



Consumer Finances in Wales: Debt and credit use

August 2010

Overview

This is the second paper in Consumer Focus Wales's 'Consumer Finances in Wales' series. It highlights the results of our latest survey¹ which examined the types of consumer credit held by people in Wales, the level of borrowing people currently have, their ability to meet these financial commitments, and what trigger points force them to default on repayments.

Key findings

- Almost half of the adult population (47 per cent) reported having at least one credit agreement in place (such as an overdraft, outstanding credit card balance, personal loan, mail order loan, hire purchase loan or loan from a doorstep lender)
- One in 10 people with credit agreements (10 per cent) have four or more credit commitments – a commonly used indicator for risk of over-indebtedness
- The average outstanding balance for those with debt was £3,390 (excluding student loans)²
- Over one in five people (21 per cent) were using credit to pay for everyday expenses; another 13 per cent were using credit to pay household bills
- Over one in three adults (35 per cent) said they struggle from time-to-time to keep up with bills and credit commitments; an additional 17 per cent said it is a constant struggle or they are facing real financial problems
- Younger people and some of the most vulnerable (eg those on lower incomes, the unemployed, those with a long-term illness or disability) are struggling the most financially
- Nearly one in five (19 per cent) of those with active credit commitments said they had fallen behind with payments at some point.
- Almost a fifth (18 per cent) of the adult population has fallen behind with payments for bills and/or credit repayments in the last 12 months; 5 per cent have fallen behind with both
- The two most frequently cited reasons for defaulting on bills and/or credit commitments are a loss of income (due to redundancy; sickness; a relationship breakdown) or just generally living on a low income

¹ See end of briefing for details

² Student loans were excluded from this analysis as the focus of this report is on consumer credit. They also operate very differently from other loans in terms of the way they are repaid and how interest is applied

Background

The last decade has seen a huge increase in personal debt levels throughout the UK. While the current economic situation has meant levels have reduced in recent years – total consumer credit lending to individuals at the end of May 2010 was £220 billion compared to £232 billion in March 2009³ – the level of consumer credit borrowing remains considerable.

At the same time it's important to remember that debt in itself isn't necessarily a bad thing. Manageable borrowing can provide huge benefits to consumers enabling them to account for the frequent peaks and troughs in income most of us experience throughout our lives. Problems do arise however when levels of debt become unmanageable.

The knock-on effect of the recession and recent budget announcements (eg public sector cuts, changes to the benefits system and the rise in VAT) will continue to hit people across Wales over the coming months, and possibly years. In such an economic climate household finances will undoubtedly come under increasing strain.

Levels of borrowing

Generally the majority of people in Wales appear to have a desire to avoid going into debt. Almost nine out of ten (87 per cent) said they would rather save for something than borrow money to pay for it. Although our evidence shows for many this is more of an aspiration than a reality. Nearly half of all respondents (49 per cent) don't currently have any savings to help with unforeseen expenses or a drop in income.

Only around a fifth (18 per cent) said they're happy to borrow money to give them the lifestyle they want.

While most may prefer to live within their means, more than two fifths of the adult population (46 per cent) disagreed they would never consider taking out a loan. Indicating for many, borrowing is more of a necessity than a lifestyle choice.

Reflecting the general situation across the UK, the proportion of people with active credit commitments would appear to have fallen in recent years. Nearly half of adults (47 per cent) currently have a credit agreement with an outstanding balance in place, compared to one in six households (57 per cent) in 2002⁴.



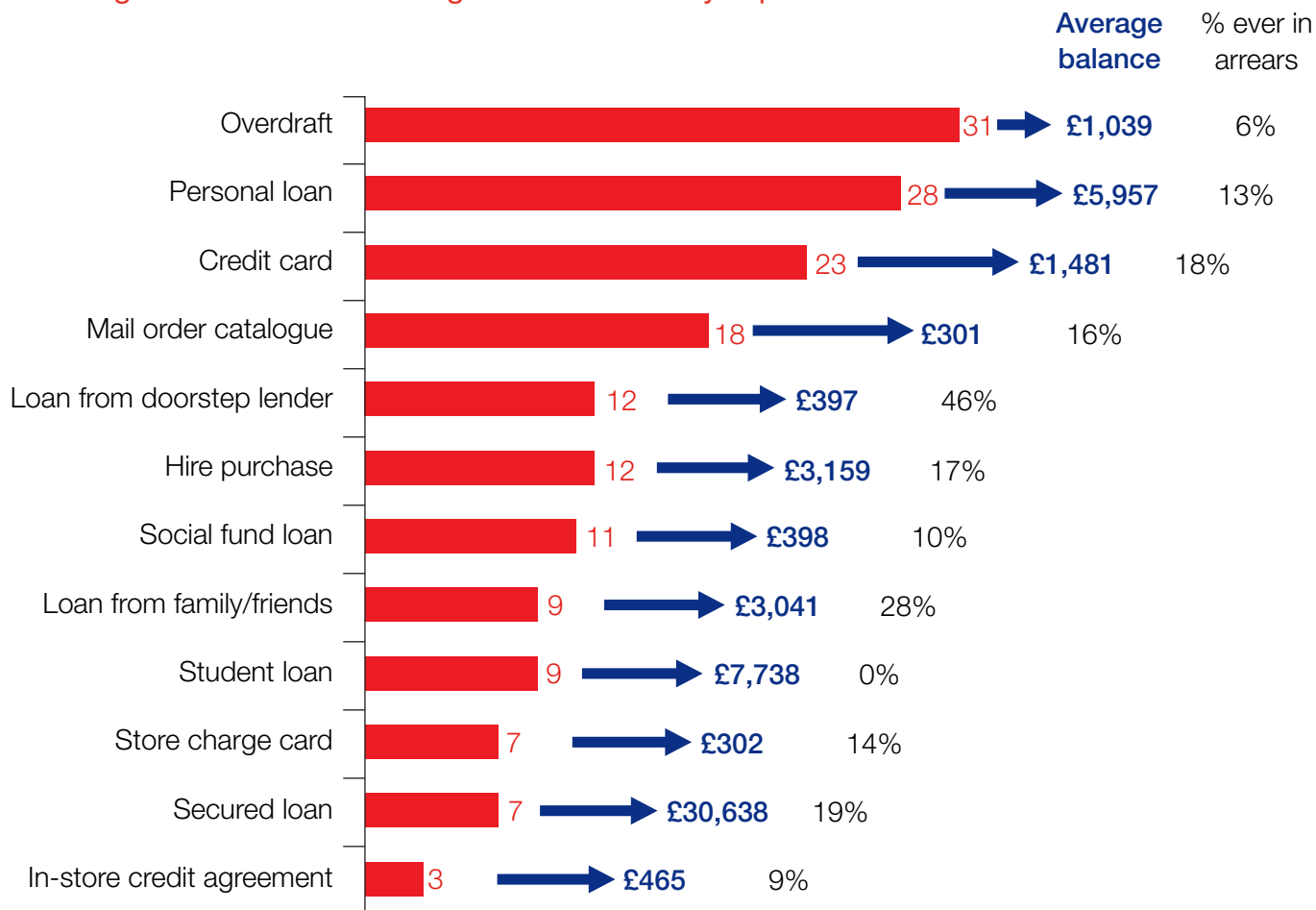
The average number of personal credit agreements held was 1.9, with almost a quarter of those in debt (23 per cent) having three or more credit commitments.

Of particular concern is the fact that one in 10 people with credit agreements has four or more credit commitments – a commonly used indicator for risk of over-indebtedness.

³ Credit Action Debt Statistics (www.creditaction.org.uk)

⁴ 'Credit use in Wales', Welsh Consumer Council (December 2003)

Figure 1: Personal credit agreements currently in place %



Base = respondents with credit arrangements with outstanding balance (490)
 NB Some bases for balance and arrears are very small

Figure 1 shows the most popular types of credit held are a bank/building society overdraft (31 per cent), personal loan (28 per cent) and a credit card (23 per cent).

For some of the most commonly held loans (eg personal loans; credit cards; mail order) outstanding balances were generally greater among people in the middle age bands (35–54 year olds) and those with children in the household.

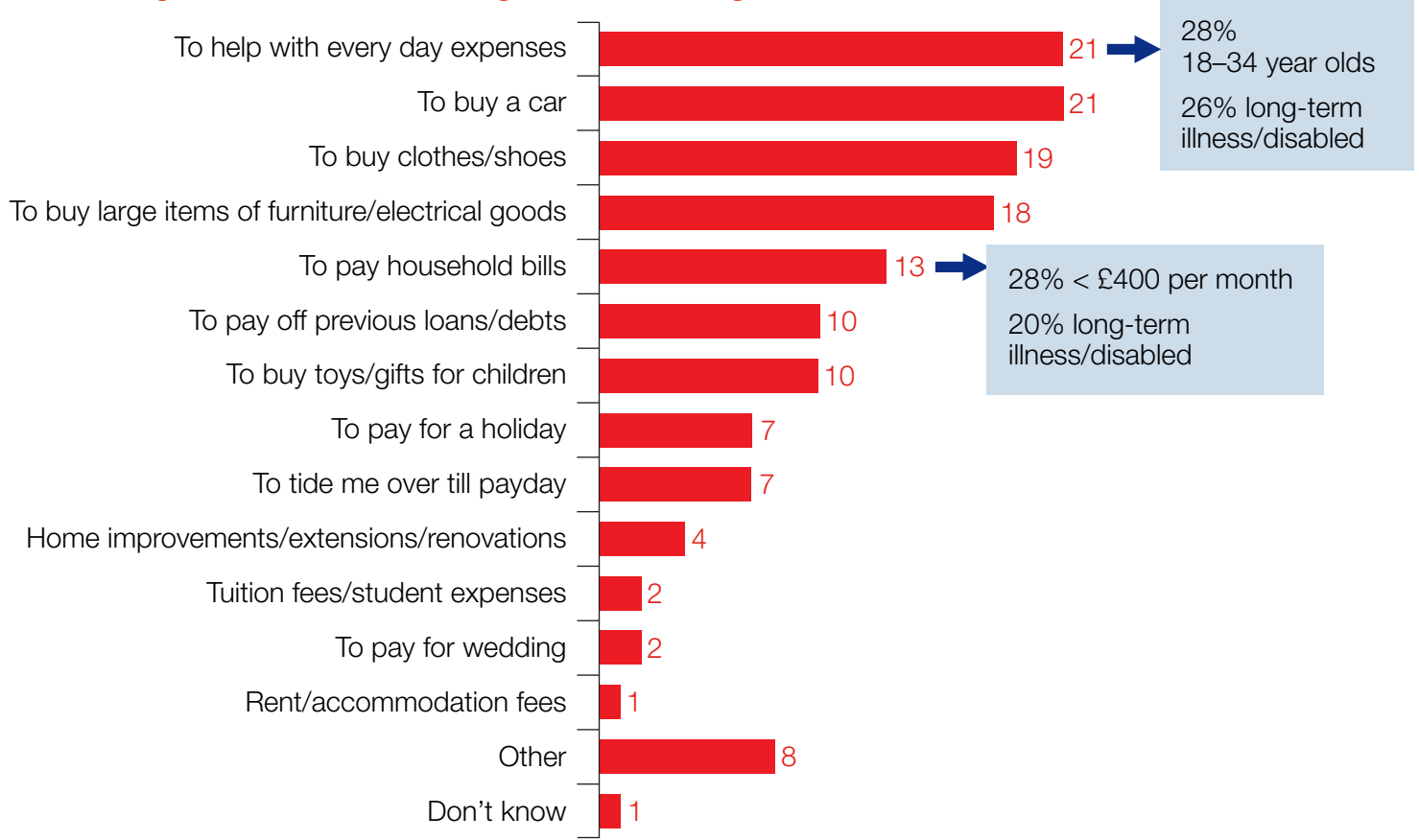
Not surprisingly loans from a doorstep lender, mail order catalogue or the social fund were more likely to be held by those from social grades C2DE and tended to be smaller in value, typically between £300–£400.

Less than 1 per cent of those with some form of credit had a credit union loan.

Around a fifth of those with credit agreements had borrowed to finance the purchase of bigger items such as a car (21 per cent) or large items of furniture/electrical goods (18 per cent). However a significant number of people were using credit to help with the general cost of living, such as to cover everyday expenses (21 per cent); to pay for household bills (13 per cent) or to tide them over till payday (7 per cent). One in 10 (10 per cent) had taken out a loan to pay off previous loans/debts. As Figure 2 shows this was more prevalent among younger respondents (18–34 year olds), those on lower incomes (with an income of less than £400 a month after tax and other deductions)⁵ and those with a long-term illness or disability.

⁵ Due to the fact the sample size is very small for this category these results should be treated as indicative rather than definitive.

Figure 2: Reasons for taking out credit arrangements %



Base = respondents who have credit arrangements (excludes refused/not answered; all consumers = 361)

Access to credit

More than two-fifths of the adult population (42 per cent) agreed it's harder to get credit now compared to a few years ago. In spite of this of the 28 per cent who'd actually made an application for credit in the last 12 months, most had been successful.

This situation did vary somewhat for certain groups, particularly in relation to the more mainstream forms of credit. Almost a third of those from social grades C2DE (31 per cent) and around half of those with a long term illness/disability (48 per cent) had failed to get the overdraft they'd applied for (compared to an average of 22 per cent). Similarly an above average proportion of people from these groups had been refused a personal loan or credit card⁶.

In contrast 95 per cent of those who'd recently bought something through a mail order catalogue had been successful in their credit request.

Servicing debt

As part of our survey people with outstanding balances on their credit commitments were asked how much their average monthly/weekly repayment was. This was then compared to their average personal monthly income to give an indication of what proportion of their income was required to service their debts.

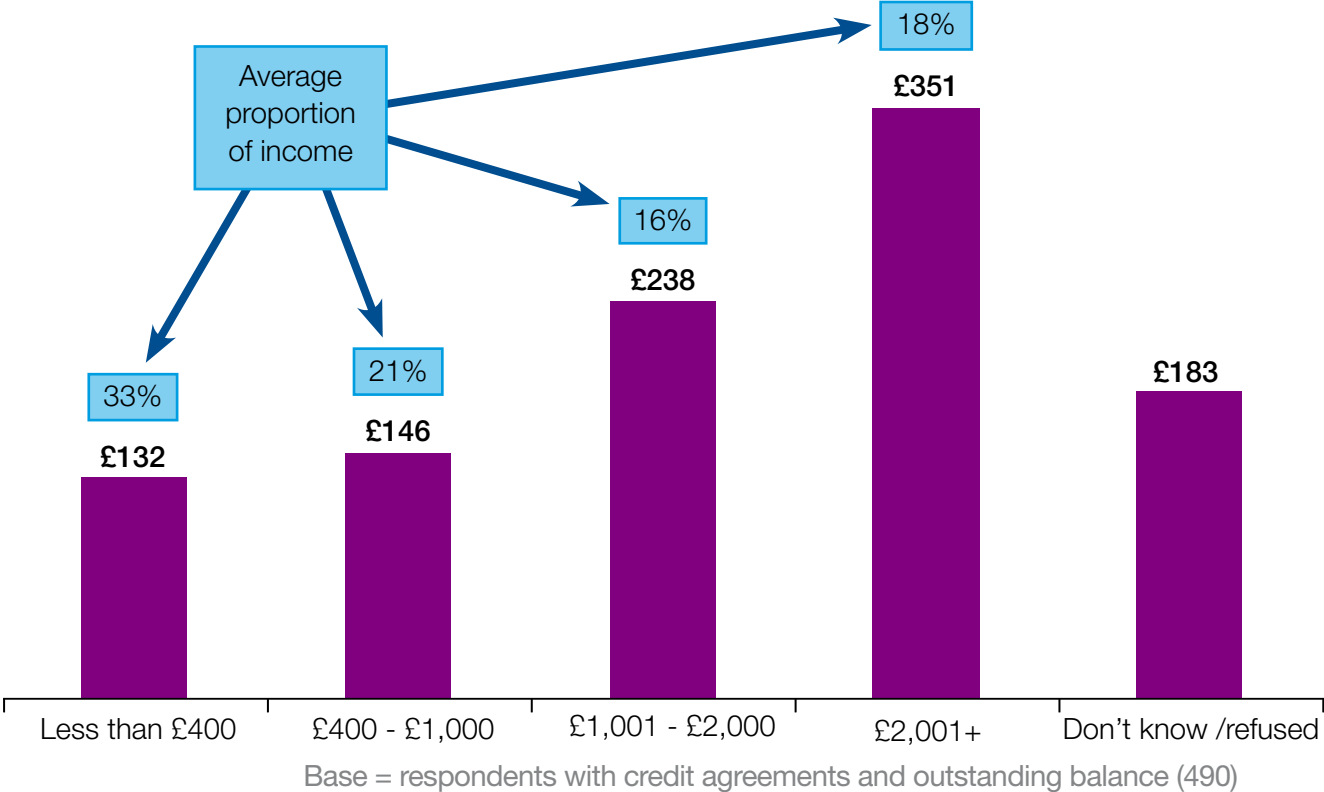
The results indicated that as disposable income rises, so does the level of borrowing, however additional analysis reveals that this is not necessarily the case. The average outstanding balance for those with a monthly income of between £400 and £1,000 was £4,258, while the outstanding balance for those on a higher monthly income of £2,001 or more was not much higher at £4,562. This pattern was also evident in previous research⁷ where access to credit was clearly linked to affluence and economic stability but use of credit was more closely linked to need.

⁶ Due to the fact the sample size is very small for this category these results should be treated as indicative rather than definitive.

⁷ Op. cit 5

Figure 3 also shows those on lower incomes are generally paying much higher proportions of their income on repaying credit commitments. It suggests that some people with a monthly income of less than £400 (after tax and other deductions) could be paying up to 33 per cent of their income on debt repayments⁸ and for those with an average monthly income of £700 around a fifth of their take home pay (21 per cent) is going towards paying off credit commitments.

Figure 3: Average repayment by monthly income %



Ability to meet credit commitments

Nearly half of the adult population (47 per cent) said they are finding it harder to manage financially now compared to a year ago, mainly due to the rising cost of living (44 per cent) and the fact household bills are increasing (19 per cent).

Of those in debt around a quarter (24 per cent) said they frequently worry about their current level of borrowing and an additional one in three (32 per cent) admitted to worrying occasionally. The main reasons for this were concerns they'd be unable to pay the money back (16 per cent), they'd lose their job or have a loss of income (14 per cent) or money was just generally very tight (12 per cent).

Around one in five (19 per cent) of those with credit commitments had been in arrears. As Figure 1 shows almost half of those with a home credit loan (46 per cent) said they had fallen behind with payments at some point. This reflects the more flexible repayment structure for such loans. In spite of the fact they are renowned for being one of the most expensive forms of credit (typical APRs for home credit loans often exceed 250 per cent), such payment flexibility is one of the main reasons why they are so attractive to people on lower incomes. In the home credit market if customers pay six out of 10 repayments on time they are regarded as 'good payers'. Similarly borrowing from family and friends also appeared to allow for higher default rates (28 per cent had fallen behind with repayments).

⁸ Op. cit 4

Perhaps of more concern is that almost one in five people with a higher value secured loan (19 per cent) said they had fallen behind with repayments at least once⁹. As this type of loan is often secured on a property the consequences of defaulting are obviously much more serious.

Among the population as a whole almost a fifth (18 per cent) had fallen behind with bills and/or credit commitments in the last 12 months. 5 per cent of people had fallen behind with both. Similar proportions of households were falling back on bill or credit payments in the Welsh Consumer Council survey in 2002¹⁰.

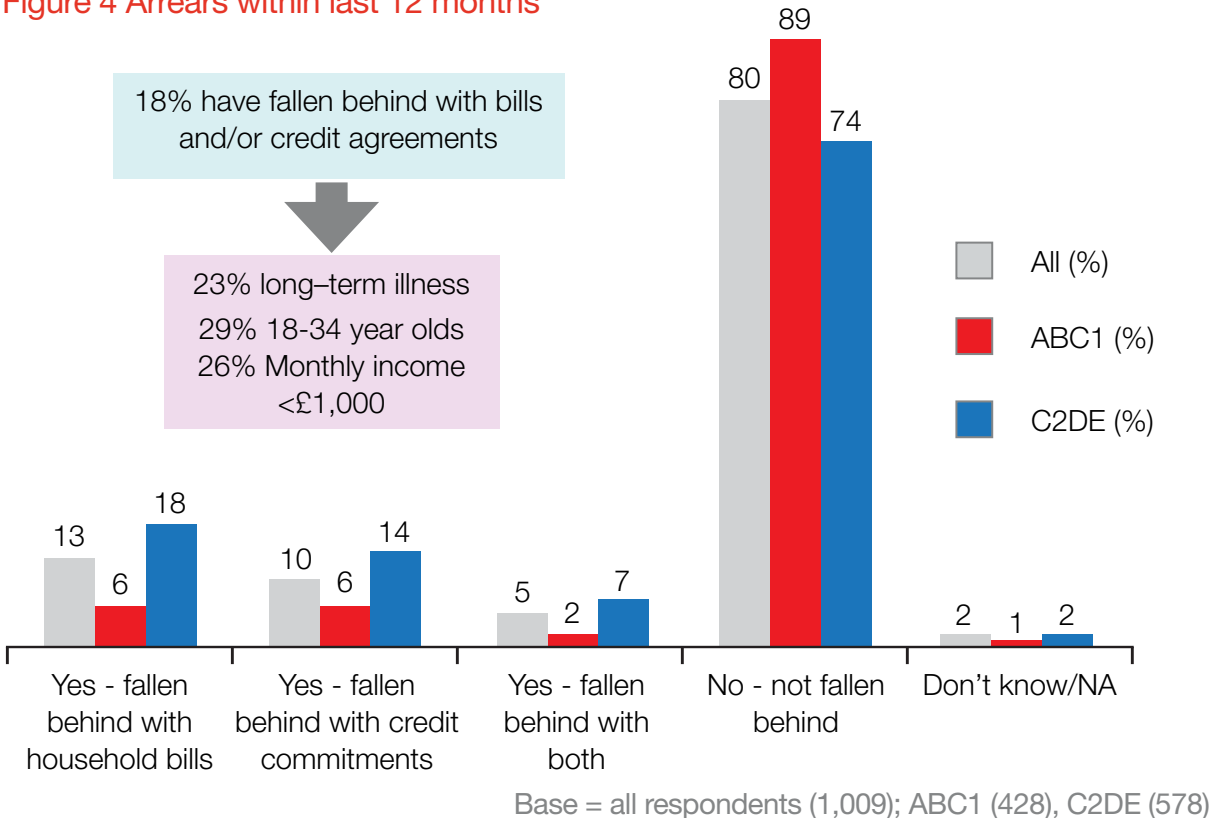
People most likely to have struggled to keep up with payments included younger people (18-34 year olds), those on lower incomes, and people living with a long-term illness or disability. Around a quarter of consumers from the latter two groups had fallen behind with paying their bills and/or credit commitments during the last year, rising to nearly one in three younger people (29 per cent).

While half of people in arrears on bills had only fallen behind with one bill (49 per cent), it was worrying to see almost a quarter had fallen behind with three or more bills (23 per cent).

Being in arrears on a water bill was mentioned most often (43 per cent). This higher default rate may be due to the fact it is illegal for companies to cut off a water supply to domestic customers for non-payment.

Just over a third of people had fallen behind on gas and electricity payments (35 per cent and 34 per cent respectively), while over one in five (21 per cent) had fallen behind with their rent.

Figure 4 Arrears within last 12 months



The two most frequently cited reasons for defaulting on bills and/or credit commitments are a loss of income, eg due to redundancy; sickness; a relationship breakdown (32 per cent) or just generally living on a low income (31 per cent).

⁹ Op. cit 5

¹⁰ Op. cit 4

Provision of debt advice

Access to timely, specialist debt advice is critical for people facing insurmountable financial problems. Even if the situation hasn't reached crisis point, being able to talk to an independent debt adviser can make a huge difference to how someone copes with and manages any financial difficulties.

Not unexpectedly, debt advice agencies have been experiencing a significant increase in the demand for their services over the last year or so. Citizens Advice Bureaux say debt is currently the biggest single area of advice they provide across England and Wales,¹¹ with the situation not expected to change any time soon. In 2009/10 they saw a 23 per cent increase in debt enquiries compared to the previous year.

Awareness of independent advice providing organisations appears to be generally high. Over half the people in our survey (54 per cent) spontaneously named the Citizens Advice Bureau – considerably higher than most of the other mentions. Around one in seven (15 per cent) named other dedicated independent debt advice providers such as National Debtline and the Consumer Credit Counselling Service (CCCS), and 8 per cent mentioned a local charity or community group.

In terms of who people would consider approaching if they found themselves in financial difficulty, more than six out of ten (62 per cent) would go to a Citizens Advice Bureau. A fifth (20 per cent) would turn to their financial services provider and around one in 10 would approach National Debtline, CCCS or their utility provider (around 10 per cent each).

Around one in six of the population (17 per cent) said they had sought advice from a trained debt adviser in the past, the majority of whom had found the advice helpful (83 per cent).

Highlighting the reluctance of some to seek formal advice, more than a quarter (28 per cent) of the population would approach family or friends if they were experiencing financial problems, rising to over half of 18–24 year olds (55 per cent). This was confirmed when people who might have had cause to contact a debt adviser, but chose not to, were asked their reasons for this. Almost a third (32 per cent) said that they would prefer to sort their problems out for themselves, while one in five (20 per cent) specifically said they would prefer to speak to family and friends about their problems.



¹¹ 'Citizens Advice's submission to the Future of Banking Commission', Citizens Advice Bureau (February 2010)

Conclusion

The findings of this research paint a picture of a cautious nation when it comes to being in debt. Many people in Wales would prefer to live within their means, however the realities of life have resulted in around half of the population turning to credit, often just to help with the rising cost of living, paying household bills, or to buy an essential item. The subsequent level of worry associated with being in debt was evident.

Our research also indicates there may be a ‘ticking time-bomb’ in terms of people’s ability to cope financially over the coming months. There are already signs that a significant minority may already be over stretching themselves, ie the proportion of people in arrears on bills and credit repayments, or those with multiple credit commitments.

Even for those who aren’t in arrears there is still a sense that many are finding it increasingly hard to manage their finances, particularly younger respondents, people living with a long-term illness/disability and those on lower incomes.

Cutbacks and consolidation in frontline support services and community-based programmes are increasingly likely over the coming years. At the same time, as the results of our research show, demand for many of these services, such as debt advice, is set to escalate. While such cutbacks may be inevitable and necessary, the way they are managed will be critical if we are to avoid many consumers facing additional exclusion, disadvantage and hardship.

Tighter controls on rogue and irresponsible lending, and equipping people with the right skills to better manage their need for credit, as well as their general finances, will also be essential to reduce the potentially devastating impact financial problems can have for individuals and families.



Equally, we believe the current financial climate offers significant opportunities to boost the role of community banking in our society. The Welsh Assembly Government’s forthcoming Credit Union Action Plan is very welcome and we hope their support of the movement is able to continue over the coming years. Building sustainability into alternative lending approaches, such as credit unions and Community Development Finance Institutions (CDFIs), is critical both for their own survival and so they can continue to provide their services to consumers. In such difficult times this is particularly important as not only are they currently the main solution for extending affordable credit to low-income consumers, they also have the potential to offer a range of other financial products and services to this group. Their continued development may also go some way to bringing back public trust in the financial services sector.

Recommendations

- In light of Government spending cuts, any future decision on the funding of debt advice, or the potential withdrawal of funding, should consider wider service implications and be accompanied by a thorough assessment of user need, current usage levels and effectiveness, as well as ensuring appropriate alternative provision exists
- Referral systems between different advice providers and other frontline agencies should be strengthened to ensure consumers in debt are able to access appropriate timely advice via a channel that's most suitable to their needs
- The Welsh Assembly Government and housing organisations behind Moneyline Cymru should continue to support the development of the alternative lending sector in Wales to ensure consumers likely to benefit most are aware of and able to access the services provided by credit unions and Moneyline Cymru
- The Welsh Assembly and UK Governments should continue to explore opportunities to improve the links between the Post Office and credit unions to widen access to credit union services among consumers and also support the Post Office network
- Funders of financial capability programmes (including the UK Government) should continue to support schemes that raise awareness of the advantages and disadvantages of different types of credit and equip people with budgeting skills
- The Consumer Financial Education Body (CFEB)¹² should ensure access to the face-to-face element of the national financial advice service in Wales ('Moneymadeclear') is truly universal, particularly in relation to coverage in rural areas and Welsh language provision
- Enforcement agencies (including local Trading Standards Departments and the Office of Fair Trading) should monitor creditors' adherence to the OFT Guidance on Irresponsible Lending and take appropriate action against any company failing to do so
- Local Trading Standards Departments should work together to crackdown on rogue lenders/bogus companies likely to target and take advantage of people in financial difficulties

¹² Set up by the Financial Services Authority, CFEB is responsible for helping consumers understand financial services in the UK and manage their finances better.

Consumer Focus Wales is Wales' consumer champion. In addition to our work on financial services, we also empower and represent consumers of energy and postal services, as well as wider consumer issues. More details can be found at

www.consumerfocus-wales.org.uk.

This research was carried out by Beaufort Research Ltd during March and April 2010. A total of 1,009 people representative of the adult population in Wales (aged 18 and over) took part in the survey, which was conducted face-to-face in people's homes.

Definition of social grades:

AB = Higher/intermediate managerial, administrative, or professional positions

C1 = Supervisor or clerical and junior managerial, administrative or professional positions

C2 = Skilled manual workers

DE = Semi-skilled/unskilled manual workers; those at the lowest level of subsistence

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