Breakthrough Britain 2015

RESTORING THE BALANCE

Tackling problem debt

July 2014

THE CENTRE FOR SOCIAL JUSTICE

In memory of Mark Duncan

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

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

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

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About the Centre for Social Justice

The Centre for Social Justice (CSJ) aims to put social justice at the heart of British politics. Our policy development is rooted in the wisdom of those working to tackle Britain's deepest social problems and the experience of those whose lives have been affected by poverty. Our Working Groups are non-partisan, comprising prominent academics, practitioners and policy makers who have expertise in the relevant fields. We consult nationally and internationally, especially with charities and social enterprises, who are the champions of the welfare society.

In addition to policy development, the CSJ has built an alliance of poverty fighting organisations that reverse social breakdown and transform communities. We believe that the surest way the Government can reverse social breakdown and poverty is to enable such individuals, communities and voluntary groups to help themselves.

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

Director: Christian Guy

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Breakthrough Britain 2015

The Centre for Social Justice shone a light on the shocking levels of deprivation that blight communities across the UK in 2007 in our report *Breakthrough Britain*. The project transformed the British political landscape, reinvigorated a tired debate on how to tackle poverty and was hailed as a definitive research paper on social problems in modern Britain.

This unprecedented diagnosis of deprivation led us to identify five interlinked 'pathways to poverty'. These were:

- Family breakdown;
- Economic dependency and worklessness;
- Educational failure;
- Drug and alcohol addiction; and
- Serious personal debt.

Alongside this, we made recommendations about unlocking the potential of the voluntary sector to reverse social breakdown.

These reports revealed how, despite the longest period of continuous economic growth in modern history – more than 60 quarters – and unparalleled levels of government spending, a large proportion of British society remained cut off from the mainstream. We argued that what was trapping people was not necessarily the economy but their exposure to long-term worklessness, family breakdown, poor education, addiction and serious debt, and that too often government intervention was focussed on trying to alleviate the symptoms of poverty, rather than these causes.

Seven years on, the UK is in a radically different political and economic position – but the need to give a voice to the most disadvantaged people could not be greater. For this reason we have spent the past two years researching *Breakthrough Britain 2015* – a fresh assessment of how the five pathways are continuing to hold people, families and communities back.

Following on from our six 'state of the nation' reports last year, over the coming months we will publish recommendations to all political parties, again showing how people can be helped back to work, families kept together, educational achievement improved, addiction and personal debt relieved. The work will amount to an exciting and radical programme for any Government in 2015.

These six policy reports are the culmination of an extraordinary process. Our team has travelled tens of thousands of miles around the country, visiting our most deprived communities – from Rhyl to Ramsgate, from Margate to parts of Manchester, from Great Yarmouth to Glasgow – to discover first-hand what is fuelling poverty. We have carried out extensive public polling, conducted several thousand meetings with charities, frontline workers and policy experts, and heard from huge numbers of people struggling to get their lives back on track. For further inspiration we have looked abroad, taking evidence from successful projects around the world including those in Australia, the Netherlands, various parts of the USA, Ireland, and Singapore.

As well as our own committed staff, the CSJ has recruited well-known specialists in each of the six areas to be on working groups who have met regularly to take evidence from those who understand the problems best. These dedicated individuals have used their extensive knowledge and contacts to ensure our research is relevant, focussed and influential.

Throughout this process we have constantly been given heart by the remarkable work people are doing to help rebuild the lives of those who have become trapped in poverty. The practical solutions presented in these reports are grounded in their experiences and they are a call to politicians to ensure that the next government continues the fight against poverty by tackling it at its roots.

Director's preface

This report is about freedom. Freedom to make good choices about money. Freedom to access safe and sensible credit. And freedom from toxic debt and the intense pressure associated with it. This is important because many people in our poorest communities lack those freedoms, even today.

Problem debt holds back too many families. Around nine million people across the country, of all age and backgrounds, are struggling with personal debt. The CSJ heard from a single mother about her rapid descent into debt after ill health caused her to lose her job. She had already cut down her spending, eating nothing but rice in order to provide for her children, but resorted to borrowing from a doorstep lender in order to buy a few meager Christmas presents for her girls. The loan and harassment spiraled out of control until she was helped by debt advisers at Christians Against Poverty

The difficult truth for policy makers today is that the problem appears to be getting worse on some key measures. Overall personal debt has almost doubled in the past decade and there are now 2.2 million more people estimated to be in need of debt advice than in 2011. The number of people filing for a Debt Relief Order – a special form of bankruptcy for the poorest member of society – has also increased every year but one since it was introduced in 2009. We know that unsecured consumer debt almost tripled in the last 20 years, reaching nearly £160 billion today. Worryingly, indebted households in the poorest 10 per cent of the country have average debts worth more than four times their annual income.

Before the 2008 crash, as the Centre for Social Justice outlined in our report Breakthrough Britain, that pockets of intergenerational worklessness, easy high-cost credit, illegal money lending, low financial literacy, a lack of reliable community-based advice, a constant struggle to save and entrenched social breakdown pushed many into this kind of debt trouble. Since then problem debt has taken even greater root in mainstream society as people are forced to borrow to get by.

In this report we argue that it is vital, therefore, that politicians planning for Government in 2015 commit to the following objectives: Helping household build savings, improving financial education for people of all ages, expanding the provision of independent debt advice and creating a more competitive market to ensure people on low incomes have access to a range of new social finance providers offering affordable credit and better banking services. We make a number of crucial recommendations to meet our objectives.

They include: cutting red tape to allow successful credit unions to develop into a network of Community Banks, facilitating peer-to-peer social investment in Community Banks, credit unions and CDFIs to help them grow, ensuring energy, telecoms and other companies that cause debt also contribute to debt advice services, improving financial education in schools through the use of the voluntary sector and creating a new savings culture through auto-enrollment in an employer-based savings scheme.

In publishing this report I would like to thank Chris Pond for his leadership of the Working Group and the group members themselves. I would also like to thank the report's author Joseph Henson for this hard work and immense dedication to the topic, and to the wider CSJ team including our Policy Director Alex Burghart.

As with our interim report, however, I want to pay special tribute to our former colleague Mark Duncan. Mark was a superb CSJ researcher who tragically died during the course of this project. We continue to miss Mark and all he gave to our organisation. We hope that in a very small way the dedication of this report and our previous one, which he began, will increase the already enormous pride his family already have in all that he achieved. He would want this work to change the lives of the poorest people in our country. In that hope we present it to all political parties and ask them to consider the ideas within it.

Christian Guy
Director

Members of the Working Group

Chris Pond, Working Group Chairman
Chairman, The Money Charity

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

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

Joseph Henson, author and researcher

Joseph has worked at the CSJ since April 2013 and currently leads the organisation's research on serious personal debt. He authored *Maxed Out: Serious Personal Debt in Britain,* which explored both the root causes and devastating effects for Britain's poorest people and communities. He previously co-authored the CSJ's report, *Turning the Tide: Social justice in five seaside towns,* which examined the distinctive economic and social factors that have contributed to the entrenched poverty in Britain's previously proud holiday resorts.

Before beginning his career in public policy, Joseph completed a Masters programme in European Union Law and Integration at the Europa-Institut in Germany. Prior to this he earned a Bachelor of Laws at BPP Law School in London and a Bachelor of Arts in Economics and History from the University of California.

Sharon Collard,
Professor of Personal Finance Capability, Open University Business School

Since May 2014, Sharon Collard has been Professor of Personal Finance Capability at the Open University's True Potential Centre for the Public Understanding of Finance (PUFin). From 1998 to 2014, Sharon worked at the University of Bristol's Personal Finance Research Centre, from 2010 to 2014 as its Director.

Sharon's background is social policy. She has 16 years' experience of policy-focused social research on personal finance and has conducted extensive research on financial inclusion, consumer credit use and problem debt, and financial capability. Her recent research includes understanding motivations and barriers to engagement in the consumer debt marketplace; the work decisions of low-income two-parent households; working households' experiences of debt problems; the impact of a cap on the total cost of high-cost credit; and the financial dimensions of wellbeing in older age.

Sharon regularly acts as an expert adviser on personal finance topics. In 2010–2012 she was an expert adviser to the World Bank-led Russia Trust Fund on Financial Literacy and Education, a large programme of work to measure financial capability and evaluate initiatives to improve financial capability. She is a member of the Future of Debt Management Steering Group, co-facilitated by Nationwide and StepChange Debt Charity and the Citizens Advice Financial Skills for Life Steering Group. In 2014, she was an academic adviser to the FCA on its work to develop a price cap on payday loans.

Joanna Elson OBE, Chief Executive, Money Advice Trust

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

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

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

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

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

Damon Gibbons,
Director, Centre for Responsible Credit

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

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

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

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

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

Phillip Holdsworth,
Head of External Affairs, Christians Against Poverty

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

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

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

Phil experienced what it is like to be a youngster in a family plagued by debt due to broken relationships, death and violence. He saw his mother work non-stop in order to provide for her kids at the expense of seeing them grow up. Then later in life as a father, himself, trying everything in his power despite redundancies and the family's debt to protect his children from the reactions and stigma of others.

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

Sian Williams,
Head of National Services, Toynbee Hall

Sian Williams is Head of National Services at Toynbee Hall, the world's first purpose-built university settlement and a pioneer in reducing poverty and disadvantage for over 125 years. She has been responsible for Toynbee Hall's financial inclusion programmes since October 2009, including Transact (the national forum for financial inclusion), financial inclusion training, research, evaluation and strategic consultancy.

During her time at Toynbee Hall Sian has pioneered a new approach to financial inclusion that looks not just at helping individuals increase their skills, but also at the policies of organisations and institutions that can make it difficult for people to make good financial choices, and has co-led the development of the Financially Inclusive Tower Hamlets programme, which adopts this approach to tackle poverty.

Sian shares Toynbee Hall's financial inclusion expertise through forums such as the British Bankers' Association's Consumer Panel, the FCA Consumer Organisation Network, the Payments Council Consumer Forum, and works with government, industry and consumer groups in pursuit of Toynbee Hall's vision of full financial inclusion. Sian has most recently been supporting the Department for Work and Pensions' work on Universal Credit and credit unions, as well as working with HM Treasury and the banking sector on improving access to basic bank accounts. Sian also advises the financial services sector on financial inclusion issues, and is a trustee for the Money Advice Trust.

Sian previously undertook a range of policy, management, training and representational roles in the UK and overseas within her 15 year career as a British diplomat with the Foreign and Commonwealth Office.

This report was written by the Centre for Social Justice. Working Group members input to its production but do not necessarily agree with all of the report content or its recommendations.

Special thanks

The CSJ would like to extend its heartfelt thanks to the many people and organisations who gave their time, expertise and research findings during evidence sessions with the Working Group and in interviews. Special thanks are due to several debt advice charities – StepChange, National Debtline and Christians Against Poverty – as well as Niall Alexander, Angela Clements and the dedicated staff at credit unions and CDFIs across Britain who provided expert insight and case studies.

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

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

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

This project was supported by Barrow Cadbury Trust. Barrow Cadbury Trust is an independent, charitable foundation committed to bringing about socially just change.

Chairman's foreword

Nine million of our fellow citizens are in serious financial debt, although many of them fail to recognise the depth of their plight or seek help to deal with it. Another 8 million are at risk of finding themselves in the same position, living only one pay-cheque or benefit payment from financial disaster. In our first report, *Maxed Out*, we highlighted the scale of serious personal debt in the UK. Now we turn to the more difficult challenge of what to do about it.

Our working group, made up of experts helping those in debt on a daily basis, those who have researched and analysed the problem, policy professionals and academics, have considered what needs to be done if we are to tackle a rising tide of personal debt that threatens to engulf not only those individuals and families directly affected, but the prospects of a more sustainable economic recovery overall. All of us will pay a heavy price if we turn a blind eye to the personal debt crisis and turn our backs on those directly affected.

Our proposals include measures to change the way we deal with those already in debt, finding ways to help people escape the debt trap which ensnares them. We have considered how we might build a savings culture in Britain, encouraging and helping people to put aside some resources during those periods of their lives when they are able to do so, in order to provide some resilience during those times when they need a cushion of support. We recognise that credit is an essential part of the way in which modern economies work, but that, if credit is not to become problem debt, it must be affordable. We have proposed how we might encourage and promote access to affordable sources of credit, through credit unions and other sources of social finance, what limitations on provision of such credit need to be removed and what incentives for its provision are necessary. Finally, we consider how we can promote a healthy financial environment and improve people's resilience against financial shocks (illness or unemployment, relationship breakdown or the arrival of a child) by equipping them with the skills and tools they need to navigate today's complex financial world. This is not only about better financial education throughout life; it is also about ensuring that financial service providers take greater responsibility for treating customers fairly and are held accountable for the mis-selling of inappropriate products. We also propose the development of a range of 'essential' financial products that can act as a baseline for those at the threshold of financial inclusion – products that customers can understand and trust.

The Working Group is grateful for the support of the team at CSJ, and particularly the report's author Joseph Henson. We also appreciate the support of Kreab Gavin Anderson in hosting most of the meetings of the group. Most importantly, we'd like to thank the many

expert witnesses who lent their time and expertise to help us understand the measures needed to support those who are drowning in debt.

We don't pretend that our proposals break new ground, but they are practical, workable and we believe effective reforms. Our report is timed to contribute to the debate over coming months as to what politicians and policy makers need to do if they are to avoid the crisis of personal debt hanging over so many of our citizens becoming a national crisis that impedes our ability to emerge fully from the economic recession. We hope they will listen.

Chris Pond

Executive summary

Introduction

Almost nine million people across the UK are struggling with problem debt.[1] As the CSJ has identified in previous reports, the human impact of this can be overwhelming, hitting people's mental health, their performance at work and placing a strain on their personal relationships.[2] Serious personal debt is not just a consequence of poverty it is also the driving force behind some of the most entrenched poverty in Britain today.

Wide ranging reform is needed to rescue the millions who are trapped in problem debt. Most importantly, the poorest in society need access to affordable credit and banking services that will not drive them into debt. This will not happen by simply capping interest rates or pressuring financial institutions to serve low-income customers out of corporate social responsibility. To remedy this, the CSJ sets out a bold vision for social finance in the UK, provided by a range of social enterprises and ethical for-profit firms we identify as Social Finance Providers (SFPs).

The growing issue of problem debt

In 2013 the CSJ published our diagnostic report, *Maxed Out*, which revealed the extent and depth of problem debt in the UK. We identified:

- Household debt has doubled in a decade to £1.43 trillion;[3]
- Consumer debt has trebled since 1993, reaching £158 billion;[4]
- As many as two million people are engaged with a debt repayment plan;[5]
- More than eight million households now have no savings at all;[6]
- Three-quarters of debt advice clients in a relationship reported it was negatively affected by their debts;[7]

1 The Money Advice Service (MAS), *Indebted Lives: The complexities of life in* debt, London: MAS, 2013
2 Centre for Social Justice, *Maxed Out*, London: Centre for Social Justice, 2013
3 The Money Charity, *Debt Statistics – October 2013*, London, The Money Charity, 2013
4 Bank of England, *LPQBI2O: Quarterly amounts outstanding of total (excluding the Student Loans Company) sterling net unsecured lending to individuals (in sterling millions) seasonally adjusted*, London: Bank of England, 2013
5 R3, Personal debt snapshot wave 7, London: R3, 2012. Note: *Given the unregulated nature of DMPs and lack of official statistics, prevalence estimates vary widely, from 300,000 up to two million*
6 The Department for Work and Pensions (DWP), *Family Resource Survey 2011/2012,* DWP, 2013, Table 2.8
7 Marriage Week, Press Release, *For Richer for Poorer – How Money Stress Wrecks Marriages*, 2013

- Almost half of people with debt problems report it impacting on their health;[8]
- One survey suggested that one in three debt advice clients has attempted or contemplated suicide.[9]

Problem debt refers to debts that have begun to spiral out of control and which a person no longer has any realistic hope of repaying without some form of intervention to stop the compounding effect of interest and penalty charges. This is distinct from debts taken on when starting a business, to buy a house or spread out the repayment for a car or other large purchase.

In order to tackle these problems, this report sets out a bold vision for how people can be protected from and helped out of problem debt:

- **More affordable finance for low-income households:** too many of the UK's poorest people have to rely on high-cost credit and incur extortionate penalty fees when using basic banking services. This is because, they either cannot get bank accounts or loans from mainstream banks, or what is offered is completely unsuitable for them. We propose sweeping reforms that will create a new generation of 'Community Banks' and a diverse market of socially responsible financial institutions who will be able to compete with high-cost lenders and drive down the cost of credit and banking for many of the most vulnerable people;

- **Helping people to escape from debt**: to support people already struggling under the weight of their personal debt, we propose recommendations to help them access free debt advice, protect them from exploitative debt management companies, and ensure that far fewer people become trapped in problem debt;

- **Managing finances and avoiding debt**: too many people fall into debt who do not need to. This can be for reasons such as because they do not understand complex financial products (such as an overdraft or ISA) or because they have been mis-sold financial products.[10] We propose ambitious market reforms that will create a duty of care amongst providers, new quality standards for financial products and increased support for programmes that help especially vulnerable groups develop their financial capability;

- **Building a nation of savers:** because people on low incomes or those who rely on benefits often have to rely on high-cost providers, such as payday lenders, they can easily become stuck in debt if they experience an income shock (such as the washing machine breaking down), we propose policies that will help Britain rebuild its savings culture.

8 Legal Services Research Centre, *Helping Hand: The Impact of Debt Advice on People's Lives*, London: Legal Services Research Centre, 2007
9 World Suicide Prevention Day, Press Release, *Thousands of suicidal people each year saved each year – by tackling their debt problems*, World Suicide Prevention Day, 2013
10 *Note: In this report we use the term 'mis-selling' to refer both to actions that are currently illegal, and situations where due care has not been taken and a customer has been sold an inappropriate product*

More affordable finance for the most vulnerable

Millions of low-income households currently struggle to access traditional high-street banking and mainstream credit or pay disproportionate amounts to do so because of high penalty charges and fees that can drive them into a debt spiral. Exclusion from mainstream finance can lead to increased costs for everyday living – known as the poverty premium – place additional financial hardship on families and make it harder for them to recover from income shortfalls and manage their day-to-day finances. It also makes millions dependent upon taking loans at exploitative levels of interest to pay for unexpected shocks to their income.

- It is estimated that between four and seven million people regularly incur bank penalty charges that negate the financial benefits of banking, with around one million people incurring financially crippling levels of penalty charges;[11]

- We estimate that in 2012 more than two million people took out a high-cost loan as they were unable to access any other forms of credit. More than three million users of high-cost credit are in serious financial difficulties;[12]

- An estimated 310,000 people borrow from illegal moneylenders, which is likely to increase if the Financial Conduct Authority's (FCA) proposed cap on interest rates for payday lenders is implemented and reduces the supply of credit (for this reason we propose an expansion of alternative finance below);[13]

- More than 1.8 million social housing tenants are unable to access basic financial service online because they are unable to complete automated checks.[14]

Imposing new interest rate caps, extra requirements or levies on mainstream financial institutions will do little to tackle the root causes of problem debt. Instead we need to reform regulations and remove barriers that prevent socially responsible financial institutions from competing in the space currently dominated by over-priced high-cost lenders and high-street banks.

In this paper, we set out a bold new vision for social finance, and a competitive market for a range of Social Finance Providers (SFPs) including credit unions, Community Banks and CDFIs, as well as a new generation of for-profit ethical financial institutions. Our reforms would create greater opportunity for socially responsible lenders to compete with high-street banks and providers of high cost credit ,thereby lowering the cost of credit and banking for the poorest in society.

11 Social Finance, *A New Approach to Banking, Extending the use of Jam Jar Accounts in the UK*, London: Social Finance, 2011; DWP, *DWP credit union Expansion Project, Project Steering Committee, Feasibility Study Report*, London: DWP, 2012

12 *Note: CSJ estimate based on applying the percentage of households who responded, "Only kind of credit I can get", to the YouGov Debttrack survey question: "Why did you take out your last loan?" to the number of customers estimated to use one of three high-cost loan products included in the survey (pawnbroker, payday loan, home credit). The number of pawnbroker customers was estimated from the minimum total of loans per year (2 million) and the average number of loans taken per customer per year (2.5); BIS, Credit, debt and financial difficulty in Britain, London: The Department for Business, Innovation and Skills (BIS), 2013;National Pawnbrokers Association (NPA), Pawnbroking: A successful and established profession, London: NPA, 2013; BIS, The impact on business and consumers of a cap on the total cost of credit, London: BIS, 2013; Financial Conduct Authority (FCA), Consultation paper CP 14/10: Proposals for a price cap on high-cost short-term credit, London: FCA, 2014*

13 BIS, *Interim evaluation of the national illegal money lending projects – summary*, London: BIS, 2010

14 Experian, *Credit Scoring Boost for 93% of Social Housing Tenants* [accessed via: http://www.experian.co.uk/blogs/latest-thinking/2013/11/credit-scoring-boost-for-93-of-social-housing-tenants/ (16/07/14)] Note: 35% of 5.2m social tenants that cannot access services online

Community Development Financial Institutions (CDFIs) are social enterprises offering affordable loans to the poorest in society, including the two-thirds of their customers who are benefit dependent. They are currently restricted by regulations and other barriers that prevent them from offering banking and insurance products that their customers want.

Some of the most successful and innovate credit unions are severely limited by existing regulation, primarily designed for smaller less professional credit unions, that prevents them from expanding and offering competitive services to people on low incomes. Because they have membership caps, restrictions on investments and have a maximum interest rate they can charge, they are restricted from growing. At present just over a million people use a credit union, and yet up to eight million people who currently use high-cost credit, would benefit from access to more affordable forms of credit.[15] There is well-acknowledged room for growth: at present credit unions only lend around £600m while the CDFA has estimated that the potential market for social lending is between £3bn and £3.5b.[16]

A Community Bank would be a type of member-owned credit union that is able to offer ethical affordable financial services – including low cost loans, mortgages and bank accounts – to almost every member of the community, regardless of credit history or income. This is because the 'one size fits all' regulations appropriate for smaller credit unions, have limited the growth, sustainability and professionalism of the best and most innovative credit unions in Britain. This status will only be available to a select few credit unions that meet strict requirements to ensure they are well run and have strong stable finances independent of government or charitable subsidy

By reforming these regulations for high performing credit unions who wish to expand, they will be able to attract more customers, thereby bringing in more capital and allowing them to offer more people lower cost credit and banking. The CSJ is calling for a radical overhaul of credit union regulation to allow high performing credit unions to become 'Community Banks' – effectively credit unions unleashed to provide a more comprehensive service to a wider range of people, but also subject to greater supervision to ensure they are well run organisations.

- The Prudential Regulatory Authority (PRA) and FCA should remove the limitations on credit unions over membership, interest rates, and investments that hinder development to create a new generation of Community Banks.

Similarly, because there are many poor people who are paying extra on their bills and are more likely to fall into debt because they are unbanked and so do not have access to direct debits, it is necessary to allow SFPs to offer this service. As we detail in Chapter 4, at present there are a number of barriers to this happening, however, it is within the power of the Payment Systems Regulator to remove them. Doing so would allow a whole raft of socially

15 Community Development Finance Association (CDFA), *Just finance, capitalising communities, strengthening local economies, a new vision for community finance*, London: CDFA, 2011

16 CDFA, *Mind the Finance Gap: Evidencing demand for community finance*, CDFA, 2013; ABCUL – in evidence to the CSJ

responsible providers to offer direct debit services to vulnerable people for the first time, saving them money and decreasing their chances of falling in to problem debt.

- The Payment Systems Regulator should remove the barriers to SFPs offering competitive banking services (such as offering direct debits). This will allow them to develop new financial products for vulnerable people (such as a budgeting account) and so give them access to cheaper services or help them to avoid the poverty premium of being excluded from these services.

In addition to these reforms we also recommend the following:

- So that SFPs can identify areas that are not currently served by others, the FCA should ensure that financial institutions disclose localised data about provision of unsecured lending, bank accounts and insurance services. They should also conduct an exercise to determine the extent of competition in lower income communities and make recommendations, including in respect of the need for greater social finance investment, in order to address any identified problems;

- Many vulnerable people on benefits are likely to fail automated identity checks because they often do not have a stable address history, or are not registered on the electoral roll. This means they find it harder to access online financial services offered by SFPs. In order to remove this barrier, providers should be able to verify a customer's identity by cross referencing their benefit claimant information against data held on the DWP's databases;

- There is a need for the FCA to review and examine the way in which the Credit Reference Agencies determine people's credit worthiness and how these processes could be improved to help more people access affordable credit and avoid debt;

- To help SFPs access investment so that they can offer better services to vulnerable communities the Cabinet Office should invest in a new Social Finance Investment Platform (SFIP). This would facilitate peer-to-peer lending from social investors to SFPs, that were approved and verified by the SFIP, at affordable rates.

Helping people escape from debt

There is a pressing need for policies that help people already struggling under the weight of serious personal debt, which can cause mental health problems and lead to family breakdown.

Our polices will tackle the barriers that are preventing people from accessing free independent debt advice and reduce the number of people who become trapped in debt without hope of relief. At present:

- 8.8 million people would benefit from debt advice but many people are ashamed, in denial or simply unaware of free debt advice services, meaning that only one in six seek help and one in five do not recognise they are in debt;[17]

- Despite a 156 per cent rise in cost-of-living related debts, many creditors – energy companies, telecoms, and government – do not adequately fund debt advice even though they recoup more money when they do;[18]

- Vulnerable people in crisis are still at risk of having their debt problems worsen through the use of exploitative fee-charging debt advice companies;

- It is estimated that 314,500 people are too poor to go bankrupt and are at risk of becoming trapped in debt.[19]

To address these issues and help vulnerable people seek relief from their debt problems, we propose the following policy recommendations:

- The Money Advice Service (MAS) should lead a new awareness campaign to decrease stigma around personal debt and help people access debt advice;

- The FCA needs to clamp down on firms that sell on the contact details of vulnerable people struggling with debt to fee-charging debt management companies, which may result in their problems getting worse;

- The regulators – Ofcom, Ofgem and Ofwat – and Government need to create a new mandate on companies and government bodies to fund debt advice services that will help decrease debt and improve rates of repayment;

- The Insolvency Service needs to review the Debt Relief Order eligibility criteria to allow more people who are unable to afford bankruptcy to seek debt relief and avoid becoming trapped in debt;

- Government should consider implementing a new regulated system for Debt Management Plans – similar to the Debt Arrangement Scheme in Scotland – that will offer people more formal protection from creditors and allow them time to repay their debts.

Making financial products simpler and safer

The increasing complexity of financial products, coupled with low levels of financial capability has created a dangerous marketplace for financial services where mis-selling still exists. This problem is most acute in Britain's poorest communities where financial capability is often low.

17 MAS, *Indebted Lives: The complexities of life in* debt, London: MAS, 2013

18 Money Advice Trust, *Changing Household Budgets*, London: MAT, 2014
Note: these only figures represent statistics from the National Debtline charity, however, in Maxed Out we highlighted similar trends for Citizen's Advice Bureau and StepChange.

19 Christians against poverty, *Too poor to go bankrupt*, Bradford: Christians Against Poverty, 2014 (unpublished – given in evidence to CSJ)

Through our research we identified that:

- Mis-selling of financial products is still widespread: since 2006, the number of complaints resolved Financial Ombudsman has increased by 311 per cent to over half a million a year, with half of consumer credit complaints upheld;[20]

- Enforcement of current guidelines by the FCA has had little impact on changing the sales culture in banks or protecting customers from mis-selling;[21]

- The inflexibility and lack of control over current payment systems, such as direct debits, can deter people from using financial services, subjecting them to a poverty premium when purchasing goods or services mean that people who are paid at irregular times or who experience an income shock, are more likely to fall into debt;[22]

- There is a lack of coordination between the Money Advice Service, Government, the third sector and financial institutions over the delivery and funding of financial capability training programmes, meaning financial education in schools may be inconsistent and many vulnerable people may not be helped to build their financial capability;

- Financial providers currently expect levels of financial capability that are unrealistic, with people needing a degree level education to understand a basic loan contract from a high street bank;[23]

- Actual levels of financial capability fall far below this level, as one in six people are unable to identify the balance on a bank statement, rising to two in five amongst people between 14–25.[24]

In order to address these problems and help people build their financial capability, make positive financial decisions and avoid debt we propose the following sweeping reforms:

- The FCA needs to reform guidelines to include new minimum standards of consumer protection to safeguard the most vulnerable against overly complex products and mis-selling;

- To ensure that there is proper accountability within the sector, the FCA should implement and enforce a new code of ethics for financial service professionals, similar to those used in law or medicine, that will hold people working in the financial sector personally responsible for unethical behaviour;

- The Treasury should lead in the development of a range of 'Essential Products' for transactional banking, savings, insurance and credit, that are simple, safe and meet the basic everyday financial needs of average consumers;

20 Financial Ombudsman Service, *Annual review of consumer complaints about insurance, credit, banking, savings, investments,* London: Financial Ombudsman Service Limited, 2014; Financial Services Authority, *Treating customers fairly – towards fair outcomes for consumers,* London: The Financial Services Authority, 2006

21 Consumer Focus, *Fair Enough?,* London: Consumer Focus, 2011

22 StepChange, *Life On the Edge*, London: StepChange, 2014

23 Consumer Focus, *Response to HMT consultation on Financial Services Bill,* London: Consumer Focus, 2011

24 Press Association, *Young people have 'dangerous gaps' in money knowledge, charity says,* 23 June 2013; MAS, *The financial Capability of the UK,* London: MAS, 2013

- The new Payment Systems Regulator needs to enable people to have greater control over the timings and amounts of the payments they authorise in order to avoid bank penalty fees and debt problem in the event of financial hardship or a change in circumstances;

- MAS should ensure that it involves all interested parties (Government, the third sector, and the financial services sector) in the development of its new National Strategy. The National Strategy must make clear the roles MAS and each of these parties play both in delivering and funding the Strategy;

- The Department for Education should establish funding and good practice guidelines recommending that financial education be delivered by teachers with specialist training and through expert third sector organisations offering innovative programmes.

Building a nation of savers

The erosion of Britain's savings culture over the past 30 years, combined with squeezed incomes for poorer households make it increasingly hard to save regularly, meaning that millions of people are living on the edge of financial ruin.[25] A lack of even basic savings means people are often unable to cover income shortfalls relating to unemployment, family breakdown, illness or crisis expenditure (such as a broken boiler). For low-income households that struggle to access mainstream credit, this can in turn lead to a cycle of debt and high-cost borrowing that is difficult to escape.

- UK households save less than almost any other country in the European Union, with one in three households reporting that they had no savings at all;[26]

- 13 million people do not have enough savings to support them for one month if they were to experience a 25 per cent reduction in income;[27]

- It is estimated that over a three-year period, one in six low-income households will experience a shock to their finances and have no savings to help cope with it, putting them at risk of serious debt problems.[28]

The scale of this savings crisis means that immediate action is needed. Without it more people will be driven into poverty through taking on crippling levels of high-cost debt. We recommend policies that will tackle the two distinct causes of low levels of household savings: the demise of a savings culture, and the lack of capacity to save amongst low-income households. Our proposals are as follows:

25 StepChange, *Life On the Edge*, London: StepChange, 2014
26 Organisation for Economic Co-operation and Development (OECD), *Factbook 2011–12*, London: OECD, 2011
27 StepChange, *Life On the Edge*, London: StepChange, 2014
28 MAS, *The financial Capability of the UK*, London: MAS, 2013. DWP, *Family Resource Survey 2011*, London: DWP, 2012
Note: Figure calculated from taking 47% of households earning less than £15,600 per year who do not have any savings and then estimating that 36% of those households have experienced income shock in last three years based on MAS survey.

- Given that most people want to save regularly but struggle to start, the Treasury should require employers to create a savings scheme for employees with auto-enrolment, ideally through employer-based credit unions (similar to auto-enrolment in pensions);[29]

- To help benefit claimants avoid problem debt, and to ensure that life under Universal Credit mirrors life in work, the DWP should consider an auto-enrolment savings component of Universal Credit that would allow people to specify a small amount to be deducted each month and placed in a savings account of their choice – ideally with a local credit union or Community Bank;

- Reforms are needed to ensure all repayment agreements and forms of insolvency, including those run by fee-charging providers and involving government creditors, allow for an element of regular monthly savings in line with the Common Financial Statement;

- The Government should pilot a scheme that will financially incentivise people to complete formal repayment arrangements, such as a Debt Management Plan (DMP) or Individual Voluntary Arrangement (IVA), with creditors in order to increase levels of repayments to creditors and to help people build financial resilience. A portion of monthly repayments could be placed on trust with a purpose built fund, or the National Savings and Investment Bank, which would be paid as a lump sum savings bonus upon the successful completion of the repayment scheme. In the event of a failure to complete the scheme the money would be distributed to creditors as normal along with any interest earned while held on trust.

29 PFRC, *Towards a nation of savers*, Bristol: PFRC, 2011 and Institute for Public Policy Research (IPPR), *Saving and Asset Building in Low Income Households*, London: IPPR, 2009

Introduction

The problem of unsustainable, personal debt has blighted the UK's poorest communities for decades. As the CSJ's Alliance of poverty fighting charities has long known, the human impact of this can be substantial – it undermines people's mental health and their performance at work, and places a great strain on their personal relationships. Serious personal debt is not just a consequence of poverty; it is also the driving force behind some of the most entrenched poverty in Britain today.

This problem is not new. Although the financial crisis has undoubtedly put a huge strain on families' finances, levels of serious personal debt highlighted last year in the CSJ's diagnostic report, *Maxed Out,* reflect growing trends that began long before the financial crisis. Yet this problem has undoubtedly got worse. Personal debt in the UK has reached record highs while household savings have reached historic lows, leaving millions with little financial resilience.

Unsurprisingly, the people who are most vulnerable to debt becoming unmanageable and spiralling out of control are those with low levels of savings, low incomes and a lack of financial resilience or capability. This group disproportionately includes those from poorer communities and in particular the unemployed, older people and single parents: an estimated 1.1 million people over 50 years old are in problem debt;[30] and over three-quarters of Christians Against Poverty's clients receive some form of state benefit, and a quarter are single mothers.[31]

Without a change of direction it is unlikely the issue of problem debt will ever subside. In fact, there is every reason to believe the build up of unmanageable, personal debts will get worse:

- 15 million people across the country are currently falling behind on bills and using credit to pay for essential costs;[32]

- Around 13 million people do not have enough savings to cover their expenses for a month if their income were to decrease by just 25 per cent;[33]

30 ILC, Press Release, 3 in 10 older people in debt are struggling to repay, 4 June 2013
31 Christians Against Poverty (CAP), *CAP Client Report 2013*, Bradford: Christians Against Poverty, 2013
32 StepChange, *Life On the Edge*, London: StepChange, 2014
33 Ibid

- A rise in the Bank of England's interest rate would put one-fifth of mortgage holders at risk of falling into debt, as they already struggle to meet their monthly repayments;[34]

- Continuing rises in the cost of living will lead to further increases in debts related to household bills, rent and Council Tax, especially amongst the five million poorest households in the UK.[35]

A particularly concerning trend has been the increasing reliance on high-cost credit to pay for bills. The mounting pressures on household budgets and restrictions on mainstream lending have led more and more households to turn to high-cost lenders such as pawnbrokers, payday lenders, home credit and illegal moneylenders:

- An estimated seven million people use high-cost credit in order to cover income shortfalls and meet unexpected expenditures;[36]

- More than 60 per cent of households using high-cost credit are in financial difficulties compared with 15 per cent of mainstream credit users;[37]

- In 2013 StepChange advised 67,000 people regarding their payday loan debt, double the number helped in 2012;[38]

- In Britain's most deprived estates, one in 12 families borrow from illegal moneylenders, compared with just one in 200 people amongst the general population.[39]

This paper has drawn on the vast experience of the CSJ's 329-strong Alliance of poverty-fighting charities, many public and private sector organisations working in this sector, as well as individuals struggling under the weight of problem debts. We have heard overwhelmingly that too little is being done to prevent people being dragged into poverty by problem debt or to rescue those currently trapped with unmanageable debts. Yet our interviews also gave us reason for optimism, because they revealed that certain reforms are possible that would turn around this dire situation.

The recommendations in this report are built upon the views and experiences of those we interviewed during our research. They are focussed on: reforming the financial provider market to ensure people on low incomes have access to more affordable credit; supporting those in problem debt to escape it; helping boost financial capability and product suitability to reduce the numbers that fall into problem debt; and reversing the UK's 'spend not save' culture to create greater financial resilience.

34 Resolution Foundation, *Mortgaged Future,* London: Resolution Foundation, 2014; *Note: Based on expected rise to 2.9 per cent by 2018*
35 ONS, *Statistical bulletin: Families and Households*, 2013 [accessed via:http://www.ons.gov.uk/ons/rel/family-demography/families-and-households/2013/stb-families.html (17/07/14)]; MAT, *Changing Household Budgets,* London: MAT, 2014
36 DWP, *DWP credit union Expansion Project, Project Steering Committee, Feasibility Study Report*, London: Department for Work and Pensions, 2012
37 BIS, *Credit, Debit and Financial Difficulty in Britain, 2012,* London: BIS, 2013
38 StepChange, *Statistics Yearbook: Personal Debt 2013,* London: StepChange, 2014
39 BIS, *Interim evaluation of the national illegal money lending projects – summary,* London: BIS, 2010

One in six adults are currently in problem debt and more of the country's poorest people are being dragged into a debt spiral that they have little hope of escaping.[40] We cannot afford to ignore this problem any longer. If political parties are serious about tackling the root causes of poverty, they will swiftly digest and implement the practical recommendations set out in this report.

40 MAS, *Indebted Lives: The complexities of life in* debt, London: MAS, 2013 Note: Based on ONS mid-year population estimates for UK adults

chapter one
Helping people escape from debt

Introduction

There are an estimated 8.8 million people currently struggling with personal debt in the UK, yet just 17 per cent seek advice and more than one in five do not even recognise they are in debt.[41] Those who do seek debt advice are most likely to wait more than a year before doing so.[42] A delay or failure in recognising and addressing debt can make the problem worse, both in financial terms and the negative effects on health and relationships.[43] In contrast, there are proven benefits of seeking debt advice both for the individual, the creditors and the national economy.[44]

In *Maxed Out,* the CSJ highlighted how various psychological, behavioural and cultural factors can influence people's decisions when in debt, can prevent them seeking advice and cause their debt problems to get worse. In order to tackle personal debt in Britain it is necessary to address the barriers that prevent people from seeking advice. These barriers include a lack of awareness about available services, failure to recognise debt issues, social stigmas, as well as cultural barriers.[45]

In this chapter we look at how to help people who are in crisis and potentially vulnerable to access debt advice, seek protection from their creditors and take action to escape from under the weight of their debts.

41 MAS, *Indebted Lives: The complexities of life in debt*, London: MAS, 2013, p1
42 StepChange, *Statistics Yearbook: Personal Debt 2013,* London: StepChange, 2014, p1
43 Legal Services Research Centre (LSRC), *Assessing the Impact of Advice for People with Debt Problems,* London: LSRC, 2007, p25–28
44 London Economics, *Funding Debt Advice in the UK – a proposed model,* London: London Economics, 2011, p2–8
45 Warwick Institute for Employment Research, *The long term impact of debt advice on low income households,* p4

We propose policies to achieve the following:

- Increase the uptake of debt advice by removing barriers to it and identifying those who are struggling financially in order to proactively engage them;
- Improve the regulation of the commercial debt advice sector and rethink how free debt advice services are funded in order to protect and help the most vulnerable people;
- Reform the system of debt repayments and insolvency in order to ensure that people with the worst debt problems do not become trapped in debt, are able to seek relief and build up financial resilience.

1.1 Helping people access debt advice

People do not seek debt advice for a variety of reasons, including a failure to recognise debt problems, over-optimism, social stigma and a lack of awareness about free advice services.[46] In order to help tackle problem debt in Britain it is vital to change the national culture and attitude towards debt, which often stigmatises people in debt and can prevent them from seeking the help they need to escape from it. As well as raising awareness and reducing stigma it is also important to proactively engage with those people most at risk when they show the first signs of financial distress, as this can help prevent their debts from spiralling out of control.

1.1.1 Changing how we think about debt

Around one in seven people do not seek debt advice in large part because of the stigma that surrounds personal debt – this can be greater amongst certain vulnerable groups.[47] A recurring theme amongst debt advice clients is that they felt a sense of guilt or personal failure about their situation.[48] In order to help people in this situation, there must be a fundamental change in how we think about debt in our society.

Evidence clearly indicates that most debt problems are not the result of a person's carelessness or character, but are caused by wider economic circumstances such as a fall in income, unemployment or an unexpected crisis.[49] Increasingly debt advice charities are reporting a rise in debt problems related to the cost of living and a persistent shortfall in household income.[50]

Often people do not recognise the extent of their debts or are overoptimistic about their circumstances and ability to manage the problem. It is estimated that one in five indebted people, or 1.8 million UK adults, do not recognise that they are in debt.[51]

46 Warwick Institute for Employment Research, *The long term impact of debt advice on low income households,* 2008, p4
47 R3, *Struggling with debts without help*, London: R3, 2010, p2
48 StepChange, *Working households' experiences of debt problems*, London: StepChange, 2012, p17
49 StepChange, *Statistics Yearbook: Personal Debt 2013,* London: StepChange, 2014, p5
50 MAT, *Changing Household Budgets,* London: MAT, 2014, p3
51 MAS, *Indebted Lives: The complexities of life in debt,* London: MAS, 2013, p10

> *'We felt embarrassed, trapped and ashamed. We were getting deeper in the red on a monthly basis and pretending to ourselves that things were going to get better.'*
>
> Mark and Lisa – in evidence to the CSJ[52]

For those people that do recognise their debt problems and want to engage with advice services, there is still a lack of awareness about where to go for advice. A recent poll found that one in four UK adults do not think it is clear where they can access free independent debt advice and support.[53] The confusion between free independent advice and commercial providers undoubtedly contributes to this problem.

In order to help the millions of people struggling with personal debt these issues need to be addressed. There is a need for a coordinated national approach to help raise awareness about the availability of advice services and to change people's attitudes towards debt.

> *'I was the only person who knew about it, I even kept it from my partner. I could not see a way out, and carried on borrowing money just to keep up appearances. Although on the outside everyone thought I was okay, inside I was in turmoil. As soon as I spoke to Christians Against Poverty it was as if the weight of the world had been lifted from me, and I could actually breathe again. I was pleased that nobody at Christians Against Poverty seemed to have judged me.'*
>
> Rachel – in evidence to the CSJ[54]

In its capacity as the independent body tasked with coordinating debt advice services, the Money Advice Service (MAS) is ideally placed to lead this national awareness campaign. However, the scale of attitudinal change needed means it is vital to involve government and businesses as well. A widespread and easily understood message is needed, akin to a public health or safety campaign, such as the successful 'five-a-day' nutrition message or the push to encourage the use of seatbelts.

MAS has taken a positive first step to evidence the different needs of various indebted groups as well as to highlight the regional differences in both the demand and delivery of debt advice.[55] We also welcome their recent efforts in piloting a regional awareness campaign and exploring the development of centralised systems to help people locate free independent advice services in their area and transfer more seamlessly between providers if necessary.

52 Case study provided by Christians Against Poverty
53 R3, *Personal debt snapshot wave 7*, London: R3, 2012, p1
54 Case study provided by Christians Against Poverty
55 MAS, *Personalising the Debt Sector*, London: MAS, 2013 and London Economics, *Audit of the supply of debt advice services across the UK*, London: London Economics, 2012

Recommendation 1: The Money Advice Service, with the assistance of creditors, should evaluate its pilot schemes and consider how to lead a national campaign to raise awareness about free independent advice services. This should also focus on changing commonly held attitudes and perceptions about debt that can prevent people in financial hardship from recognising their debt problem and getting help, potentially leaving them trapped in debt.

1.1.2 Helping people with their debt before it becomes a problem

Many people delay in seeking help with their debt problems, which can cause them to get worse.[56] Delays can result from a lack of awareness about available services, failure to recognise debt issues, social stigmas and other cultural barriers.[57] StepChange debt advice charity reports that 40 per cent of its clients wait more than a year before seeking help.[58] There is consequently a need for more early intervention programmes that proactively identify people who are experiencing financial hardship and help them engage with independent debt advice, utilising local community-based organisations when possible.

Creditors, including financial institutions, landlords (especially social landlords), utility providers and local government are ideally placed to recognise when people are experiencing financial difficulties and offer early intervention services. These programmes attempt to recognise early signs of financial distress, such as consecutive missed payments or an application for welfare assistance, and engage people with debt advisers before their debts spiral out of control.

There is widespread evidence on the effectiveness of early intervention programmes, both in helping to reduce people's debt problems and increasing the amounts collected by creditors.[59] These programmes are also cheaper than traditional 'crisis intervention' debt advice.[60]

Pilot programmes conducted with social landlords resulted in an average reduction in rent arrears of £360 for every tenant engaged with debt advice, with 71 per cent experiencing a reduction in their rent arrears.[61] Although offering early intervention services costs money, the study found significant savings for landlords in terms of decreased spending on evictions and collection efforts.[62]

Research by the Financial Inclusion Centre estimated that if similar programmes were delivered nationally the social housing sector would receive £49 million in savings each year.[63] There are also wider benefits and savings for society, which would normally shoulder the financial burden of rehousing people following an eviction.

56 Legal Services Research Centre (LSRC), *Assessing the Impact of Advice for People with Debt Problems*, London: LSRC, 2007, p36–7
57 Warwick Institute for Employment Research, *The long term impact of debt advice on low income households,* 2008, p4
58 StepChange, *Statistics Yearbook 2012,* London: StepChange, 2013, p4
59 Friends Provident Foundation, *The impact of independent debt advice services on the UK credit industry*, York: Friends provident foundation, 2010, p3 and MAS, *The effectiveness of debt advice in the UK*, London: MAS, 2012, p15–16
60 London Economics, *Debt advice in the UK*, London: London Economics, 2012
61 The Hyde Group, *does debt advice pay: a business case for social landlords,* London, Hyde Group, 2011
62 Ibid
63 Ibid

Similar evaluations conducted by financial institutions and utility providers have also returned positive results. A pilot scheme run by Barclays found that 80 per cent of customers they approached went on to engage with the specialist team to address their financial issues.[64] Those customers with low incomes or who were unemployed were significantly more likely to welcome this early intervention service.[65] After an evaluation of the debt collection practices of major energy providers, Ofgem recommended that '*suppliers must focus greater efforts on early proactive follow-up which offers prompt help to customers struggling with energy debt.*'[66]

This suggests that the recent rise in debts owed to government could also be addressed by developing similar early intervention schemes run by local authorities working with local community based organisations. If delivered effectively this form of debt advice could increase debt repayments, help vulnerable people suffering mental and financial hardship as a result of their debts and improve the financial position of many local authorities.

Several local authorities have already recognised the benefits and economic case for this. Their initial pilot programmes are varied, but they all make use of data that is already held by the local authorities about local residents in order to target those who are most likely to need and benefit from debt advice.[67] This includes demographic information, eligibility for welfare support programmes such as Council Tax support or Housing benefit, previous applications for discretionary welfare payments, levels of Council Tax arrears and previous engagement with social services or registration as a 'troubled family'. The ability to cross reference various indicators of financial distress or vulnerability can help to target these services and identify people that other debt advice schemes may have missed.

64 MAT, *Understanding Financial Difficulty*, London, MAT, 2011
65 Ibid
66 Ofgem, *Review of suppliers' approaches to debt management and prevention*, London: Ofgem, 2010
67 Evidence given to CSJ during workshop at LGiU/StepChange Conference on 21 January 2014

The CSJ has heard about an innovative programme led by Oxford City Council which aims to save £3 million from the annual Housing Benefit expenditure by providing debt advice and other support to people applying for discretionary housing payments (DHP).[68] The programme uses the application process as an opportunity to offer debt advice and other support to those in need.[69] As funds for DHP support are limited the council has recognised the benefits of helping people address the underlying issues – which often include debts or a lack of financial capability – that led to the person seeking the DHP. Not only does the DHP application present the opportunity to talk to people about their finances, who might otherwise not have done so, but the council is also able to increase engagement by directly referring people to local third sector support services for debt advice, budgeting or employment.

An expansion of programmes based on this and other successful models would help vulnerable people. It could also help to address the limited forbearance procedures and aggressive debt collection methods employed by local authorities – including the use of bailiffs, notorious for illegal collection practices and excessive fees that can worsen debt problems, on 1.8 million occasions in just 12 months – often for very small amounts and with little regard for a person's financial situation or mental health.[70]

Recommendation 2: Local authorities should share and build upon the successful early intervention programmes currently being piloted across the country, that utilise local community based organisations, existing data and council services to identify and proactively engage with people most at risk of debt problems and the associated harms.

1.2 Improving debt advice

Delivering debt advice services has benefits for the recipient, their creditors and society as a whole. A shortage of these services could leave millions of people without adequate support and cause significant financial and emotional harm. In this section we set out how to increase funding for debt advice and ensure people are not harmed by the poor practice of fee-charging debt advice providers.

1.2.1 Increasing funding for debt advice

There are several prominent models for funding debt advice services based on corporate social responsibility, public policy objectives, charitable aims and as part of good business practice.[71] No model is necessarily better than any other, but it is important that the burden of funding debt advice is spread as fairly as possible across those organisations that benefit from its provision to people who owe them money in the form of increased repayments.

68 Oxford City Council, *Discretionary Housing Payments Policy* [accessed via: http://www.oxford.gov.uk/Library/Documents/Benefits/Discretionary%20Housing%20Payment%20Policy.pdf 17/07/14)]

69 Policy in Practice – in evidence to CSJ; Oxford City Council, *A report on the monitoring of Discretionary Housing* Payments, 4 March 2014 [accessed via: http://mycouncil.oxford.gov.uk/documents/s16962/DHP%20Report%20to%20Scrutiny%2003-14%20v03.pdf (17/07/14)]

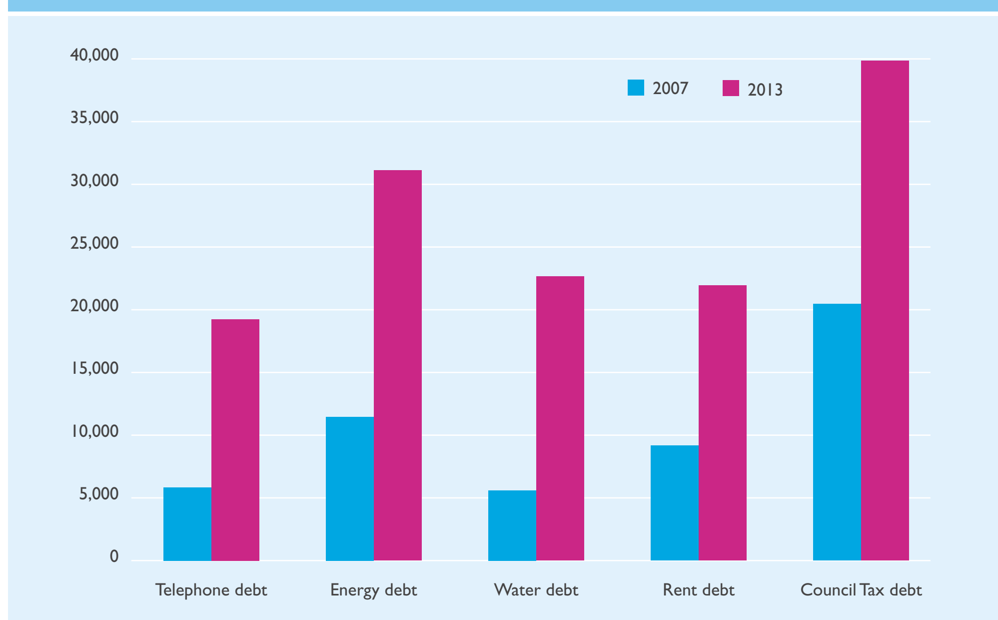
70 Department for Communities and Local Governments (DCLG), *Council Tax: guidance to local councils on good practice in the collection of Council Tax arrears*, London: DCLG, 2013

71 Friends Provident Foundation, *Funding Money Advice Services*, Dorking: Friends Provident Foundation, 2009

At present the major funders of debt advice are financial institutions, both through individual arrangements with debt advice providers and through a central levy administered by the FCA.[72] Not every financial institution contributes to funding debt advice and there is little attempt to tie funding to the varying levels of harm caused by debts owed to different types of financial institutions, or how likely their customers are to need debt advice. As an example, Parliament recently failed to introduce a levy specifically for firms offering payday loans.[73]

While the financial sector is responsible for a large proportion of debt problems, in *Maxed Out* we highlighted that recent rises in the cost of living have led to a spike in non-credit related debts.[74] These include household bills (energy, telecoms, water etc.), rent arrears and debts owed to government (Council Tax, income tax, magistrates' court fines etc.). Data collected by debt advice charities show just how significant the growth of these debts has been:[75]

Figure 1: National Debtline clients in arrears on households bills (2007–2013)[76]



The financial industry has historically funded debt advice because research shows that it improves the financial outcomes for their customers and that the increased levels of debt repayment exceeds the cost of funding free advice services.[77] At present non-financial creditors, such as local government, magistrates' courts, telecoms and energy companies,

72 Ibid

73 This Money, *Parliamentary plans to impose levy on payday lenders stumble at first hurdle after key clause fails to make it into Consumer Rights Bill through lack of time*, 17 May 2014

74 Centre for Social Justice, *Maxed Out*, London: Centre for Social Justice, 2013

75 MAT, *Changing household budgets*, London: MAT, 2014; StepChange, *Statistical Yearbook 2013,* London: StepChange, 2014; Citizen's Advice Bureau, Press Release, *"Bills are still piling high" as economy improves*, 25 July 2014

76 Ibid

Note: these only figures represent statistics from the National Debtline charity, however, in Maxed Out we highlighted similar trends for Citizen's Advice Bureau and StepChange.

77 Friends Provident Foundation *The impact of independent debt advice services on the UK credit industry*, York: Friends provident foundation, 2010, p3

benefit from the provision of free independent advice to their customers, but often do not contribute substantially to funding these services.

> *'We couldn't do our life-changing work at Money Advice Trust without the support of creditors, which we value greatly. Yet there are whole sectors – home shopping companies would be a good example – who benefit from our services because their customers contact us for help and yet the vast majority of them do not contribute a penny.'*
>
> Joanna Elson, CEO Money Advice Trust – in evidence to CSJ

Given the impact and growth of non-credit debts, which have increased the need for free independent debt advice, it is necessary that more creditors contribute to funding these services. If delivered effectively, the costs of funding debt advice are outweighed by increased profits in the form of higher levels of debt repayment and customer retention.

> **Recommendation 3:** The regulators of industries that have contributed to the rise in household debts (Ofcom, Ofgem and Ofwat) should evidence the business case for funding debt advice in their sector and require the firms they regulate to do so.
> The Treasury should explore how government departments, agencies and local authorities who act as creditors should fund debt advice services, and evidence the benefits of doing so in the form of increased repayments.

1.2.2 Regulating commercial debt advice to protect vulnerable people

Previous analysis of commercial providers of debt advice has highlighted the harm they can cause to people experiencing financial hardship.[78] A recent study found that the failure rate for debt repayment arrangements is twice as high amongst people who paid for a debt advice service than those who accessed free advice.[79] This can lead to vulnerable people, often approached by fee-charging companies when under extreme pressure, experiencing increased mental hardship and becoming trapped in debt as a result of these services.

> *'Claire from Tyne & Wear approached Five Lamps recently for a loan towards car repairs. Whilst discussing her income and expenditure, Vince Rodger, Five Lamps Loan Officer at their Newcastle office, established she was paying fees of £30 per month to a debt management company.*
>
> *He introduced Claire to StepChange, a leading UK debt charity who arranged to cancel Claire's payment arrangement and set her on a fee-free revised payment plan. This means she will save 18 months fees as the new arrangement will be completed in 42 months compared to the original arrangement, which would have taken 60 months'.*
>
> Five Lamps – in evidence to CSJ

78 MAT, *Sustaining Debt Repayments*, London: MAT, 2012
79 Ibid

We welcome new standards of good practice developed by the sector and the new Financial Conduct Authority (FCA) rulebook, including a ban on the front-loading of fees, but there are still concerns about this sector identified in recent FCA research, including how debt management companies acquire customers.[80]

The CSJ has heard from debt advice charities that fee-charging debt management companies often masquerade as free services, and acquire customers through 'lead generation'. This process refers to debt management companies that pay to obtain contact details for potential customers who are experiencing financial hardship. This information can either be provided by creditors, such as payday lenders, or obtained by companies that specialise in 'cold calling' or other marketing techniques to find people who might be struggling financially.

Debt advice charities often do not have the marketing budget or other resources to compete with fee charging providers, meaning many customers do not know there are free options available.[81] We are particularly concerned about practices which may target people who are desperate and vulnerable to being mis-sold a debt advice service that can actually worsen their situation. In 2011 the OFT shut down 19 websites that were targeting disabled people in financial distress and referring them to commercial debt management companies.[82]

While commercial providers are regulated in terms of how they use lead generators and what steps they must take to ensure vulnerable customers are protected, there is still a lack of oversight over the practices of the lead generators themselves. FCA regulation is needed to protect people from being referred to a service that could make their debt problem worse and ensure that lead generators provide people with information about free independent debt advice services.

Recommendation 4: The FCA needs to closely monitor fee charging debt advice providers to ensure they are adhering to existing regulations, as well as take action to regulate lead generators and prevent vulnerable customers being referred to commercial debt management companies.

1.3 Tackling problem debt

Debt advisers recommend a range of appropriate measures to help tackle problem debt, ranging from maximising income and reducing expenditures, which includes creating a suitable budget using the Common Financial Statement, all the way to debt relief options such as a formal debt management plan or insolvency.[83]

80 FCA, *Potential issues in the market*, 2014 [accessed via: http://www.fca.org.uk/firms/firm-types/consumer-credit/consumer-credit-research/debt-management/potential-issues-in-the-market (16/07/14)]
81 R3, *Struggling with debts without help*, London: R3, 2010
FCA, *Consumer Credit Research: Payday loans, logbook loans and debt management services*, London: FCA, 2014
82 Debt Management Today, *OFT shuts down 19 lead generation firms,* 13 April 2011 [accessed via: http://www.debtmanagementtoday.co.uk/newsstory?id=1154& (17/07/14)]
83 MAS, *The effectiveness of debt advice in the UK*, London: MAS, 2012

However, the CSJ has learned through interviews with debt advice charities that there are several cracks in the current system which can leave people susceptible to future debt problems and, in extreme cases, trapped in debt with no possibility of repayment or insolvency.

In order to ensure people can deal with their debts and rebuild their lives, debt advice services and debt remedies must be able to:

- Stop the debt spiral and offer people statutory protection from creditors;
- Offer people a fair, standard and structured way to repay their debts;
- Prevent people from being trapped in debt with no way of seeking relief.

1.3.1 Stopping the debt spiral

In *Maxed Out*, we highlighted how accessing debt advice services can greatly help to reduce the negative impact that debt can have on a person's mental and physical health, employment and family relationships.[84] This is partly because creditors will often reduce their collection efforts and/or offer to freeze interest and penalty fees once people access debt advice and demonstrate their intention to repay. However, the CSJ has heard that creditor behaviour in regards to forbearance procedures is inconsistent despite the existence of FCA rules.[85]

Amanda was left with her ex-husband's debts that she did not know about during their marriage.

> *'I owed two debts, one on the mortgage and one for the hire-purchase (HP) on the car, both from the same bank. It was like night and day how they treated me. The mortgage people were very understanding, they listened to me and I was able to work out an arrangement with them, even though the debt was more than ten times the size of the HP debt. The HP people were different though, they were nasty.*
>
> *They would regularly call me three or four times a day. The latest call was 10 minutes before 10 in the evening. Eventually I would hide and not answer the phone. We could not afford to pay anymore, but that did not matter to them, it was still not enough. They just would not listen. A brick wall would understand better than they do.*
>
> *I tried to make payment arrangements, but they just said "we will drag you through the courts...we will get what we want." Eventually they took us to court and got exactly what I had offered them all along, £25 a month, because that was all we could afford.'*
>
> Amanda – in evidence to the CSJ[86]

In order to alleviate the strain placed on people it is vital that they are able to seek some form of statutory protection from the collection efforts of their creditors, especially from the actions of bailiffs. There is also a need for people to be able to have their interest and penalty charges frozen, so that their debt does not spiral out of control and to allow debt advisers time to help them decide a long-term strategy.

84 Centre for Social Justice, *Maxed Out*, London: Centre for Social Justice, 2013

85 Mortgage solutions, *FCA challenges lenders over arrears and forbearance*, 25 February 2014; FCA, *Detailed rules for the FCA regime for consumer credit Including feedback on FCA QCP 13/18 and 'made rules'*, London: FCA, 2014

86 Case study provided by Stepchange

one

A StepChange Debt Charity client, who was a low paid part-time worker, began to suffer from tendonitis and arthritis in her hands, and had to reduce her working hours for a period of time. Around the same time, her husband was forced to become self-employed as the company he worked for could no longer afford to keep him on as a full-time employee. The couple struggled with their finances during this difficult period, and turned to an overdraft and credit cards more and more for day-to-day living.

Already with two loans, the client asked for help from her bank, but was only offered more credit. She then received a letter from the bank's credit card department saying that, as she wasn't running her accounts properly, they would have to **increase** her interest rate until her spending or credit improved. The client now has debts of almost £11,000.

If she had been given some breathing space to get her finances in order by the bank when she first called, rather than encouraged to take on more credit, she feels she would be in a much better place now. She says: 'I'm sure that if my bank had stopped the charges and interest for a while it would definitely have reduced the amount of debt I ended up with. The stress levels wouldn't have been as bad either. I sometimes feel like a failure, but the bank played a part in this too.'

StepChange Debt Advice Charity – in evidence to CSJ[87]

Forbearance procedures can benefit creditors and people in debt. Evidence suggests creditors are more likely to collect debts owed to them if people are given the time and space to address their problems and seek debt advice.[88] This need for 'breathing space' is especially important for those people who are experiencing debt problems related to a short-term income or expenditure problem.[89]

Helen, a single client in her late 30's, began to struggle to repay her loans and credit card after being off work for nine weeks with an illness. Her employer only paid for one month of contractual sick pay and although she managed to cover her essential bills, she did not have the £450 to repay her credit commitments that month. Despite returning to work full time, she was worried about the impact this short-term problem would have on credit file and long-term future, especially if they added fees and interest. National Debtline helped her to negotiate with her creditors, but without this advice and their cooperation it could have been far worse.

National Debtline – in evidence to CSj

Without temporary protection from creditors there is a real risk that people within this group may seek out risky forms of borrowing in an attempt to make ends meet. The compounding effect of penalty fees and interest charges can turn what was a relatively minor and temporary debt problem into one that is both larger and harder to recover from.

We recommend that the FCA examine the state of forbearance procedures, including existing FCA rules, creditors' internal guidelines and , most importantly, what is actually taking place in practice and, if necessary, work with the Department for Business, Innovation and Skills, to bring in a statutory form of protection for people in financial distress.

87 Case study provided by StepChange in evidence to CSJ
88 Deloitte, *Loan forbearance: No such thing as a free lunch*, London, Deloitte, 2012
89 StepChange, *Life On the Edge*, London: StepChange, 2014

Recommendation 5: The FCA should examine existing forbearance standards and practices amongst creditors. If existing practice is insufficient then they should work with the Department for Business, Innovation and Skills, to bring in legislation that will provide temporary protection from creditors for people who are experiencing short-term financial hardship and ensure they do not fall deeper into debt.

1.3.2 Protecting people who are trying to repay their debts

After seeking debt advice, many people enter into a Debt Management Plan (DMP) if they are able to repay their debts.[90] This is a formal agreement negotiated with creditors, normally handled by a debt advice provider, under a set of standards and rules set out by the FCA.[91] It is estimated that at present there are anywhere between 300,000 and two million people currently repaying their debts under a DMP.[92]

The terms and conditions of the DMP vary, but typically it will involve the client making monthly repayments for three to eight years that are then distributed amongst the creditors.[93] During the DMP, most unsecured creditors will typically suspend interest and penalty fees, providing the terms of the DMP are met. The total amount repaid under a DMP is often not the full amount owed, which is intended to incentivise people to seek repayment rather than insolvency, after which a creditor would not receive any repayment.

Unfortunately the DMP system is voluntary and does not provide statutory protections from creditors. Creditors are not required to accept the terms of a DMP proposed by a debt adviser, to freeze interest charges and penalty fees or desist from contacting the person in debt.[94] There is a public policy case to protect people attempting to repay their debts, rather than seek insolvency, which has wider consequences for firms and the economy. Therefore, it is necessary to institute a more formal DMP scheme that will balance the rights of a creditor against the need to protect vulnerable people who are struggling to repay their debts.

In Scotland a centralised statutory scheme for the operation of DMPs, known as the Debt Arrangement Scheme (DAS), was brought into force in 2004.[95] People in financial hardship can apply for protection under the DAS. Once an adviser approves a Debt Payment Plan (DPP) creditors are required to accept the repayment terms and freeze interest and penalty charges and stop any further enforcement action. People also have the opportunity to rearrange the terms of their DPP if their circumstances change and there is a degree of debt forgiveness built into the scheme. Since 2009 the number of approved DPPs in Scotland has

90 StepChange, *Statistics Yearbook: Persaonl Debt 2013*, London: StepChange, 2014
91 FCA (FCA), *Consumer Credit Research: Payday Loans, Logbook Loans and Debt Management Services*, London: FCA, 2014 and Debt Managers Standards Association, *Debt Management Plan Protocol*, accessed via http://www.demsa.co.uk/wp-content/uploads/Debt-Management-Plan-Protocol-06-02-13.pdf [16/07/14]
92 R3, *The depth of personal debt iceberg*, London: R3 [accessed via http://www.r3.org.uk/media/documents/about_us/The_Depth_of_the_Personal_Debt_Iceberg.pdf [17/07/14]
93 R3, *Personal debt snapshot wave 7*, London: R3, 2012
94 R3, *Debt management plans*, London: R3, 2010
95 Debt Arrangement Scheme, *Why was das introduced? [*accessed via: http://www.dasscotland.gov.uk/about/why-was-das-introduced (16/07/14)]

increased each year while the level of personal insolvencies has decreased by 40 per cent.[96] In contrast, over the same period personal insolvencies have only decreased by 25 per cent in England and Wales.[97]

The CSJ found that there is support amongst debt advice charities for the implementation of the DAS, or a similar programme, in England and Wales, based on the results and experiences in Scotland.

'StepChange Debt Charity clients tell us that a period of protection where interest, default charges and recovery action by creditors are frozen is a crucial step towards recovery. It stops debts from spiralling upwards and out of control and it reduces the unbearable pressure of being chased for money that you just don't have. Currently this form of statutory protection is only available for people seeking insolvency, not those attempting to repay their debts.

While creditors will often offer to freeze interest, charges and recovery action on a voluntary basis, their practices vary – only one in five of our clients told us they thought all of their creditors had treated them well. The consequence is more debt, more stress and a much harder problem to solve. We need policy makers to learn from Scotland and deliver a similar form of protection for people England and Wales as a priority.'

Peter Tutton, Policy Director for StepChange – in evidence to CSJ

Recommendation 6: In order to encourage people to repay their debts and offer them greater statutory protection from creditors, legislation should be considered to implement a system similar to the Scottish Debt Arrangement Scheme in England and Wales.

1.3.3 Protecting people who cannot pay their debts

There are several types of insolvency options available to people who are unable to repay their debts including bankruptcy, Debt Relief Orders (DROs) and Individual Voluntary Arrangements (IVAs). It is important that people who are unable to repay their debts have access to one of these forms of debt relief so that they do not become trapped in debt and poverty.

The DRO was created in 2009 to help people on low incomes escape the burden of problem debt without having to go through full bankruptcy proceedings, which can be lengthy and costly.

96 Account in Bankruptcy, *Scottish Insolvency Statistics 2013–14: Quarter 4* accessed via http://www.aib.gov.uk/scottish-insolvency-statistics-2013-14-quarter-4-0 [16/07/14)]

97 The Insolvency Service, *Insolvency Statistics January to March 2014 release*, London: BIS, 2014

DRO Criteria: In order to apply for debts to be written off under a DRO people must not owe more than £15,000, have assets over £300, or a monthly disposable income greater than £50.

The CSJ has heard from debt charities about the number of people who become trapped in debt, as they do not meet these criteria, but are unable to afford the £700 (including a £525 deposit) required to apply for bankruptcy. A report this year by Christians Against Poverty (CAP) estimated that there are 315,000 people who are too poor to go bankrupt each year.

A recent publication by R3, the trade association for insolvency practitioners, recommended the maximum debt threshold should be increased to £30,000, supported by CAP, and the asset threshold should be raised to £2,000.[98]

Research by CAP suggests that reform to the DRO qualifying criteria would allow 170,000 more people to seek debt relief while also saving the state money as the DRO procedure is relatively cheap to administer compared to bankruptcy petitions. However, the increased numbers of DRO applications would potentially place a greater financial burden on the free independent debt advice services that provide them.

The CSJ heard that, despite their best efforts to streamline DRO applications, debt advice charities still incur a cost of around £200-£400 per application and only receive £10 from the Insolvency Service for each one.[99] The large costs are predominantly because the application system debt advisers must use is time-consuming and inefficient. The interpretation of the rules for DROs is also increasingly complex as policies develop over time.

Without improvements to these IT systems and/or increased funding for debt advice charities that provide DROs, there is a real risk that some vulnerable people will be unable to access this vital form of debt relief.

Initial consultations prior to the creation of the DRO identified the possibility that unemployed applicants could be disincentivised from seeking employment.[100] This is because a DRO can be invalidated if a person's financial situation improves substantially during the 12-month period following the application. The advice given by debt advisers is key, as even if people could potentially return to work without affecting their DRO, they may be too worried about the implications of this depending on how the information was presented to them.

Recommendation 7: The Insolvency Service should conduct a review of the DRO in order to expand access by raising the maximum debt, asset and available income thresholds while also streamlining the application procedure to decrease operating costs for debt advice charities.

98 R3, *The Personal Insolvency Landscape*, London: R3, 2014
99 MAT, in evidence to CSJ
100 R3, *Debt Relief Orders*, 2010 [accessed via: http://www.r3.org.uk/media/documents/policy/policy_papers/personal_insolvency/R3_Debt_Relief_Orders_Paper.pdf (18/07/14)]

chapter two
Making the market safe

Introduction

Being able to access and use financial services that meet your particular needs is an essential part of modern life and can help protect against debt. However, far too often, people, particularly vulnerable people, are using – or having to use – services that cost them too much money and so put them at risk of sliding into and becoming trapped in debt.

We have heard that this is because:

- Products and services, such as bank accounts, are often mis-sold to people as insufficient attention is paid to their needs and because some firms target vulnerable people with inappropriate services that are not designed around their needs, capabilities and expectations, leaving consumers underserved and at risk. The problem is exacerbated by products and services that have increasingly become too complex to be easily and fully understood.

- People do not always have the financial capability to manage the necessary products and services they need.

This chapter asks how these issues can be resolved.

2.1 Ensuring customers are treated fairly

The CSJ has heard during the course of its research that vulnerable people are often mis-sold financial products, such as a packaged current account, which can cause them financial hardship.[101] Whilst it is always helpful for people to have better financial skills, in a world of increasingly diverse and complex financial products, which are not always designed to meet consumers' actual needs, this alone will not protect them. For

101 *Note: In this report we use the term 'mis-selling' to refer both to actions that are currently illegal, and situations where due care has not been taken and a customers has been sold an inappropriate product*

example, a 2012 report found that there were more than 2,434 savings products on the market, making differentiation of the features so difficult that other research has found 30 per cent of people are unable to pick the best ISA when given three options.[102]

Consumers should be provided with a market that is easy to navigate and where they are treated fairly. Consequently it is necessary to find ways to:

- Protect consumers from being mis-sold financial products and services that they either do not need or want;
- Ensure financial products and services are clear, transparent, reflect customers' needs, meet certain quality standards, perform as expected and do not harm consumers.

Despite the complexity of the financial market the onus is placed almost entirely on people as 'empowered consumers' to understand the products and services they are buying.

The Financial Conduct Authority guidelines state that the principles of Treating Customers Fairly (TCF) should be at the core of financial institutions' ethos and are the basis for their regulation and enforcement activities.[103] These guiding principles set out six outcomes for customers that financial providers are expected to deliver including:[104]

- **Outcome 1:** Consumers can be confident that they are dealing with firms where the fair treatment of customers is central to the corporate culture;

102 Moneyfacts Treasury Reports: *UK Savings Trends*, London: Moneyfacts, April 2012; MAS, *The financial Capability of the UK*, London: MAS, 2013

103 FCA, *Treating customers fairly* [accessed via: http://www.fca.org.uk/firms/being-regulated/meeting-your-obligations/fair-treatment-of-customers (15/07/14)]

104 Ibid

- **Outcome 2:** Products and services marketed and sold in the retail market are designed to meet the needs of identified consumer groups and are targeted accordingly;
- **Outcome 3:** Consumers are provided with clear information and are kept appropriately informed before, during and after the point of sale;
- **Outcome 4:** Where consumers receive advice, the advice is suitable and takes account of their circumstances;
- **Outcome 5:** Consumers are provided with products that perform as firms have led them to expect, and the associated service is of an acceptable standard and as they have been led to expect;
- **Outcome 6:** Consumers do not face unreasonable post-sale barriers imposed by firms to change product, switch provider, submit a claim or make a complaint.

Despite the requirement that firms embed TCF principles into their business. The CSJ has heard that in practice this guidance is not sufficient to ensure consumers receive products and services that meet their needs (over their lifetime) or protect them from being mis-sold financial products.

The Financial Ombundsman, which handles consumer complaints, dealt with over 500,000 cases in 2013/2014, a 311 per cent increase since 2006.[105] The two biggest areas of complaint were in regards to banking (savings, current accounts etc.) and PPI insurance, with 40 per cent of current account-related claims being upheld in 2014. It is estimated that as many as one in five packaged current accounts, which can cost between £5 and £25 per month and offer additional, but often unnecessary, features such as travel insurance, may have been mis-sold.[106]

This strongly indicates that the current TCF guidelines are not protecting consumers as well as they should. The CSJ has heard from debt advice charities that this is particularly damaging for vulnerable people and those on low-incomes.

> *'A 50-year-old single mother, whose adult son was still living with her, contacted us with just one debt – a personal loan with her bank, on which she owed £14,000. When talking the debt through with the client, it became clear that she had been sold insurance on the loan, on the basis that it would protect her son from having to take on the repayments for the loan if anything happened to her. We advised her that the loan cannot be transferred to anyone else, and to make a complaint to the bank, as including this product in her monthly repayments has clearly inflated her debt problems.'*
>
> StepChange Debt Charity – in evidence to CSJ

105 Financial Ombudsman Service, *Annual review of consumer complaints about insurance, credit, banking, savings, investments,* London: Financial Ombudsman Service Limited, 2014; Financial Services Authority, *Treating customers fairly – towards fair outcomes for consumers,* London: The Financial Services Authority, 2006

106 BBC, *One in five may have been mis-sold packaged current account, 23 October 2013* [accessed via: http://www.bbc.co.uk/programmes/articles/3jZ3jX7kbZscC3dH2HPBJf2/one-in-five-may-have-been-mis-sold-packaged-current-account (16/07/14)]

The CSJ has been told that the current TCF guidelines are not effective in part because they allow financial firms to assume average consumers have an unrealistic degree of financial capability.

> *'Many people do not have a good understanding of financial products and services which are in common use.'*
>
> Shaun Mundy, International financial capability consultant – in evidence to CSJ

The lack of minimum standards and more specific guidance on how to treat customers fairly makes it easy for poor practice and harmful products to pass a financial institution's internal approval process, even when TCF guidelines are fully implemented.

We propose that the FCA amend existing TCF guidelines to incorporate the following principles:

- Consumers should have access to a range of safe financial products that do not cause harm through normal use;
- Essential, everyday types of products and services should be simple, transparent, and meet the basic needs of average consumers;
- All costs, fees and charges that apply throughout the life of a product should be clear to allow customers to compare their options;
- Customers should be treated fairly and not misled prior to, during and after the purchase of a financial product or service;
- Advertising should be clear, easily understood by average consumers and due care should be taken to ensure vulnerable groups are not targeted;
- Additional care should be taken to identify and proactively protect consumers in vulnerable circumstances.

These small but significant extensions to existing TCF principles will help to create a more supportive market environment and shift the responsibility in a way which aids consumers – so they are better able to use what financial capability they have.

Recommendation 1: The FCA needs to reform existing TCF guidelines to include new minimum standards of consumer protection that clarify what firms must achieve when dealing with customers and designing products and services.

Effective enforcement of TCF principles by the FCA is needed if people are to be protected from harm caused by mis-selling and poor practice. An evaluation found that while organisations may implement TCF principles well at the top, this often has little actual impact on the quality of services and products that customers receive.[107]

Numerous whistle-blowers from a variety of large financial institutions have come forward recently to reveal how internal policies and procedures, both official and cultural, have led to poor practice and mis-selling that has harmed consumers.[108]

The FCA needs to hold individual employees at all levels accountable for actions that result in consumer harm. This may be via direct contact with customers or through approving and designing products and internal policies that fail to meet the new TCF minimum standards.

We propose this is achieved through the creation of a new code of ethics and standards for those working in the financial services industry, similar to that which exists in other regulated professions, such as medicine and law. This should attempt to maximise the number of people held accountable for monitoring and implementing adherence to the new TCF principles at every level, including the retail sales environment.

Sanctions under this new code should be based on a person's culpability and seriousness of the harm caused by their actions, with the ultimate penalty being a lifetime ban from working in the financial sector.

Recommendation 2: The FCA should implement and enforce a new code of ethics for financial service professionals that is better able to hold individuals accountable for gross violations of standards and/or unethical behaviour that harms consumers.

2.2 Making financial products and services that are simple and safe

Creating a supportive market environment where people are treated fairly must be complemented by improvements in the quality, simplicity and safety of financial products and services. The sheer variety and complexity of existing products means people will always struggle to make informed choices and avoid falling into debt through the use of an inappropriate product. For example, a 2012 report found that there were more than 2,434 savings products on the market, while the OFT found that more than two-thirds of people do not know or understand the overdraft charges applied by their bank.[109]

107 Consumer Focus, *Fair Enough?*, London: Consumer Focus, 2011

108 This is Money, *Revealed: Nationwide traffic light 'sales' system that flashes red if staff aren't 'selling enough' – as whistleblowers warn of pressure to hit targets*, 31 May 2013 and ITV, *Whistleblower reveals Lloyds' sales techniques*, 11 December 2013 [accessed via: http://www.itv.com/news/2013-12-11/whistleblower-reveals-lloyds-sales-techniques/ (16/07/14)]

109 Moneyfacts Treasury Reports: *UK Savings Trends*, London: Moneyfacts, April 2012; Parliamentary Briefing Paper, *Retail banking: overdraft and credit card charges & the OFT review into the current account market*, SN/BT/3941, 3 June 2014

In order to tackle problem debt there is an immediate need for:

- A range of 'Essential Products' that are easy to use and meet the basic needs of average consumers;

- Improvements to payment systems, such as direct debits, to give people greater control over their money and help them avoid problem debt.

2.2.1 Creating a range of Essential Products

Customers need to know that there are a range of straightforward financial products available – particularly for transactional banking, easy-access savings and basic insurance – that are easy to understand and use and that are completely transparent with regards to restrictions, fees or penalty charges. Such 'Essential Products' have the potential to minimise the harm that they can cause to consumers and help people trust rather than fear the financial system.[110]

> **Essential Products:** Kitemarked financial products that are easy to identify and understand, have transparent fees and are designed with a set of standard features that meet the needs of average consumers and minimise the potential for harm.
>
> These will provide a baseline for the selling of other products by providers, who will be required to explain how other products, with more or less features, differ from the common baseline product on offer.

In 2011 the Government began the process of developing a suite of 'Simple Products' – similar but less extensive than our proposal for Essential Products – that were transparent and easy to understand, and which would help people manage their everyday finances. Unfortunately this initiative has stalled despite endorsement from the Treasury..[111]

This would provide one standard product that consumers will become knowledgeable about, but also allow companies to charge what they think appropriate and also provide a common baseline for consumers to use when choosing products with more or less features.

Essential Products should include:

- A transactional bank account;
- An instant access savings account;
- A standard personal loan;
- Common insurance products such as home contents, buildings, car, income protection and life insurance.

110 HM Treasury, *Sergeant Review of Simple Financial Products*, London: HM Treasury, 2013
111 HM Treasury, Letter from Sajid Javid, *Simple Financial Products*, 19 March 2013

These products, particularly the transactional bank account, could potentially help prevent debt problems for millions of people who struggle to use or access current transactional banking products. This includes the 6.6 million adults who incur more than £100 in bank charges each year and who are disproportionately likely to be on a low-income and/or have low savings.[112] Similarly, there are still 1.4 million people who do not have access to a transactional bank account, which may reduce the positive impact of switching to Universal Credit for some people.[113]

It is beyond the scope of this paper to set out full details for the proposed suite of Essential Products, but these principles should be adopted:

- Essential Products must be simple, easy to use and identify, and have set limits on any fees and charges, which must be transparent;
- Essential Products must be designed with input from a range of consumer groups and financial providers to ensure they are commercially viable propositions and appropriate for for the most vulnerable consumers;
- Providers must be required to offer an Essential Product in each category for which they already offer a different product, but retain the ability to set the price.

Recommendation 3: The Treasury in consultation with the FCA and consumer groups should work to push forward the development of Essential Products, bringing in appropriate legal requirements to develop and provide them if necessary.

2.2.2 Putting people in control of their payments

In order for people to avoid problem debt it is vital that they have control over their money and the payments they make. This is especially important for low-income households, who are disproportionately likely to incur penalty fees and charges as a result of going overdrawn or having a direct debit fail.[114] This is partly because they are more likely to have irregular incomes, such as a zero-hours contract, which exacerbates this problem.[115] The result is that low-income households are less likely to use direct debits to pay for bills, which contributes significantly to the 'poverty premium' – a 10 per cent premium low-income households pay when accessing goods and services.[116]

112 Parliamentary Briefing Paper, *Retail banking: overdraft and credit card charges & the OFT review into the current account market*, SN/BT/3941, 3 June 2014
113 DWP, *DWP credit union Expansion Project*, London: DWP, 2012
114 Parliamentary Briefing Paper, *Retail banking: overdraft and credit card charges & the OFT review into the current account market*, SN/BT/3941, 3 June 2014
115 StepChange, *Life On the Edge*, London: StepChange, 2014
116 Consumer Futures, *Addressing the Poverty Premium*, London: Consumer Futures, 2013

Charley, a young woman in her early 30s, attributed her financial difficulties to overspending and not being able to meet her direct debit payment dates. She exceeded her authorised overdraft limit several months in row, incurring charges for missed payments and overdraft fees. Charley had never drawn up a budget and found it difficult to manage her money. National Debtline helped her create a budget and she now has a separate bank account to ensure she can pay her bills and doesn't incur penalty fees.

National Debtline – in evidence to CSJ

Penalty fees and a lack of control are the leading reasons why many people choose to remain unbanked.[117] There are currently 1.4 million unbanked people, including some of the poorest and most vulnerable, who rely exclusively on cash and are subject to a poverty premium that can worsen their financial situation and debt problems.

'I used to go to Post Office on Tuesdays, take out cash for the weekly shop and had all my bills paid there. When things started going Direct Debit I never got the hang of it. I would get a £30 charge for a £6 Direct Debit. Things escalated, and the more kids I had the more costs there were. I had to get credit for clothing and started not being able to pay rent, so I had to move from house to house. I bought things on credit, but they often collected early, so I had no money left for food. I went without food a lot, and the kids only had basic meals. I was really depressed, not ever opening the curtains. I had no friends; they'd invite me out but I couldn't go. Slowly I withdrew from them. I felt suicidal a few times, but didn't know who would look after my kids. No one knew I was in debt. I contacted CAP who helped me budget and avoid bank penalty fees.'

Anonymous – in evidence to CSJ[118]

A similar problem has been highlighted by the FCA in regards to the exploitative use of continuous payment authority (CPA) by some payday lenders when attempting to collect repayment of a loan.[119]

'StepChange Debt Charity sees many problems with CPA – clients are usually unaware that they can cancel this authority, and often have problems with the process, with banks and lenders blaming each other for the CPA continuing. One particular client sent letters and emails to all her creditors to tell them the CPA had been cancelled. Her bank was very supportive, but the lenders carried on using the CPA – one lender called her six times to contest the cancellation. The bank issued refunds every time the CPA was taken, but in the time between the money being taken and the bank refunding it, the client was unable to pay her priority bills, and struggled even to pay for food.'

StepChange Debt Advice Charity – in evidence to CSJ

117 HM Treasury, *Realising banking inclusion: The achievements and challenges*, London: HM Treasury, 2010
118 Case study provided by Christians Against Poverty
119 FCA, *PS14/3: Final rules for consumer credit firms* [accessed via: http://www.fca.org.uk/news/ps14-3-final-rules-for-consumer-credit-firms (17/07/14)]

In order to help people avoid penalty fees and debt problems, the new Payment Systems Regulator should bring in regulations that enable customers to have greater control and flexibility over the payments they authorise. They should aim to help people in financial difficulty or who struggle to manage their finances to more easily alter the frequency, exact dates and amounts of regular payments, temporarily suspend them or even cancel the authorisation.

The payments industry and regulator will need to work together in order to create a range of electronic payments which offer a scale of control versus flexibility, so that consumers can select the level of flexibility that best matches their individual income pattern.

These changes would enable many people on low-incomes to engage with and benefit from financial services and help them avoid problem debts that can be caused by penalty charges.

Recommendation 4: The new Payment Systems Regulator should reform the existing payment systems to enable people to have greater control over the timings and amounts of the payments they authorise, as well as make them easier to suspend or cancel.

2.3 Helping people to build financial capability

At present there are 17 million adults in the UK who run out of money before payday.[120] Whilst economic conditions obviously play a significant role in this, poor money management can also lead to debt problems.[121] In 2013 problems with budgeting were the third most commonly cited reason for seeking debt advice, after unemployment and reduced income.[122]

'I am of a generation who kept financial problems to themselves. Prior to reaching crisis level, I had been in full time employment with a good salary but on reflection, living above my means. I had loans for holidays, credit and store cards etc. When I was made redundant I got a part time job, going down from 40 to 16 hours a week. I could not meet my commitments and my debts grew and grew. I had a nervous breakdown and made two attempts at suicide. I was in despair. Then, I saw a leaflet for CAP, rang up, the local adviser and a mentor visited. They took my pile of papers, set up a budget that I could afford. I saved up money as well. CAP literally saved my life.'

Anonymous – in evidence to CSJ[123]

The wide-ranging impact debt and low levels of financial capability can have on individuals, families, the economy and the state's welfare system, mean there is a clear public policy case to fund and coordinate programmes that help people improve their financial financial capability during times of stability.

120 MAS, *The financial Capability of the UK*, London: MAS, 2013
121 Institute for Fiscal Studies, *IFS Green Budget 2014*, London: IFS, 2014
122 StepChange, *Statistics Yearbook: Personal Debt 2013*, London: StepChange, 2014
123 Case study provided by Christians Against Poverty

2.3.1 Improving the funding and coordination of financial capability programmes

Governments around the world have increasingly recognised the importance of financial capability in helping people to make positive financial decisions, manage their money and avoid problem debt.[124]

In 2011 the responsibility for developing financial capability was taken over by the Money Advice Service (MAS), an independent body created by Government and funded through a levy on the financial sector.[125] MAS have committed to producing a new National Strategy for financial capability in partnership with the sector. They intend to publish a consultation in August, with the final Strategy due by the end of the year. It is vital that this Strategy sets out a strategic direction for financial capability in the UK and clarifies the roles of MAS, the third sector, the financial services sector and the Government in delivering it.

MAS has an annual budget of around £80 million, although it remains unclear what portion of this money will be used in coordinating the national approach to financial capability and for delivering certain objectives in the draft National Strategy.

> *'It's good news that progress is now being made on the new National Strategy for Financial Capability. We are hopeful that the Strategy will consolidate the latest evidence and research plus opinion from across sectors to produce a new strategic focus and agreed priority areas for all of us working to improve financial capability in the U.K. For the Strategy to be a success however, it will need to clearly set out how the Money Advice Service itself will adjust to deliver and fund the Strategy as well as making clear these same roles for Government, the financial services sector and the third sector in this joint endeavour.'*
>
> Michelle Highman, CEO The Money Charity – in evidence to CSJ

In addition, funding for financial capability and education programmes is provided through the CSR programmes of many financial institutions. At present these programmes compete for leadership and profile within the financial education sector, and are therefore not closely enough coordinated within the wider arena of financial capability work. The CSR programmes often provide useful services that can plug gaps within the sector, but decisions about the length and type of funding are firmly located within each organisation's business strategy, not within a wider UK financial capability strategy.

This can mean that valuable programmes can be cut when the funder's business strategy changes, and funders compete to provide 'unique' programmes that give them media profile, regardless of the existing funding needs within the sector. In 2013–14 the Personal Financial Education Group (pfeg) led a programme to increase coordination between these and other financial education services, but the funding for the coordination secretariat has come to an end. This lack of coordination means limited resources are at risk of being allocated based on

124 Russia's G20 Presidency and Organisation for Economic Co-operation and Development, *Advancing National Strategies for Financial Education*, London: Russia G20 and OECD, 2013

125 MAS, *A Financial Capability Strategy for the UK: The Evidence Base*, London: MAS, 2014

funders' CSR and media agenda, rather than on identified needs in a coordinated and effective process. We recommend that MAS coordinate these programmes more closely and with a greater emphasis on ensuring that programme funds are targeted at areas of priority needs, as identified within the new National Strategy.

Finally, without a much more co-ordinated response on financial capability between MAS and Government, there is a risk that in the future government messaging and policy neglects to consider financial capability and inadvertently makes money management harder or too complicated to be understood by the average person, which could cause financial harm. Examples of this include:

- HMRC's delivery and enforcement of the tax system;
- Treasury's policies on pensions and savings.

There is a need for a government body tasked with coordinating and advising departments to ensure their messaging and policies are simple and easily understood by the average person and that they do not inadvertently make managing money harder to do. This same body should also be responsible for holding departments to account in regards to the funding they allocate for addressing financial capability issues related to their policies and work, as well as the levels of support they provide to help people understand new policies and avoid any financial hardship that could result.

> *'Several government departments have important roles to play in strengthening the financial capability of the population. But there is a need for their contributions to be coordinated better – and it is essential that all Government communications relating to personal finance are clear and simple.'*
>
> Shaun Mundy, International financial capability consultant – in evidence to CSJ

As an example, the Government has committed to developing a 'guidance guarantee' that will offer every individual financial advice upon their retirement. Without oversight there is the risk that the support provided to vulnerable people will be insufficient or unrealistic relative to average levels of financial capability, which could result in people failing to adequately plan for their retirement and becoming dependent on the state for support.

Other examples include the Department for Educations's delivery of financial education in schools, as mandated by the new curriculum, and the DWP's role in supporting vulnerable people during the switch to Universal Credit.[126] Both programmes have desirable objectives, but there is a lack of clarity about funding and delivery. For instance it is unclear if funds should be used for direct delivery of financial education by third-sector providers or to train teachers to deliver financial education themselves.

There is also a need for clarity over what precise measures are being taken to provide support for Universal Credit claimants during the transition to UC. Without oversight within

126 Personal Finance Education Group (PFEG), *Financial education's place in the new National Curriculum confirmed*, London: PFEG, 2013 and DWP, *Local Authority Led Pilots*, London: DWP, 2014

government of these programmes, and a requirement to consider and adequately fund any necessary financial capability measures, the objectives of these policies may well not be achieved and people could fall into debt as a result.

The CSJ strongly believes that if MAS is to be successful in the creation of a new National Strategy, there is a need for better strategic coordination of both its own funding, that of the financial services sector and government funding and policy in regards to developing financial capability.

Recommendation 5: The Treasury should designate a government body or department to coordinate, advise and hold government departments accountable for the messaging and delivery of their policies to ensure they are easily understandable, that people do not suffer harm through a lack of understanding, and that sufficient resources are allocated to addressing issues of financial capability which are necessary to deliver policies and programmes effectively.

Recommendation 6: The MAS should ensure that it involves all interested parties (government, the third sector, and the financial services sector) in the development of its new National Strategy. The National Strategy must make clear the roles MAS and each of these parties play both in delivering and funding the Strategy.

2.3.2 Improving the delivery of financial capability programmes

Helping people to develop their financial capability is often more difficult than teaching a traditional subject or skill for a variety of reasons including:

- Difficulties engaging people with programmes because of stigma, a reluctance to talk about money and lack of recognition about the real world benefits;
- Problems designing programmes suitable for groups as people's needs and interests in regards to financial capability often vary widely and change over time; [127]
- Pre-existing attitudes and behaviours in regards to money management that are often formed at an early age.[128]

Evaluation of programmes delivered by the FSA and in other countries has established that successful programs and strategies for financial capability should:[129]

- Be delivered throughout people's lives to reflect their changing circumstances and needs – at school, during work, planning for retirement etc.;

127 MAS, *A Financial Capability Strategy for the UK: The Evidence Base*, London: MAS, 2014
128 MAS, *The financial Capability of the UK*, London: MAS, 2013
129 Russia's G20 Presidency and Organisation for Economic Co-operation and Development, *Advancing National Strategies for Financial Education*, London: Russia G20 and OECD, 2013

- Utilise 'teachable moments' when people are more receptive to developing financial capability as they see the real world benefits of it – examples include leaving home, a new job, a new tenancy, unemployment, illness, or family breakdown;

- Work with 'trusted intermediaries' when possible to help engage people, especially the hardest to reach groups – employers, youth workers etc.;[130]

- Target resources on certain vulnerable groups and where the impact would be most substantial – such as young or older age groups;

- Base funding and evaluations on the outcomes of programmes rather than their reach – such as increases in savings by particpants rather than number of participants.

The CSJ heard from TwentyTwenty, an Alliance member that works with hard to reach young people, that these principles are particularly important when attempting to deliver financial capability training.

Case study – Twenty Twenty

TwentyTwenty works with children at risk of being excluded from school due to challenging behaviour, truancy or other issues, and works with young people who are not in education, employment or training. They operate every day of the week, running two purpose-built 'Lifeskills' centres where young people come for anything from a few hours up to three full days a week, according to need.

While financial capability is not the primary focus of their work, mentors use real life opportunities to talk about financial skills, budgeting and more general issues such as and making sound financial choices.

> *'Things to do with money are sensitive and often explosive. Remembering this is vital in how we deal with it – that is why trusted mentors and tutors play wonderful critical roles. Asking the challenging questions – why are you spending it on this etc – is easier from someone they trust, rather than someone they think is out to get them.'*
>
> Andy Cook, CEO Twenty Twenty – in evidence to CSJ

Based on the evidence available and these established principles there are four specific situations where we believe helping people improve their financial capability would be particularly effective:

- Financial education in schools;
- Supporting Universal Credit claimants;
- Providing financial capability through the Work Programme;
- Helping rebuild family finances through the Troubled Families Programme.

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130 Financial Service Authority, Evidence of impact: *An overview of financial education evaluations*, London: Financial Service Authority, 2008

1. Financial education in schools

Recent reforms to the national curriculum mean that as of September 2014, all maintained secondary schools will be required to teach financial education as part of citizenship education and secondary mathematics.[131] While this is a welcome development, the CSJ highlighted in *Maxed Out* that there are widespread concerns amongst experts and charities that this reform will accomplish little in practice and may divert attention and funding from programmes to develop financial capability at other important stages of people's lives.[132] Other concerns are that:

- It does not apply to academies which make up 54 per cent of schools;[133]
- No additional funding has been set aside for delivery;
- Teachers in schools are not prepared or confident enough to deliver the new subject matter from September, with few having undergone specialist training;
- Research shows it is hard to engage students and achieve lasting outcomes.[134]

> *'Teachers are asked to cover a lot: personal finance for young people is a niche area with different requirements at different life stages: requiring all to train to become experts is not optimal. Schools should/can use internal and external strategies and our specialists are here to support them to maximise effectiveness.'*
>
> Guy Rigden, Interim CEO MyBnk – in evidence to CSJ

In contrast, the CSJ has seen the positive results that can be achieved with students of all ages when schools bring in external charities to provide specialist financial education. However, we have heard that funding is in short supply for these organisations, with many financial service organisations retreating from funding these initiatives under the mistaken belief that 'the job is done' now that financial education is on the curriculum.

Case study – The Money Charity

The Money Charity provides free direct delivery in schools and colleges in England, Wales and Northern Ireland through their Money Workshops which are offered to students between the ages of 11 and 19. They have reached over 90,000 young people in this way and will reach 100,000 by the end of 2014.

The workshops follow a modular system that allows teachers to pick and choose the money management topics that are most relevant for their students. Topics focus on five key areas; planning, saving, debt, financial products and everyday money; that provide the bedrock of sound money management. The modular system offers choice and flexibility to schools by offering age/curriculum appropriate workshops that can be delivered as a standalone unit or progressively year on year.

131 Personal Finance Education Group (PFEG), *Financial education's place in the new National Curriculum confirmed*, London: PFEG, 2013
132 Centre for Social Justice, *Maxed Out*, London: Centre for Social Justice, 2013
133 Ofsted, *Schools 2012/13*, Manchester: Ofsted, 2013
134 Financial Service Authority, Evidence of impact: *An overview of financial education evaluations*, London: Financial Service Authority, 2008

Results

Teacher: 'The external speakers have more knowledge about subjects that I am unable to discuss.'

Pupil: 'I think that seeing this workshop will change how I manage money in the future because I will be more sensible with spending and setting priorities.'

Before the workshop only 32 per cent of students were confident they could create a budget – this doubled post workshop, to 68 per cent.

Case study – MyBnk

The charity MyBnk designs and delivers financial education and enterprise programmes for 11–25 year olds in schools and youth groups. They mine youth culture and collaborate with financial experts, teachers and young people to produce workshops covering saving, budgeting, pensions and student finance, microfinance schemes and resilience projects such as Hyde Housing's Money House.

It takes six days and just over £1,700 to train an individual to deliver on average 500 hours of money lessons to around 300 schools a year. 80,000 young people in over 450 secondary schools have gone through their programmes and they have also trained others to deliver their workshops.

MyBnk places a high standard on quality with tests and observations and all sessions are monitored and evaluated. Last year their Money Twist programme was mapped to the new National Curriculum and 100 per cent of teachers rated their programmes as effective in engaging young people and 94 per cent of students said the sessions were good.

Recommendation 7: The Department for Education should establish funding and best practice guidelines recommending that financial education be delivered in a multi-channelled approach, both through specialist third sector organisations offering innovative and effective programmes and by teachers themselves who have the required following professional development training.

2. Supporting vulnerable Universal Credit claimants

The rollout of Universal Credit – which combines six different benefits into one monthly payment – represents the biggest reform to the welfare state since its creation. The DWP has recognised that while most people will have little difficulty in switching to the new payment system, there is a group of vulnerable people that will need additional support in order to manage monthly payments.[135]

135 The DWP, *Local Authority Led Pilots*, London: DWP, 2014 and DWP, *Direct Payments Demonstration Projects: Learning the lessons, six months in*, London: DWP, 2013

Recommendation 8: The DWP should take care to identify all Universal Credit claimants that would benefit from additional support to develop their financial capability during the switching process. Programmes should be delivered by third sector organisations or trusted intermediaries (ie housing associations) in order to reduce costs and increase engagement with claimants.

3. Providing financial capability through the Work Programme

The Government's development of the Work Programme, to deliver specialist support to those people who are furthest from obtaining employment, represents a perfect opportunity to help a particularly vulnerable group develop financial capability. The various correlations between long-term unemployment, low income, low educational attainment, and problem debt identified through various CSJ reports, means many people being supported by the Work Programme would benefit from being offered the opportunity to develop their financial capability. Claimants would benefit both financially and in terms of finding employment, while also supporting their transition from benefits to employment.

Recommendation 9: The DWP should include a new requirement for Work Programme providers to offer financial capability programmes, either directly by trained staff, or in partnership with third-sector organisations, as part of the next tendering process.

4. Helping rebuild family finances through Troubled Families Programme

The Government committed to turning around the lives of 120,000 families by 2015 through intensive support offered under the Troubled Families Programme.[136] These families struggle with multiple issues, such as addiction and unemployment, which keep them trapped in poverty. It is likely that many of these families also struggle with problem debt and would benefit from improved financial capability and debt advice.

The CSJ heard from Chance UK, an alliance member, about how families could be engaged with debt advice and financial capability programmes through a trusted intermediary.

Case study – Chance UK

Chance UK is a CSJ Alliance member that provides mentoring for children aged 5–11 who have behavioural difficulties and are at risk of developing anti-social or criminal behaviour.

They operate a two-pronged approach: whilst a mentor takes the child out for their sessions each week, a Parent Programme Manager visits parents or carers to support them at the same time. The work being done by the mentor helps the Parent Programme Managers reach parents who would not normally engage with such services.

136 Department for Communities and Local Government (DCLG), *Helping troubled families turn their lives around*, London: DCLG, 2014

The charity generally works with children for two years, which helps them to build up a rapport with both the children and their parents/carers. This is crucial for building the trust necessary for parents to share information about their financial situation and seek help from Chance UK where it is needed. It also helps the Parent Programme Manager be more direct in offering advice around debt management and prioritising expenses. Their aim is to empower parents to take control of their financial situation and feel confident doing so, even if it requires small steps, patience and perseverance.

The great work of local third-sector organisations shows just how families could be engaged under the Troubled Families programme.

Recommendation 10: Resolution of debt issues, where present, should be established as an outcome under the Troubled Families funding and evaluation criteria, in order that providers can help people with debt advice and to build their financial capability.

chapter three
Building a nation of savers

Introduction

Over the past decade, UK households have consistently saved less than almost any country in the European Union, with one in three households reporting that they have no savings at all.[137] The poorest families find it especially hard to save, with 80 per cent of the poorest households failing to save regularly.[138]

Inadequate savings mean people are significantly more likely to incur problem debt if they suffer an income shock. There are currently 13 million people who do not have enough savings to support them for one month if their income were to drop by a quarter, including 40 per cent of all households with an annual income under £15,000.[139]

Income shocks
Over a third of people in the last year report having had significant changes in their circumstances that impacted their finances.[140] This can include a switch to insecure employment (such as a zero hour contract), a reduction in hours worked or in benefit entitlements, increased caring responsibilities or relationship breakdown.[141]

In order to tackle problem debt it is essential to reverse the erosion of the UK's savings culture. Without adequate savings people will always be more reliant on credit and vulnerable to problem debt. This chapter will set out:

137 Organisation for Economic Co-operation and Development (OECD), *Factbook 2013–14*, London: OECD, 2014
Note: Based on analysis household savings rate as percentage of disposable income across EU countries. Only households Denmark (high tax rates mean low levels of disposable income) and Greece (in economic crisis) consistently scored lower based on this measure.
138 University of Birmingham, *Financial Inclusion Annual Monitoring Report 2013*, Birmingham: University of Birmingham, 2013
139 StepChange, *Life On the Edge*, London: StepChange, 2014
140 Ibid
141 Personal Finance Research Centre (PFRC) *Towards a nation of savers*, Bristol: PFRC, 2011

- New policies to help people build savings;
- Reforms to allow those people who have already fallen into debt the opportunity to save and avoid future debt problems.

3.1 Helping people to save

As credit is increasingly used to cover income shortfalls in lieu of savings, households on the lowest incomes stand to potentially gain the most from savings as they pay disproportionately more to access credit, yet also find it the hardest to save.[142] Only four in ten low-income households have access to any form of savings account, while just under a third have saved anything in the past year, with average savings of £371 per household compared to an average of £2,000 amongst the 70 per cent of better off families who save regularly.[143] Levels of savings are particularly low amongst people in insecure work, such as zero hour contracts, who are also more likely to experience an income shock.[144]

The lack of savings can lead to financial hardship for low-income households and cause problem debt through the need to rely on high-cost credit.[145] We estimate that in the last three years one in six low-income households have experienced a substantial income shock that they have not had sufficient savings to cope with.[146]

Research has shown that people in low-income households see the logical benefits of saving money and would like to save more, but are often simply unable to or fail to prioritise it over other expenditures.[147] This section looks at how people, particularly those on low incomes or dependent on benefits, can be helped and encouraged to save in order to build their financial resilience and tackle rising levels of problem debt.

3.1.1 Building savings while in employment

The CSJ has heard that a potentially powerful way to incentivise saving amongst those in work would be to create an employer-based auto-enrolment savings scheme. The same principle has recently been successfully used to introduce opt-out contributions to private pension plans.[148]

As pensions are a form of long-term saving the same logic and evidence is applicable to developing a new system of auto-enrolment in employer based short-term saving schemes.

142 Ibid

143 PFRC, *Towards a nation of savers*, Bristol: PFRC, 2011

144 StepChange, *Life On the Edge*, London: StepChange, 2014

145 FCA, *Consumer credit and consumers in vulnerable circumstances*, London: FCA, 2014

146 MAS, *The financial Capability of the UK*, London: MAS, 2013 and DWP, *Family Resources Survey*, London: DWP, 2013; *Note: estimate based on 2013 survey finding that 37 per cent of all households had experienced a substantial income shock in the past three years and FRS data indicating that 47 per cent of households earning under 15,600 have no savings*

147 PFRC, *Towards a nation of savers*, Bristol: PFRC, 2011 and Institute for Public Policy Research, *Saving and Asset Building in Low Income Households*, London: Institute for Public Policy Research, 2009

148 *Note: The auto-enrolment of employees into private pension schemes was introduced in the Pensions Act 2008. There is substantial evidence that supports the principle of auto-enrolment and payroll deductions as an effective means of increasing investment in pension schemes. Since the introduction of the scheme, around nine million people have begun to save towards retirement for the first time (for more information please see* DWP, *Individuals' attitudes and behaviours around planning and saving for later life*, London: DWP, 2009 and DWP, *Press Release, Pension savings – 9 million newly saving or saving more, says Pensions Minister*, 11 April 2014)

Many firms already operate schemes to help employees save and plan for future spending, but few help people deal financial emergencies. These include:

- Save as You Earn (SAYE): a 3–5 year scheme requiring monthly savings that are then topped up with a tax-free bonus at the end;
- Share Incentive Plans (SIPs): schemes to allow employees to buy shares in their employer with a variety of tax incentives and other bonuses;
- Workplace ISAs: as they are negotiated in bulk by the employer these ISAs offer better terms and interest rates, with some employers offering payroll deductions to make saving easier.

Currently one in six UK companies already offer their employees access to a cash ISA savings scheme, while 41 per cent either already offer or are considering implementing a centralised online savings management platform in the future, which would help increase employee savings.[149] There are clear benefits for employers who offer saving schemes, in terms of lower levels of employee stress, increased productivity and reduced absenteeism.[150] The CSJ recommends that all employers are required to develop a saving scheme for employees, either internally or in partnership with a financial institution, with the requirement being rolled out gradually, beginning with the largest companies.

Under our proposed scheme employers would have almost complete flexibility in terms of designing the savings programme, including the option to offer it internally or through an

149 Employee Benefits, *Workplace Savings Quarterly*, Crawley: B & C E Financial Services Limited, 2012; Towers Watson, *The future of workplace savings*, London: Towers Watson, 2011

150 Sodexo, *Financial stress is impacting productivity for nearly a quarter of UK employees*, London: Sodexo, 2014; Barclays, *Savings buffer key to improving employee financial wellbeing*, [accessed via: http://www.employeebenefits.co.uk/suppliers/savings-buffer-key-to-improving-employee-financial-wellbeing/104841.article (16/07/14)]

external provider, such as a Community Bank (see Chapter 4 for more details). However we propose that certain minimum standards are required of all employers' schemes:

- Ability to specify theamount and frequency of a periodic deduction from wages;
- Option to have an instant access savings account;
- Requirement to offer at least one 'fee-free' savings account;
- Savings must be covered by the FSCS deposit guarantee scheme in order to protect people's savings in the event that an employer, or external provider, becomes insolvent.

Allowing employers to offer the saving scheme through a third party will ensure that all employees have access to a high quality savings scheme, without placing an unrealistic expectation and financial burden on small employers to design and operate the programme. The majority of standard savings accounts with a credit union or Community Bank would meet all of the above minimum conditions.

Evidence suggests that people are more likely to save if their employer operates a payroll deduction scheme with a credit union, which can result in benefits for both the employee and employer in terms of decreased stress, improved productivity and reduced absenteeism.[151]

One study found that when employers offered an ISA savings product alongside automatic enrolment in a pension programme, only three per cent of people who stayed enrolled in the pensions scheme opted to not invest an additional two per cent of their salary in an instant access ISA.[152]

The success of existing employer-run credit unions, both in the UK and abroad provides evidence at to what can be achieved with this policy.

> *'When employers work with credit unions to put in place payroll deduction schemes, everyone benefits. It is really easy for staff to gain a savings habit and gain access to affordable credit and other financial services. Fewer money worries lead to less stress and a more productive workforce for the employer. Payroll deduction is a cost effective way for credit unions to reach large numbers of members and makes it easier for them to provide sustainable services in their communities.'*
>
> Mark Lyonette, CEO ABCUL – in evidence to CSJ

Recommendation 1: In order to increase levels of savings and help people avoid problem debt, the Treasury should bring in legislation that requires employers to create a savings scheme for employees with auto-enrolment, ideally through an employer-based credit union or strong local Community Bank.

151 London Capital credit union, *Employee Benefit Scheme For Local Employers and Employees*, [accessed via: http://www.credit-union.coop/content.asp?section=190 (16/07/14)]; Standard Life, *Keep on nudging: Making the most of auto-enrolment*, Edinburgh: Standard Life, 2011

152 Standard Life, *Keep on nudging: Making the most of auto-enrolment*, Edinburgh: Standard Life, 2011

3.1.2 Building savings while out of work

People who are out of work have at least as great a need of savings as those in work. Consequently the DWP should consider offering those claiming benefits access to an auto-enrolment savings scheme, to ensure life under UC mirrors that of work and help encourage people to save as they move in and out of work. Under this proposal a small portion of a claimant's Universal Credit (UC) entitlement, after taking into consideration the impact of any other benefit deductions, could be automatically set aside into a savings account chosen by the claimant, with the claimant being able to access the funds at anytime and easily opt-out.

We recognise that for many people saving regularly under UC would be difficult if not often impossible, and that any amounts they are able to save would be small, perhaps just a few pounds per month. However, there are wider benefits of saving even small amounts in terms of changing attitudes towards savings and planning for the future. We recommend that the claimants are directed towards a local credit union or Community Bank when choosing an account for their UC savings to be paid into. This would help connect people with local organisations that can provide affordable forms of ethical finance, including banking and loans, when needed in the future.

The CSJ heard from MyHomeFinance, a CDFI that offers loans primarily to social housing tenants dependent on benefits, about the demand for savings products.

> *'A surprising number of our customers (around 50 per cent) are very keen to save, if only minimal amounts.'*
>
> Tess Pendle, CEO My Home Finance

Similarly, Moneyline, another CDFI, said that around 80 per cent of its customers chose to save a small amount each week as part of their loan repayment, with 18,000 customers saving a total of £4.3 million since 2002.[153] This implies there is a clear desire amongst many prospective UC claimants to save small amounts of money.

In the past, Government has offered a range of additional financial support – either directly by the DWP or through devolved local welfare assistance schemes – to claimants who are unable to cover their living costs from their standard benefit entitlement or savings. [154] This may be because of a large unexpected expense such as being sanctioned, a change in circumstances or a delay in benefit payments. Savings accrued through a UC savings scheme could help reduce demand for welfare support as well as help those entering work cover associated one-off costs, such as required clothing, transport or equipment, while also helping to cover the period between the last UC payment and the first receipt of wages.

153 Moneyline – in evidence to CSJ

154 DWP, *Annual Report by the Secretary of State for Work and Pensions on the Social Fund 2012/2013*, London: The Stationary Office, 2013; National Audit Office, *Social Fund Account 2013–14*, London: National Audit Office, 2014

'Michael, 45 from Billingham found himself out of work in 2012. He searched for work on a regular basis but without success, he came on to the Work Programme in 2013. Michael is educated to degree level and has a BTEC in Customer Service so he thought he would get a job easily enough, however this was not the case. He quickly became frustrated with his progress and concerned about rising debts.

His adviser, Karen, suggested looking at jobs he wouldn't normally apply for. Michael took her advice and the following week he said that he had applied online to McDonald`s as he had the skills to do the job and was prepared to work his way up to become a Manager. Within a week he was interviewed and offered a full time job as Floor Assistant, however he needed some form of transport to get to work due to shift times. Karen realised how important transport was and with the help from the Work Programme money was provided in order to purchase a bicycle for him.'

Five Lamps – in evidence to CSJ

In order to help increase savings, the Treasury and DWP should consider how to financially incentivise savings amongst those UC claimants that would arguably benefit most from increased regular savings. For example, the savings culture that used to exist in Britain has largely disappeared amongst younger generations, meaning that there is a public policy case for incentivising savings for UC claimants under the age of 30.

The CSJ heard from TwentyTwenty – a CSJ Alliance charity working with disadvantaged young people – about how important changing attitudes towards savings can be in terms of empowering young people to take control of their money.

'Learning to save is critical for us all, and becomes even more important when you have as little as our young people do. A scheme that helps them save and incentives them for it would be helpful, but it is important that the onus and responsibility is on the fact that it is their money and they can do with it as they please.

We have to entrust responsibility on them in this, not force it – otherwise it will be met with disdain, and achieve nothing. Only when our young people see for themselves the benefit of something new do they take to it and allow it to form habitually, as we must remember that they have been burned by so much before.'

Andy Cook, CEO Twenty Twenty – In evidence to CSJ

Similarly, several smaller groups of claimants such as NEETs, those enrolled on the Work Programme or identified for support under the Troubled Families Programme, would benefit most from savings and could all be incentivised to do so without huge expenditure. The effect of these financial incentives could then be evaluated to determine if more claimants would benefit from a wider rollout.

There is a strong case for introducing an auto-enrolment savings scheme for claimants under UC including: increasing financial resilience and reducing demand for welfare assistance schemes, wider positive effects on attitudes and life quality, helping people back to work, and preparing people to save once employed.

Recommendation 2: The DWP should investigate the viability of establishing an auto-enrolment savings component of UC that mirrors the employer requirements as closely as possible. The DWP and HMT should consider offering financial incentives to encourage UC claimants to save, beginning with pilot programmes for those most in need, such as NEETs, and those engaged with the Work Programme or Troubled Families initiative.

3.2 Preventing people from falling back into debt

Savings are not only needed to help people avoid falling into debt, but also to help people that are already in debt to rebuild their finances and prevent them from defaulting on repayment agreements after further unexpected income shocks.

Even small amounts of savings can prevent someone from getting into problem debt. For example, the average amount borrowed through high-cost credit is between £100 and £300, yet 40 per cent of people have insufficient savings to cover an income shortfall of £300.[155] Around one in five people who drop out of a debt repayment plan do so because they are unable to keep up with the repayments, most often because their financial situation has changed.[156] This problem is significantly worse amongst low-income households.[157]

In order to help low-income households recover from debt, either through repayment or insolvency, it is vital that the importance of allowing people to save suitable amounts regularly is recognised by creditors and encouraged by debt advisers. A failure to do so can result in people becoming trapped in debt and ultimately can decrease the amount of money creditors are able to recover through repayment arrangements.[158]

3.2.1 Giving people in debt the opportunity to save

In 2013 more than 100,000 people were declared insolvent, and it is estimated that between 300,000 and two million UK adults are currently repaying debts through a Debt Management Plan (DMP) or Debt Arrangement Scheme (DAS).[159] People seeking debt relief – either through insolvency or a repayment arrangement – face restrictions on their surplus income (after repayments and living costs), and their ability to access credit and banking, which last for the duration of the debt relief (typically three to five years).[160] Furthermore, credit reference agencies typically hold data on a person's insolvency for six years, which can further limit their access to mainstream credit. These restrictions make it very difficult to regularly save money to deal with income shocks and increase the cost of accessing credit in an emergency.

155 MAS, *The Financial Capability in the UK*, London: MAS, 2013; Personal Finance Research Centre, *The impact on business and consumers of a cap on the total cost of credit*, London: BIS, 2013
156 Zero Credit, *DRF Research: DMP Dropout Outcomes,* Derbyshire: Debt Resolution Forum, 2013
157 Ibid
158 MAT, *Sustaining Debt Repayments*, London: Money Advice, 2012
159 HM Government, *Insolvency Statistics January to March 2014 release*, London: HM Government, 2014; Zero Credit, *Debt Resolution in the UK*, Timperley: Debt Resolution Forum, 2012; R3, *Debt management plans*, London: R3, 2010; R3, *Personal Debt Snapshot*, London: R3, 2012
160 R3, *Debt management plans*, London: R3, 2010; Trust Deed, *Debt Arrangements Scheme Failure*, 13th November 2013 [accessed via: http://www.trust-deed.co.uk/news/debtarrangementschemefailurerateincreases.php (17/07/14)]

'The client has been on a Debt Management Plan with StepChange Debt Charity since February 2012. He initially had credit card debts, personal loan and catalogue debts amounting to £12,872, and has been paying these back via a DMP of £109 a month. Payments have been received regularly and on time throughout this period.

Unfortunately, the client contacted us in June 2014 to say that he has been having problems with his roof, and has been advised that the whole roof will need replacing. The cheapest quote he has been given for this is £5,000, which he cannot cover through savings. He has contacted his buildings insurance company, who say he is not covered for this as they classify it as maintenance work. His mortgage company is reluctant to help as he has already remortgaged twice.

He feels like taking out further credit may be his only option, but he may find it difficult to access mainstream credit due to his current financial situation. Monthly repayments on a loan of £5,000, particularly if from a high-cost lender, may eat up the money he has spare each month to pay towards his DMP, thereby putting his current plan at risk.'

StepChange Debt Advice Charity – in evidence to CSJ

One of the first priorities when accessing debt advice is to determine the extent of a person's debts and their ability to repay, taking into account average income and expenditures (rent, food, utilities etc). To help standardise this process, The Money Advice Trust has developed the Common Financial Statement (CFS) in partnership with the British Bankers Association and others. This provides debt advisers and creditors with guidelines on average household expenditures to use when negotiating how much a person is able to repay each month.[161]

The CFS has recently been amended to allow people to save a small amount each month as part of their 'essential expenditure'. The CSJ welcome this. The use of the CFS is now widespread including being recognised in the FCA rulebook and used as the basis for various forms of debt relief and/or repayment agreements.

Unfortunately, it is still not universally accepted, especially amongst government creditors (local authorities, courts and HMRC) meaning many people are unable to save while repaying their debts or seeking relief. This can put vulnerable people at risk of becoming trapped in debt if they are unable to meet a creditor's unrealistic repayment expectations or suffer an income shock that they are unable to recover from without savings.

It is vital that a small element of savings is considered as an essential monthly expenditure when determining someone's financial situation and their ability to repay creditors. This will help ensure people do not become trapped in debt and that more people are able to complete their debt repayment arrangements, even after experiencing an income shock.

There is also a case for Government to support the building of savings for those on low incomes who are attempting to repay their debts. Without access to savings people must often turn to credit to cover income shortfalls, but can have limited options because of their

161 RS Consulting, *Ability to Pay*, London: Consumer Futures, 2013

debt problems.[162] Many will be forced to rely on forms of welfare support in order to make ends meet, at a cost to the taxpayer. Similarly, if their lack of savings causes their debt problems to worsen and/or means that they are no longer able to repay their creditors after an income shock, then they may seek debt relief through insolvency, which has a negative impact for the Treasury and the wider national economy.

Recommendation 3: Government and the FCA should bring in the necessary regulations to ensure all repayment agreements (DMPs, IVAs, DAS) and forms of insolvency (Bankruptcy, DROs etc) allow people to save a small amount each month, in line with the Common Financial Statement, in order to avoid future debt problems.

3.2.2 Rewarding people for debt repayments with increased savings

Building an element of savings into budget calculations for people seeking debt relief is necessary to helpthem to build financial resilience and avoid future debt. However, it is also important to reward those people who are able to repay their debts and attempt to do so rather than applying for their entire debt to be written off through insolvency. Providing people with a financial incentive to repay their debts has benefits for their creditors, the wider national economy, and can greatly improve their future financial resilience.

There are several formal and informal forms of debt relief that allow a person to repay their creditors, either partially or in full, including: Debt Management Plans (DMP); Debt Arrangement Scheme (DAS) – *Scotland only*; and Individual Voluntary Arrangements (IVA).

The CSJ has heard from debt advice charities that repayment arrangements can fail for a variety of reasons, including unrealistic demands from creditors, a change in life circumstances and the inability to save enough to respond to financial shocks. In some cases it makes more financial sense for people to declare themselves insolvent than attempt to pay off their debts. Around one in 10 DMPs fail because a person chooses to become insolvent instead.[163] Just as work should always pay, so should responsibly paying off your debts.

While it will not stop every DMP or IVA from failing, we believe that a small financial reward, in the form of a lump sum of savings paid to a person, either at regular intervals or upon completion of their repayment arrangement, will increase the likelihood that they will complete their arranged repayments. This lump sum of savings will help the person avoid future debt problems and has helped increase the total amount repaid to creditors.

We propose that the Government pilot a new savings incentive scheme that is incorporated into IVAs, DMPs and DAS.[164] Under this scheme a small proportion of the arranged monthly repayment (around 10 per cent) would be diverted by the administering organisation – normally a debt advice charity or insolvency practitioner – and held on trust in a central

162 StepChange, *Life on the Edge*, London: StepChange, 2014
163 Zero Credit, *DRF Research: DMP Dropout Outcomes, Derbyshire*: Debt Resolution Forum, 2013
164 *Note: The creation of this system would require parallel changes to DAS, IVA protocol, and incorporation into the new statutory form of DMP discussed in Chapter One*

purpose built fund or with an existing organisation, such as the state-run National Savings and Investment Bank.[165]

If a person completes their repayment arrangement then they will be paid the lump sum that has been collected, but if they fail to complete the arrangement then the money held on trust will be divided up between their creditors as normal, along with any interest earned while the money was held on trust.

As some DMP arrangements can last for eight years or longer, there is a case to be made for paying out the lump sum at several intervals to ensure continued engagement with the repayment plan.[166] This is because people may struggle to see the benefit of a lump sum payment that is so far in the future.

Incremental releases of the bonus increases the risk for creditors, as they will no longer be able to easily recoup that money following a failure of the DMP. However, research suggests DMPs are more likely to fail in the first few years, so providing a financial incentive to someone who has already completed several years of repayment period is likely to increase the likelihood they will complete their repayments.[167]

Using a proposed bonus rate of 10 per cent, to be deducted from each monthly repayment, it is possible to calculate the potential benefits for people under this scheme. The average monthly repayment for a StepChange client under a DMP is £230 each month over five years, which would result in a savings pot of £1,380 per person who completed their DMP and significantly increase their resilience.[168]

The lack of data on DMPs and IVAs makes it hard to model the impact of this proposal. However, using DAS statistics as a proxy, we estimate that creditors would collect more money under this scheme if the savings incentive caused the annual failure rate for DAS repayment plans to drop by as little as three percentage points.[169]

Recommendation 4: The Government should pilot new savings incentive scheme for people attempting to repay part or all of their debts through a DMP, IVA or under DAS. A portion of their monthly repayments should be placed on trust – such as with a purpose built fund or the National Savings and Investment Bank – which would be paid as a lump sum savings bonus upon the successful completion of the repayment scheme. In the event of a failure to complete the repayment arrangement the money would be distributed to creditors as normal along with any interest earned while on trust.

165 *Note: Small changes to existing FCA rules regarding how money is handled under a debt management plan may be necessary to exempt this savings scheme*

166 R3, *Debt management plans*, London: R3, 2010

167 Zero Credit, *DRF Research: DMP Dropout Outcomes,* Derbyshire: Debt Resolution Forum, 2013

168 Stepchange, *StepChange Statistics Yearbook Personal Debt 2013,* Leeds: Foundation for Credit Counselling, 2014

169 *Note: This is a very rough model based on a failure rate of 13.41 per cent, 80 monthly repayments of £238, a savings incentive of 10 per cent and one cohort of 4,632 debtors.;* The Accountant in Bankruptcy, *Presentation by Rosemary Winter-Scott*, AiB Stakeholder Event 2012; Scottish Trust Deeds and Debt Advice, *Debt Arrangement Scheme Failure Rate Increases*, 13 November 2013 [accessed via: http://www.trust-deed.co.uk/news/debtarrangementschemefailurerateincreases.php (26/07/14)]

chapter four
Improving financial services for the most disadvantaged

Introduction

The poorest in society often have little access to the financial services that most people take for granted. The numbers tell their own story.

Around seven million people struggle to access basic financial services such as banking, savings, borrowing and insurance, and must often pay disproportionately more when using them.[170] Amongst this group around three million people either do not have access to a bank account or choose not to use one.[171] Between four and seven million people regularly incur bank penalty charges that negate the financial benefits of banking, with around one million people incurring financially crippling levels of penalty charges.[172] We estimate that in 2012 more than two million people took out a high-cost loan as they were are unable to access any other forms of credit. More than three million users of high-cost credit are in serious financial difficulties[173]

170 Social Finance, *A New Approach to Banking, Extending the use of Jam Jar Accounts in the UK*, London: Social Finance, 2014; CDFA, *Just finance: far and affordable finance for all*, London: CDFA, 2014; DWP, *DWP credit union Expansion Project, Project Steering Committee, Feasibility Study Report*, London: DWP, 2012

171 Social Finance, *A New Approach to Banking, Extending the use of Jam Jar Accounts in the UK*, London: Social Finance, 2014; CDFA, *Just finance: far and affordable finance for all*, London: CDFA, 2014

172 Social Finance, *A New Approach to Banking, Extending the use of Jam Jar Accounts in the UK*, London: Social Finance, 2014; DWP, *DWP credit union Expansion Project, Project Steering Committee, Feasibility Study Report*, London: DWP, 2012

173 *Note: CSJ estimate based on applying the percentage of households who responded, "Only kind of credit I can get", to the YouGov Debttrack survey question: "Why did you take out your last loan?" to the number of customers estimated to use one of three high-cost loan products included in the survey (pawnbroker, payday loan, home credit). The number of pawnbroker customers was estimated from the minimum total of loans per year (2 million) and the average number of loans taken per customer per year (2.5).*
BIS, *Credit, debt and financial difficulty in Britain, London: BIS, 2013;National Pawnbrokers Association (NPA), Pawnbroking: A successful and established profession*, London: NPA, 2013; BIS, *The impact on business and consumers of a cap on the total cost of credit*, London: BIS, 2013; FCA, *Consultation paper CP 14/10: Proposals for a price cap on high-cost short-term credit*, London: FCA, 2014

People can struggle to access financial services for a range of reasons including a poor credit history, previous debt problems or a lack of identity documents.[174] There are also people who avoid using financial services because they distrust banks, lack financial capability or have a fear of losing control and incurring debts through the use of credit or a bank account. A third group are those who can access financial services, but struggle to use them without incurring debts from penalties and fees. This is because many of the products and services provided by mainstream providers do not meet the needs, wants or lifestyle – control, transparency, budgeting, overdraft protection etc – of many low-income households.

Mainstream financial institutions have largely ignored this sizeable minority, as they are seen as unprofitable customers that are often only served out of corporate social responsibility. The result has been widespread financial exclusion and decreased living standards resulting from the poverty premium and growing levels of problem debt incurred through penalty fees, bank charges and disproportionately high interest rates. This is a market failure.

This chapter sets out a new vision for the development of more and better Social Finance Providers (SFPs), capable of providing innovate and competitive financial services to around seven million people that at are underserved by mainstream banks and at risk of problem debt.

Social Finance Provider (SFP): Social enterprises with a clearly defined ethical objective to provide financial services – transactional banking, savings, lending and insurance – to people who struggle to access or use mainstream finance.

These take a variety of corporate forms, including Industrial and Provident Societies, Community Interest Companies, Co-operatives, credit unions, and Companies Limited by Guarantee or Shares.

While the majority of SFPs are required to reinvest all of their profits into the enterprise, a new generation of ethical profit-making SFPs is also needed in order to provide innovative services to financial excluded people on the scale demanded and without government subsidy.

In order to tackle rising debt, poverty and financial exclusion we set out a range of policies necessary to develop a competitive market for social finance providers that will serve low-income people better and help them avoid problem debt.

These policies will:

- Identify communities and people who would benefit from the expansion of social finance;
- Help people access social finance by allowing them to prove their identity and credit worthiness in new ways; and
- Improve and expand social finance by increasing the sustainability, competitiveness and number of SFPs.

174 New Philanthropy Capital, *Short changed*, London: New Philanthropy Capital, 2008

4.1 Identifying areas that would benefit from social finance

In order for SFPs to develop and help those excluded from mainstream finance it is vital that they know where there is a demand for social finance. There is a need for more sharing of transparent and standardised data by financial institutions to help identify people and areas that are currently underserved and would benefit form services provided by SFPs.

Whilst some progress has been made in recent years, more action is needed.[175]

> *'There are clearly significant regional disparities in the provision of financial services, evidenced by bank branch closures and clustering of payday lenders in poorer communities. To effectively tackle financial exclusion we need a more sophisticated picture to understand market gaps in financial services provision. This would help new and alternative financial providers to identify market opportunity and provide affordable financial products to small businesses and low-income households. This would require investment but would also result in significant economic gains.'*
>
> Jennifer Tankard, Director, Community Investment Coalition – in evidence to CSJ

At present the FCA may take into account access to financial services amongst low-income communities as part of its objective to ensure effective competition, however it has yet to set out how it plans to achieve that. We therefore recommend that the FCA, after consulting with the Treasury and the financial sector, bring forward guidance to expand the provision of data by all financial providers – including high-cost lenders – to include:

- Provision of bank accounts, broken down by type and with some indicators about how the account is used and the average levels of penalty fees incurred;
- Provision of data on lending and insurance products linked to basic household type;
- Levels of declined applications for lending, basic insurance products and bank accounts.

It is important that standards are also set for data disclosure to ensure that comparisons can be made between providers and that it can be collated. The CSJ has heard of excellent work being done by one local authority to analyse and supplement data released by lenders in order to coordinate and support local SFPs.[176]

We recommend that local authorities take a proactive approach towards helping SFPs expand into underserved market by using data available to them about local residents – such as receipt of housing benefit or Council Tax support – in combination with ONS census data, indices of deprivation and data published by financial institution, to identify people and areas most in need of social finance.

175 BBA, *British lenders set out levels of borrowing across country in major move for transparency*, 17th December 2013; In a December 2013 agreement between members of the British Bankers Association and the Council of Mortgage Lenders to publish localised data on their lending

176 CfRC, *Annual CfRC Conference: How should we respond to Britains Personal Debt Crisis?* 11th March 2014

Recommendation 1: The FCA should ensure that financial institutions disclose localised data about their provision of unsecured lending, bank accounts and insurance services. They should also conduct an exercise to determine the extent of competition in lower income communities and make recommendations, including in respect of the need for greater social finance investment, in order to address any identified problems.

4.2 Enabling access to social finance

There are a variety of factors that prevent people from accessing financial services and also limit the development of SFPs. These include problems with online identification checks and poor credit history. Removing these barriers would help people access better and cheaper financials services and avoid problem debt.

4.2.1 Removing identification barriers that prevent people accessing finance

Low-income and vulnerable groups can struggle to access financial services because they are often unable to provide the necessary identity documents and proof of their address that are required by 'Know your customer' regulations.[177]

Know your customer (KYC): Financial providers are required to verify the identity and address of all potential customers before providing services in order to comply with various fraud and anti-money laundering regulations.

In branch services require a person to provide approved ID and proof-of-address documents. Online financial providers must use a reference agency that checks information provided by a customer against publicly available information on their address history, registry on the electoral roll and information on their credit file.

The problem is especially acute for certain vulnerable groups, such as the homeless or children leaving care, who often lack a driver's licence, passport, or other form of photo ID and may not be have a stable address history.[178] Recent improvements and coordination amongst financial providers, including agreement between the BBA and DWP to accept the Universal Credit acceptance letter as proof of ID, have decreased this barrier to access.[179] However, it remains a significant issue for people accessing online banking services and for SFPs that rely on the more automated system of online KYC checks. More than 1.8 million social housing tenants are unable to access basic financial service online because they fail KYC identity checks.[180]

177 Toynbee Hall, *Banking the unbanked – a snapshot*, London: Toynbee Hall, 2005
178 Ibid
179 BBA and DWP – in evidence to CSJ
180 Experian, *Credit Scoring Boost for 93% of Social Housing Tenants* [accessed via: http://www.experian.co.uk/blogs/latest-thinking/2013/11/credit-scoring-boost-for-93-of-social-housing-tenants/ (16/07/14)]

'Currently about 40 per cent of all applicants fail the automated KYC process, reducing the effectiveness of the marketing considerably. These customers are then manually processed to weed out errors and are asked to send in other supporting documentation. As soon as this off-line manual intervention takes place, the majority of the outstanding applications fall away, with the pass rate rising from 60 to 65 per cent.

It is inevitable that the financially excluded are more likely to fail KYC due to their lower social stability, more frequent relocation, infrequent registration on the electoral register and generally poorer documentation skill sets. KYC as it currently stands reinforces financial exclusion and needs to be reformed as a matter of extreme urgency.'

Alex Letts, CEO Ffrees – in evidence to CSJ

'Since providing access to online applications, around 77 per cent of customers do not provide the necessary documentation for follow up e.g. ID, AV and bank statements.'

Sharon MacPherson, CEO Scotcash – in evidence to CSJ

We propose that the DWP create a system that allows reference agencies to more easily verify the identity of benefit claimants. This would involve a claimant providing several specific pieces of information about their benefit entitlement – such as date and amount of payment, NI number, address etc – which would be checked against DWP claimant data. A similar system already exists to allow providers of welfare assistance schemes to check a claimant's eligibility for certain loans or grants.[181]

Recommendation 2: The DWP should work with providers of KYC services to enable them to verify a customer's identity by checking the information provided by the customer against claimant data held on the DWP databases.

4.2.2 Reforming the credit rating system

Millions of people are unable to access mainstream credit because their credit score is too low.[182] As a result, many of these people have little choice but to borrow from high-cost lenders or illegal moneylenders, in order to cover income shortfalls resulting from unemployment or an unexpected crisis expense. The use of high-cost or illegal credit can quickly exacerbate a person's financial problems and drive them deeper into poverty.

A poor credit score can be the result of prior debt problems or a history of missed payments, but it can also simply be because there is a lack of information about a person. However, increasing the types of payment information held by reference agencies could have a downside for some consumers – especially some vulnerable benefit claimants – who may struggle to maintain monthly payments, such as for rent and Council Tax.

181 Five Lamps and DWP – in evidence to CSJ
182 CDFA, *Mind the Finance Gap*, London: CDFA, 2013

Nevertheless, people on low incomes do find it disproportionately hard to maintain a good credit score and access mainstream credit, because: [183]

- Regular repayment of utilities, rent and Council Tax are not recorded on someone's credit file;
- A high value is placed on stable address history and registry on the electoral roll;
- Many high-cost lenders do not report good repayment history, but do report if a customer fails to repay; and
- Use of high-cost credit, even when repaid on time, can impact negatively on someone's credit score and ability to access mainstream financial services.[184]

The increasing reliance on computer based credit scoring and automated lending decisions has largely removed a lender's discretion over individual loan decisions.[185] This has led to a situation where many of the poorest in society are at risk of falling into problem debt after being forced to take out a disproportionately expensive loan to cover income shortfalls.[186] The CSJ has also heard that the emphasis placed on maintaining a good credit score can influence people's financial decisions and prevent them from accessing debt advice for fear of harming their credit score.[187]

At best the data that is used to make lending decisions is incomplete, non-transparent and fails to fully capture how someone handles their money and financial commitments. At worst, it can make it almost impossible for someone to ever access mainstream credit and trap them in a cycle of high-cost credit and debt. It is estimated that around a million people are trapped in a catch-22 situation where they do not have a good enough credit rating to access affordable mainstream credit, but have no way of improving their situation because they cannot access credit and demonstrate their ability to repay.[188]

It is important that the impact and validity of current credit scoring systems are fully evaluated, as increasing the data made available to CRAs may simply allow lenders to be even more selective about who they lend to, and may contribute to the targeting of a section of lower income consumers for high-cost credit products.

Recommendation 3: The FCA should conduct a review of credit referencing and scoring systems. This should explore the pros and cons of increasing the information available to credit reference agencies, and identify potential winners and losers. As part of the review, the FCA should examine the 'disciplinary effect' of credit scoring, and whether a lack of transparency drives borrowers to maintain payments and delay seeking advice when they fall into financial difficulties.

183 Ibid
184 BBC News, *Payday loan 'risk to mortgage applications'*, 26 November 2013
185 Charles River Associates, *CRA Insights: Financial Economics*, Washington DC: CRA, 2014
186 Joseph Rowntree Foundation, *Affordable Credit*, London: Joseph Rowntree Foundation, February 2005
187 Sian Williams (Toynbee Hall) and Damon Gibbons (CfRC) – in evidence to CSJ
188 Experian, *Credit Scoring Boost for 93% of Social Housing Tenants*, 21 November 2013 [accessed via: http://www.experian.co.uk/blogs/latest-thinking/2013/11/credit-scoring-boost-for-93-of-social-housing-tenants/(16/07/14)]; Big Issue Invest, *The impact of social housing rent-payment data on credit scoring*, London: Big Issue Invest, 2013

4.3 Improving and expanding social finance

The provision of social finance in the UK is small – serving just over one million people. There are also many low quality providers, who are too reliant on grant funding. As a result SFPs often fail to provide services that are competitive with mainstream finance.[189]

In order to develop a truly competitive market for social finance to drive down the cost of credit and other financial services for the most vulnerable it is necessary to:

- Remove the barriers that prevent SFPs from offering banking services;
- Facilitate crowd funding investment in SFPs;
- Reform credit union regulations to help create a new generation of competitive and sustainable 'Community Banks.'

4.3.1 Allowing social finance to offer full banking services

One in every seven adults are underserved by mainstream banking products.[190] The current lack of competition for retail banking means many do not benefit financially from having a bank account. For instance, an estimated 6.6 million people, who are primarily in low-income households, incur over £100 in penalty fees and charges each year.[191] The 'free in credit' model that retail banks use also means banks have little incentive to serve low-income customers, as they are not considered profitable.[192]

The CSJ heard from several SFPs that current accounts do not meet the needs of many of their low-income customers.

> *'The imposition of bank charges for failed Direct Debits adversely effects our customers who with limited incomes require flexibility and forbearance. The bank charges represent a significant challenge to many customers who, sometimes through no fault of their own, cannot make payment or need a greater degree of flexibility than that offered by rigid computer systems.*
>
> *A transactional account with fixed charges will be preferable for Moneyline customers, which meets the need for flexibility and forbearance, whilst offering the functionality that allows access to online services, ATMs, and compatibility with mobile technology.'*
>
> Niall Alexander, Development and Communications Director for Moneyline – in evidence to CSJ

At present four banks dominate the market for transactional banking services, providing 85 per cent of all current accounts in the UK.[193] The launch of Metro Bank in 2013 represented the first new bank to enter the market in over 100 years and government policies designed

189 ABCUL – in evidence to CSJ
190 Social Finance, *A New Approach to Banking*, London: April 2011
191 Ibid
192 *Note: Free in credit refers to a current account with a monthly fee for the user, so long as they always maintain a positive balance. This allows the bank to invest their deposits and make a profit*
193 CDFA, *Just finance: far and affordable finance for all*, London: CDFA, 2014

to create new 'challenger banks' have yet to make a significant impact on the market, especially outside of London.[194]

Those in the lowest income deciles are disproportionately underserved and likely to incur debts from banking.[195] SFPs are ideally situated to offer new competition in the market, with products specifically designed to meet the needs of the poorest in society.

Low-income households, especially those that are dependant on state-benefits, often have different priorities in regards to banking services.[196] They value transparency of fees, budgeting features, greater control over when payments are made, and integrated tools to help with saving, budgeting and financial planning. Surveys also indicate a willingness amongst this group to pay for banking products, so long as the fees are clear and transparent.[197] Currently the 'free-in-credit' banking products available from mainstream banks do not meet these needs.

> *'I came to Ffrees (an e-money account provider) from a big UK bank following technical issues and incorrect standing order payments set up from my account resulting in around £900 in overdraft charges. I have a large family and so managing money is a top priority for me so I don't go overdrawn and can pay bills on time etc.*
>
> *What I love about Ffrees is that you cannot go overdrawn with their current accounts, meaning there are no risks of extensive charges for going into the red by mistake. They also have a fantastic Money Management tool so I can move bill money out of the main account and set standing orders up to pay bills on time and then I can see what I have left for the month.'*
>
> Suzie, Northampton – in evidence to CSJ

Because the cost of offering a traditional current account is simply too high for most providers, an alternative for SFPs is to offer banking through an internet based E-money provider. This makes the authorisation process quicker and the operating costs substantially lower. E-money providers are licenced by the FCA to offer financial services, but they are not fully authorised to handle payments or take deposits.[198]

SFPs offering E-money banking services, especially those tailored specifically for mobile phones and tablets, have the potential to make financial services much more accessible to low-income households. The most recent Ofcom annual report shows that smartphone ownership is growing fastest amongst C2 and DE socio-economic groups, and that the poorest quarter of households were twice as likely to use a smartphone as their main form of internet access than the richest

194 Ibid

195 Competition and Markets Authority (CMA), *Market Study Notice*, London: Competition and Markets Authority, 2014; Office for Fair Trading, *Review of the personal current account market*, London: Office for Fair Trading, 2013; CMA, Press release, *Personal current accounts and small business banking not working well for customers,* 18 July 2014

196 Boorer K, *Universally speaking: how the Post Office can help benefit recipients through the transition to Universal Credit*, London, Consumer Futures, 2014

197 Ibid

198 FCA, *E-Money institutions,* [accessed via: http://www.fca.org.uk/firms/firm-types/emoney-institutions (16/07/14)]
All bill payments, purchases deposits and other banking transactions are handled behind the scenes by a mainstream bank under an 'agency banking arrangements', with funds being held on trust by the bank and protected under the deposit guarantee scheme

quarter of households.[199] In just the last year the number of smartphone banking transactions has doubled, while more than a third of people with tablets use them for online banking.[200]

The CSJ also heard from several successful CDFIs about the demand for online services amongst their customers, especially through a mobile phone.[201]

> *'Customers cite face to face as their preferred method of accessing finance. However, many customers have smartphones and like the idea of an app that can advise on loan and savings progress (i.e number of weeks remaining, potential for further advances etc).'*
>
> Niall Alexander, Development and Communications Director for Moneyline – in evidence to CSJ

There are good examples of for-profit SFPs offering online financial services, including budgeting accounts, affordable credit and matched savings accounts.

Case study – Ffrees

Ffrees was established to provide a digital alternative to customers who were either feeling excluded from or unwanted by the retail banking sector. The evidence suggests there is a huge latent demand for a much more inclusive, innovative and modern digital-only banking service with the benefits of lower costs, easier access and less red-tape. This has recently been supported by the July 2014 Accenture Online banking survey which says that 25 per cent of people would consider using a digital bank. This number will only grow in the future.

After a year in testing with some real customers, Ffrees moved to its live production service platform in October 2014. In the ensuing nine months it has met with heavy demand, opening 27,000 new accounts. Its current rate for account openings is over 200 new accounts per day, which given a marketing budget smaller than a retail bank CEO's salary, is remarkable. Ffrees is already seeing account throughput of around £50m pa and expects this to rise to £100m pa by end of December 2014. It has recently added an ethical loan product to its offering, which has attracted over 500 applications in the first two weeks.

Despite great examples such as this, this new form of banking provider has failed to break into the market on the scale commensurate with the potential market for underserved customers. The CSJ has heard this is primarily because mainstream banks have refused to provide them, or other financial intermediaries, with access to the payment systems through agency banking arrangements.[202]

With only one exception the CSJ has found no E-money provider that is able to offer its customers full direct debit facilities.[203] This is a significant barrier to competition, as a bank account without direct debit functionality is of little use as a primary bank account given the insistence of many firms that bills be paid through direct debits.

199 Ofcom, *Consumer Market Report: United Kingdom*, London: Ofcom, 2013
200 Ibid; BBC, *Smartphone banking transactions double in the past year*, 31st Match 2014 [accessed: http://www.bbc.co.uk/news/business-26815873 (17/07/14)]
201 Scotcash – in evidence to CSJ
202 Contis and Ffrees – in evidence to CSJ
203 *Note: The Eccount also offers direct debit functionality but only on a limited basis where customers pay per direct debit, which partially negates the benefit.* Eccount money, *The eccount money current account fees summary table*, [accessed via: http://www.eccount.com/fees/#.U8drG1ZFEds (16/07/14)]; Thinkmoney, *thinkmoney: the account that offers more*, [accessed via: http://www.thinkmoney.co.uk/account/account-features/ (16/07/14)]

Contis Group provide an ethical banking like product to credit unions and their members who are excluded from mainstream banking services. The credEcardplus product we provide has functionality specifically developed for this sector and helps credit union members to be financially included so that they can take advantage of lower prices through internet shopping and be rewarded with cash back for loyalty. Contis cannot offer a full banking package as is has been impossible to obtain Agency Banking facilities from the clearing banks. This means that we cannot provide direct debit processing for credit union members and therefore they are subject to higher utility bill payments because of this exclusion.

Mike Fromant, Managing Director for Contis Group – in evidence to CSJ

The lack of competition for retail banking and the amount of households that would benefit from banking services offered by SFPs mean there is an immediate need to remove this barrier. This could be especially beneficial for the 1.4 million unbanked people who currently pay a poverty premium when purchasing goods and services.[204]

Much the same way as electricity, gas and telephone networks were opened up to competition in the 1980s and 1990s, it is necessary to open access to the payment systems that underpin the financial system. This will increase competition and allow SFPs to offer better banking services to low-income households and help them avoid debt.

Recommendation 4: In order to tackle financial exclusion and help people who constantly struggle with bank penalty fees, the new Payment Systems Regulator should set fair transparent fees and access conditions for agency banking arrangements. This will allow providers of social finance to offer competitive financial products to low-income groups which are tailored to their needs.

4.3.2 Increasing investment in social finance

There is substantial demand for cheaper forms of social finance for the poorest, but SFPs are unable to meet the demand as they lack access to investment capital.[205] While it is estimated that there is demand for around £3–3.5bn in social lending, CDFIs and credit unions combined provide just over £600 million each year.[206] This gap means millions of people are forced to pay excessive interest rates to borrow from other providers,w such as payday lenders, and risk becoming trapped in a cycle of high-cost borrowing and debt.

Liz's story – a Moneyline customer in evidence to CSJ

Liz is 64, divorced, she lives in private rented accommodation in Haydock. She is retired from a life in the hotel and hospitality industry. She lives modestly on £216 a week pension and pension credit. She has borrowed five times from Moneyline: *'I borrowed £200 the first time for decoration. I repay*

204 DWP, *DWP credit union Expansion Project, Project Steering Committee, Feasibility Study Report*, London: DWP, 2012
205 CDFA, *Mind the Finance Gap*, London: CDFA, 2013
206 Ibid

every Monday, when my pension credit and state pension goes in, £30 comes out. I don't miss it, I've never missed a payment. I pay some money toward my loan, and the balance toward my savings account. It is out-of-sight, out-of-mind, I do occasionally draw on it, I go into the office and wow, there might be £78. It's good, it's a bonus; I look on it as a bonus'

'I generally manage allright, I'm careful, house-proud, still clean my step! I don't cater for things like holidays but sometimes I find emergencies hard, and that's where Moneyline helps. My cooker broke recently and Moneyline helped. I used the money to get a good deal at a local electrical shop. I could have gone to BrightHouse, used them before, used catalogues years ago. BrightHouse, they were very nice, but very expensive, I think I paid £3,000 in total for my TV; next time Moneyline'

'When emergencies happen it's peace of mind to know Moneyline is there. My son was working in Dundee and last year I got a call from a friend saying he had septicaemia, a ruptured bowel. I'd drawn on my savings, my daughter had just changed jobs and had no money so I went straight in to see Gareth. I apologised for coming in, it was an emergency. I needed to get to Dundee. He could see I was upset, he was brilliant. I borrowed £300, paid £120 petrol money to get me up there. My son passed away when I was there. I'll never forget what Gareth did for me that day.'

'I like that Moneyline don't discriminate if you are on low income or benefits, people find it hard to get finance. I don't think you over price, I like that they are a non-profit company, it's not all take and no give with them, I'm 100% comfortable with Moneyline.'

Even successful CDFIs have found that despite operating a sustainable business model that is not dependent on long-term grant funding, they struggle to access the capital they need to expand. This is for two reasons:

- They are relatively small organisations who struggle to get the attention of mainstream financial organisations and present their business case;
- The model of lending to low-income households is non-standard and there is a lack of evidence and understanding amongst investors about CDFIs.

'Generally there are difficulties in accessing the substantial funds required to expand the operation. Moneyline, like all CDFIs, will look like a credit risk, the loan book is largely made up of small, unsecured loans from vulnerable people, the headroom within the book is miniscule (if there at all) and the understanding of the sector is limited.'

Niall Alexander, Development and Communications Director at Moneyline – in evidence to CSJ

The Cabinet Office estimates that for successful CDFIs to fulfil their current potential, there is an immediate demand for £30 million in investment funding, both for IT systems and to increase the size of their loan book.[207] The CSJ has visited numerous CDFIs across the country that could increase the size of their operation if they had access to more capital funding, which would allow them to help more people avoid problem debt and predatory lending.

207 Cabinet Office – In evidence to CSJ

Case study – Moneyline

Moneyline is a social business formed as an IPS (Industrial & Provident Society) in 2002 in order to give people affordable credit for the benefit of the community. We have no private shareholders to satisfy and no target driven bonus culture. Our rules state our business purpose "to provide a social dividend rather than personal financial reward".

We were established in Blackburn with one branch in 2002. We now operate from 20 branches in England and Wales, seeing customers' face to face. We employ over 80 people, everyone is employed above the living wage and there is a salary ratio of under 4:1. Our principal business is the provision of small sum credit, but we also offer a linked savings account, bank account opening and referrals to debt and money advice partners.

Since 2002, to end of June 2014 we have written over 80,000 small, personal loans worth a total value of over £44 million. Customers have also set aside over £4.3m into almost 18,000 savings accounts (with our partner Bank of Scotland), withdrawing £3.8m over the same period.

Statistics

- 66 per cent of customers are working age but unemployed;
- Only 10 per cent of loans, which average between £300–£500 and are repaid over a 36 week term, are in default;
- Moneyline plans to operate 100 per cent sustainably in 2015/2016;
- Customers have expressed significant interest in having access to a transparent bank account offering direct debits and a smartphone app to monitor balances and loan repayments;
- In need of £12 million capital to fund expansion.

Case study – My Home Finance

My Home Finance (MHF) was established by the National Housing Federation and in 2010 began to offer small low-cost and other financial services in order to promote financial inclusion.

From opening its first premises in Hereford in September 2010, MHF is reaching increasing numbers of financially excluded individuals across the country. By May 2014 MHF had made almost 15,000 loans exceeding £5 million in total, with around 50 per cent of these going to Housing Association tenants.

MHF is often a lender of last resort for its clients. Many are unemployed, and/or have fallen victim to usurious lenders who, in lending irresponsibly, frequently push borrowers down the slippery slope of over-indebtedness and its associated difficulties. There is a complex web of problems allied to excessive debt and this covers life areas including employment, physical and mental health, and personal relationships.

Statistics

- Saved customers around £2.5 million in interest and fees since opening;
- Only around eight per cent of loans default;
- Serves predominantly low income housing association tenants;
- Has an immediate need for £10 million in capital investment at around six per cent APR;
- Will achieve full sustainability in 2018.

Case study – Scotcash

Scotcash was formally established as a Community Interest Company (CIC) in October 2006 in order to serve as a one-stop shop for affordable loans, access to banking and credit union savings as well as high quality money and financial advice.

We also provide access to a range of other related services provided by our partners:

- Energy advice to help reduce fuel bills
- Discounted white goods packages
- Foodbank vouchers

The overall aim of Scotcash is to reduce financial exclusion in Glasgow by increasing access to financial goods and products, particularly for those who experience difficulties accessing mainstream financial services. We work with Glasgow Central CAB to provided integrated money advice services and consider this a key early intervention mechanism interrupting the cycle of debt.

Statistics

- 60 per cent of customers live below the poverty line;
- One in eight customers do not have a bank account;
- Only around five per cent of loans default;
- There is a potential market of around 100,000 people just in Glasgow;
- Will achieve full sustainability under its current four year business plan.

One reason that mainstream banks are unwilling to lend to CDFIs is that they request loans that are relatively small and which offer little potential profit for the bank. Commercial lenders are unwilling to invest substantial time and money into researching small social lenders with an unproven and risky business model when the profit on the loan would be relatively small. Similarly, the CSJ has heard that while many housing associations are interested in investing in CDFIs, they are run by boards that do not feel confident in evaluating the investment risk of lending to a CDFI.[208]

In order for the sector to grow it is necessary that there is support for organisations in both preparing their investment applications and also in evaluating the viability of their business model.

To overcome this problem, Big Society Capital (BSC) and the Cabinet Office need to take the lead in helping to build the economic case for investing in CDFIs as a sustainable ethical business. They should commission independent research to empirically evaluate the performance of a range of CDFI models. This detailed and thorough evaluation will help bring investors, both social and commercial, into the market and expand the pool of money available to CDFIs.

In the USA this process has been taken one step further, with an independent organisation offering a credit rating service for CDFIs and potential investors, similar to Moody's or Standard & Poor. The CDFI Assessment and Rating System (CARS) provides potential

208 My Home Finance – In evidence to CSJ

investors with a specialised vetting service to evaluate the performance of a CDFI – helping the CDFI to prove itself and saving investors time and money in their evaluation process.[209] Over 300 ratings have been issued in this way, with large institutional investors such as Citi Bank and Wells Fargo relying on the service.[210]

Part of the success of the CARS in the US is because of the Community Reinvestment Act, which has encouraged larger financial institutions to invest in smaller local banks and SFPs.[211] As there is no equivalent legislation in the UK we believe there is an immediate need for a new organisation capable of both vetting SFPs, similar to the CARS, and facilitating investment in authorised SFPs through a new peer-to-peer Social Financial Investment Platform (SFIP).

Creating a p2p Social Finance Investment Platform

Rather than supporting individual CDFIs through one-off grants or small loans from banks offered as part of their CSR programme, which will inevitably fail to reach the scale demanded, Big Society Capital and the Cabinet Office should work to help establish the Social Finance Investment Platform (SFIP), a p2p platform to help approved CDFIs attract social investment.

Such a platform would perhaps not develop by itself, but once created will allow individual and institutional investors the opportunity to invest directly in social lenders, without the need for special expertise or incurring excessive risks and costs. The CSJ heard from Street

209 CARS Inc, *CARS™ On the Road: Edition 7*, Philadelphia: CARS Inc (accessed via: http://www.aerisinsight.com/CARS_OTR_7_final.pdf (17/07/14)]

210 Opportunity Finance Network, *CARS™*, Philadelphia: Opportunity Finance Network (accessed via: http://www.opportunityfinance.net/store/downloads/cars_set.pdf17/07/14)]

211 The Community Reinvestment Act 1977; Woodstock Institute, *The Community Reinvestment Act and Community Development Financial Institutions*, Chicago: Woodstock Institute, 1998 [accessed via: http://www.federalreserve.gov/communitydev/cra_about.htm (17/07/14)]

UK, a Birmingham based CDFI, that they had already found it easier to access capital through traditional p2p lending platforms than from a mainstream bank.[212]

As the CDFI model is largely unproven at scale and many of the organisations are small, there is a need for the SFIP to both support and evaluate CDFIs before matching them up with potential social investors. The Cabinet Office has already expressed interest and invested in supporting CDFIs, so it is a natural source of initial funding for the creation of the SFIP.[213] The newly created SFIP would have the following roles:

- Help provide investment readiness support for new and existing SFPs;
- Conduct due diligence and investment appraisals of SFPs seeking finance;
- Underwrite part of the lending to approved SFPs to encourage investors to fund lending through the new p2p platform.

P2P Lending Platforms: This innovative form of investing matches borrowers directly with investors, or savers, through an internet-based platform. Investors set how much money they want to invest, which is then divided into smaller chunks and spread out amongst a number of loans to borrowers that are approved by the intermediary p2p platform. Investors can also often choose how much risk they want to assume and what interest rate they want to receive, with riskier borrowers paying a higher cost for their loan to the investor.

By removing the operating costs of a traditional bank investors earn significantly higher returns than through traditional saving products and borrowers can access loans at a reduced interest rate. The UK is already a world leader in p2p lending, both to small business and individuals, with innovative companies such as Ratestetter and Zopa.

Once an SFP is vetted and approved by the SFIP they would be able to access a loan funded by a variety of individuals, institutions – banks, trusts, housing associations etc – or even local authorities, that want to fund social finance providers but do not feel they have the expertise to choose or vet individual organisations. In order to further mitigate the risk and encourage investment these loans should be partially underwritten by the SFIP, at a rate of 10–20 per cent, using the initial start-up funding as a guarantee. In this way £20 million of investment from the Cabinet Office could be leveraged to generate more than £60–80 million of investment in SFPs.

Such a scheme would require initial investment of around £20 million, but ultimately it would allow for significantly greater levels of capital to be accessed by SFPs than through current programmes of grants and special ring fenced lending pots. It is only by leveraging the commercial and social investment market that SFPs can ever hope to scale up to meet the demands of people excluded from affordable credit.

212 Interview with Martin Hockly, CEO Street UK
213 HM Government, *Growing the social investment market: 2014 progress update*, London: HM Government, 2013

Recommendation 5: In order to develop a network of innovative SFPs able to meet the needs of financially excluded communities, the Cabinet Office should invest in a new Social Finance Investment Platform (SFIP) to facilitate p2p social investment.

4.3.3 A new generation of competitive Community Banks

In *Maxed Out,* the CSJ highlighted both the successes and limitations of credit unions in the UK, and how the majority have not reached the scale or level of professionalism seen in other countries such as the US and Canada.[214] The Government's Credit Union Expansion Project has been a positive step in this area, but more radical action is needed.[215]

In order to overcome limitations and expand access to social finance for people in the most deprived communities, we propose that credit union regulations are reformed to create a new category of credit unions known as Community Banks. Large and successful credit unions would be able to apply for this new status, but existing or new credit unions could also continue to operate as normal.

The CSJ heard from Angela Clements – the ex-CEO of CitySave who built the Birmingham credit union up from the verge of bankruptcy into one of the most advanced and competitive in the country – about the need for reforms.

'I would fully support a widening of the regulation for credit unions operating in the UK. Running a sustainable credit union in a city like Birmingham has meant too often making the choice between being sustainable or limiting our provision of expensive services – such as loans to riskier members – where we could not pass on the cost to the member.

At a time where there is such a clear call for credit unions to step in to provide financial services to a wider audience, we must support their ability to do so.

Pressure on mainstream banking providers has not bridged the gap to the financially excluded, being filled instead by higher cost providers, causing lower income households to be even less robust to small financial shocks. The ensuing debt spiral has a clear and proven adverse impact on the individual, the household, and their wider family and community.

I have been obliged to relinquish my role as CEO in order to try to create a new SFP that will be a real challenge to higher cost lenders, in a manner that I found impossible within the current credit union archaic regulatory framework. There is an urgent need to review this situation and allow this sector to expand and flourish, to the wider benefit of the communities they serve.'

Angela Clement, Ex-CEO, Citysave credit union

214 *Note: the credit union movement in NI is significantly bigger and more developed than in the rest of the UK*

215 HM Government, Press Release, Credit union £38 million expansion deal signed, 16 April 2013 [accessed via: https://www.gov.uk/government/news/credit-union-38-million-expansion-deal-signed (17/07/14)]

Community Banks would operate under the same regulations set out for other credit unions but with the following changes:

- Relaxed membership rules allowing them to offer services to a greater number of people and expand into new markets;
- New rules allowing members' deposits to be invested ethically, either directly or collectively with other credit unions through a Credit Union Service Organisation (CUSO), in order to generate sufficient income to ensure sustainability, growth and to subsidise riskier lending tothe most vulnerable members;
- The power to raise social finance and other investment, including through the securitisation of credit union loans and the new Social Finance Investment Platform detailed earlier;
- A removal of interest rate caps for small loans under £1,000 to facilitate ethical lending to the poorest members in competition with high-cost lenders;
- The legal right to be a shareholder in a joint venture or member of a CUSO;
- Access to a new streamlined framework allowing them to absorb failing credit unions that submit a merge application prior to being liquidated;
- They would be subject to greater oversight by the PRA and FCA.

We believe these reforms are necessary to allow for a competitive form of SFP that can overcome the challenges that have limited the development of successful credit unions. We explain the key features and benefits of Community Banks below.

Membership rules

Successful credit unions often struggle to grow and offer services to the people most in need because membership is only available to those who fall within the credit union's 'common bond'. Despite relaxation of these rules in 2012, this system is both complicated and confusing for prospective members, while also limiting the total number of members that can be served. [216] Community Banks would be able to offer services to an unlimited number of members in any defined geographic area of their choosing.

Investing members' deposits

Currently even the most successful credit unions struggle to generate sufficient income and operate without grant funding as they are prohibited from investing their members' deposits**.** Community Banks would be exempt from these restrictions, with new regulations in based on those in Canada and the USA, that allow low-risk ethical investments. This would enable them to generate enough income to pay for marketing, expansion projects, IT systems and to help subsidise lending to those vulnerable customers who most need affordable credit.

216 ABCUL, *Legislative change for credit unions*, [accessed via: http://www.abcul.org/media-and-research/briefings/legislativechange (17/07/14)]

Ownership of joint ventures

The prohibitive cost of modern IT systems is perhaps the biggest barrier preventing the growth and development of SFPs in the UK. Community Banks would be allowed to invest and become shareholders in a joint venture with other Community Banks in order to spread the cost of IT and product development, pool investment resources to mitigate risks, and share common backend processing systems. This is very successful in the US and Canada and would limit dependence on grant funding.

Removing interest rate caps

In order to best serve those people most in need of affordable credit, who can currently only access loans from CDFIs at around 100 per cent APR, Community Banks will be exempt from current interest rate caps for loans under £1,000. This will allow them to serve more vulnerable people without losing money on each loan.[217] As they can cross subsidise loans and do not have to pay for investment capital, these loans could be made available at a lower cost than through a CDFI.

Merger procedure for failing credit unions

The new regulations will allow failing credit unions to petition to merge with a local Community Bank under a streamlined procedure prior to entering liquidation, or if commanded to by the PRA upon the first signs of financial hardship. This procedure would require the agreement of both organisations and would only be possible if the PRA determined that certain financial 'stress tests' were met that ensured the long-term financial safety of the Community Bank. This will help ensure people have access to SFP services even if their credit union fails.

Recommendation 6: The PRA and FCA should create a new simpler, two-tier regulation system for credit unions, placing greater monitoring and prudential requirements on category four credit unions wishing to apply for new status as a "Community Bank." These Community Banks would benefit from:

- New looser geographic or employment common bond with no membership limits;
- New rules allowing members' deposits to be invested ethically in approved low risk investments, either directly or through pooled investment with other credit unions through joint venture;
- New rules allowing Community Banks to invest and act as a shareholder in a joint venture that has a clear ethical purpose and is approved by PRA;
- A removal of interest rate caps for small loans under £1,000 to facilitate ethical lending to the poorest members in competition with payday lenders;
- Access to a new streamlined framework allowing them to absorb failing credit unions that submit a merger application prior to being liquidated.

217 CIVITAS, *Credit unions: A Solution to Poor Bank Lending?* London: Civitas, 2013

Conclusion

The scale, complex root causes and devastating consequences of problem debt in the UK means it can only be tackled with strong political leadership and radical reforms.

It is important that the debate around personal debt is moved on from a discussion about interest rate caps, payday loans and a lack of personal responsibility. Instead politicians and society need to look at why people have stopped saving money and started relying on credit. Why people often do not even recognise when they are in debt, or how they got there. Why average consumers still struggle to understand and use basic financial products without incurring debts. And why new financial providers are not competing for the opportunity to serve low-income households, offering them a choice of products and services that they want and that match their needs, rather than serving them out of corporate social responsibility and forcing them to always settle for second best.

In this report we have answered these questions and set out a raft of reforms that will help tackle the root causes of problem debt, rather than just place blame on people and banks, or attempt to plaster over the cracks with yet more regulations. Implementing these reforms will not be easy, but the long-term benefits for vulnerable people and for society will be huge.

Regulatory reform is needed to break up the current banking monopoly and create a nationwide network of social finance providers – including Community Banks, CDFIs, credit unions and ethical for-profit firms – able to provide fair financial services in Britain's poorest communities. Government needs to kick-start the drive to re-establish our national savings culture, such as through employer based savings schemes, which will help decrease our reliance on credit and debt. Financial products and services need to be made simpler and easier to understand. This will help people make positive financial choices and benefit from better financial capability training delivered in school and throughout their lives. Lastly, we propose policies to increase funding for free debt advice and set out reforms that will help prevent people, no matter how poor, from becoming trapped in debt and poverty.

Any incoming government must prioritise tackling problem debt because the human cost vastly outweighs even the eye watering monetary figures. We can no longer sit idly by and accept debt as a part of life, or something that is just a consequence of being poor or irresponsible. Action is needed now.

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