Stuck in debt

Why do people get trapped in problem debt?

citizens advice

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Summary

Ten years after the first signs of the financial crisis, people's finances are again stretched.[1] Prices are rising faster than incomes, the savings ratio is at a record low, and consumer borrowing is growing at its fastest rate since before the financial crash.

The fast growth of borrowing is not necessarily a problem itself. It becomes a problem - for lenders as well as individuals - when people take on debts they can't repay. The impact of unaffordable debt on people's lives is clear and Citizens Advice helps people minimise it every day. Last year we helped 350,000 people who were struggling to afford their debts.

Their experiences aren't uniform. For large numbers of people, struggling with debt is a short-term situation, driven by a temporary loss of income or an unexpected cost such as a high bill or household emergency. However, for a significant minority, it is a situation they find difficult to escape. Of the 2.9 million households who were struggling with debt in 2015, 1.37 million (47%) were still struggling with debt over a year later.

People can struggle for far longer than a year. Of the 4.3 million people who were struggling to afford their debts during the financial crisis (2006-8), 800,000 were still struggling in 2012-14. And around 1.2 million of them were struggling again in 2014-16 - spending nearly a decade in and out of problem debt. Those people are still dealing with the consequences of the high levels of borrowing in the build up to the financial crisis.

People get stuck in debt for a wide range of reasons. Two stand out. First, people who use credit cards are more likely to remain in problem debt. Credit cards, unlike most forms of borrowing, don't have a repayment schedule so borrowing can go on indefinitely. Nearly a fifth of people struggling to pay their debts had their credit limit increased without them asking for it last year.

Second, people enter into a debt-spiral - where they borrow more despite struggling to afford their debts. People who are struggling to repay their debt are just as likely as those who aren't struggling to borrow more - on average taking on an extra £1,506 between 2010-12 and 2012-14.[2] Too many people are able to borrow large sums even when they are already struggling to manage.

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[1] On 9 August 2007, BNP Paribas suspended three hedge funds which specialised in the US subprime mortgage sector. BBC News (2009) Timeline: Credit crunch to downturn.
[2] All figures throughout this report have been adjusted for inflation.

Lenders, the Financial Conduct Authority, and the government have a crucial role in helping people stay on top of their debts and getting their finances back on track when they fall into difficulties. This report makes four recommendations:

Recommendation 1: The FCA should make sure credit cards don't push people into long-term problem debt by:

- Stopping lenders from increasing people's credit limits without them requesting it.
- Requiring lenders to conduct an affordability check before offering an increase.
- Increasing the statutory minimum repayment for new credit cards so people's balances are paid down more quickly.
- Requiring credit card firms to offer forbearance to customers who have paid back more in charges than in capital for 2 years. This is a significant time period in which to leave a customer making only minimum payments.

Recommendation 2: Lenders should scrap unarranged overdraft charges.
In 2014, consumers paid £1.2 billion in unarranged overdraft fees. People in problem debt are more likely to pay them - more than a third (35%) of people in problem debt paid overdraft fees last year compared with 17% of all UK adults. Scrapping unarranged overdraft charges limit the extent to which overdraft charges push people further into problem debt.

Recommendation 3: The government should work with the Single Financial Guidance Body to provide financial help at key moments in people's lives.
Changes in circumstances, sudden expenditure shocks, and loss of income can push people into problem debt. The new guidance body should fund advice at key moments in people's lives - such as having a baby or starting a new job. Using those touch points would help more people get the advice they need.

Recommendation 4: The government should give certainty to people who are struggling to repay their debts by:

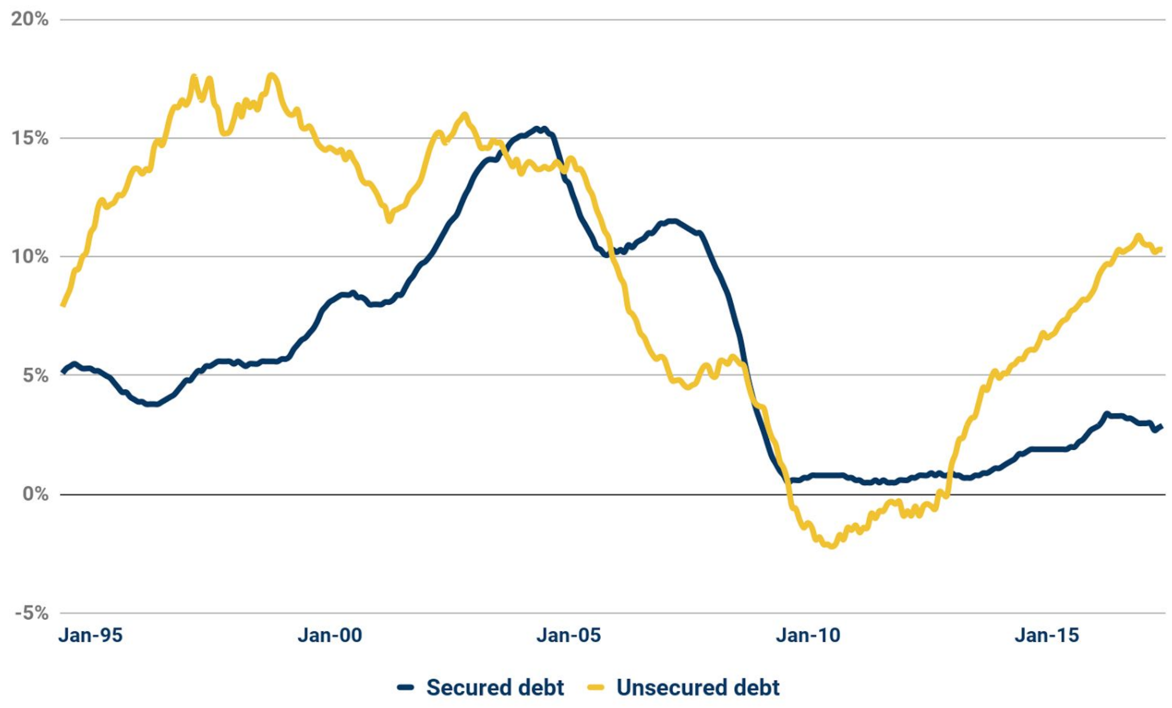
- Introducing 'breathing space' for people struggling with their debts, meaning they are protected from interest and charges.
- Creating a legally backed debt repayment scheme so people have a clear way out of debt.

Introduction

Household debt is growing quickly. After falling slightly following the financial crisis, total household borrowing has been increasing since 2012, and has been growing faster than incomes since the last quarter of 2015. The pace of that growth has increased since 2016, with the amount of debt growing by 3.2% - £48 billion - in the last 12 months.[3]

The total level of personal debt in the UK now stands at £1.5 trillion.[4] The vast majority, £1.3 trillion, is mortgage debt. The remaining £200 billion is made up of consumer credit - mainly credit card debt, personal loans, and car finance.

Figure 1: Two decades of household debt
Monthly 12 month growth rate of secured and unsecured debt (excluding student loans) from 1994 - 2017 (seasonally adjusted)



Source: Bank of England

The fast rate of growth is being driven by consumer borrowing. Consumer debt is growing at a rate of more than 10% per year - its fastest annual growth since 2005.

[3] Bank of England, Bankstats (Monetary & Financial Statistics) May, *Table A5.2 Total lending to individuals excluding student loans*.
[4] Bank of England, Bankstats (Monetary & Financial Statistics) May, *Table A5.2 Total lending to individuals excluding student loans*.

The ratio of unsecured debt as a proportion of household income is now almost as high as it was before the financial crisis, currently standing at 40% compared to a high of 42% in 2008.[5]

The current high level and fast growth of consumer debt is an indicator that people are taking on unaffordable debts, but aggregate measures only tell us a limited amount. British households remain firmly in the black - they have £200 billion in consumer debts and £700 billion in cash saving accounts.[6] But debt - like savings - is not evenly distributed. It is when individuals and families take on debts they can't afford that they become harmful. That is true for lenders and the wider economy as well as for individuals.

For lenders, unaffordable consumer lending makes them vulnerable to losses in an economic downturn. While the majority of debt is mortgage debt, consumers are more likely to default on consumer borrowing when they struggle to make repayments. As a result of that risk the Bank Of England recently required UK banks to increase the amount of capital they hold to protect them from losses if more people start to fall behind with their consumer debt repayments.[7]

The harm caused to individuals is more straightforward and Citizens Advice helps thousands of people every day to minimise the impact of unmanageable debt on their lives. When people struggle with debt it not only affects their living standards - forcing them to go without essentials. They are also more likely struggle in other areas of their life and to experience mental health problems in particular.[8]

The experience of struggling with debt, though, is not uniform. For large numbers of people, struggling with debt is a short-term experience. Most people who get into difficulties with their debt are able to pay them down and get their finances back on track. For those that can't, debt problems are more damaging.

Due to the rate of growth, and the fact that consumer credit is the primary cause of problem debt, this report focuses on consumer borrowing. It presents new analysis of the extent of long-term problem debt in Great Britain. For the first time it uses multiple waves of the Wealth and Assets Survey and the Bank of England's NMG survey to look at how people struggle with debt over a long period of time. The NMG Survey is used to provide upto date data - for 2015 and 2016. The Wealth and Assets Survey allows us to look at people's debt between 2006 and 2014, as well as look at people's characteristics in more detail.

[5] Office for National Statistics, UK Economic Accounts time series (UKEA), June 2017.
[6] FCA, Cash Savings Market Study, January 2015
[7] Bank of England, Financial Stability Report, June 2017.
[8] Citizens Advice, A Debt Effect?, 2016.

Part 1: Who is in debt?

i. How much consumer debt are we in?

British adults hold more than £200 billion of consumer credit. A third of that, £67 billion is credit card debt. Car finance - loans offered to car buyers at the point of sale - accounts for another £58 billion. The bulk of the remaining £72 billion is made up of personal loans, but also includes overdrafts, store credit, and debts owed to pawnbrokers and payday lenders.

Consumer borrowing is currently growing at a rate of more than 10% per year. Within that, credit card debt has been growing steadily since 2012 and increased by £3.5 billion in the last year alone, an annual growth rate of just over 9%.

Car finance has been growing faster still at an average rate of 20% since 2012, peaking at nearly 23% in 2014. More than £30 billion was added to the total stock of car finance debt during that period. Over the past year, the growth rate has slowed to just over 15% per year, which still accounts for around half of the growth in consumer debt over that time. However, other types of unsecured lending such as personal loans have also begun to grow, rising from a negative growth rate in 2014 to over 7% this year.[9]

ii. Who is more likely to be in debt?

The level of debt and the speed at which borrowing is growing are indicators of people getting into financial difficulty and broader economic risk. To understand whether that debt poses a risk and how it affects people's lives, we need to consider how it is distributed between households and individuals. It is when individuals and households take on too much debt that it becomes harmful.

This research uses two main data sources to look at who holds Great Britain's stock of consumer debt. The Bank of England's NMG Survey is used to provide data for debts of *households* in 2015 and 2016. The Wealth and Assets Survey is used to look at the characteristics of *individual* debt holders between 2006 and 2014.

[9] Bank of England (2017), Financial Stability Report, June 2017.

Using the most recent NMG survey data, around 46% of British households - approximately 12 million - held some form of consumer debt in 2016.[10]

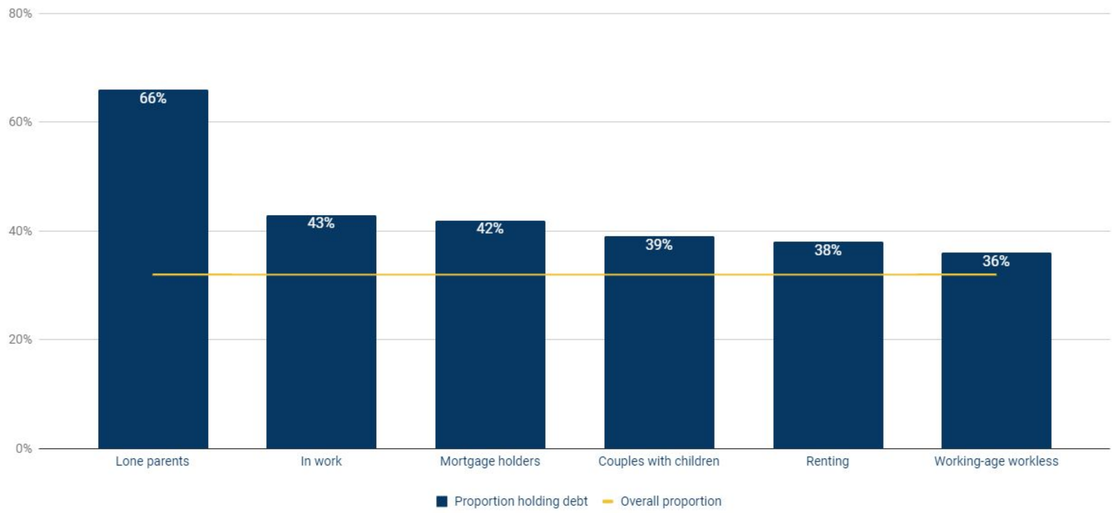
The Wealth and Assets Survey data allows us to look at who is more likely to have debts. The survey shows that nearly a third (32%) of adults in Great Britain - around 17 million - held non-mortgage debt in 2012-14. We would expect the proportion of adults to hold debt to be lower than the number of individuals as households often have more than one adult in them.

A number of groups stand out as more likely to hold consumer debt:

- Lone parents are twice as likely to hold unsecured debt when compared to all adults, with 66% having some form of consumer debt. Couples with children are also overrepresented, with 39% holding unsecured debt compared with only 28% of people with no children.
- People in work, people with a mortgage, and those who are renting their home were also more likely to hold unsecured debt.

Figure 2: Who is in debt?

Proportion of British adults holding debt by demographic group (2012-14)



Source: Citizens Advice analysis of the Wealth and Assets Survey

iii. What debts do people have?

Our analysis of Wealth and Assets Survey data indicates that the median consumer debt held by people who use consumer credit in Great Britain is £1,910.

[10] We exclude student loans throughout this report. The average student debt for the post-2012 cohort of students is £32,000 per person. Total student loans are expected to exceed £100 billion in 2018. House of Commons Briefing Paper - Student Loan Statistics (21 June 2017).

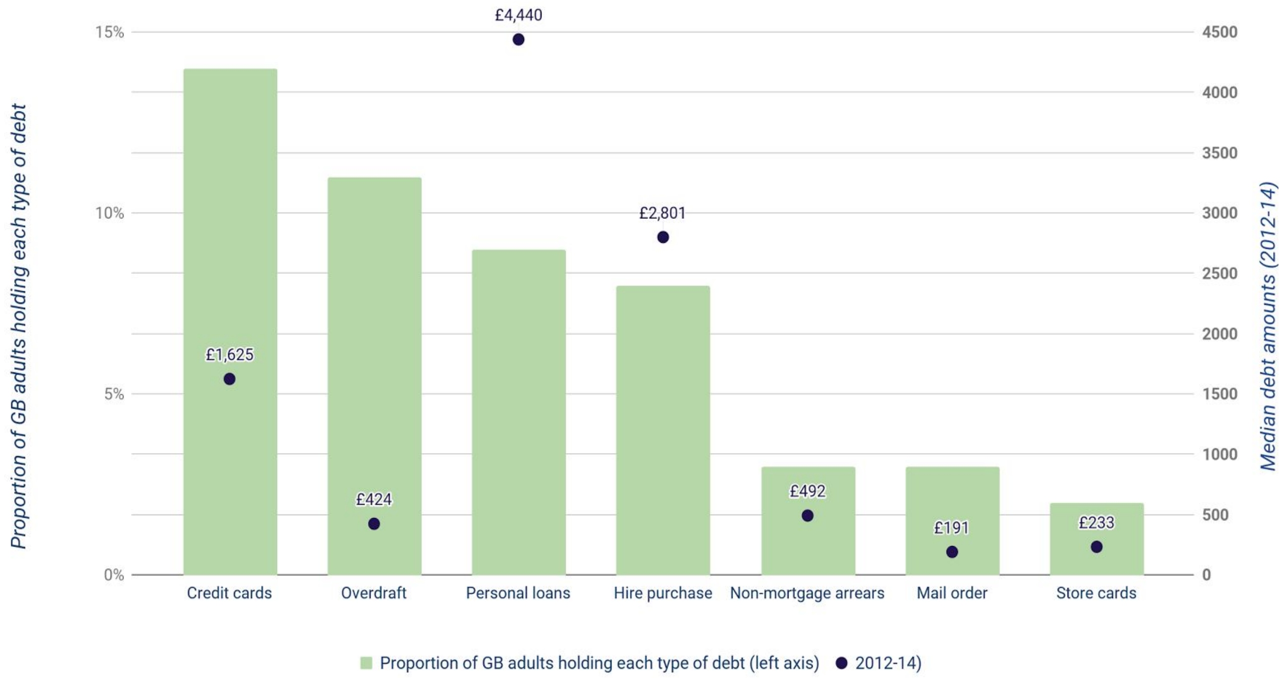
[11] The majority of consumer debt is made up of credit cards, personal loans, hire purchase debt, and overdrafts.[12]

The most common way in which people borrow money is by using a credit card. Analysis of the Wealth and Assets Survey data indicates that 14% of British adults held some credit card debt, the median amount being £1,625.

Overdrafts are the second most common type of consumer debt, with 11% of adults having an outstanding balance on their overdraft in 2012-14. People tend to borrow smaller amounts using an overdraft than a credit card - the median amount outstanding was £424.[13]

Figure 3: What types of debt do people have?

Type of debt held by British adults and median debt amounts (2012-14)



Source: Citizens Advice analysis of the Wealth and Assets Survey

Personal loan and hire purchase debt are less commonly held. However, people tend to borrow larger amounts using these types of credit. The median personal loan debt in 2012-14 was £4,440 - the largest of any type of consumer debt.

[11] The median debt figure is well below commonly reported average debt figures for two reasons. First, a minority of debt holders have very large debts skewing the average debt figures. Second, survey data consistently underestimates people's debt holdings.
[12] 34% credit cards, 30% car finance and 30% other - comprised of personal loans, overdrafts, peer-to-peer lending, store credit, credit unions and other lenders. Bank of England (2017), Financial Stability Report, June 2017.
[13] Analysis of Wealth and Assets Survey data.

Part 2: Who has too much debt?

i. Citizens Advice evidence

Citizens Advice sees the direct impact on people when they get into difficulties with their debts. Last year Citizens Advice helped nearly 350,000 people face to face and over the phone with their debts and our online pages for debt and financial information, guidance and advice have been viewed 8.9 million times.

The median debt of people we helped last year was £3,806.[14] People had 5 different debts on average.

Figure 4: Citizens Advice debt clients have complex problems

When people come to Citizens Advice for help with their debts, they are often already in crisis and face other other challenges in their lives. Two fifths of our clients are disabled or have a long-term health condition, of which mental health is the highest reported problem.[15] Their problems are also complex. More than half (52%) the people we helped with their debts last year had problems in other

[14] This data has been cleaned and sorted from data recorded in Quarters 1 and 2 2016/17 in our electronic case recording module for complex debt casework. Not all clients who receive advice are referred to this level of specialist debt help.
[15] We recorded the health status for the majority (80%) of clients we helped last year. 40% indicated they had a disability or long-term health condition. Only a small number (19,000) were asked to specify which disability or long-term health condition they experienced. 27% of those asked indicated they experienced a mental health problem and a further 13% indicated they had unspecified multiple conditions. If this group of clients is taken as a representative sample, it would indicate that at least 10.8% of our clients had a mental health condition. Due to underreporting, and the total not captured due to unspecified multiple conditions, this number is likely higher.

areas of their lives - such as with their benefits or housing. The impact of those complex problems on people's lives can be severe:

Dan came to Citizens Advice for help with debts he had accrued in the years since separating from his wife. When he came to Citizens Advice, Dan had built up £2,000 in rent arrears. He also owed £600 in council tax and had accrued £3,100 in credit card and mobile phone debt. He was facing eviction and was worried about the impact this would have on his son. He was also issued with food vouchers as he no longer had enough money coming in to pay for essentials.

ii. How should we measure problem debt?

People who come to Citizens Advice - and who get specialist help with their debt from other sources - are by definition, struggling to manage their debts. But how many people are struggling who don't seek debt advice?

The number of people identified as struggling with debt depends on how 'struggling' is defined. Commonly used metrics can be split into *measures* - that count the number of people that are struggling, and *indicators* - which are used to estimate the number of people that are likely to be struggling.

The most commonly used indicators of problem debt are a high debt to income ratio or high debt servicing to income ratio. People spending a large proportion of their income on debt repayments, or who have a large amount of debt when compared with their income, are more likely to get into financial difficulty.

The number of people in arrears is the most commonly used measure of problem debt and captures the extent to which people are already struggling. Other commonly used measures are subjective - based on how people judge their own ability to manage financially - such as whether they are concerned about meeting repayments, or find their debts to be a burden.

We use a definition which combines objective and subjective measures of problem debt. In our analysis, people are counted as struggling with their debt if they experience any of the following:

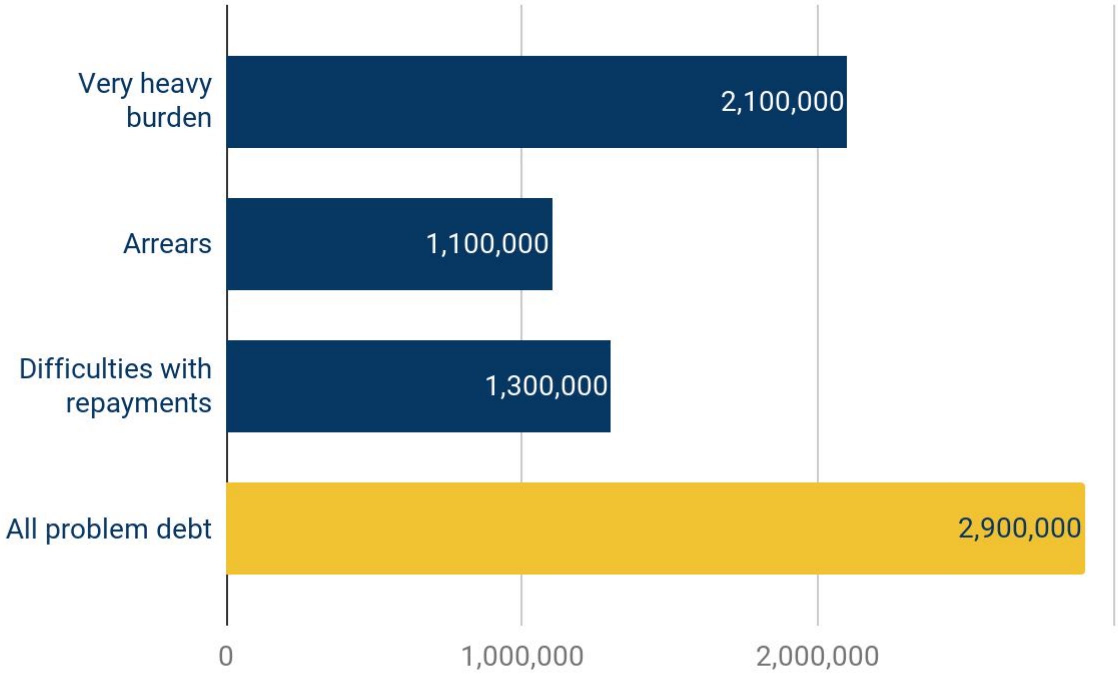
- In arrears
- Say they are struggling to meet debt repayments
- Say they find their debts to be a heavy burden.[16]

[16] This is the definition used by the FCA in Occasional Paper 20 (August 2016) Can we predict which consumer credit users will suffer financial distress?.

When looking at individuals' debt using the Wealth and Assets Survey we can also count people who say they have missed credit or store card repayments.

Looking at the most recently available data - from the Bank of England NMG Survey from 2016 - 46% of households have unsecured debt. Just under a quarter (24%) of them - 11% of all households - were struggling with their debts. That means around 2.9 million households were either in arrears, struggling with bill payments, or found their debts to be a heavy burden.[17] The chart below shows the breakdown of how people are struggling with their debts.

Figure 5: How many households are struggling with their debts in 2016?



Source: Bank of England NMG survey

iii. Who is struggling with their debt?

Who makes up the group that is struggling with their debt? Using the Wealth and Assets Survey, we can dig further into people's characteristics and identify who is most likely to be be struggling with their debt.

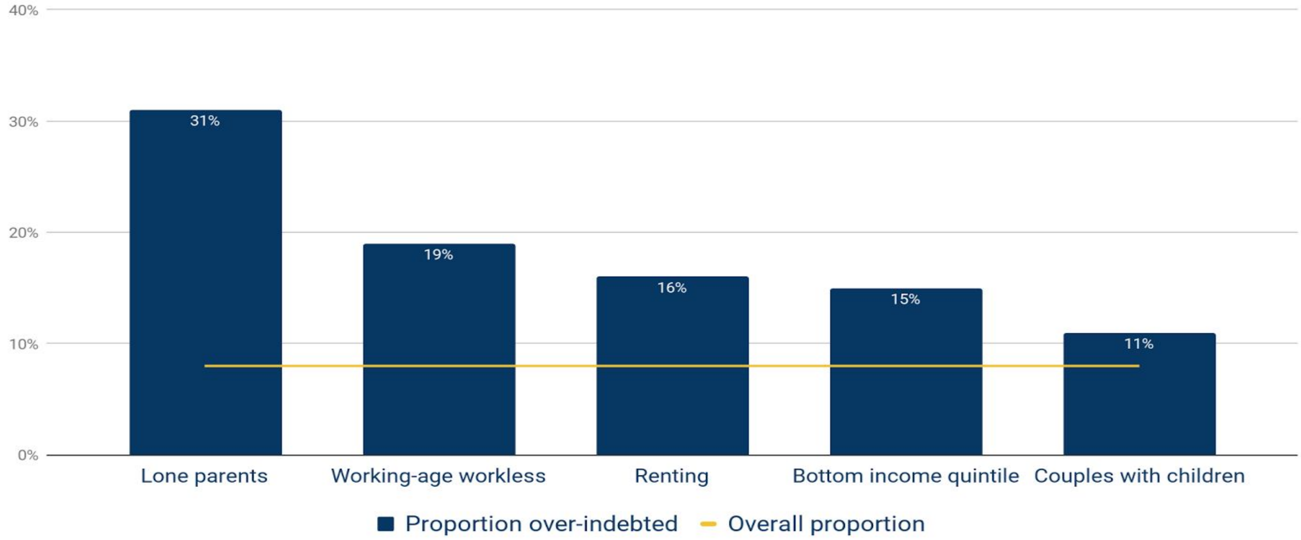
Our analysis shows that of the 16.6 million people who held consumer debt in 2012-14, 26% were struggling to manage their debts - equivalent to around 4.3 million adults, or just less than one in twelve adults in Great Britain.

[17] These statistics come from analysis of the raw data of the Bank of England 2016 NMG Consulting Survey.

The likelihood someone will be struggling depends on their circumstances. While around 9% of all adults were struggling in 2012-14, nearly a third (31%) of lone parents were struggling, as were one in five people (19%) who were out of work. Families also struggle to stay on track with their finances, with one in nine (11%) couples with children struggling to manage their debts.

Figure 6: Who struggles with debt?

Proportion of British adults who are over-indebted, by demographic group (2012-14)



Source: Citizens Advice analysis of the Wealth and Assets Survey

iv. What debts are people struggling with?

The median level of consumer debt held by people who are struggling with their debts is around £2,140, which is £230 more than the median amount held by all people with any debt.[18] More striking than the amount of debt held by people who are struggling financially is the types of debt they have.

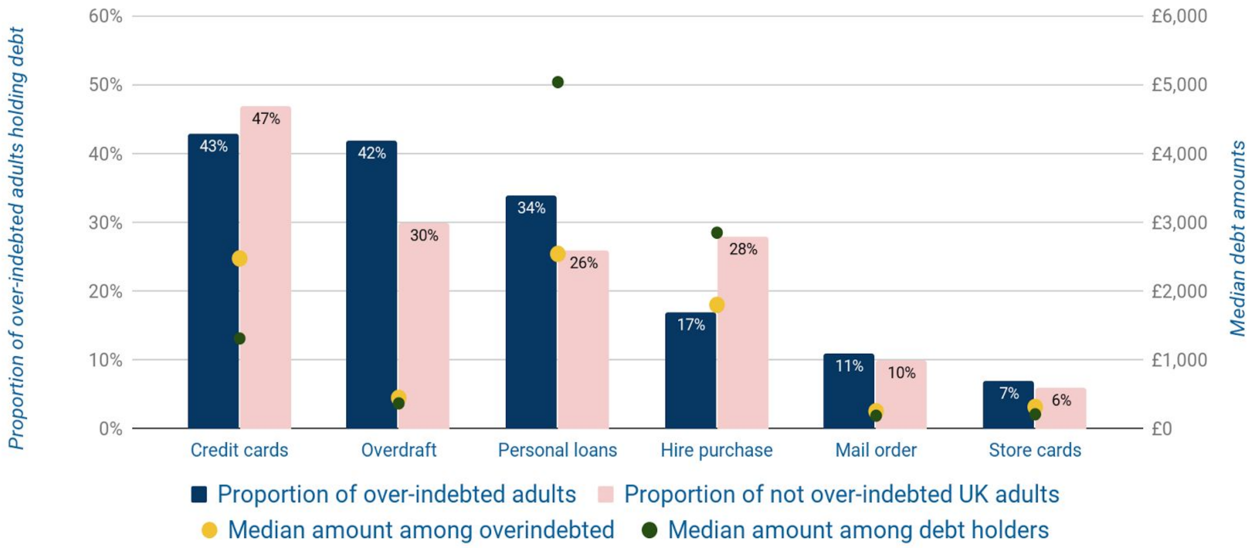
In particular, people who are struggling with their debts are far more likely to have large credit card debts. The median credit card debt of someone who is struggling financially is £1,165 more than people with credit card debt who are on top of their finances (£2,480 compared to £1,315).

In contrast, people who are in debt but not struggling are more likely to have higher levels of personal loans (£5,046 compared to £2,546) and hire purchase debt (£2,855 compared to £1,804).

[18] All figures on the amount of debt people hold are from the Wealth and Assets Survey which under reports the total amount of debt.

Figure 7: What debts do people struggling have?

Type of debt held by over-indebted British adults and median debt amounts (2012-14)



Source: Citizens Advice analysis of the Wealth and Assets Survey

People who are struggling with their debts are both more likely to have a credit card compared to all adults with debts, and to have a higher amount of credit card borrowing. We look more closely at some of the reasons credit card borrowing is so closely associated with debt problems in Part 5 below.

Part 3: How do people get into problem debt?

People end up struggling with their debts for a range of reasons. In our analysis of the Wealth and Assets Survey, two features of people's journey into problem debt stand out - a drop in income or other sudden change to people's finances.

i. A drop in income

Our analysis found that people who experience a drop in income are more likely to fall into problem debt than those who don't. People who experienced a significant fall in income - defined as moving to a lower income quintile - were 33% more likely to fall into problem debt two years later.[19]

Losing a job or reducing the hours that you work are the most obvious reasons for a drop in income. However, people's incomes can also fall when they go through major changes in their health, housing or family life.

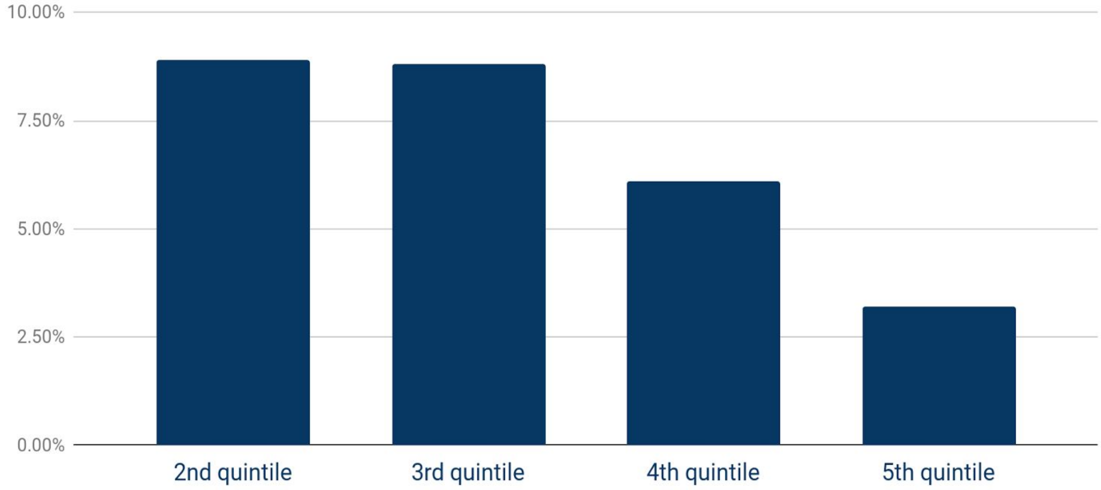
Hannah contacted Citizens Advice after a period of ill-health. She had been admitted to hospital a few months and had undergone an operation, meaning she was unable to work and was getting by on income from her Employment Support Allowance. Despite having contacted her creditors before her operation, Hannah incurred late payment fees and was threatened with enforcement action. She also incurred overdraft charges, further reducing her income. Although Hannah was due to start a new full-time job, she was concerned that the gap in income whilst she was waiting to receive her first month's pay would make her situation worse.

A drop in income is more likely to lead to problem debt for people on a middle income than it is for people who are better off. If we divide the population into fifths according to their earnings, we can see that only 3% of people in the top quintile who had a drop in income became over-indebted. People whose income put them in the 3rd and 4th lowest income quintiles were three times more likely to become over-indebted after a drop in income - nearly 1 in 10 (9%) who experienced a drop in income became over-indebted. A drop in income is more harmful for people with less income to spare.

[19] 6.4% of people who moved to a lower income decile fell into problem debt, compared to 4.8% of British adults who remained in the same income quintile or increased their income.

Figure 8: A drop is worse for people on a low income

Proportion of British adults who moved to a lower income and became over-indebted, by quintile of origin (2010-12 and 2012-14)



Source: Citizens Advice analysis of the Wealth and Assets Survey

ii. Sudden shocks

A second cause of problem debt which stood out from our analysis was people suddenly taking on debt. Looking at people who were over-indebted in 2012-14, more than a third (34%) of people who were struggling with debt had not been borrowing at all two years earlier.

People take on debts for a range of reasons. One reason people with no history of borrowing fall quickly into problem debt is due to unexpected changes in their personal circumstances and major life events - such as losing a job or separating from a partner.

Julie came to Citizens Advice for help because she was taking on debt during a period of unemployment. After her contract had come to an end just before Christmas, Julie struggled to find other work. Despite claiming the benefits she was entitled to, she was having difficulty meeting her living costs. By April, Julie had rent arrears of nearly £200 and owed around £1,100 in loan, credit card and overdraft debt.

People who quickly became over-indebted typically held lower amounts of debt than those who were already struggling. The median amount of debt held by someone who has only recently taken on debts and is already struggling is just £663. The median debt of someone struggling with their debts is £2,140.

They are more likely to have borrowed using a credit card or overdraft and to be in arrears than people with debts generally. Nearly half (48%) of the debt held by people in this group was overdraft or credit card debt, compared with 31% for all debt holders. In total, 48% of newly over-indebted people had borrowed using a credit card or overdraft.

They are also more likely to be in arrears. Nearly half (47%) of those who fell into problem debt and were newly indebted were in arrears, compared to 1 in 11 (9%) of all debt holders. Overall, 16% of people who became newly over-indebted in 2012-14 were people who had no debts two years earlier but had fallen into arrears.

The use of small amounts of revolving credit - such as credit card and overdrafts- - and the likelihood of falling into arrears suggests that many of the people get into difficulties with their debt as a result of sudden changes in their lives such as a one of expense or a period out of work.

Part 4: Who is stuck in debt?

The number of people struggling with debt has remained relatively stable over the since the financial crisis, with around 9% of all individuals struggling in any one year.

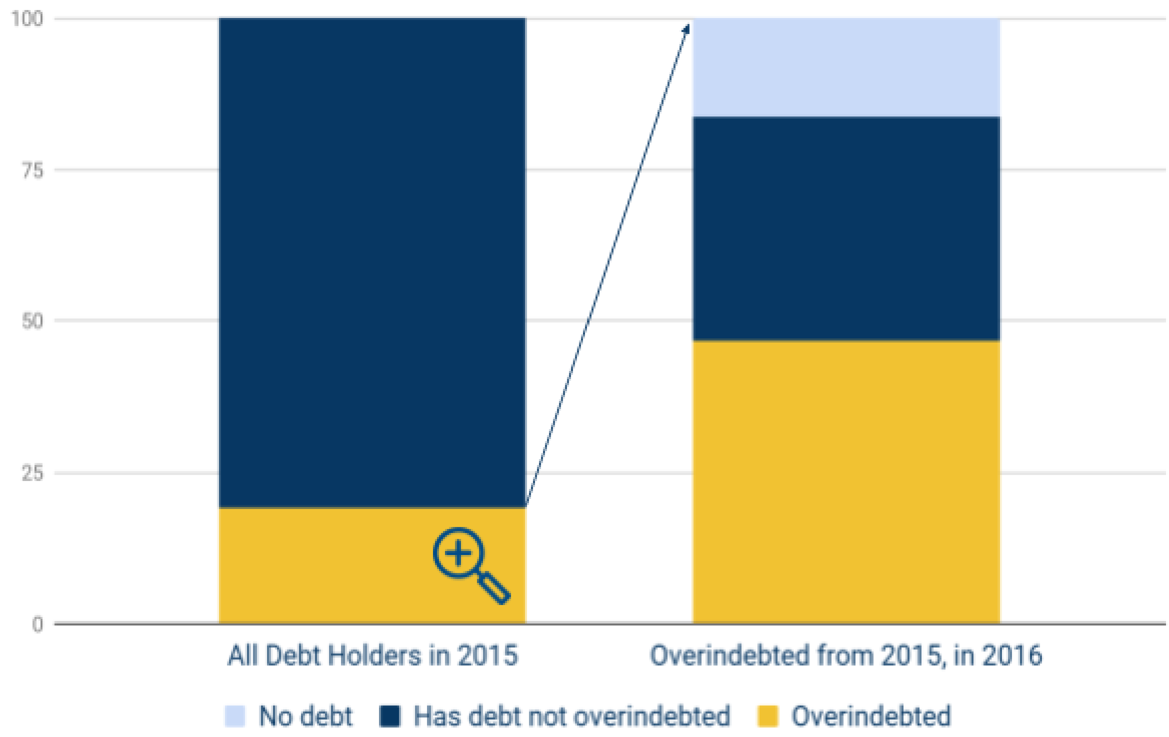
The stability of the overall figure masks the fact that large numbers of people move in and out of problem debt. The majority of people who get into difficulties with their debts are able to get back on track a year or two later. However, a significant minority struggle with their debts over a long period of time.

i. How many people are stuck in debt?

Of the 2.94 million *households* struggling with their debts in 2015, a year later:

- 1.37 million were still struggling - they were stuck in debt.
- 1.10 million were still in debt but were no longer struggling.
- 470,000 had no debts at all.

Figure 9: The transition from over-indebtedness, 2015-16



Source: Bank of England NMG survey

That pattern holds in other years and over a longer period of time. Again using the Wealth and Assets Survey to look at individual debt holders - of the quarter of debt holders who struggled with their debts in 2010-12 (4.4 million people) just less than half (45%) were still in problem debt two years later. Around a third (31%) still had debts but were no longer struggling and 23% had no debts.

Figure 10: How common is long-term debt?
British debt holders and those struggling with their debts in 2010-12 in 2012-14

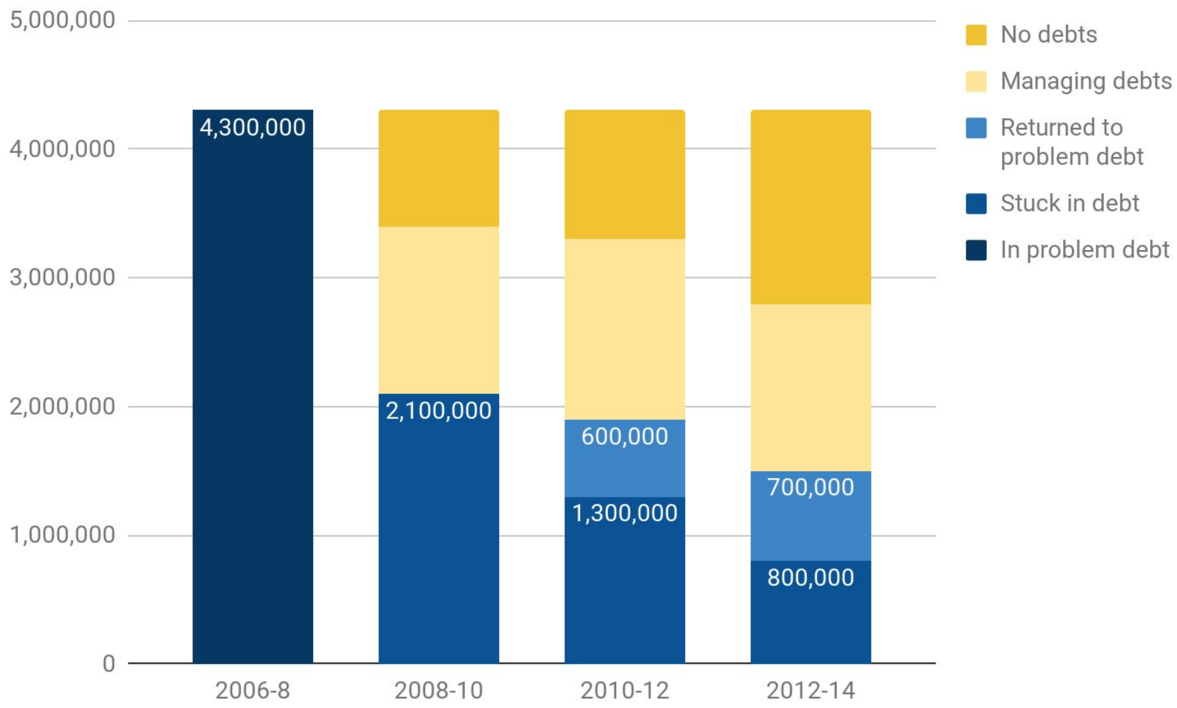
Source: Citizens Advice analysis of the Wealth and Assets Survey

The Wealth and Assets survey also allows us to look at the number of people who have been struggling with debt for a long period of time. Of the 4.3 million people who were struggling with debt in the wake of the financial crisis in 2006-08, over a third (1.5 million) were struggling with debt 6 years later in 2012-14:

- One in five (19%) - around 0.8 million - had been over-indebted in every year since 2006.
- One in six (16%) - around 0.7 million - had not been over-indebted at every wave of the survey, but had left and then returned to over-indebtedness.
- Two in three (65%) people had no debts six years later.

Nearly a million people are still dealing with the consequences of high levels of lending in the run up to the 2008 financial crisis. The figure below shows how people move in and out of problem debt over time.

Figure 11: What happens to people in problem debt?
Debt position of British debt holders who were struggling with their debt in 2006-8 between 2006-8 and 2012-14 (figures rounded to the nearest 100,000)



Source: Citizens Advice analysis of the Wealth and Assets Survey

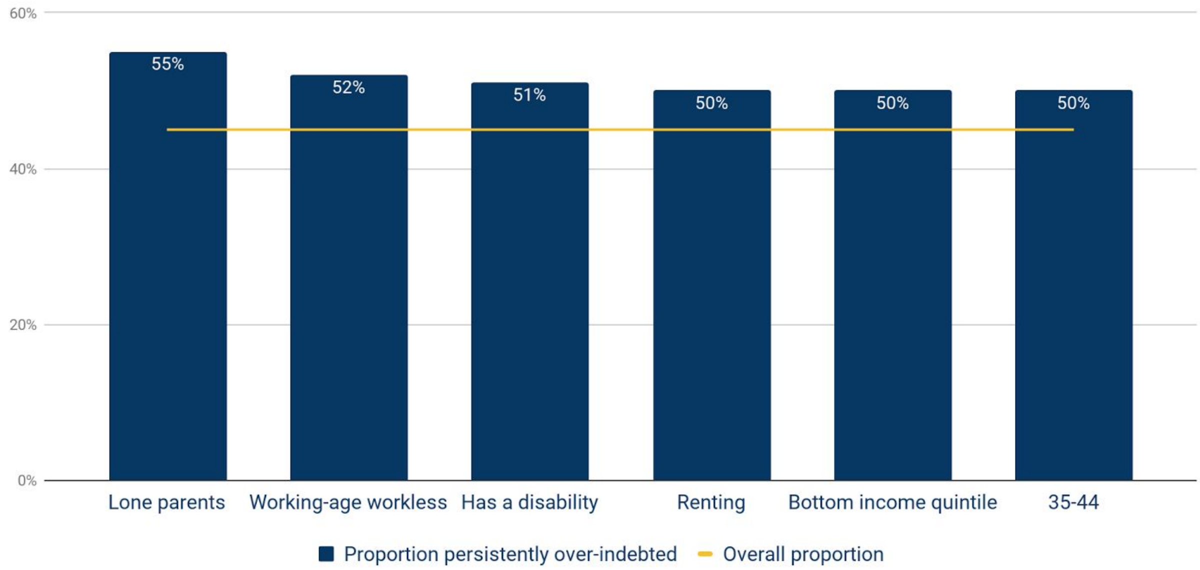
Using the previous waves of data we can also estimate how many people who were struggling in 2006-8 were likely to be struggling again in 2014-16. Of the 4.3 million people struggling with their debts in 2006-8, we estimate that more than half (57%) - or 1.2 million people - were likely to be struggling again 8 years later. They have spent nearly a decade in and out of debt.

ii. Who is trapped in debt?

The Wealth and Assets Survey also lets us look at who is more likely to get trapped in debt. The chance that someone who is struggling with debt will get trapped in debt depends on their personal circumstances.

Overall, 45% of all those who were struggling financially in 2010-12 were still struggling two years later. The likelihood of being stuck in debt was higher for people more likely to be experiencing vulnerability. More than half (55%) of lone parents remained over-indebted across the two years, as did 51% of disabled people and 50% of renters. People who are more likely to be vulnerable are not only more likely to struggle to afford their debts, they are more likely to struggle for a long period of time.

Figure 12: Who is trapped in debt?
Proportion of people in problem debt 2010-12 still over-indebted in 2012-14



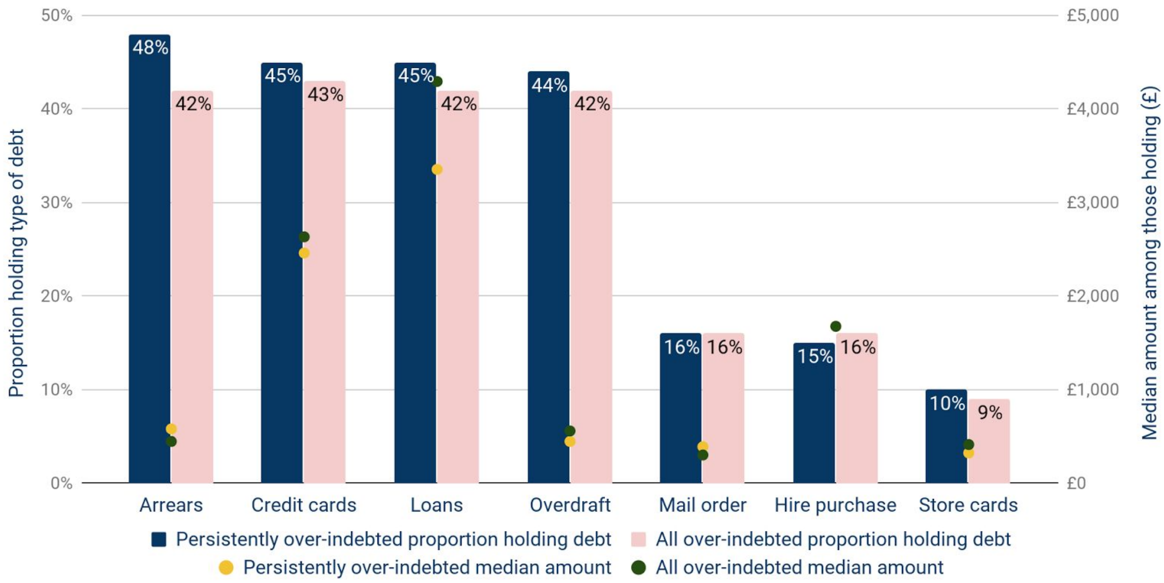
Source: Citizens Advice analysis of the Wealth and Assets Survey

iii. What debts do they have?

People trapped in debt - those who are persistently over-indebted year on year - typically have £2,517 in consumer borrowing. This compares to £1,910 for all debt holders, and £2,140 for everyone struggling with debt during a year.

As the chart below shows, people who are trapped in debt over a long-period of time are more likely to hold almost every form of debt, with the number who are in arrears standing out. 48% of people with long-term debt problems have arrears, compared to 42% of people struggling with their debts over a smaller period. That suggests that people's debt problems worsen as they go on.

Figure 13: What type of debt do people who are trapped in debt hold?
Type of debt held by persistently over-indebted British adults and median debt amount (2010-12 and 2012-14)



Source: Citizens Advice analysis of the Wealth and Assets Survey

The debt holdings, however, are very similar. So why do people get trapped in persistent debt?

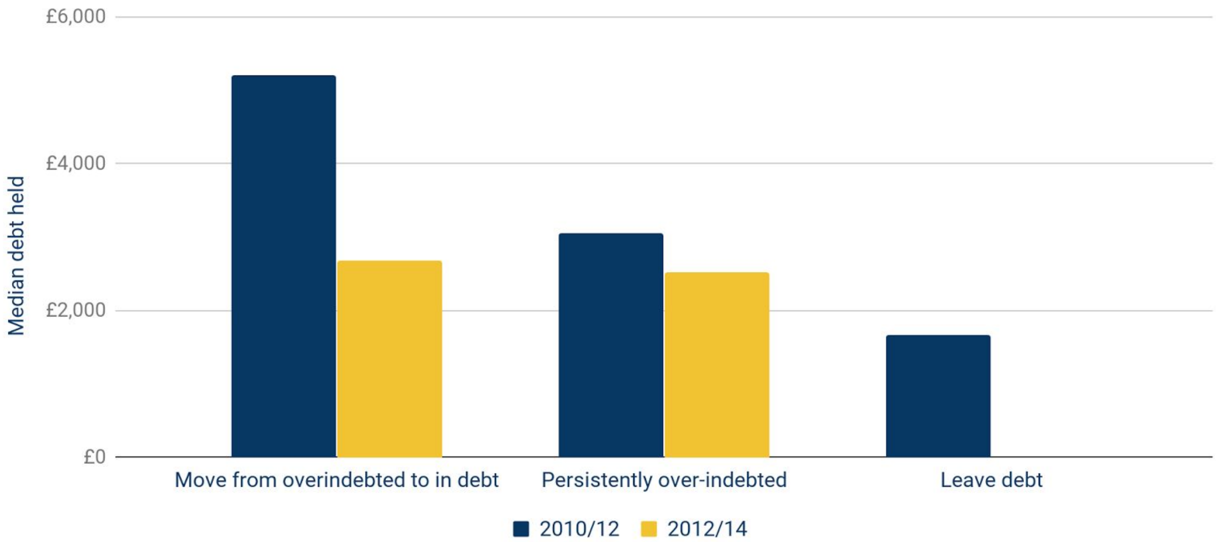
Part 5: Why are people stuck in debt?

For the majority of people - 53% of the 2.9 million households in problem debt in 2015 for instance - struggling with debt is a relatively short term experience. A year on, they have recovered - paid down their debt or got back on track with their bills. So why do some people get trapped in persistent problem debt?

i. Not simply due to over-borrowing

People who are in long-term persistent debt do not simply have more debt than people whose financial difficulties are short-term. In fact, people who were able to get back on top of their debts generally had higher levels of debt than people who struggled for two years or more.

Figure 14: How much debt do people who are trapped in debt have?
Median debt held by groups moving out of and into persistent over-indebtedness (2010-12 and 2012-14)



Source: Citizens Advice analysis of the Wealth and Assets Survey

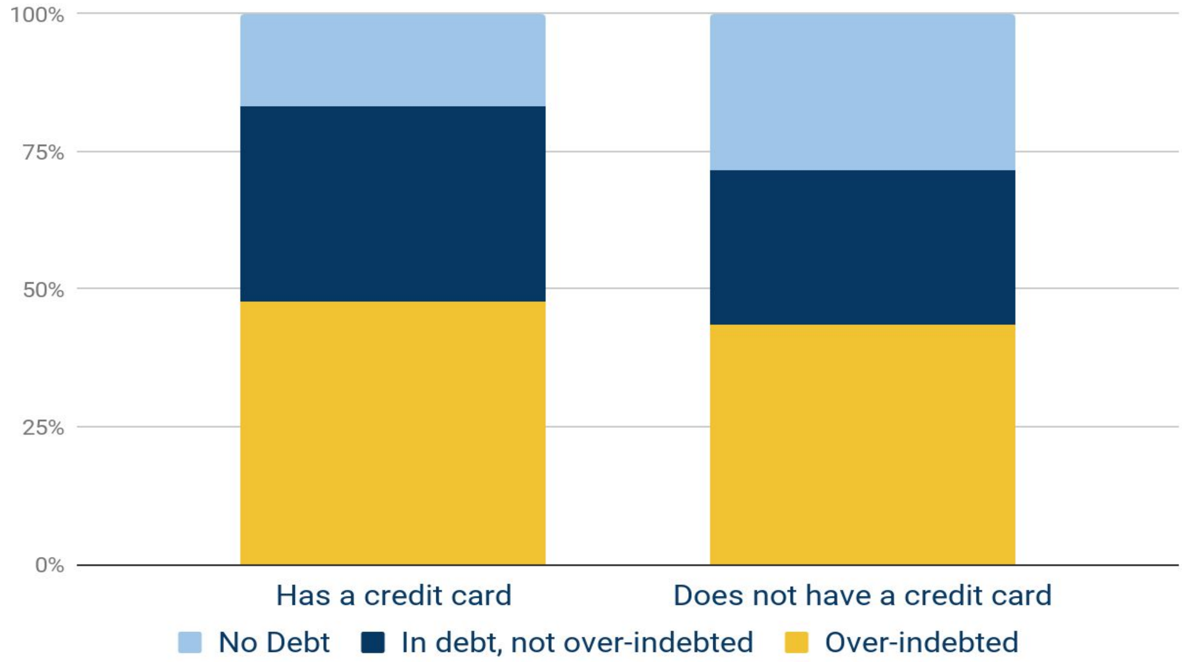
Between 2010-12 and 2012-14, the median debt of someone who was struggling across both periods was £2,780, compared to £3,940 for people who had been struggling but escaped that situation two years later.

Those who got back on track were able to reduce their debts by over £2,500 over two years, while people who were stuck in debt were only able to pay down just over £500 on average despite lower borrowing overall.

ii. Credit card debt is hard to repay

People who use credit cards are more likely to get trapped in debt. Of people struggling with debts in 2010-12 who used a credit card, 48% were still struggling two years later, and 36% still had some debt. That compares to 44% and 28% for people struggling but who didn't use a credit card.

Figure 15: How long do people with credit card debt struggle?
Outcomes in 2012-14 for British adults who were struggling with debt in 2010-12, by type of debt held.



Source: Citizens Advice analysis of the Wealth and Assets Survey

In part, that is because a credit card does not come with a repayment plan. When someone takes out a personal loan they are given a repayment schedule which means they know what their debt repayments have to be unless they default. Credit card users are able to make minimum repayments rather than having to repay what they've borrowed. That provides flexibility, but it means people have to be active in repaying their debts.

That pattern can be seen more clearly when we look at how people who are stuck in debt repay different types of credit. Between 2010-12 and 2012-14, 72% of over-indebted people with loans were able to reduce their loan debt, while only 60% of those with credit card debt were able to reduce their credit card debt. People struggling with their debts typically paid down their personal loan by £620, while they reduced their credit card debt by only £449. Citizens Advice sees the impact when people struggle to stay top of their credit card debt:

Joseph has held the same job for eight years and earns £15,000. Over this time, his credit card limit has increased from £800 to £12,000 at his lender's initiation. After paying for living costs, Joseph is able to put £200 a month towards his credit card debt. At the current interest rate of 12.5% APR, it will take him nearly 8 years to pay off his debt. To minimise his debts, he applied for a 0% balance transfer card. He was unable to transfer the full £12,000 balance across - as no other major credit card provider thought he could afford a credit limit above £4,100.

FCA analysis of long-term credit card debt

In its market study of the credit card market the FCA found that there was a widespread problem of persistent over-indebtedness. Just looking at people's credit card debt they found:[20]

- More had been paid back in fees and charges than in capital on 2.2 million credit card accounts over a three year period.
- 600,000 cards had been in severe arrears for 3 years.
- 750,000 cards had only minimum repayments made for three years.

iii. People fall into a debt spiral

It is not just credit cards that push people who are struggling with their debt into further difficulties. People who get stuck in debt are more likely to enter a 'debt spiral' - where they take on more debt despite already struggling with their debts.

People who were struggling with their debts in 2010-12 were just as likely to increase their borrowing by 2012-14 as people who were not struggling with their debts. Half of people (50%) who were struggling with their debt were further in debt two years later. The median increase in debt was by £1,506.

The increase in borrowing was driven by people taking on more loan debt - moving from sources of revolving credit, particularly credit cards, to longer term personal loans. More than half (56%) the increase was due to people taking out more or larger personal loans.

[20] FCA (2017) Credit card market study: consultation on persistent debt and earlier intervention remedies.

They were also more likely to fall further into arrears. While arrears only made up 8% of the debt held by people who were struggling with their debts in 2012-14, 15% of the £1,506 average increase was made up of a build up of arrears debt. The increase suggests that people who are struggling are able to borrow too easily and are not getting the help they need before they get into crisis debt.

iv. Lenders push people further into debt

Part of the reason people find it difficult to get out of a debt spiral is that lenders don't always act in a way which encourages people who are struggling to address their situation.

Credit card lenders in particular often push people who are struggling financially further into debt. In our survey, nearly a fifth (18%) of people who had a credit card and were struggling with their debts said they had their credit limit increased without them asking for it last year. That compares to 12% of all credit card holders.

Many of those people use their credit cards to pay for essential living costs. We found that 35% of people in problem debt have used a credit card to pay for essentials in the last year, compared to 21% of all UK adults. However, by increasing people's credit limits without engaging with them, lenders may be pushing people further into debt, trapping them in problem debt.

People's difficulties are compounded by the additional costs of borrowing when using both credit cards and overdrafts. In the last year, more than a quarter (28%) of people in problem debt have paid credit card interest or late fee charges compared with 16% of all UK adults. Similarly, more than a third (35%) of people in problem debt have paid overdraft fees, compared with 17% of all UK adults.

Irresponsible credit card lending is keeping people in debt

Last year Citizens Advice helped more than 66,000 clients with over 140,000 credit card issues. 70% of those issues related to people struggling with credit card repayments. Many clients had been able to accumulate unaffordable debt on multiple credit cards despite having little spare income. Only 22% had an income greater than £18,000 per annum and over half weren't in employment.

Clients with a credit card debt who received specialist debt advice are more likely to hold other debts. 37% held personal loan debt (compared to 20% of those without a credit card) and 35% received advice for overdraft debt (compared to 18%).

Nearly half of all clients with a credit card who received specialist debt advice held had debt on more than one credit card. 24% had debt on two credit cards, 12% had debt on three credit cards, and 13% had debt on four or more credit cards. One client had been able to accumulate debt across 24 credit cards.[21] Many of these debts would take our clients decades to repay from their income.

v. Not enough people get the help they need

Although people in problem debt are more likely to seek help with their financial problems than those not in debt, the vast majority are still not accessing money advice or taking steps to address their situation. Only 10% of people in problem debt said they have spoken with a debt adviser in the past year and only 31% said they have made a budget or a spending plan.[22]

Large numbers of people rely on informal support to make ends meet. Our survey indicates that 17% of people struggling with debts have sought financial support from friends or family.

As well as not accessing advice, not enough people in problem debt have a plan to pay it back. Amongst those in problem debt who have an outstanding balance on their credit card, 37% have not paid off the balance for more than a year. Similarly, 18% of those in problem debt who have outstanding overdraft debt have not paid it off fully in over a year.

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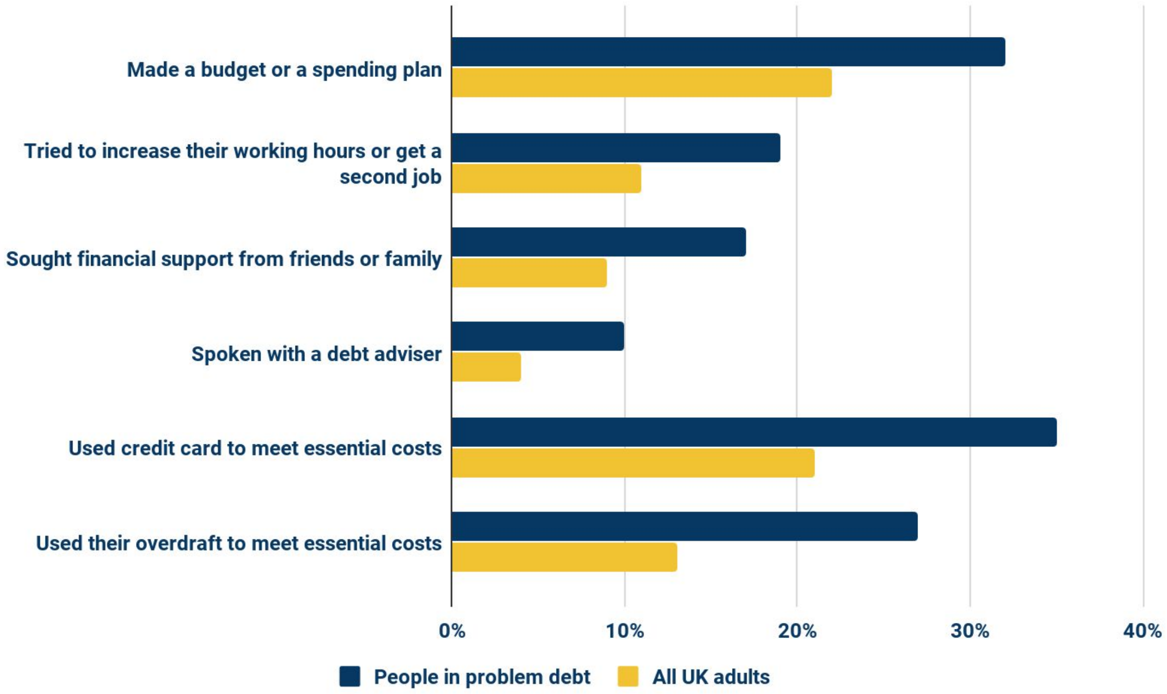
[21] This data has been cleaned and sorted from data recorded in Quarters 1 and 2 2016/17 in our electronic case recording module for complex debt casework. Not all clients who receive debt advice are referred to this level of specialist debt help, while some complex debt cases may be recorded through other case handling systems depending on locality. Over these two quarters we recorded the credit card debts of 11,758 clients, who held debts across 23,606 credit cards amounting to nearly £61 million debt.

[22] Our survey defined people in problem debt as those who felt their debts were a burden and had not felt able to afford household bills or debt repayments for more than a year.

Figure 16: What steps are people in problem debt taking?
Actions and spending behaviours of UK adults over the past 12 months



Source: Online survey of 2,116 UK adults conducted on behalf of Citizens Advice (June 2017)

When people do look for help, it's effective - 9 in 10 people who receive debt advice report an improvement in their life.[23] However, it is difficult to encourage people to seek advice. Previous Citizens Advice research has shown that people would be willing to take financial advice if they were offered it at key moments of their lives. For example:

- 43% of people surveyed with dependent children said they would have taken money advice if it had been offered when they were expecting a baby.
- 44% of those who had been seriously ill said they would have taken money advice if it had been offered during the time of illness.[24]

vi. Debt solutions aren't good enough

A final reason people struggle with debt for a long period of time is there is a lack of help for people to repay their debts. In England and Wales, the only formal solutions available to people who are struggling with their debts are insolvency procedures - bankruptcies, Debt Relief Orders, and Individual Voluntary Arrangements - used when people aren't able to repay their debts.

If consumers are in a position to repay their debts, but need support, they can only access informal solutions - that aren't legally backed. The primary informal

[23] Citizens Advice (2016) Helping people find a way forward.
[24] Citizens Advice (2016) The preventative advice gap.

debt solution is a debt management plan (DMP). A DMP is an informal agreement between a debtor and a creditor to pay back non-priority debts. The debtor pays back the debt in one set monthly payment which is distributed between the creditors. A DMP can be arranged directly with creditors, but most are administered either by a creditor-funded free to client service, or a fee-charging debt management company (DMC).

Around 400,000 people currently have a debt management plan. While DMPs can work for many clients, DMPs have presented problems. Research with 272 Citizens Advice advisers highlights three core problems facing some DMPs.[25]

First, DMPs do not provide enough protection for people in difficulty. One in five advisers told us they had helped clients who were still being charged interest and other fees by creditors despite having a DMP in place. 38% had helped people with a DMP who were still having debts enforced against them. DMPs are not legally binding so there is no requirement on lenders to suspend charges or enforcement action.

Second, DMPs don't provide security. 17% of advisers had helped people whose DMP had been altered after it had been arranged. While it is important that plans are flexible, changes can often be made without the consent of the person in debt - 12% said they had seen people whose DMP had been made longer and 28% had helped people who'd had their monthly payment or interest rate increased.

Third, many DMPs don't help people move out of debt. Of the advisers we surveyed three in four (74%) had helped people whose DMP was unaffordable.

[25] These statistics come from surveys answered by 272 advisers who attended a Citizens Advice Money Conference in London, Leeds or Bristol in November 2016.

Part 6: Recommendations

The loss of a job or an unexpected expense can push people into financial difficulty. Income or spending shocks are by their nature unplanned and low levels of savings, high levels of borrowing, and high levels of spending on essentials mean people are poorly placed to deal with those shocks.

Over the coming months Citizens Advice will be exploring the impact of those income and expenditure shocks on people's finances in more detail. We will also examine how to help people become better prepared to deal with that insecurity.

However, there are a number of steps lenders, government, and the Financial Conduct Authority can take to help people stay on top of their borrowing and to avoid getting into long-term problem debt.

Recommendation 1: The FCA should make sure credit cards don't push people into long-term problem debt. There is a clear link between credit card borrowing and getting trapped in problem debt. The FCA found that 2.2 million people had paid back more in charges than capital over a three year period and our analysis shows people who get into difficulties with the debts find it easier to pay down other forms of borrowing. Four changes would make credit card borrowing easier to manage:

First, people's credit limits should not be increased without them requesting it. People who get stuck in problem debt frequently enter into a debt spiral and nearly a fifth (18%) of credit card users struggling with their debts have had their credit card limit increased by their lender without them asking for it. Currently, firms must provide 30 days notice when they increase a customer's credit limit, but the customer must contact the firm if they do not want their limit extended. Someone's credit card limit should only be raised after their express consent.

Second, credit card lenders should check whether people can afford more debt before offering them a credit increase. Lenders currently have to assess a customer's creditworthiness before increasing their limit 'significantly'. The FCA has found that many credit firms will assess a customer's credit history before offering a limit increase, but often fail to conduct affordability checks.[26] The FCA should provide clear guidance to lenders that before increasing a borrower's credit limit they should check whether they can afford it.

[26] FCA (2015) Credit card market study: interim report 74.

Third, credit card firms should offer forbearance to customers who have paid back more in charges than in capital for 2 years. The current proposal by the FCA to require lenders to help people repay their debts after they have struggled for 3 years leaves people in problem debt for too long. Lenders should be required to get in touch with customers after 12 months to encourage them to make larger credit card repayments. After two years lenders should show forbearance to help those struggling with their credit card debt to repay it affordably.

Fourth, the statutory minimum repayment on credit card debt should be increased for new cards. The rolling nature of credit cards mean they offer no clear path for people to repay their debt. The 1% statutory minimum repayment plus interest means people often don't repay their debt in a reasonable timeframe. Increasing the statutory minimum repayment for new cards would require people to pay off their credit card debt sooner and save consumers money on interest and fees.

Recommendation 2: Lenders should scrap unarranged overdraft charges. More than a third (35%) of people in problem debt paid overdraft fees last year, compared with 17% of all UK adults. In 2014, consumers paid £1.2 billion in unarranged overdraft fees and there were over half a million instances where customers incurred cumulative unarranged overdraft charges in excess of £100 in a month. Those charges push people further into problem debt.

Recommendation 3: The government should work with the Single Financial Guidance Body and Department of Work and Pensions to provide financial help at key moments in people's lives. Changes in circumstances, sudden expenditure shocks, and loss of income can push people into problem debt. Currently not enough people get help with their money before they get into crisis. The new guidance body should fund the provision of advice which is targeted at people going through changes in their lives - such as having a baby, moving house, or starting a new job. Using those touch points would help more people get the advice they need.

Recommendation 4: The government should give people a clearer route out of debt to help people with long term problem debt get back on track. Two changes would make it easier for people to get out of financial difficulty:

First, the government should introduce breathing space for people in problem debt. While the majority of people who struggle with their debts are able to get on top of them after less than a year, large numbers struggle for a long time.

Protection from charges and enforcement for people who seek debt advice would help more people get their finances back on track and avoid long term difficulties.

Second, the government should give people a clear way out of debt by creating a legally backed debt repayment scheme. Our research with advisers shows that too often debt management plans are changed, don't include some debts, or don't help people pay down their debt. Giving debt management plans legal backing would provide certainty to people struggling to repay their debts. A legal scheme would prevent interest and fees being incurred after a person has sought formal debt advice and has devised a repayment plan. It would also set restrictions on the type and frequency of communication which a creditor could make, so that customers who are abiding by their repayment agreement do not receive unnecessarily frequent communications regarding their det.

Appendix 1: Methodology

This report used three main external sources of information - the ONS Wealth and Assets Survey, Bank of England NMG Survey, and a nationally representative opinion poll of over 2,000 respondents - as well as Citizens Advice client data.

Wealth and Assets Survey Analysis

Citizens Advice examined responses across the four available Waves (2006-08, 2008-10, 2010-12 and 2012-14) of the ONS Wealth and Assets Survey. The survey is conducted by the ONS over a two year period and full results are made available towards the end of the subsequent year. Respondents to the survey are each allocated a unique identifier which makes it possible to track their experience of debt across a number of years. By measuring responses across different Waves it was possible to track the experience of people in debt and identify those experiencing persistent over-indebtedness.

NMG Survey

The Bank of England commissions the NMG Consulting survey on household finances which is released in the last quarter of every year. Raw data is available for this report in addition to a summary of key information published by the Bank.

National opinion poll

An nationally representative opinion poll was commissioned by Citizens Advice, with a number of questions relating to household finances, life events, debt, savings, expenditure and other behaviours. Online field research with 2,116 respondents was conducted 23 to 26 June 2017.

Citizens Advice data

Citizens Advice records extensive information of advice trends provided to its face-to-face debt clients. This includes demographic information and advice trend data. Advice information codes summarise top level advice issues and break these down into two further sub-categories. Using this information it is possible to identify the demographic features of categories of clients and analyse clusters of advice problems they experience. Our Money Advice Module is a tool used by most debt advisers for particularly complex debt casework - some local offices use other case recording systems depending on their locality. The Money Advice Module records debt information for particular clients, although not all clients progress to this level of advice. Finally, advisers are able to submit case notes for study where they believe a case demonstrates a particular policy issue worthy of consideration by our researchers.

Appendix 2: How should we measure problem debt?

There are multiple ways to define problem debt. Citizens Advice based its working definition on the the FCA Occasional Paper 20 which was written by John Gathergood and Benedict Guttman-Kenney.[27]

In our analysis, people were regarded as struggling with their debt if any of the following were true:

- They are in arrears
- They have missed repayments on either a credit or store card
- They say they find meeting debt repayments a struggle
- They find their debts to be a heavy burden.

It was possible to identify these respondents through answers given (bold) to two questions:

Which one of the following statements best describes how well you are keeping up with your bills and credit commitments at the moment?

1. Keeping up with all of them without any difficulties

2. Keeping up with all of them, but it is a struggle from time to time

3. Keeping up with all of them, but it is a constant struggle

4. Falling behind with some of them

5. Having real financial problems and have fallen behind with many of them

6. Don't have any commitments

Thinking about the [debt] you have just told me about, to what extent is keeping up with the repayment of them and any interest payments a financial burden to you?

1. A heavy burden

2. Somewhat of a burden

3. Or, not a problem at all?

[27] This is the definition used by the FCA in Occasional Paper 20 (August 2016) Can we predict which consumer credit users will suffer financial distress?.

When looking at individuals' debt using the Wealth and Assets Survey we could also count people as being in arrears when they said they had missed credit or store card repayments.

Our analysis of more recent results from the the Bank of England NMG Survey also relied on a similar methodology:

To what extent is the repayment of these unsecured loans and the interest a financial burden on your household?

1. A heavy burden
2. Somewhat of a burden
3. Not a burden

Which one of the following statements best describes how well your household is keeping up with your bills and/or credit commitments at the moment?

1. I am keeping up without much difficulty
2. I am keeping up, but it is a struggle from time to time
3. I am keeping up, but it is a constant struggle
4. I am falling behind on some
5. I am having real financial problems and have fallen behind with many
6. Don't know
7. Prefer not to state

In the past 12 months have you ever found yourself more than two months behind with your mortgage payments (known as being 'in arrears')? Please exclude any pre-arranged payment holidays.

1. Yes
2. No
3. Don't know
4. Prefer not to state

Similarly, we adopted these measures in our national opinion survey. Our survey defined people in problem debt as those who felt their debts were a burden and had not felt able to afford household bills or debt repayments for more than a year.

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