Financial Services Consumer Panel
AN INDEPENDENT VOICE FOR CONSUMERS OF FINANCIAL SERVICES

Telephone: 020 7066 9346
Email: enquiries@fs-cp.org.uk

Clerk to the Treasury Committee
House of Commons
London
SW1A 0AA

27 December 2017

Dear Sir / Madam

Household finances: income, saving and debt inquiry

The Financial Services Consumer Panel is an independent statutory body. We represent the interests of individual and small business consumers in the development of policy and regulation of financial services in the UK. We welcome the opportunity to respond to the Treasury Committee's inquiry into household finances.

UK households are becoming less financially resilient, and unsecured debt is rising. The root cause is a combination of government policy, an irresponsible retail financial services sector, and personal behaviour skewed by culturally-driven, technologically-enabled spending and borrowing.

Saving and debt also need to be seen in the context of a seemingly permanent low interest rate environment, and economic growth that is in large part driven by consumer spending. It is difficult and unrewarding to save; easy to borrow and spend. Successive governments have failed to tackle the high human and economic costs of 'too much' spending on credit. There has not been a government department with explicit responsibility for tackling over-indebtedness since 2010.

<u>Resilience and debt</u>

Persistent low levels of financial resilience:

- 13% of UK adults (around 6.5 million citizens) have no cash savings, and 24% have total savings less than £1,000.[1] Faced with a significant life event (e.g. unemployment, relationship breakdown) these citizens may struggle to manage or turn to consumer credit.
- A third of UK adults (nearly 16 million citizens) do not have contents insurance, and most of these have little or no savings to replace their possessions in the event of fire, theft or flood.[2]
- Few UK adults have personal protection insurance such as income protection (4%), personal accident insurance (6%) and critical illness insurance (10%). Among self-employed people, only 6% have income protection.[3]

Worrying levels of financial fragility:

- The trend of weak household income growth is forecast to continue; and £12 billion cuts to working-age welfare are likely to be a major contributor to falling living standards at the bottom half of the working-age income distribution.[4]

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[1] www.fca.org.uk/publication/research/financial-lives-survey-2017.pdf
[2] www.financialinclusioncommission.org.uk/pdfs/improving_access_to_household_insurance.pdf
[3] www.fca.org.uk/publication/research/financial-lives-survey-2017.pdf
[4] www.resolutionfoundation.org/app/uploads/2017/01/Audit-2017.pdf and www.jrf.org.uk/file/50680/download?token=eP9MyZI5&filetype=findings

- 38% of UK adults have debt (excluding Student Loan Company loans), with an average debt of £3,320.[5] This rises to over £5,000 per adult among the 35-44 age group.
- One in ten residential mortgage holders (11%) have loan to household income ratios of at least 400%. Among the groups with the highest mortgage debt to household income ratios are younger adults, single people, those with three or more financially dependent children, and those with no savings or investments.[6]

The Panel wants to see government, regulators, industry and the new Single Financial Guidance Body work together to help people increase their financial resilience, by encouraging them to save rather than borrow, where they are able to do so. The government's new Help To Save scheme will help for some, but for those who are too poor to save and can only borrow at high cost (if at all) a different solution is needed.

The rest of our response focuses on household indebtedness, consumer credit and incomes.

1 Have household incomes become more variable as a result of more flexible labour markets and the "gig economy", and does this raise the need for new credit products?

It seems likely this is the case, but new credit products are not necessarily the answer. The growth of payday lending (prior to the introduction of the price cap) and other new forms of credit show commercial lenders to be adept at exploiting new business opportunities that arise from changing socio-economic conditions.

The main issue is that fluctuating and uncertain incomes make it difficult to maintain steady, regular debt repayments. This is an area where we would like to see innovation e.g. systems and processes that can better mirror the flexibility/insecurity of people's income and mean borrowers can sustain payment arrangements through the ups and downs of their income. This is relevant to financial services firms but also other creditors including central and local government.

2 What are financial regulators doing to monitor the issues of problematic debt?

The UK lacks any robust system for monitoring problem debt, and there is no coherent cross-government policy for tackling the issue. There is not even an agreed definition of 'over-indebtedness': some organisations use objective measures, such as repeated missed payments, others also include subjective measures, ie whether people feel their debt is a burden.

Problem debt generally includes arrears owed to financial services firms (e.g. on mortgages, credit cards, personal loans or overdrafts), on household bills (rent, energy, water, telecoms, Council Tax) and on other payments such as tax debts or fines. In a report on vulnerable customers, the National Audit Office found dealing with debt to be the most common issue for consumers across the four industry sectors it examined (water, energy, telecoms and financial services).[7]

The Financial Conduct Authority (FCA) oversees regulated financial firms, which are only one source of debt. While the FCA's research and analysis provides insight into the sectors it regulates, it does not have a specific remit to monitor problem debt. Nor would this provide

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[5] This figure includes the 62% of UK adults with no debt [www.fca.org.uk/publication/research/financial-lives-survey-2017.pdf]. Other statistics estimate average UK consumer credit borrowing to be higher, at £3,945 per adult [from http://themoneycharity.org.uk/media/November-2017-Money-Statistics.pdf]

[6] www.fca.org.uk/publication/research/financial-lives-survey-2017.pdf

[7] www.nao.org.uk/wp-content/uploads/2017/03/Vulnerable-consumers-in-regulated-industries.pdf

the whole picture. Problem debt arises because people owe money to a wide range of creditors, including local authorities and utility providers. While data exist about problem debt in its broader sense (e.g. the Money Advice Service Indebted Lives Survey, the Wealth and Assets Survey, and research and statistics from debt charities) there is no one body responsible for bringing all this data together, analysing it, and developing policy solutions.

For its part, the FCA should focus on stamping out poor conduct and exploitative practices in financial services, in order that problem debt is prevented rather than having to be 'cured' (at great expense to citizens and the government). Particular areas where the FCA should do more include:

- Ensuring that firms carry out proper affordability checks before lending or raising credit limits, and that they take account of multiple credit cards when making decisions about the affordability of borrowing[8];
- capping the costs of unarranged overdrafts, which are very expensive and in some cases exceed the cost of payday loans[9];
- taking proactive action to ensure payday lenders cannot side-step the price cap by taking advantage of access to customers' financial transactions that will be available through Open Banking[10].

The FCA could also usefully examine the question of whether high cost lending is 'fair' – ie does the price charged reflect the actual costs and risks of serving a particular consumer, or are firms reaping higher profits from those who have fewer choices? What matters to people on lower incomes is not the APR, but the affordability of repayments. Do firms exploit this bias?

3 Has the UK financial services market been effective in providing suitable credit products for low income households?

While some low-income consumers are unable to access the credit products they need (and could afford to repay), there is evidence that others have been granted credit when they should not have been. Moreover, the commercial borrowing options available to low-income borrowers often come at a high cost that forms part of a broader 'poverty premium' they face in their day-to-day lives. Recent research shows that, among low-income high-cost credit users, the estimated interest costs ranged from £120 per year for small-sum, short-term payday loans to £540 for larger-sum, longer-term home-collected loans.[11]

The question therefore remains: where can low-income households turn to for good quality, affordable credit products? Better access to affordable non-commercial credit on a large-scale has been slow to materialise in the UK. While the value of unsecured high-cost credit remains in the billions, the Community Development Finance Institution (CDFI) market lent a total of £20 million in personal loans in 2016[12]; and the value of credit union loans outstanding at the end of 2016 was £1.3 billion. There are some excellent credit union loan products, some of which include a savings element in the repayments, but not everyone has access to a credit union, and they can't help the riskiest customers. The scaling back of the government's Social Fund (traditionally a major source of borrowing for those eligible) also leaves a gap in the options open to low-income households.

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[8] https://www.fs-cp.org.uk/sites/default/files/fscp_response_creditworthiness_in_consumer_credit.docx_.pdf
[9] https://www.fs-cp.org.uk/sites/default/files/fscp_response_hcstc_price_cap_review.pdf
[10] ibid
[11] www.bristol.ac.uk/media-library/sites/geography/pfrc/pfrc1710_making-the-poverty-premium-history.pdf
[12] http://responsiblefinance.org.uk/download/responsible-finance-the-industry-in-2016/

The financial services market cannot deliver good quality affordable credit products for low-income households. Some people present a very high risk of default, others have no credit history, or volatile incomes. Even if lending is 'fair', these groups cannot be served commercially at an affordable price. If it is public policy that people should have access to loans that are cheaper than their risk profile would indicate, then these loans will need to be subsidised, either by the taxpayer, or through a cross-subsidy paid for by other customers. Successive governments have failed to address this basic issue.

4 What interventions can the Government make, including "breathing space" schemes?

The Panel welcomes the Treasury's consultation on 'breathing space' and a statutory debt management scheme. In our response to the consultation, we will highlight that 'breathing space' must be longer than six weeks in order to be effective, given that citizens in debt are highly unlikely to be able to access free help in that period. It should also apply to all forms of debt, including money owed to central and local government.

Andrew Bailey, FCA Chief Executive, has recently called for stakeholders to come together to do something about affordable credit '*for the public good'*[13]. This issue has been around for at least two decades, with little concrete progress. The government needs to take the lead here. A first step would be to establish clear Ministerial responsibility for tackling problem debt, including monitoring household debt.[14] The Department for Business Innovation and Skills[15] was responsible for a UK over-indebtedness strategy, but this was discontinued under the coalition government of 2010-2015. The coalition government also disbanded the Financial Inclusion Taskforce, which had a leading role in advising Ministers on debt. For too long this economically important topic has suffered from a lack of government and ministerial ownership, which means that we have no robust system for monitoring problem debt; no coherent cross-departmental policy for tackling problem debt; and slow progress on improving access to affordable credit for low-income households.

Yours faithfully,

Sue Lewis
Chair, Financial Services Consumer Panel

[13] www.fca.org.uk/news/speeches/challenges-regulator-mansion-house-2017

[14] The Economic Secretary to the Treasury's responsibilities cover financial inclusion and retail financial services (including banking competition, consumer finance, financial advice and capability) but not specifically household debt. The Parliamentary Under Secretary of State for Pensions and Financial Inclusion's responsibilities cover financial inclusion and guidance (including the Single Financial Guidance Body, Credit Union Expansion Project and Post Office Card Account) but again no specific responsibility for household debt.

[15] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/36990/10-830-over-indebtedness-second-report.pdf