain, but for many it could have cut their indebtedness by 30 to 50 per cent – if the advice had been taken. Moreover, they would have been making an informed choice on expenditure and debt.

The interviewees were not asked specifically about advice, but more generally, about what might have helped them:

“But then, if you think from the High Street point of view, unless you go to the banks and say ‘Can you advise me?’ they don’t exactly put their hands up and come forward and say ‘Why do you want this credit card?’ and ‘Is there anything we can do to help you?’ (Case 15)

“We are going to lend it to you. But also we want to give you this telephone number to call to ensure that we do get our money back in a timely manner, but also to see that all the other debts you already had – liabilities, what you’ve actually taken on – you’re going to manage those effectively as well. And then we’re going to pass you over to this group of people who may be able to give you some advice or some guidance about how to stay on top of all your bills etc’... That would have helped a lot.” (Case 1)

“But if they’d turned round maybe a couple of years before that, and said ‘Look why don’t you call XYZ to see if they can help you’. But that advice was never available. I’d never heard advice; maybe the banks would give you a bit of advice on the phone. Just looking for – obviously not every case is going to be the same as mine – but I see my brothers and that and they’re forever going down putting their overdraft up and then getting an extra loan. Maybe at a stage like that, maybe when I was younger, just to say ‘Look you’re doing it the wrong way here’. Maybe just come back and say ‘Look, why do you want to get a loan because you’re already so much in debt?’ – sort of thing. Just do that to help. It would save you getting to that point that you owe X amount of money. They don’t encourage people to save up; they just give them the easy route – it’s too easy to get a bank loan.” (Case 14)

“The thing that I’ve learnt from the whole experience – the biggest thing I’ve learnt – was I was very, very silly not to go and get help sooner.

Interviewer: *Do you think you might have rung the number if you'd received a letter saying that?*

"I don't know whether I would have rung it straightaway. But it is the sort of thing that I would have kept hold of. And then perhaps, having that number there, things wouldn't have got quite so bad before I finally reached breaking point and thought I've got to get help here or I'm going to crack up. What it may not have done is it may not have caused me to take action there and then. But it may have caused me to take action sooner than I did, having that number there and knowing there was a number there that I could phone and say Help." (Case 10)

"I think it would have been good if they had said 'Well you're paying off the thing, that's fine'. But when we started to pay perhaps just the minimum payments, I wish they'd turned around and said 'Look, don't you think you ought to curb this a bit, you're getting near danger level?'. Or some sort of warning that if we weren't careful, things could nosedive." (Case 18)

Well before the final loan, this borrower's opinion was clear:

"...because at that point, I could actually see it getting out of control. And if they had suggested somebody who I could have rung up, then Yes I would have gone for it." (Case 4)

## Help with budgeting . . .

In the case of compulsive spenders, they were generally very receptive to the idea of help on budgeting:

"I've never actually worked to a budget, if you know what I mean....I was never in control of my finances. So now I'm working to a budget. So I have to control my finances. I don't really have a choice. And actually it's quite a relief." (Case 7)

Any advice that was offered would not necessarily have been followed. But even the most extreme examples did try to regain control of their finances:

"Even though now I don't go out and spend the money in the way that I used to, I still do try to balance and I still don't think I've quite clicked how to budget properly. But fingers crossed. ...I think because I now have a book, so that every time I spend money I write it down, so I know exactly how much I've got. I know how much I've got to live off and everything. From the beginning of the month, when I've been paid everything, all the bills, direct debts and everything is taken out so that I know exactly how much I've got." (Case 13)

In some cases, it is clear that a borrower would not be easy to help:

"I think they could have offered a bit more advice. But, on saying that, I was at the stage where if I asked them for something and they said No, I'd just get angry with them. I was blaming other people rather than myself at the time, I suppose."

Even so, the same borrower added an important qualification:

"...had some of these companies said to me earlier on 'Look, we feel that things are creeping up a bit; rather than increase your limit do you honestly feel that you can meet these payments or would you like to speak to somebody about debt?', I think that would have been enormously helpful." (Case 16)

Of course, not all lenders are good with advice. This borrower had very poor guidance from his bank on handling money, and concluded (reasonably) that the bank simply acted in its own short-term interests:

“Whether I would have listened to the advice is another matter. Unfortunately there is – and with my friends as well – another thing is young men, you know, you think you know everything and your way is best – and it isn’t. And it’s very hard to listen to other people. And you’re very willing to listen to people like banks and stuff because you think they know what they’re talking about. And you think they’ll have your interests at heart, but really they don’t. And it’s that naivety sometimes that I think they lay on quite a lot.” (Case 2)

## Debt education...

Younger borrowers in my sample were more inclined to emphasise the need for more education both in school and (where relevant) when starting college:

“I think I needed more knowledge of the consequences of it all. How to do budgets, how to work out interest rates and things like that. Just a lot more money management skills altogether really... I think there should be a lot more at schools these days. When you think about the amount of disposable income kids have, I think if you’d learned these lessons at 12-16 or whatever, you would be far better equipped to move forward... It might sound really, really dumb, but... I thought if you borrowed £100 on the card, then it was £100 you paid back. I really just had no comprehension of how it worked and how you can pay back the £100, but you’re still going to be paying whatever off on top of it. And that’s the stupid thing.” (Case 30)

“There should be something made clear to Sixth Formers. Because even when I started at university, when I went on the course, I was 23 and...with all these free credit cards and everything. You know, here you are, get yourself into more debt.” (Case 2)

# 12. Lenders – the over-indebted want you to be more responsible

## Just say "No" (or look before you lend) . . .

As noted before, borrowers are frequently surprised that a lender has agreed to give them another loan or to increase their limit. Many borrowers allow themselves to be convinced that, if a lender is prepared to advance them the money, they must be able to afford it. They do not realise that credit-scoring is not designed to help them, or that their difficulties are a profit-making opportunity given the high level of fees and charges that results. In some instances, borrowers actually view the granting of a loan or credit card as a kind of reward.

From my interviews, I am convinced that many borrowers would have accepted that they had reached the limit of borrowing had they been turned down – though some admit that they would have looked elsewhere:



“I think that they could have probably looked more into the account and thought this woman obviously is earning £11,000 a year. She’s got so many cards, you know, with probably an example of the XYZ who I had a loan with and a credit card with. And was seeing every month what was going into that account and my salary, you know. I understand that they haven’t got the manpower to sit and go through people’s accounts because I understand I’m not the only one with an account with the XYZ. But maybe they could have had a stopping point, you know, ‘No more’.”(Case 5)

Borrowers recognise that they might have faced problems if further credit was refused. But these would have been as nothing compared with the financial disaster that eventually overtook many of them.

Borrowers tend to believe that a lender knows the amount of debt outstanding, especially as so few lenders request any information on existing debts. They do not realise that it is very likely that the only data being accessed relates to arrears and defaults:

“Proper credit checks, you know, to see if... But even though I went in for the loan, I went in for the money, they should do proper research, check to see if in the long term I could pay it back. You know.” (Case 8)

“I think really, when they’re getting your credit checked, they should have looked into it more thoroughly to see exactly what – because the thing is really, obviously you have to say what your wage is, but when they do a credit check they can see exactly what you owe.” (Case 11)

“I think they lent us too much money as well, especially with X. Because Y, the most they will lend anybody is £15,000 I think it is; whereas that was the initial rule with X. But as we were trying to consolidate a bit more, he was going to his special book. And because you’re a Gold Card member or something, even though we hadn’t got credit cards, it was the type of bank account we’d got. And because you’ve got this credit rating and that credit rating we are prepared to lend you more. I think they would have lent us about £40,000 or £50,000 if we’d wanted it.” (Case 20)

“I think to look at the overall picture and do something to help me, as opposed to just lending me the money and expecting it to be paid back. The money was too easy to get.” (Case 21)

There was a strong view amongst those I interviewed that the credit checking process should be for the benefit of the borrower, and that it should be done responsibly. The lack of any hurdle in the lending process made it too easy for borrowers to acquire loans without considering whether it was sensible for them to do so.

## Make the consequences clear . . .

Among my sample, there was very little notion of the charges that would be imposed if a borrower fell behind with the minimum payment. There was also no notion of how unpleasant being put in the hands of collection agents could be – or of the speed with which letters offering credit line increases to “valued customers” can become threatening demands for repayment. Many borrowers were shocked that a lender who had apparently treated them well for many years could become so unpleasant and unapproachable so quickly. This was felt most strongly by those who had built a relationship over a number of years with a single lender.

Borrowers from an immigrant background tended to feel that this apparently capricious treatment was because they were foreign – but it seems to be a more general problem.

It was also not well understood that over-borrowing can affect an individual’s credit rating – and that it can be a major obstacle to a borrower in rented accommodation obtaining a mortgage.



Charges on credit cards are a big problem. Borrowers are routinely given limit increases so long as they make a minimum payment; but as soon as they cannot afford the minimum, a charge is put on (typically £20), together with a further charge (another £20) if the interest and charges increase the balance so that it exceeds the limit. Interest is then payable on the charges, and the cycle continues. For example, one borrower I interviewed had run up £700 of interest and charges on a credit card balance of £1,500. This was made up of approximately £480 of charges and £220 of interest at 14pct:

“It’s alright if they start by saying to you ‘Well look Mr X, the good news is we’re going to give you £500. You’ll pay it back at 7.9% APR’. 7.9% APR – I haven’t got a clue what that means. If they’d have sat down and explained it through and through, and then said ‘Well look Mr X, here’s the good points, here’s the bad points. We’re going to give you £500; you do what you want with these cards. But what you also need to know is that your minimum payment is, let’s say, £5 but you also need to know that if you don’t make that payment we will charge you £40 on top of that every time you miss a payment’. And if somebody said that to me, I would have been like ‘Whoa, alright, I tell you what, you keep your card’. I don’t see why I should miss a payment of £5 and have to pay £40 – do you see what I mean?” (Case 34)

The penalties for getting into difficulty with a bank account are equally significant. Borrowers can easily end up with £160-180 of charges and interest over a couple of months – and, with many lenders, the borrower is powerless to stop it continuing. These costs are largely caused by unauthorised overdrafts. Typically there will be either a fee for using the overdraft or a charge per item paid.

The Consumers Association has argued strongly for greater transparency of interest and charges. It has suggested that customers should be given clearly worked-out examples of how long it will take to repay a credit card balance and the accumulated interest cost if he or she continues to pay at the current level. This could be a good way of highlighting the rapid accumulation of interest and charges as soon as repayments drop – and it could stop further borrowing. Certainly, there needs to be more information on the consequences of not being able to meet debt repayments, particularly on credit cards.

## Stop providing automatic limit increases . . .

This is a straightforward point that was frequently made by borrowers:

“...when you’re in a position of debt and you’ve got to buy food, you’ve got to put petrol in the car, your son’s birthday comes up, Christmas comes up, if they stretch the limit you spend to the limit. It’s not a case of saying ‘Oh I’ll leave that there, because you never know there might be a bill in three months’ time; and let’s leave it there as a back-up’. Because when you’re a single parent, every penny counts. If you’ve got that available spending, you use it. You don’t think about the consequences in that sense, because it’s a means to an end. The next couple of months you’re going to buy food, because you’ve got £300 sat on the credit card that you can use. The repayments are something that come secondary.” (Case 15)

“One thing that I think is very wrong is automatically increasing credit limits without reference to you – or presumably without doing any sort of checks first. Because X were happily increasing my credit limit when I had defaulted on loans and where I was making sort of hardship payments to other people. And X was still merrily increasing my credit card limit. That can’t be right can it?” (Case 3)

“They mustn’t put the limit up without people asking for it. I started with £500 and ended up with a £5,000 limit.” (Case 23)

“I wish the lender had not increased my limits without asking me, because in doing so I accepted them, even though I wouldn’t – if they’d rung and asked me, I probably would have thought twice about increasing it. I wouldn’t have done that. In terms of – I don’t know – I think to a certain extent at one time when I had all my credit cards, the amount of money I could have borrowed on all of them was absolutely ridiculous.” (Case 36)

## 13. Recommendations

The recommendations that follow are based on the interviews I conducted and what the borrowers I talked to felt would actually have helped them.

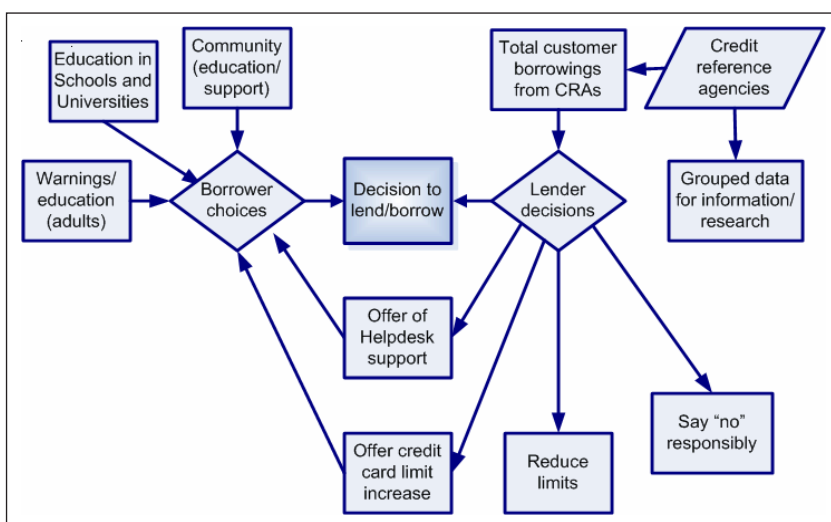
First, a general point: It is important for a lender to appreciate the pressures a potential borrower is under. These pressures can lead to short-term choices that have a very heavy long-term price. Encouraging a borrower to be realistic about his or her position is critical. It cannot be in the interests of any stakeholder for customers to make unrealistic choices. Borrowers are vulnerable, and they deserve better from lenders to ensure that the loan provided is fit for purpose. It cannot be fair to sell an unsecured loan to a vulnerable customer without explaining the enormous risks that are attached to it in terms of future affordability.

Spelling the risks out must also be in the long term interests of the lenders themselves. Over-indebting customers in this way is producing a core of borrowers who are bound to undermine the market – and to play into the hands of those who want to significantly curtail it.

Second, it is equally important to appreciate that the recommendations I am offering are really part of a package. As shown in the diagram, they fit together, and their effectiveness will be greatly enhanced if they are implemented as a package:

My proposals are framed in terms of improving the decision-making of both lenders and borrowers. The underlying idea comes from the Alcohol Harm Reduction Strategy for England, produced in March 2004 by the Prime Minister’s Strategy Unit – which emphasised co-operation between industry and government to cut the number of people suffering the effects of excessive drinking.

Several of these recommendations are not new. However, it is fair to say that progress on the issue of over-indebtedness is very slow – and where progress is being made (e.g. the summary box for credit cards), the impact on the broader problem will inevitably be limited.



## A. Improving the decision-making of borrowers

I have five main recommendations in this area:

1. **Helpdesk/advice (help the borrower to identify the “tipping point”):** The rules governing the sale of investment products currently require the seller to ensure that they are in line with a customer’s requirements. In the case of debt, this is not the case – suggesting that more protection is offered to the wealthy than to the poor. This is difficult to justify given the effects on society of over-indebtedness and the need for people to save for retirement. It is difficult to see why a borrower should be in a different position to an investor, given that an unsecured loan has the potential to cause enormous harm.

I believe that it must be incumbent on all lenders to offer an independent helpdesk to borrowers in the following circumstances:

- when the request for an increase in borrowing is substantial (any amount above £500, for example, which would exclude most store card and catalogue debts);
- when the borrower has experienced a period of making only the minimum payment on credit cards;
- when there has been a marked build up in overdraft usage;
- when the borrower has fallen into arrears; and/or
- if the borrower is below a certain age (say 25).

The borrower may, of course, choose not to receive advice – or not to take the advice that has been offered. The advice would need to cover two topics:

- **Budgeting assistance:** This would consider the ability of the borrower to repay his or her debts and to understand the repayment implications. It would be aimed at ensuring that the borrower understood how long it would take to repay the debt and would identify whether the household budget was realistic. The helpdesk might suggest the alternative of saving for a particular expenditure – recognising that, for many borrowers, the risk of borrowing is too great.
- **Explaining consequences:** This would provide an opportunity for a borrower to understand what would happen if he or she is unable to meet the minimum repayment. Most borrowers have no idea about collection agencies, the accumulation of interest or penalty charges. The depth of explanation needs to be considered, but the main issue is that the borrower should be under no illusion that the decision to acquire debt is an important one – with the potential for major negative life consequences.

The helpdesk would be funded by lenders, but would need to be independent of the lending decision – perhaps outsourced to an independent party. The key point is that it should be a wake-up call to the seriousness of the borrowing decision. There is a well-justified lack of trust by customers in lenders, which means that without regulation requiring lenders to provide evidenced assistance to borrowers, it is difficult to envisage advice being offered that is truly in the borrowers’ interests. It is difficult to be conclusive, but it is possible there would be little net cost to lenders from this proposal. There should certainly be savings in future write-offs, and there could be savings in the cost of recoveries. Where there could be a cost to the lender, it would be in the dubious practice of charging escalating fees and interest as a borrower gets deeper into difficulty.

Marketing departments in lenders may take the view that funding a helpdesk will upset the good customer who is on top of the situation. However, one major bank concluded that, whether or not they use the service, customers appreciate evidence that a lender is trying to assist them.

In my discussions, several have suggested that such assistance should be made available by lenders to *all*

borrowers. A strong argument can be made for this given the long-term nature of the relationship and the difficulty of identifying borrowers who would benefit. It is difficult to see an objection to this other than cost.

To some extent a lender could control the cost of a helpdesk by:

- specifying the type of the borrowers who could use the service;
- setting up a web-based service – with a personalised helpdesk being available if the customer needed further support; and
- ensuring that, at the point of sale, customers are specifically probed for signs of difficulty – and, if there are problems, are pointed in the direction of the helpdesk.

Initially, it is possible that the helpdesk could be covered by a voluntary Code of Conduct. If it was shown that lenders were not making it available to borrowers, it could become a regulatory requirement.

2. **Education for adults:** There is a huge need to educate people as to the consequences of debt. Many people are financing routine expenditures with unsustainable levels of debt. There needs to be much better information, treated in a similar way to health education. This could be funded (in whole or in part) by a levy on lenders or through an industry body, such as the Banking Code Standards Board.

Earlier, I referred to almost £1 billion a year being spent by the industry to advertise secured and unsecured loan products. In this context, a significant spend on customer information and warnings appears eminently reasonable – particularly when one looks at some of the present advertising for high-risk unsecured loans. One such, for instance, shows, at the top of the screen, “pennies (or pounds) from heaven” – with beautiful blue pound symbols cascading appealingly down the sides. A balanced response might show between one in 10 and one in 25 unpleasant red pound symbols ascending alarmingly from the bottom to represent the statistical probability of a customer failing to meet the payments.

My belief, based on the cases I have looked at, is that borrowers must be encouraged not to be “naïve” or “foolhardy” when taking life decisions. This needs a greater understanding of the health, family and stress-related consequences of excessive borrowing. This is more than just financial literacy. It relates to life choices and the implications of taking personal risk with finances. In the context of borrowing, it involves the need to understand budgeting – and that it may be better to forego consumption, even when credit is available.

To support the initiatives from lenders there must also be greater public awareness on the lines of “Don’t get into the debt trap - think before you borrow”.

The emphasis should be on why thinking is necessary, and it must ram home the message that savings should be the main way of dealing with unexpected changes in income or expenditure. It may be useful to target parents, since they are the model of money management for their children. The type of content for a public information leaflet that could be distributed by lenders is contained in Appendix 4. In some respects, this is no different to the obligation on drug companies to warn of side effects.

It may be that lenders would balk at mandatory warnings. But I believe all their likely arguments can be countered:

- “The problem is not sufficiently large”: Nonsense; at present at least 2-4 million people are affected, and there is the potential for even greater impact – with serious consequences.
- “We cannot justify the expenditure”: How serious does the problem have to become before more public information/advice can be justified?
- “We do not want people to be put off borrowing”: Why not? Part of my argument is that savings should be the primary support for those who find themselves in temporary financial distress. In any case, it is unlikely that more information in isolation will have a significant effect.

3. **Debt education in schools/colleges:** This is an area currently being given attention by the Personal Finance Education Group, the FSA and other organisations – all of whom recognise that we have to change attitudes and behaviour. The pressure from society for immediate consumption must be resistible – at least by those who cannot afford it.

It is enormously important to teach how choices in later life can be constrained by acquiring too much debt too early. A student loan is only a small component of this potential debt burden. More broadly, managing debt in the context of a budget is crucial for all young people, and not just students. Most important is education about the consequences of not being able to meet repayment schedules; the result being escalating interest costs and sky-high charges. Further research may be needed into the most effective form of education for young people in this area. There is already some evidence that the children of parents who have got themselves into financial difficulties are more careful; it must be possible to educate others without such direct experience.

For students, it is clear that help should be given to them as they enter college. There are wider issues, but it is particularly important that students are encouraged to keep first year expenditure in check. Lenders could do much more to help students recognise the need for budgeting from the start of college.

4. **Encouragement of employers, charities and community groups to provide support:** There are many organisations that can be used to empower people to make a rational decision over whether more debt is appropriate. Employers, for instance, have an interest. There is some activity in this area, for example, with the armed forces; but there is more potential. The consequences for productivity from debt-related stress can be serious, and a caring employer is likely to benefit from being able to provide support. Other bodies – housing associations, religious groups, doctor's surgeries etc – can also be used to provide support and to educate people to make better choices on debt.
5. **Credit line increases on credit cards must require agreement of the borrower:** It is a huge temptation to spend when somebody who has run up a full limit and is only paying the minimum balance on a credit card receives an automatic credit line increase. Such a customer may be profitable as he or she soldiers forward under a growing debt burden; but the credit limit increase is surely irresponsible.

Credit card companies in our society are allowed the most extraordinary latitude. It is as though a department store were permitted to send customers a large selection of goods – with the request that they return any they do not want. It takes considerable willpower to return them all – even if the customer cannot really afford any. This practice of automatically increasing credit lines must not be permitted, and, in all instances, the borrower must contact the lender to specifically agree a limit increase. This is already the case in some European countries, where the signature of the borrower is required before any extra lending has a legal basis.

The main objection to this is convenience. If it could be proved that automatic credit increases were in the clear interests of the majority, this might be a good argument. However, I do not for a moment believe that this could be demonstrated. What is clear is that having to “opt in” to a credit increase will sharply reduce debt take-up – and that would undoubtedly be a positive development.

Some of the borrowers for whom accepting the increase would not be in their interest would agree to it. However, this recommendation is linked with Recommendations 1 and 2 above. The offer to increase the credit limit would be linked to making available the use of the credit helpdesk and issuing information/warnings that would make it clear that over-borrowing has serious consequences for the borrower.

## B. Improving the decision-making of lenders

I have seven key recommendations in this area:

1. **There must be a total view of debt:** It is a major weakness for lenders that there is no central database of outstanding loans. It is not possible for a lender to have a well-informed relationship with a borrower without this

information. Whether deliberately or not, borrowers have a tendency to understate the amount of out-standing debt and it is crucial that a reliable source of information exists. In order to ensure this, it may be necessary to require all lenders to share positive (balance, limit and payment profile) information. This could be done by legislation or regulation; but the most important issue is that lenders should respond as quickly as systems permit. This is so important that it should not be left to voluntary agreement. Creation of such a database is a common good.

A potential issue is data protection. This is a matter for government (or the Information Commissioner) to address as priority. Consumer bodies regard this kind of data-sharing as being in the public interest, and as an example of the industry being responsible. It would, therefore, be surprising for anybody to challenge the use of information for this purpose; but if they were to do so, a solution could be found – provided the government regarded the topic of over-indebtedness as important.

This sort of approach already exists elsewhere. In Belgium, for instance, a ‘Centrale’ database has operated since mid-2003, collecting both positive and negative data. Lenders are required to consult the Centrale before lending. There could be a similar requirement in the UK that lenders know the amount of debt (and limits) that a borrower has on existing facilities at the time of the new loan. This might mean that co-operation by financial institutions with the credit rating agencies would be a statutory/regulatory requirement.

There are currently three competing credit reference agencies for personal customers in the UK (Experian, Equifax and Callcredit). They are commercial organisations that provide customer data to financial institutions (much of the information having been collected from financial institutions themselves). The CRAs currently provide excellent data on credit history, but do not provide a comprehensive view of total debt or credit facilities. The fact that three CRAs exist may be sufficient competition in itself, but service and standards should be monitored, probably by the FSA.

A requirement that lenders should have a total view of borrowing and credit limits will not be sufficient; it must also be used in decision-making. Lenders should have to form a view that certain levels of borrowing are not in a customer’s interest.

Many borrowers are already under the impression that the reason that lenders can give such a quick response to a credit request is that they have a clear view of the overall debt level of the customer. As a result, they are unlikely to oppose such an initiative. The main objection to data-sharing is the potential for misuse of the data. There are already safeguards to ensure that shared credit data is not used to identify marketing opportunities. If these safeguards require greater formalisation in order to enforce the sharing of positive data, this would be a reasonable trade-off.

2. **Lenders must not knowingly over-indebt:** There must be a point at which a lender decides that the level of a customer’s indebtedness is too high – and that, despite the lack of any default, no more credit will be granted. Making further advances to borrowers with high ratios of unsecured debt to income involves a duty of care

I propose that, if a customer can show that a lender could not reasonably have expected him to perform on the debt, the debt will not need to be repaid. The courts should have the discretion to insist that lenders write off loans advanced under these circumstances. This is already part of the law in France and Belgium. It is clear from my research that, in many circumstances, lending has been entirely inappropriate. It is not fair that a borrower should suffer many years of hardship owing to the lender not taking sufficient care with the lending decision.

An alternative might be to expect the last unsecured lender to take responsibility for all the previous debts of which it was aware. This recommendation may be too difficult to deal with administratively, but it is a useful idea given that this is effectively the case in mortgage lending – where later lenders have charges on the property that rank behind an earlier lender. If this approach were to be adopted, it would make later loans more expensive – and make later lenders much more careful.



There are other possible approaches. In the Conduct of Business rules for mortgages that came into effect on October 31, 2004, for instance, there is a requirement that “a firm (*lender*) must be able to show that before deciding to enter into a regulated mortgage contract with a customer... account was taken of the customer’s ability to repay”. Expansion of this to unsecured credit would be entirely congruent with the FSA’s statement that it “regards it as important that customers should not be exploited by firms that lend in circumstances where they are self-evidently unable (to repay) through income and yet have no alternative means of repayment”.

I propose that it should be a legal requirement that a lender must not knowingly over-indebt a person. This must be reflected in the way the courts use their discretion to deal with the over-indebted. In clear cases of irresponsible lending, a loan should not need to be repaid. This would act as an incentive to lenders, and would avoid borrowers having to repay the most irresponsible of lending.

3. **Lenders must be required to regularly review limits – and to reduce them if the customer shows signs of becoming over-indebted:** This depends on the lender having sufficient data on credit limits and utilisation. It requires institutions to be customer-focused, and not to view a reduction in limits as a loss of potential earnings. Even within a single financial institution, there can be disputes over the need to take a customer view on debt for fear that one business (e.g. a bank account) loses limits to another (e.g. a credit card). This cannot be in the interests of a customer who has the potential to become over-indebted.
4. **Lenders must steer borrowers towards independent help when there is evidence of over-indebtedness:** It is clear that the speed with which borrowers obtain help once they are over-indebted makes a big difference to the amount that they ultimately owe. Two types of borrower would particularly benefit from early advice – those who are making regular payments on one debt by drawing down another, and those who are paralysed by indecision and are running up huge charges and penalty interest

There are several independent money advice agencies available for this service – and indeed some lenders do recommend them to borrowers. Unfortunately, many lenders do not refer – and, in addition, referrals are often too late.

5. **Release of grouped information by the CRAs:** Studies produced in the last two years show how difficult it is to obtain good information on the level and trend of over-indebtedness. The credit reference agencies undoubtedly have the best data. The banks regard themselves as owners of this; but, in the public interest, grouped data should be made available and the government should determine that relevant data from the CRAs is made publicly available.
6. **Further research on over-indebtedness:** There are several areas for further research identified in this report, and a case could be made for a specialist research centre. The key topics where further work is important include:
  - understanding the health (and other social) consequences of over-indebtedness;
  - examining the behaviour of borrowers who do not become over-indebted to identify differences (it is understood that this research has been commissioned by the DTI and is keenly awaited);
  - responsible lending – and the right balance between responsibility and a natural desire by lenders to sell product;
  - comparison with other countries;
  - identifying ways to help vulnerable people before they get into trouble; and
  - the factors that make a successful public information campaign.
7. **A single body responsible for over-seeing activity to reduce over-indebtedness:** It is difficult to see how serious progress will be made without more and better leadership. At present, responsibility is diffused. Even if my recommendations were taken seriously, they require co-ordination and careful implementation – perhaps through a new Consumer Debt Authority. Over-indebtedness must rank along with alcohol, drugs, obesity and smoking as an issue on which consumers need much better understanding. Borrowers deserve a body with a mandate to ensure that, as far as possible, they understand enough to make a good choice.



## Appendix 1

### Methodology

The research was undertaken using multiple case studies. The objective was to generate a theory, rather than to test a theory. The 35 interviews were analysed using a methodology called “grounded theory” that has been developed by Dr. Barney Glaser and Anselm Strauss<sup>1</sup>. This seemed appropriate given the lack of information on the causes of over-indebtedness from multiple creditors in the UK; it would have been difficult to generate a hypothesis to test. Three broad issue areas – pressures on borrowers, personal financial management and borrower temptation – were identified through a detailed analysis of the first 12 interviews. This framework was then used for subsequent cases to provide greater depth and insight. From Case 20 onwards, there was little additional insight, although the combination of pressures faced by borrowers continued to show enormous variety.

The 35 cases were obtained from the Consumer Credit Counselling Service, a non-profit credit advice agency, by writing to approximately 300 of its clients. As a result of becoming over-indebted, these clients had all entered into a debt management plan around October 2003. The reason for choosing this data set was that the borrowers are now in a fairly stable financial position and may be able to look back dispassionately about how they got into financial difficulties. Even so, many borrowers were embarrassed by what had happened to them, and found the interview to be an extremely emotional experience.

The interviews were conducted between July and October 2004. The interview questions are outlined below. The telephone interviews were all tape-recorded and transcribed. The earlier interviews took between one and one and a half hours, and the later interviews generally took just under an hour. For each interview, case notes were generated. In addition, quantitative analysis was performed on the amount of debt that the borrower could afford, given detailed knowledge of his or her income and expenses. In order to test the theory further for wider application, interviews were also conducted with nine borrowers who were not over-indebted.

The initial interviews generated a number of questions for further study, in particular:

- What would have helped encourage these borrowers to be more realistic?
- If temptations cannot be removed, what would help prospective borrowers see them for what they are?
- What would help borrowers identify that financial decisions are in their best long-term interests?

The interview questions were built around two issue areas:

- How would you describe the reasons for your debt problem (summarise in one sentence)?
- Establish income level during the period (chronologically as far as possible)

Detailed questions were then posed in relation to debts:

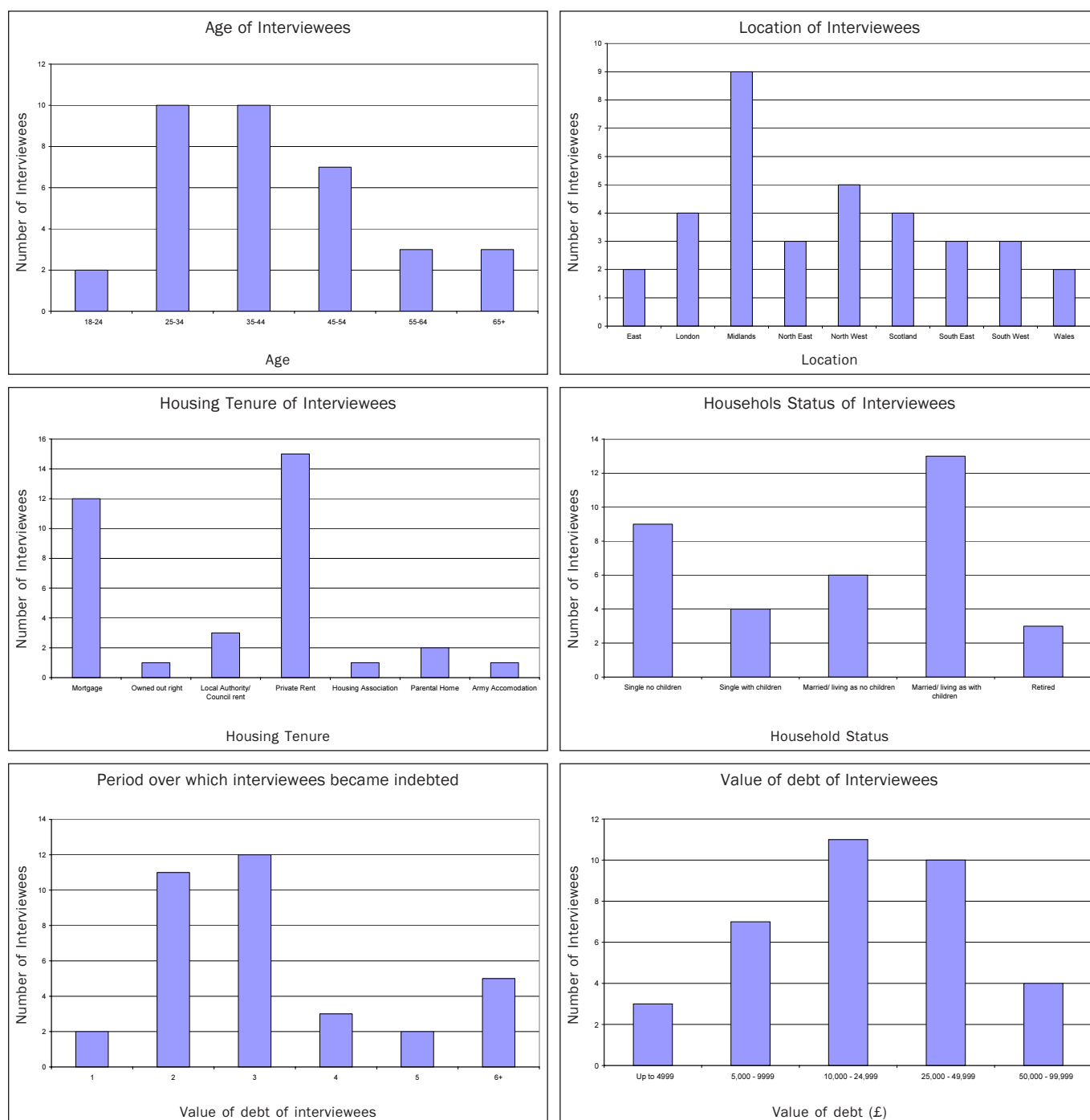
- **For each loan:**
  - What was the expenditure that required the debt? Who was doing the spending? What was your motivation?
  - Describe the process you went through to choose a lender – and the process with the lender as each piece of extra debt was acquired?
  - At the time, were you comfortable with your ability to make payments on the debt?
  - How did you feel about borrowing the money?
  - Did you get pleasure from the expenditure? How did you feel after the money was spent?
  - Did you have any reservations about whether spending in this way was a good thing to have done?
- **General questions:**
  - At what point did you realise that your debt level was too high?
  - What have been the effects of your debt on you and your family?
  - With hindsight, what, if anything, would you have done differently?
  - What do you feel you have learnt from the experience?
  - What, if anything, would you have wished the lender had done differently as you were acquiring the debt?
  - Would you describe yourself as optimistic?
  - How would you characterise yourself in terms of acquiring the debt?

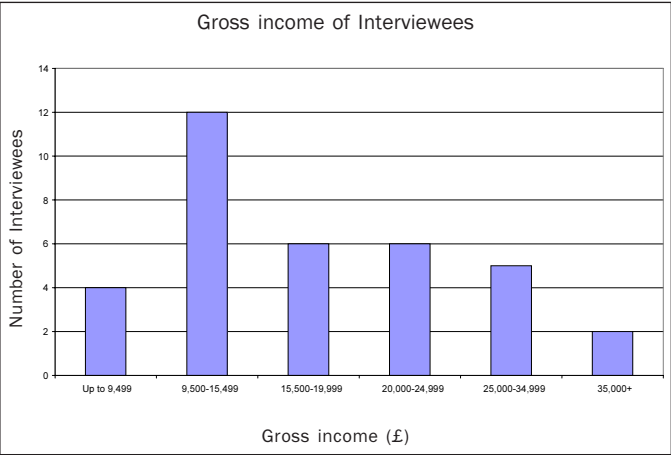
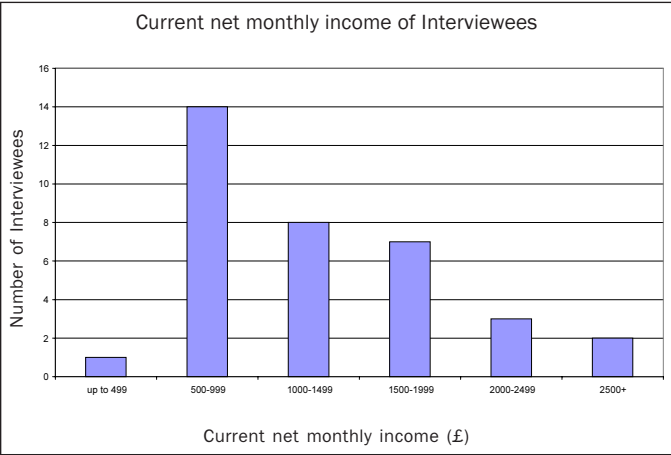
In addition to the detailed interview, each individual's financial circumstances were analysed to identify his or her financial position as the debt was being acquired.

## Appendix 2

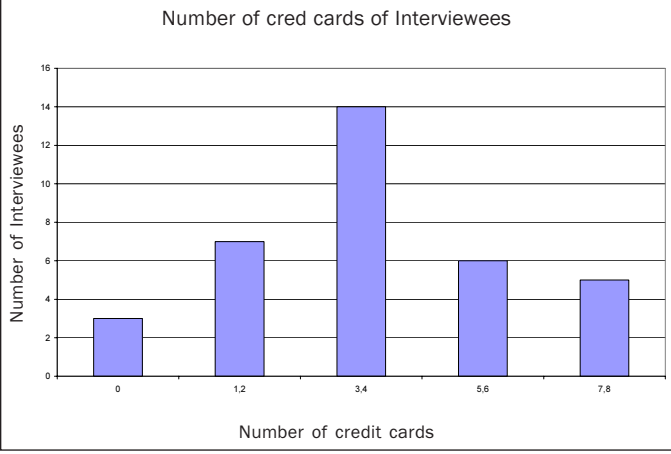
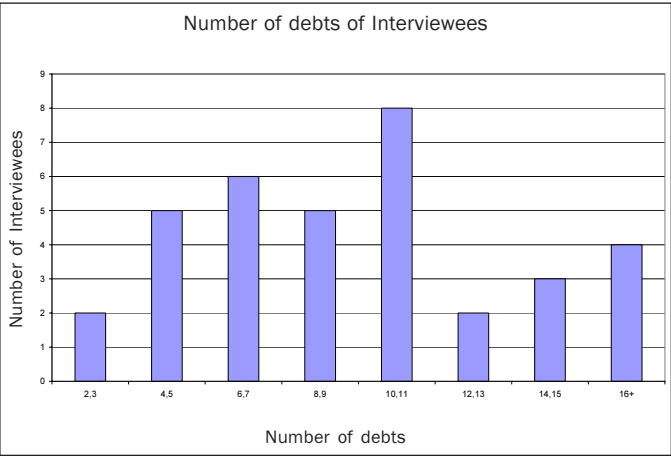
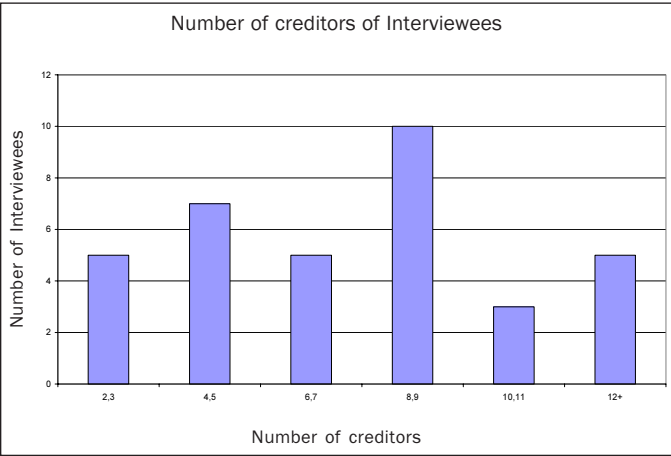
### Interviewees by type

Below is a breakdown of the 35 cases. There was no prior selection involved in choosing cases. The variety came from the willingness of borrowers to be interviewed:





Note: gross income was calculated from a breakdown of monthly net income.



## Appendix 3

### NOP Survey Data

The NOP Financial Research Survey is the largest and longest running monitor of financial product holdings, interviewing a representative sample of 60,000 consumers over 16 years old in every year in Great Britain (5,000 per month).

The time series goes back to 1991, but credit card revolving balance information has only been collected from January 2003. For this reason, it was not possible to produce meaningful time series information for unsecured debt as a whole. The main data utilised was for the six months to June 2004, consisting of 30,000 interviews.

### Definitions:

- Unsecured loans include mail order, DSS and employer loans.
- Credit card data does not include store cards.
- Income is gross household income.

	Share of population	Participation rate (any unsecured debt)	Mean debt: household income ratio of debtors	Share of those with positive debt	Mean debt of those with debt
<b>Overall</b>		25%	0.22	25%	£4646
<b>Age group</b>					
18-24	12%	24%	0.19	11%	£2682
25-34	18%	37%	0.23	26%	£4768
35-44	19%	36%	0.24	27%	£5492
45-54	16%	30%	0.20	20%	£5211
55-64	14%	20%	0.21	11%	£4021
65+	20%	6%	0.27	5%	£2914
<b>Income group (£)</b>					
Up to 4,999	4%	14%	0.51	2%	£1662
4,500-9,499	21%	17%	0.33	11%	£2310
9,500-15,499	17%	26%	0.26	14%	£3193
15,500-19,999	10%	33%	0.23	11%	£4091
20,000-24,999	9%	40%	0.22	11%	£4979
25,000-34,999	14%	40%	0.20	18%	£5264
35,000-49,995	13%	42%	0.17	18%	£6265
50,000-74,999	8%	38%	0.13	9%	£7413
75,000+	4%	34%	0.10	4%	£7816
<b>Tenure</b>					
Mortgage	36%	35%	0.20	51%	£5566
Owned out right	28%	13%	0.24	14%	£4250
Rent LA	19%	22%	0.25	17%	£3083
Rent Private	10%	28%	0.20	11%	£3814
House Ass.	6%	27%	0.26	6%	£3782
<b>Housing Status</b>					
Single no children not retired	20%	26%	0.24	21%	£3988
Single with children not retired	7%	32%	0.27	9%	£2984
Married/living as, no children, not retired	25%	31%	0.2	30%	£5361
Married/living as, children, not retired	24%	35%	0.21	34%	£5156
Retired	25%	7%	0.26	6%	£3043

## Appendix 4

### Customer information: Suggested content

Information to be provided to all borrowers might read along the following lines:

"For the vast majority, borrowing is not a problem. We want you to be entirely comfortable that you are making a good decision when acquiring further credit.

"For approximately four per cent of households (1 in 25), however, further borrowing requires careful consideration and may make a difficult situation worse. A household needs to consider all debt when considering further borrowing – including loans, hire purchase, overdrafts and balances on credit and store cards that cannot be paid off.

"Borrowers who become over-indebted frequently suffer from stress and relationship problems. This is a risk that you should consider before borrowing. An alternative approach may be to regularly save for a purchase; many financial organisations will be able to assist you.

"You should be particularly careful if you have suffered or may suffer a reduction in income, for example from one of the following:

- redundancy;
- loss of over-time;
- divorce; or
- change of job

"Or if you are under a financial pressure, for example, from:

- having a baby;
- children of any age;
- a new home to furnish or equip;
- suffering from compulsive shopping (a condition that results in finding it difficult not to keep making purchases).

"It is never advisable to borrow on a credit card to finance a business.

"It is not recommended to borrow long-term (more than a few months) following cash withdrawal on a credit card. The cash withdrawal is only advisable to meet a short term pressure.

"It is very rarely advisable to borrow on a credit card to pay off other debts – an exception being a transfer of a loan to a credit card to attract a lower rate.

"Credit card limits do not have to be accepted; many people find them too tempting and are unable to keep the credit card only for use in emergency. Contact your credit card lender to have them reduced if you do not feel able to manage. Many lenders are reluctant to reduce limits and you may find this difficult to achieve.

"You cannot rely on your lender to know your financial position. The fact that a lender may offer a loan to you does not mean that it is in your interests.

"If you would like help with your budget, understanding your loan repayments or charges, or understanding the consequences of being unable to meet your debt repayments, please contact our Credit Helpdesk."

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- <sup>11</sup> Families in Debt (Jubilee Centre Research Paper No.7, 1988)
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- <sup>14</sup> In too deep – CAB Clients' Experience of Debt (Citizens Advice Bureaux, May 2003)
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Antony Elliott FCIB has spent 20 years working for a number of banks in the field of risk control. For 13 years, he was with Abbey plc. For the last 10 years, he had the role of group risk director or chief risk officer. He had overall responsibility for the control of consumer credit risk during this period. Prior to joining Abbey, he was head of risk policy for group treasury and capital markets at NatWest Bank.

For many years, he contributed to or was chairman of committees providing industry input to the supervision of banks, particularly at the British Bankers' Association and the Institute of International Finance. He was particularly active in contributing to the industry responses to the revised Basel Accord. He has a BSc in Banking and International Finance from City University and an MSc in Operational Research from Imperial College, London.



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Thanks are due to the 46 people who were prepared to be interviewed. For many, it is a source of embarrassment to discuss personal financial circumstances, and it was inspiring that so many were prepared help so that others may benefit:

“...if one person gets something out of this or if something gets changed, if one person doesn't get into the same trap that I did then, as far as I'm concerned, I'll talk to you for another hour.” (Case 2)

“...if I can help save one person from getting into the pickle that I did then at least it's not all been for nothing.” (Case 30)

The Consumer Credit Counselling Service provides an excellent service to the over-indebted. For the most distressed borrowers, it would not be an exaggeration to describe the CCCs as a life-saver. Thanks to the CCCS for allowing me to access its clients. However, the conclusions and recommendations in this report are entirely my own.

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