Policy Paper:
Credit and Debt

Credit and debt are central to the UK economy and to the financial lives of most individuals and households. Credit can be used to enhance wellbeing, but when it leads to unmanageable debt can also land people in deep trouble. People should have access to affordable credit on fair terms but, when things go wrong, there should be help available for people to get back in control of their money.

What are the issues?

Credit and debt have become central to the lives of most individuals and households in the UK. In March 2019, the average debt per UK household was £59,540.[1] Credit can improve wellbeing by smoothing spending, enabling people to buy things sooner than they would otherwise and acquiring assets such as a house. However, it can also land people in deep trouble. Helpful credit can turn into unaffordable debt as a result of a change in circumstances (loss of a job, illness, relationship breakdown etc) or from the accumulation of borrowing, interest and fees.

[1] The Money Charity, The Money Statistics May 2019, page 5. This total includes mortgages, credit cards and other forms of unsecured consumer debt (store cards, personal loans etc).

Over eight million people in the UK face problem debt,[2] arising often from low income and life events, but also from behavioural traits and gaps in money management skills.[3]

We live in a consumer culture that tends to prioritise instant gratification over long-term saving. This is compounded if firms encourage spending through offers that take advantage of our cognitive and emotional weaknesses, or that confuse us with too much complex detail.

Some types of credit designed for the short term – such as credit card borrowing or overdrafts - too easily become long term debt: long term borrowing at short term interest rates.[4]

Debt advice charities such as StepChange and the Money Advice Trust have highlighted two recent trends: the prevalence of 'broken budgets'[5] and the rise in debts on everyday expenses such as Council Tax, rent and utilities. These trends have been linked to austerity, lower real pay and benefit reforms.[6] Another factor is the fall in the rate of home ownership and the rise in renting.

While household debt has risen, the household savings rate has fallen to a rate of only 4.3%, compared to over 10% in earlier decades.[7] Many UK adults have zero or very low savings, so are vulnerable to any interruption to income. Debt charities report that a shock to income is often the trigger of a downward debt spiral.[8]

Responding to evidence of consumer harm, the Financial Conduct Authority is undertaking a programme of work on high cost credit. This has led to the introduction of repayment caps on payday lending and rent-to-own, planned limits on the cost of overdrafts and buy-now-pay-later deals and wider reviews of FCA consumer protection principles including the concept of 'fair pricing' in financial services.

An issue that needs to be addressed is the advice/guidance boundary. Under current rules, financial capability charities are prevented from giving general advice tailored to individual circumstances, even where this flows naturally from the financial

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[2] National Audit Office 2018, Tackling Problem Debt. Available at: https://www.nao.org.uk/report/tackling-problem-debt/
[3] See, for example, Student Diagnostic Tool – A YouthSight Report for the Money Advice Service, June 2018, p 42.
[4] In April 2019, the average overdraft interest rate was 18.5%, while a £10,000 loan cost 3.79%. The Money Statistics May 2019, page 14.
[5] A 'broken budget' is one where even after advice from a debt advice charity the client still has a deficit between income and necessary expenditure.
[6] See, for example, Money Advice Trust 2018, A Decade in Debt.
[7] ONS.
[8] See, for example, Sorcha Mahony and Larissa Pople 2018, Life in the Debt Trap, The Children's Society.

capability context. It should be possible to give general advice tailored to individual circumstances without crossing the threshold into regulated financial advice.

In our financial capability work, The Money Charity helps people understand:

- the difference between manageable and unmanageable debt,
- the dynamics of debt, such as the impact of compound interest,
- when to prioritise savings or debt repayment,
- how emotions and behavioural traits affect borrowing and spending, and how to establish a healthy relationship with credit and debt.

Our financial capability work is engaging and interactive, using anecdotes, personal stories and examples to bring money management to life. We offer people simple and practical strategies to stay in control of their finances.

What needs to happen?

Overall:

- People should have access to affordable credit on fair terms, with safeguards to avoid excessive debt or unreasonably high charges paid over too long a term.
- When things go wrong, there should be sources of advice, assistance and redress that kick in quickly and effectively.
- Firms should have systems in place to spot potential financial difficulty before a customer gets into problem debt. Early action should be taken to assist the customer. Firms should avoid actions that worsen the situation for the customer.
- Debt advice should include financial capability support (with funding for this work) as part of the integrated approach being developed by the Money and Pensions Service.
- Encouragement should be given to the development of financial management products and services – including new digital apps - that are engaging and tailored to their audiences, assisting people to avoid problem debt and make financial decisions that are beneficial for them in the long term.

Government and the regulator:

- The Financial Conduct Authority (FCA) should introduce a Duty of Care on the part of firms to avoid reasonably foreseeable harm to the customer and to act in the customer's best interests.
- The FCA should continue to strengthen its scrutiny of high cost credit, making sure that the terms of all credit products are fair and consistent with good personal financial management.
- Government should proceed with the planned debt 'breathing space', which should be of several months' duration, enough for people in problem debt to get advice and put in place a statutory debt repayment plan. All debts should be covered by the breathing space. Statutory debt repayment plans should include appropriate financial education toward the end of the plan. This is to ensure that the person has the financial capability they need for the next phase of their life.

Credit cards:

- The FCA definition of 'persistent credit card debt' should be strengthened to ensure that it covers all cases of persistent credit debt, with earlier intervention to stop short term lending turning into long term debt and to enable customers to reduce or pay off their credit card balances.[9]
- The FCA should consider raising the legal minimum credit card payment (currently 1% of the outstanding balance plus interest)[10], consistent with credit card debt being short-term rather than long-term borrowing.[11]
- Each month's credit card statement should carry a message with examples expressed in £, years and months showing how different levels of repayment lead to different repayment periods.

Money advice and guidance:

- All people in problem debt should have free access to professional debt advice, the cost of such advice being carried by creditors as part of negotiated debt reduction plans.

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[9] See The Money Charity July 2017, Response to FCA consultation on persistent credit card debt and earlier intervention remedies. Available at: https://themoneycharity.org.uk/work/policy/consultation-responses/

[10] FCA, CONC 6.7.5

[11] For example, introduce a rule that the minimum £ payment in Month M+1 must be greater than or equal to the minimum payment in Month M. This would create a 'ratchet' preventing the minimum monthly payment falling as the outstanding balance falls, with the result that credit card debt is paid off much faster than under the current diminishing balance rule. See The Money Charity, The Money Statistics May 2019, page 5.

- The Money and Pensions Service (MAPS)[12] should ensure that its debt strategy has a financial capability aspect (with funding for this work), so that people recovering from problem debt have the opportunity to gain the financial management skills appropriate to their particular situation.
- MAPS should initiate a process that leads to a better definition of the advice/guidance boundary. It should be possible for financial capability charities to give people general advice tailored to individual circumstances without crossing the threshold into regulated debt advice.

The Money Charity is the UK's financial capability charity providing education, information, advice and guidance to all.

We believe that everyone achieves financial wellbeing by managing money well. We empower people across the UK to build the skills, knowledge, attitudes and behaviours to make the most of their money throughout their lives, helping them achieve their goals and live a happier more positive life as a result.

We do this by developing and delivering products and services which provide education, information and advice on money matters for those in the workplace, in our communities, and in education, as well as through influencing and supporting others to promote financial capability and financial wellbeing through consultancy, policy, research and media work.

We have a 'can-do' attitude, finding solutions to meet the needs of our clients, partners, funders and stakeholders.

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[12] The new Single Financial Guidance Body (SFGB), combining the Money Advice Service (MAS), Pension Wise and The Pensions Advisory Service (TPAS).