A vicious cycle

The heavy burden of credit on low income families

Believe in children

Barnardo's

December 2011

By Ivan Mathers and Neera Sharma

Contents

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Executive summary

Problem debt can have a persistent and invasive impact on the lives of families struggling to live on low incomes. The Coalition Government[1] acknowledged, in its Child Poverty Strategy, the heavy burden that debt can have on the lives of families and children living on low incomes.[2] This is mirrored in the Scottish,[3] Welsh[4] and Northern Irish[5] Child Poverty Strategies. Barnardo's believes that progress on tackling child poverty will be impossible without addressing the burden of high interest debt carried by poor families. One in five households with an income of less than £13,500 per year who have borrowed money spends above 30 per cent of their weekly income on repaying debts,[6] and two in five report having debts equivalent to 60 per cent or more of their income.[7]

At 14, Jelani is the eldest of four siblings and he shows an understanding and sensitivity to his mother's situation. When asked how he would describe his mum's life he says: 'Quite difficult…she can't cope. We're always asking for too much… she's asking for loans and debts… she's putting her own life at risk'.

Barnardo's – *Below the breadline* report[8]

Each year Barnardo's works with more than 190,000 of the most vulnerable and disadvantaged children, young people and families in over 800 projects. In a previous study[9] Barnardo's showed how the families it works with found it relatively easy to obtain credit, often from home credit companies. As a consequence, they faced punitively high charges or interest rates. For example, one of the families in the study had a loan of £100 over 31 weeks from the Provident Financial with an Annual Percentage Rate (APR) of 367 per cent. This study highlights the high penalty that families using rent-to-own credit face – in one example we found a washing machine purchased using rent-to-own credit would be up to £780 more expensive than if bought outright.[10]

Barnardo's assists some of the most vulnerable families[11] by providing emergency grants which help them avoid having to borrow money. In 2010/11 Barnardo's provided nearly £370,000 to 1,600 people facing severe financial difficulty. Grants included:

- £200 for two single beds for two children, one of whom was sharing a sofa bed with her mum while the other was sleeping on a mattress
- £200 for a cooker for a single mum who left her partner after suffering domestic violence and has two children, one of whom was being treated by Great Ormond Street Hospital
- £300 for a family of five whose father had lost his job and was unable to afford oil to heat their home.

1 All references to the 'Coalition Government' in this report refer to the UK Government.
2 www.education.gov.uk/publications/eOrderingDownload/CM-8061.pdf – accessed 28/11/11.
3 scotland.gov.uk/Publications/2011/03/14094421/6 – accessed 28/11/11.
4 wales.gov.uk/docs/dsjlg/policy/110203newchildpovstrategy2en.pdf – accessed 28/11/11.
5 www.northernireland.gov.uk/final_child_poverty_strategy_-_agreed_by_executive_-_22_march_2011.pdf – accessed 28/11/11.
6 Please see glossary for an explanation of this and other terms used in this report.
7 Department for Business, Innovation and Skills (BIS) (2010) *Credit, Debt and Financial Difficulty in Britain, 2009/10*. BIS, London.
8 Harris, J; Treanor, M; and Sharma, N (2009) *Below the breadline: A year in the life of families in poverty.* Barnardo's, Barkingside. www.barnardos.org.uk/11325_breadline_report_final.pdf
9 Ibid.
10 Brighthouse rent-to-buy scheme: www.brighthouse.co.uk/washers-and-dryers/beko-9kg-washing-machine/ – accessed 1/11/11.
Comet online: www.comet.co.uk/p/Washing-Machines/buy-BEKO-WMB91442LW-Washing-Machine/752533 – accessed 1/11/11.
11 Barnardo's grants are given to children and young people aged 25 years and younger who use our services.

Barnardo's is concerned that if, as expected, the economic situation worsens, the poorest families may find they have no choice but to borrow, to cope with the sort of unexpected emergencies illustrated above – or just to pay for the everyday essential costs of living. The Institute for Fiscal Studies (IFS) projects that incomes will fall until 2012-13,[12] whilst at the same time the Office for Budget Responsibility (OBR) is projecting that rising interest rates will push up the cost of credit.[13]

The Coalition Government and the devolved National Governments of Scotland and Northern Ireland must put a coherent strategy in place to reduce the impact of problem debt on those with the lowest incomes. The Welsh Government published its Financial Inclusion Strategy in 2009 and this has been subject to review in 2010 and 2011.[14] However, there are still elements of the strategy that are beyond its current jurisdiction and where the powers remain with the Coalition Government at Westminster. It is important that governments act sooner rather than later, as economic conditions are likely to get worse before they get better.

This report is relevant to policy development on financial inclusion across the UK. There are some differences between England, Scotland, Wales and Northern Ireland, which relate to policy and also to how services such as debt recovery and money advice are delivered. However, the recommendations in this report are applicable across the UK.

We call on the Coalition Government and the devolved National Governments in Scotland and Northern Ireland (and in Wales, where relevant aspects apply) to establish a strategy to tackle debt, credit and financial exclusion based on three key pillars. Our key recommendations are:

1. **A financial safety net to help protect those at most risk from the negative impacts of debt and high-cost credit**

    - The Coalition Government should reverse its decision not to hold a post-implementation review of Social Fund reforms. The Social Fund is the ultimate safety net for many of the most vulnerable people in society. There is a real risk that devolving responsibility for Community Care Grants and Crisis Loans to local authorities and tightening up eligibility rules for Crisis Loans, could force more people down the road of using high-cost credit. Currently, the Coalition Government has not set out sufficient plans to monitor and evaluate this policy, given the significant consequences it could have. Similar evaluations should take place in Scotland and Wales.
    - When times are toughest, the demand for free money advice increases sharply. A one percentage point increase in unemployment[15] is associated with 60,000 more debt advice enquiries per quarter. There is clear evidence that when the economy struggles, so does the debt advice sector.[16] The Money Advice Service[17] should, when considering a new model,[18] examine

12 Brewer, M; Browne, J; Joyce, R; (2011) *Child and Working-Age Poverty from 2010 to 2020.* IFS, London. Median household income projected to fall until 2012-13.

13 http://budgetresponsibility.independent.gov.uk/wordpress/docs/obr_economy_supplementary_tables%20new%20200411.xls#'1.7'!A1 – accessed 28/11/11.

14 wales.gov.uk/topics/ho wales.gov.uk/docs/dsjlg/publications/comm/111018finstrat1213en.pdfusingandcommunity/regeneration/publications/fistrategy/?lang=en

15 Based on the International Labour Organisation (ILO) definition.

16 Gathergood, J (2010) *Demand, capacity and need for debt advice in the United Kingdom.* Money Advice Trust, University of Nottingham, Nottingham.

17 The Money Advice Service is a UK wide, free independent service. It was set up by Government and is funded by a levy on the financial services industry www.moneyadviceservice.org.uk/default.aspx – accessed 28/11/11.

18 www.moneyadviceservice.org.uk/about/mediacentre/corporatenews/article.aspx?a=20110719_debt – accessed 28/11/11.

how capacity can be increased when times are toughest – such as when unemployment is increasing and wage growth is slow.

2. **A strategy to reduce demand for high-cost credit**

- The Coalition Government cancelled the roll out of the Savings Gateway, saving £310million[19] to the Exchequer, but the Government does not seem to have come up with an adequate alternative strategy to help individuals on low incomes save the small amounts that would help insure against life's emergencies. One year of saving less than £5 per week can replace up to two years of payments to rent-to-own credit companies. The roll out of Universal Credit (UC), as part of the changes to Welfare Reform,[20] is an ideal opportunity to develop a saving product to meet the needs of low income families, potentially through the Post Office.

3. **A financial fair deal for all**

- The Coalition Government must set out a clear strategy to allow people to establish a credit history without turning to high-cost lenders. This could be achieved by making rent-to-own companies share payment histories with reference agencies. Expensive credit, being sold with the promise of improving credit ratings for those with thin or poor credit histories, could in fact trap people into long-term reliance on high-cost credit.
- Payment of benefits into a bank account will be a key principle of the Coalition Government's introduction of Universal Credit. Ensuring that bank accounts for low income individuals are fit for purpose by the time UC is rolled out will be crucial. In the Coalition Agreement there was a commitment to ensuring that Post Office Card Accounts (POCA) became fully functioning bank accounts. The Government's plans for reform of the Post Office did not extend to these accounts being able to offer direct debit facilities, which denied some of the poorest families access to discounts for utilities and other goods offered through direct debit. Excluding the POCA, around one in 10 households with an income between £100 and £200 per week do not have a bank account, compared to only around one in 50 with incomes between £500 and £600 per week.[21] Around seven per cent of households have a POCA[22] and 71 per cent of those without a transactional bank account rely on the POCA to receive their income.[23]

Please see chapter five of this report for a full list of our recommendations.

19 Budget 2010: cdn.hm-treasury.gov.uk/junebudget_complete.pdf – accessed 28/11/11.
20 Please refer to the glossary of this report for an explanation of the Government's proposals on Welfare Reform.
21 Department for Work and Pensions (DWP) (2011) *Family Resources Survey 2009-10*. DWP, London.
22 Ibid.
23 HM Treasury (2010) *Banking Services and Poorer Households*. HM Treasury, London.

Introduction

In July 2009, Barnardo's published *Counting on credit*[24] – a review of the impact of high-cost credit and lack of access to financial services on the lives of people living below the breadline. This report was based on a year-long study[25] which followed 16 families living in poverty in the UK.[26] Tracking these families over a period of time showed the real life impact of high interest loans on the living conditions of poor families, the significant extra costs that families excluded from the financial mainstream face when paying for life's essentials, and the difficulty of saving enough to cover emergencies.

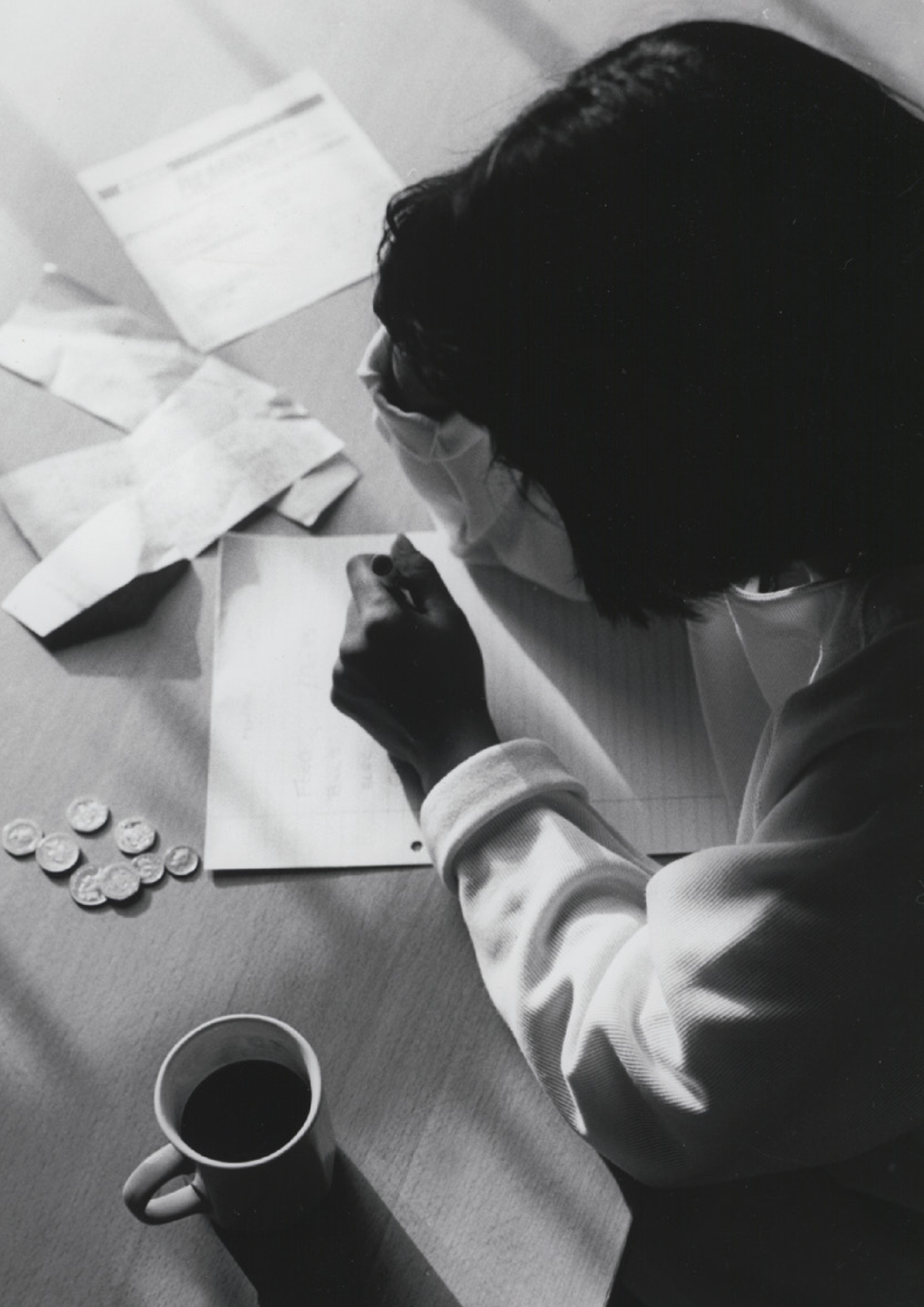
Two years on and the country has been through the worst recession in 80 years. High inflation, unemployment and sluggish income growth have all combined to push down household incomes,[27] and things are unlikely to get better soon, with the Institute for Fiscal Studies (IFS) projecting that household income will continue to fall until 2012-13.[28]

Now is an ideal time to revisit the lives of low income families, to look at what has happened since the publication of *Counting on credit* and to examine the impact of the Coalition Government's key policies on debt, saving and financial exclusion. As the poorest families are pushed further and further away from the types of financial services that others can access easily through bank accounts – such as short-term overdraft facilities – the cost of credit, both financially and personally, increases dramatically. Every day Barnardo's works with families and individuals who find themselves excluded from the type of finance that the majority take for granted.

This report highlights the increasing demand for high-cost credit and proposes that the Coalition Government and the devolved National Governments in Scotland and Northern Ireland (and in Wales, where relevant aspects apply) put into place a strategy for tackling debt and promoting financial inclusion, which has three main pillars:

- A financial safety net – for people who have fallen into the trap of high-cost credit use, or who could potentially end up there.
- A strategy to reduce demand for high-cost credit products.
- A focus on providing a financial fair deal for all – providing equal access to financial products and services to eliminate the poverty premium.

24 Stewart, T (2009) *Counting on credit*. Barnardo's, Barkingside.
25 From January 2008 to January 2009.
26 www.barnardos.org.uk/11325_breadline_report_final.pdf – accessed 28/11/11.
27 The Office for National Statistics (ONS) (2010) *The Impact of the Recession on Household Income, Expenditure and Saving*. ONS, London.
28 Brewer, M; Browne, J; Joyce, R (2010) *Child and Working-Age Poverty from 2010 to 2020*. IFS, London. Median household income projected to fall until 2012-13.



Chapter one:
The increasing demand for high-cost credit

In its Child Poverty Strategy[29] the Coalition Government stated:

"Unmanageable personal debt can drive a cycle of poverty and distress that is very difficult for families to escape. It reduces household income available to spend, creates further pressures on parents and relationships, and in the most extreme cases has a significant impact on the quality of life and life chances for children."

Barnardo's agrees with this assessment and thinks that tackling debt and financial inclusion should be a key part of the Coalition Government's strategy on child poverty. There are 2.6 million children living in poverty in the UK today, before housing costs, and 3.8 million after housing costs.[30] The latest estimates from the IFS show that the Coalition Government is likely to miss the legal requirement to end child poverty by 2020,[31] by which time around 800,000 more children could be in poverty than there are currently.[32 33]

'I've had quite a few loans from people who come to the door. They offer high street vouchers and when Christmas or birthdays are coming it's hard to say no. Sometimes it's not even that – the kids need new clothes, new shoes, they're growing all the time. I know that I'll end up paying more back but what can I do? I got £80 worth of high street vouchers a few weeks ago to pay for food, nappies and new clothes for Emma. The man knocks on the door every week – I pay him £6 – so there's no forgetting.

'Emma is getting too big for the little bed that she sleeps in so I know I'll have to get her a new one soon. I'll need to borrow the money for that.'

Jodie, case study from one of Barnardo's services in Yorkshire

Credit has a pervasive influence on the lives of many people with a low income. Those who cannot rely on a safety net, such as that provided by the Social Fund[34] or credit unions, can find themselves becoming reliant on costly credit from home credit providers. Nearly 20 per cent of those with incomes in the bottom 10 per cent, and nearly 30 per cent of those with incomes in the next 10 per cent, are users of home credit.[35] Those who can no longer rely on credit from licensed sub-prime lenders, perhaps as a result of falling behind on repayments or becoming insolvent, can be forced to turn to illegal money lenders; the lender of last resort for the most vulnerable members of our society.[36]

In 2008[37] around £7bn[38] worth of loans were made by high-cost credit providers. These consisted of around:

- £900m of payday loans
- £600m of pawnbroking loans
- £1.26bn of home collected credit, and
- £4.25bn of sub-prime retail credit.[39]

The consumer credit landscape has changed significantly in recent years. The story of lending from banks has been one of retrenchment, with banks and lending institutions scaling back the amount of credit that they provide. According to the Bank of England, between 2007 and 2009 the amount of unsecured credit being offered by lenders declined every quarter, and has not picked up since.[40]

29 www.education.gov.uk/publications/eOrderingDownload/CM-8061.pdf – accessed 28/11/11.
30 statistics.dwp.gov.uk/asd/hbai/hbai2010/pdf_files/full_hbai11.pdf – accessed 28/11/11.
31 This is enshrined in the Child Poverty Act 2010.
32 www.ifs.org.uk/comms/comm121.pdf – accessed 28/11/11.
33 For further information on the definition of child poverty see note i in the notes section at the end of this report.
34 For definitions of the Social Fund, and all other terms used please see the glossary at the end of this report.
35 The Office of Fair Trading (OFT) (2010) *High-cost credit review – annexe C*. OFT, London. Home credit generally taken to mean small value loans delivered and collected directly from a customer's door.
36 Department for Trade and Industry (DTI) (2006) *Illegal Lending in the UK*. DTI, London.
37 Unfortunately regular information on the size of the high-cost credit sector is not collected so it is not possible to be sure of the amount of loans made beyond 2008. The OFT committed to exploring better ways of capturing the makeup of the sector in their review of high-cost credit.
38 OFT (2010) *High-cost credit review – annexe E*. OFT, London.
39 For full definitions of these different types of loans see the glossary section of this report.
40 Bank of England (2011) *Credit Conditions Survey: Survey Results Q3*. Bank of England, London.

However, the story for high-cost credit is markedly different. In 2010 the Office of Fair Trading (OFT) reported on high-cost credit and concluded that the sector has shown substantial growth in recent years, and some areas of high-cost provision continued to grow even during the financial crisis. Payday loans have seen the fastest growth, but there has also been growth for home credit providers and pawnbrokers. Retailers have reduced the amount of credit they offer through items such as store cards; but worryingly, rent-to-own credit – where households purchase essential household goods, such as cookers and washing machines through the use of high-cost credit – appears to be establishing a small, but significant position in the provision of credit to low income households.[41]

'(I) borrow, borrow, borrow. It's so easy…they tend to give it more to people on benefits…I mean I can get credit no problems and I've got it…I have got a lot of debt and I'm not… ashamed of it ..'cos everybody has debt. If somebody says they don't have debt they're telling lies…I am careful with my money and budget well. I pay all my bills and even though I can get a lot of debt, I pay it.' (Jane, 32, mother of five children)

Barnardo's – *Below the breadline*

Rent-to-own credit

Barnardo's has strong concerns about the rent-to-own credit[42] sector, in terms of the price paid and the confusing way in which products are often marketed.

Those who rely on these schemes not only pay high interest rates (up to 49.9 per cent Annual Percentage Rate (APR) in some cases) but the initial price to be paid for the product is often higher than prices available from other retailers. The OFT recognised this, and stated that increasing the cost of credit through either raising the initial price of goods, or through the APR charged, was confusing for customers.

Often retailers offer what appear to be relatively attractive APRs, but credit is much more costly once the higher initial cost of the goods is taken into account. Furthermore, the websites of these rent-to-own credit providers often do not explicitly give the manufacturer model numbers of the items that they are offering. This means that while they often offer guarantees to match the list price of other retailers, it can be a complicated process to make an accurate comparison.

The OFT recognised the misleading nature of the rent-to-own model in its review, but did not make recommendations to address the problem of companies marking up the initial price of their goods.[43] Barnardo's believes that the OFT should compel rent-to-own providers to clearly display information on the average internet and high street retail price of the products that they are providing, for both the initial product and optional service cover. They should also be required to show the model numbers of the products they sell, both on their websites and in store.

41 OFT (2010) *High-cost credit review – annexe E*. OFT, London.
42 Stewart, T (2009) *Counting on credit*. Barnardo's. Barkingside.
43 OFT (2010) *High-cost credit review*. OFT, London.

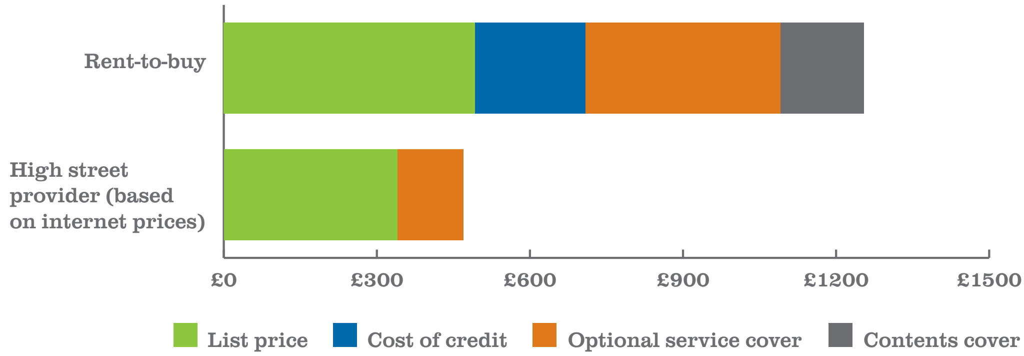
In a spin: the cost of rent-to-own credit
The cost of a BEKO WMB91442LW washing machine

Barnardo's has found that an individual could pay £780 more when buying through rent-to-own companies than through the high street.

In this example the person would face a premium of over £150 on the list price of a washing machine when purchased through rent-to-own. This is before interest of around £215 paid over three years.

Perhaps more shocking is the premium paid on service cover. Two additional years service cover (on top of the statutory one year guarantee) costs £382 through the rent-to-own scheme. Three additional years taken from a high street retailer costs around a third of the price, at £130. There appears to be no clear rationale for this premium paid by low income families on service cover. The total cost through rent-to-own credit comes in at over £1,250 compared to £470 when bought from a high street retailer.

Cost of a BEKO WMB91442LW bought through rent-to-own credit and outright purchase



Source: See footnote[44]

Personal insolvencies

The economic downturn has seen a large increase in personal insolvencies in recent years. While the upward trend in personal insolvencies began before the economic downturn, it has continued to increase rapidly from 2008 onward. The rate of personal insolvencies is around four times higher than it was in 2004, and during 2010 it hit an all time high. Around one in every 361 people became insolvent during the 12 months ending at the third quarter of 2011. During 2011 the insolvency rate has fallen back to the level it was at in 2009,[45] but it is still elevated compared with the last decade. The growth in personal insolvencies is worrying, as it could be mirrored by an increasing number of people who have reached the end of the line for accessing credit through formal, licensed routes. This problem could get worse once an economic recovery takes hold, as lenders look to pursue debts accumulated when the economy was struggling, as has been seen after previous recessions.

Reaching the end of the line with licensed credit providers is a key driver behind the decision to access unlicensed credit. The best available estimate is that four per cent of those who are refused credit from elsewhere turn to illegal lenders, and that 82 per cent of those that access unlicensed credit do so because they have no other options for credit.[46] Any increase in

44 Source: Brighthouse rent-to-buy scheme – accessed 1/11/11 www.brighthouse.co.uk/washers-and-dryers/beko-9kg-washing-machine/
Comet online – accessed 1/11/11 www.comet.co.uk/p/Washing-Machines/buy-BEKO-WMB91442LW-Washing-Machine/752533

45 *Third Quarter Insolvency Statistics* – www.insolvencydirect.bis.gov.uk/otherinformation/statistics/201108/index.htm, accessed 31/10/2011.

46 DTI (2006) *Illegal Lending in the UK*. DTI, London. Based on data from a 2004 poll, this is the best available estimate.

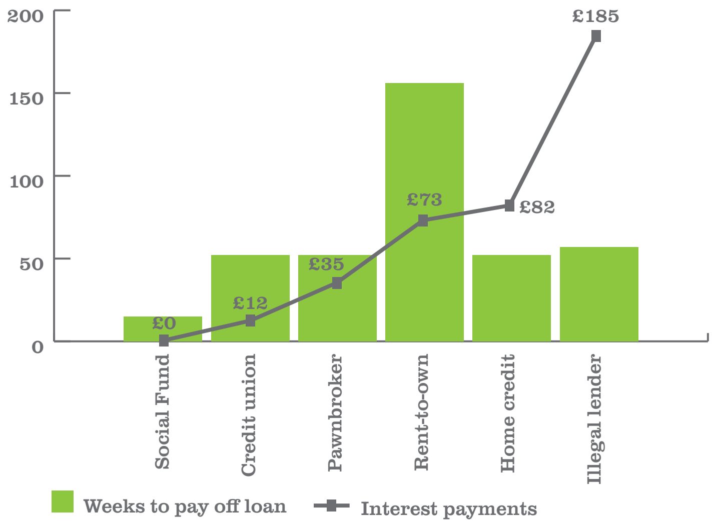
insolvencies could have potentially dire consequences for the poorest families across the UK, who may resort to unlicensed credit.

Unlicensed lenders

Unlicensed lenders are the lenders of last resort to the most disadvantaged in society. The people who access credit in this way do so at considerable financial and personal cost. Illegal lending often offers affordable repayments for low income individuals, but poorly defined, or non-existent payment schedules frequently mean that individuals pay back many times the value of their original loan. It has been estimated that a £100 loan from a loan shark would need repayments of £285 and take 57 weeks to repay. The same loan from the Social Fund would cost £100 and take only 15 weeks to repay.[47] There is a real risk that increasing financial pressure will lead to an increase in illegal lending. The National Local Government Network has already estimated that illegal lending may rise from 165,000 to 200,000 cases, as a result of the economic downturn.[48]

The cost of credit

The graph below demonstrates how the cost of credit can rapidly escalate once an individual cannot access loans from affordable lenders such as the Social Fund or a credit union. Someone taking a £100 loan would repay £100 if that loan was from the Social Fund and £112 if that loan was from a credit union, but the cost of loans from high-cost providers increase rapidly. A loan, taken over 12 months, from a pawnbroker would typically lead to total repayments of £142, whilst a rent-to-own loan would typically be repaid to the value of £173, and home credit provided by Provident Financial would need repayments of £182. For the most vulnerable members of society, who are forced to borrow from illegal money lenders as a result of being excluded from all other forms of credit, it has been estimated that they would have to repay £285 or more to pay off their initial £100 loan.



Cost of a £100 loan from different providers

Source: Author's calculations based on a number of sources and assumptions. Full details provided in notes at the end of this paper.[49]

47 Based on a total cost of credit of £185 for illegal money lenders and repayment of £5 per £100 borrowed (repayments estimated at between £5-£10 per week per £100 borrowed) – taken from DTI (2006) *Illegal Lending in the UK*. DTI, London.
Social Fund repayments based on 10 per cent deduction from weekly income support award – 10 per cent rate charged to those with a few, but not substantial, outstanding commitments. Five per cent and 12 per cent rates applied to those with other levels of outstanding commitments would lead to repayment in 30 and 13 weeks respectively.

48 Leslie, C; Hood, A (2009) *Circling the Loan Sharks*. National Local Government Network, London.

49 See note ii in the notes section at the end of this report for a full explanation of assumptions underlying this chart.

Analysis: What does being heavily in debt really mean for people on low income?

Gary expected the Provident representative to visit and offer another loan to pay off an existing debt with a sum left over for Christmas. He was determined to turn it down:

'I don't want to go that way again. I want to get that cleared. I would rather not borrow at all but just have to...' (Gary, a married man with two disabled children)

Evidence from a report by the Department for Business, Innovation and Skills (BIS) on credit, debt and financial difficulty in Britain[50] suggested that:

- Around 22 per cent of individuals with a Social Fund loan had no other unsecured credit commitments.
- 26 per cent had two other commitments.
- 27 per cent had three other unsecured commitments.

Having a number of financial commitments, especially from high-cost providers, can be particularly troublesome for low income households. In order to get a realistic idea of the impact of debt on low income households, Barnardo's looked at how building up debts to different credit organisations can rapidly affect household finances and lead to increasing distress for families.

The table shows the average debts held across a range of credit products.

Average debts for types of credit[51]

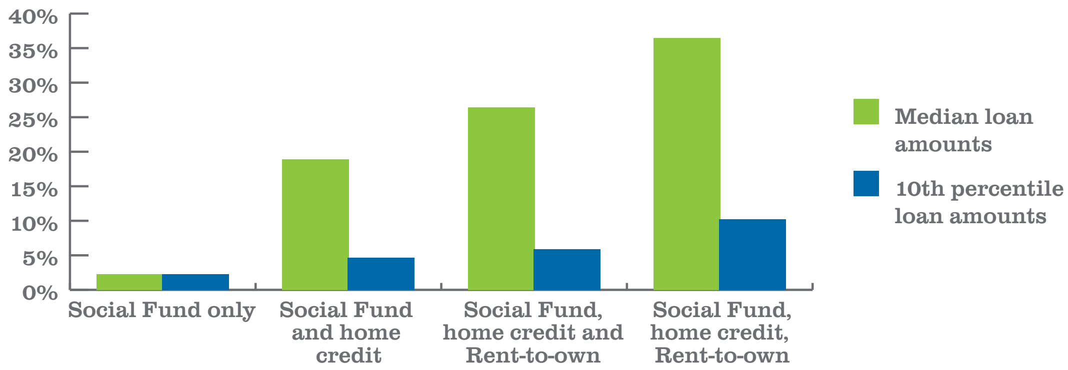
	Median amount of debt held (i.e. 50% of debt below this value)	10th percentile of debt held (i.e. bottom 10% of debt below this value)
Hire Purchase	£1,200	£100
Store Card	£400	£100
Home Collected	£700	£100
DSS/Social Fund Loan	£500	£200

Source: BIS (2010) *Credit, Debt and Financial Difficulty in Britain, 2009/10*
Note: Hire purchase takes into account a range of different loans and may not be exclusively rent-to-own credit. For example, hire purchase loans can be used to buy equipment for starting a business. However further breakdown is not possible.

Based on average loan amounts highlighted in the table, a lone parent out of work, with one child aged under 14, who has outstanding debts to the Social Fund, a home credit provider and a rent-to-own company, would have to make repayments of over a quarter of their disposable[52] income – or nearly £40 – on a weekly basis. If they also held store card debts this figure would rise to over 35 per cent – or around £53 per week.[53] We also looked at the impact of holding smaller amounts of debt and found the impact could still be fairly large for a low income household. The same lone parent holding lower levels of debt across all of these areas would still face payments of up to 10 per cent of their income.

50 BIS (2010) *Credit, Debt and Financial Difficulty in Britain 2009/10.* BIS, London.
51 The 10th percentile is the value that 10 per cent of all debts lie below. For example, the value for store cards is £100; this means that 10 per cent of all store card debts are less than £100. The median is the value that 50 per cent of debts lie below. For example, the value for store cards is £400; this means that 50 per cent of all store card debts are less than £400. For further information on these figures see note iii in the notes section to this report.
52 After Housing Costs.
53 For modelling assumptions see the note iv in the notes section at the end of this report.

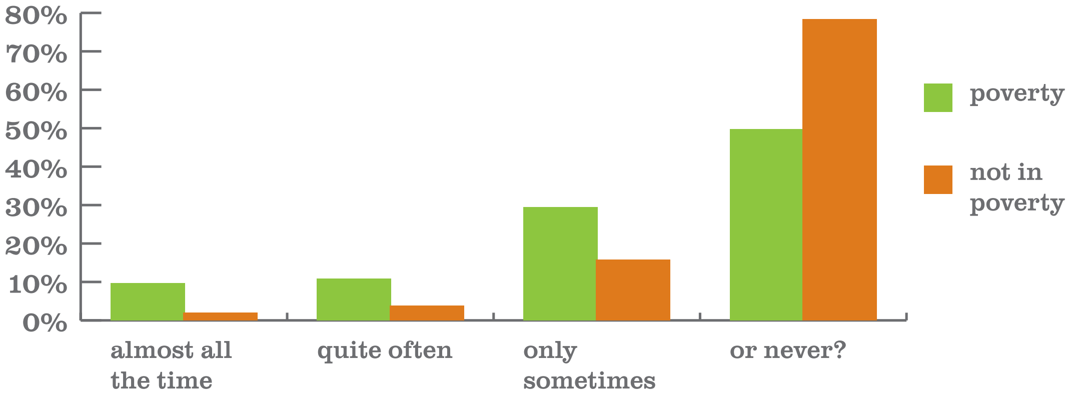
Lone parent with one child aged under 14: Repayments as a proportion of weekly after housing costs (AHC) income for different loans



In the same report (see footnote 50), BIS found one in five households who have borrowed money and have an income of less than £13,500 per year reported spending more than 30 per cent of their income on servicing debts and around 41 per cent reported having debts equivalent to 60 per cent or more of their income.[54] For some people, having high debt repayments compared to their income may not be a problem, but for others it can lead to real financial distress. However, the BIS research also highlighted that nearly a quarter of households with income of less than £13,500 were already in financial difficulties, and a further one in five were at risk of financial difficulties. Barnardo's analysis of the 2008 Families and Children Study reinforces this[55] – around 21 per cent of those in poverty reported struggling with debt 'almost all of the time' or 'quite often' in the 12 months prior to being asked, compared to only around six per cent of those not in poverty. Of those who are not in poverty, nearly eight out of ten reported 'never' struggling with their debts. For those in poverty this figure was around five out of ten.

54 BIS (2010) *Credit, Debt and Financial Difficulty in Britain*, 2009/10. BIS, London.
55 FACS was cancelled after 2008, and these proportions are likely to have changed in the intervening period, but this is one of the best available sources for looking at financial difficulty in low income families.

Proportion of people in poverty and not in after housing costs (AHC) poverty who have struggled with debts over the last 12 months



Source: Families and Children Study 2008

Any strategy for tackling the problems of debt and financial inclusion for families and individuals on low incomes should have three main pillars.

- A financial safety net – for people who have fallen into the trap of high-cost credit use, or who could potentially end up there.
- A strategy to reduce demand – for high-cost credit products.
- A focus on providing a level playing field – for people accessing financial products, to eliminate the poverty premium.

It is against these three pillars that the range of policies implemented by the Coalition Government and devolved nations should be assessed.

Chapters two, three and four of this report examine in detail each of these three pillars. Chapter five sets out Barnardo's conclusions and key recommendations.

Chapter two:
A financial safety net

Providing a financial safety net means offering realistic alternatives to high-cost credit for low income households, while at the same time helping those who experience severe financial difficulty to get back onto their feet. Some Coalition Government measures have the potential to strengthen the financial safety net – such as suggested reforms to credit unions and insolvency rules – but other measures, such as reform of the Social Fund, could significantly weaken it.

The Social Fund

'it's a loan but not the same pressure …the good thing about the Social Fund, the money – they take it all out (at source) so you don't have to worry about going down and paying the bill.' (Ralph)

Barnardo's – *Below the breadline*

Crisis Loans and Community Care Grants

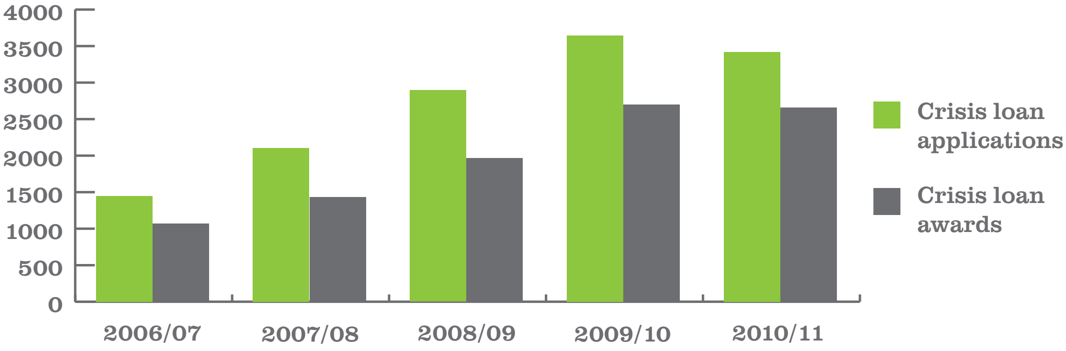
As part of its plans for Welfare Reform and the introduction of Universal Credit (UC) in 2013, the Coalition Government is proposing to make radical changes to the discretionary part of the Social Fund. The money allocated for Crisis Loans and Community Care Grants (the discretionary part of the Social Fund) will be transferred to local authorities and the devolved administrations in Scotland and Wales to deliver welfare assistance. In addition, from April 2011, new tighter rules on accessing Crisis Loans were brought in, limiting loans for items, (except in the case of a 'disaster'), reducing the maximum daily rate on loans for living expenses, and limiting individuals to three awards over a 12 month period. At the moment there are no plans to ring fence funding for the Social Fund provided to local authorities, which raises the concern that poorer families may ultimately lose out.

Barnardo's has already highlighted in research the critical role that the Social Fund plays in the lives of many people that we deal with on a day to day basis.[56] Interest free loans from the fund provide a lifeline for people who otherwise could be drawn into using expensive alternative credit sources. It is therefore of real concern that changes may reduce access to affordable credit for families who need it, and potentially lead to more people accessing expensive loans or falling into severe financial difficulty.

The case for reform of the Social Fund made by the Government focuses on significant increases in applications and expenditure for Crisis Loans in recent years. Crisis Loan awards have increased from around 1.1million in 2006/07 to around 2.7million in 2010/11, more than trebling expenditure.[57] In 2006 the Department for Work and Pensions (DWP) introduced a widely publicised free phone number to apply for Crisis Loans. In recent consultation documents the DWP has stated that the observed increases in Crisis Loans in recent years are predominantly due to the introduction of this free phone number, and crucially, not due to increasing hardship arising from the economic downturn.[58]

56 Stewart, T (2009) *Counting on credit*. Barnardo's, Barkingside.
57 DWP (Various years) *Annual reports by the Secretary of State for Work and Pensions on the Social Fund*. DWP, London.
58 DWP (2011) *Local support to replace Community Care Grants and Crisis Loans for living expenses.* DWP, London.

Crisis Loan applications and awards from 2006/07 to 2010/11



Source: DWP (Various years) *Annual reports by the Secretary of State for Work and Pensions on the Social Fund*

Barnardo's believes that the Government's case is not clear, particularly as the economic downturn is likely to increase demand for Crisis Loans. A tightening of rules on Crisis Loans will restrict a key source of low cost credit for people who are potentially in the most need and could lead to increased take up of high-cost credit.

In order to prove its case, the Coalition Government should set out clearly how it intends to monitor and evaluate Social Fund localisation in England, including plans for clear and comprehensive information collection. In addition, local authorities should also have a responsibility for collecting data on how their funding is allocated.

Barnardo's firmly believes that the Government should review its decision not to have a post implementation review of Social Fund localisation and should instead have a formal review one year after implementation. Similar processes should take place in Scotland and Wales once their plans for replacing the Social Fund become clear. A post implementation review will help to ensure that high-cost credit is not replacing the Social Fund for people who can no longer access a loan this way.

Monitoring of the impacts of Social Fund reform should also link in with better data collection on users of the high-cost credit sector in general, as current surveys have patchy coverage. The BIS reports annually on credit use and debt, using data from the YouGov Debttrack survey. However, the numbers of high-cost credit users captured by this survey are small. The BIS should investigate whether the Debttrack survey can be expanded to improve data on the use of high-cost credit products.[59]

Budgeting loans

There is clear evidence that people can become particularly financially vulnerable on becoming unemployed, and those with outstanding credit commitments are at significantly greater risk of going into arrears after losing their job.[60] Budgeting Loans paid through the Social Fund, which will continue to be managed nationally, can help repay debts that they have taken out to pay for a range of living expenses, such as furniture, household equipment and clothing,[61] however, these cannot be accessed until 26 weeks after first claiming benefits. Waiting for six months could have a potentially devastating impact on those struggling to make debt repayments

59 BIS (2010) *Credit, Debt and Financial Difficulty in Britain, 2009/10*. BIS, London.
60 Disney R; Bridges, S; Gathergood J (2008) *Drivers of Overindebtedness*. Department for Business, Enterprise and Regulatory Reform, London.
61 www.direct.gov.uk/en/MoneyTaxAndBenefits/BenefitsTaxCreditsAndOtherSupport/On_a_low_income/DG_10018905 – accessed 28/11/11.

after losing employment, particularly if they are forced to turn to high-cost credit to keep up. Previous Barnardo's research also shows that the granting of loans can be slow compared to high-cost providers, so there should also be a focus on speeding up the process.

Recoveries from Budgeting Loans are generally high, as loans are usually recovered directly from benefits. Between 2008/09 and 2010/2011 the DWP spent around £1.4bn on Budgeting Loans, but in the same time period recovered only £45m less than it had loaned – or around 97 per cent of expenditure. [62] [63] Speeding up processing and abolishing the 26 week rule would lead to some increased expenditure, but the amount is not likely to be substantial.

There is a need for better signposting towards money advice for those applying for larger budgeting loans. A larger application for a loan could be an indicator of financial difficulty and it is important to ensure that people have access to the right advice when they need it most. It would be appropriate for the Government to signpost these individuals to the Money Advice Service.

Case study

Moving on – The floating support scheme in Preston

Stacey is a 21-year-old single mother with a six-month-old baby who was referred to the Barnardo's Moving On service by her local Sure Start Outreach worker. Stacey had fled from a violent relationship and was living in one room in shared private rented accommodation. The property was in a very poor state of repair which made caring for her child particularly difficult.

Following an assessment by the local council, Stacey was given 'priority need' status and allocated an independent property. It was entirely unfurnished and was Stacey's first tenancy, so she needed support to set up a home for herself and her baby. Moving On helped her to set up her utilities and transfer her benefits to her new address. Her project worker also supported her to set up a repayment plan to deal with her debts and helped her to apply for a Community Care Grant, which was successful. However, the amount awarded was not enough to buy carpets and curtains, essential for keeping her home safe and warm. Barnardo's provided an emergency grant to pay for these items, without which Stacey would not have been able to maintain her tenancy.

Moving On provides housing related support to young people aged 16 to 25, who have their own accommodation in the community. Barnardo's delivers the service in partnership with Developing Initiatives Supporting Communities (DISC) and Lancashire Young Homeless Project (LYHP). The floating support scheme offers practical and emotional help to young people who live in their own accommodation. The programme is flexible and can last for up to two years; however, the average stay on the scheme is approximately six months. The support offered covers a range of issues, including claiming benefits and grants, independent living skills (such as budgeting, shopping, and cooking), connecting to utility services, obtaining furniture and information about relevant services.

62 Note – some of these recoveries will refer to loans made prior to 2008/9.
63 DWP (Various years) *Annual reports by the Secretary of State for Work and Pensions on the Social Fund*. DWP, London.

Credit unions

'On the issue of controlling loan sharks, one part should be encouraging credit unions. There is all-party support for that.' (Prime Minister, David Cameron MP, 26 January 2011)[64]

Credit unions provide an important source of low-cost credit for families on low incomes who need a loan. The rate of interest that they can charge is capped at two per cent per month (or around 26.8 per cent APR), but many charge much lower rates. Barnardo's analysis shows that a £500 loan from a credit union would be up to £160 cheaper and be paid off over 100 weeks sooner than an equivalent loan from rent-to-own credit providers.[65] Furthermore, evidence from the Growth Fund, an initiative designed to encourage access to credit unions introduced by the previous Government, found that on average those who accessed a loan through the Growth Fund saved between £377 and £425 in interest payments.[66]

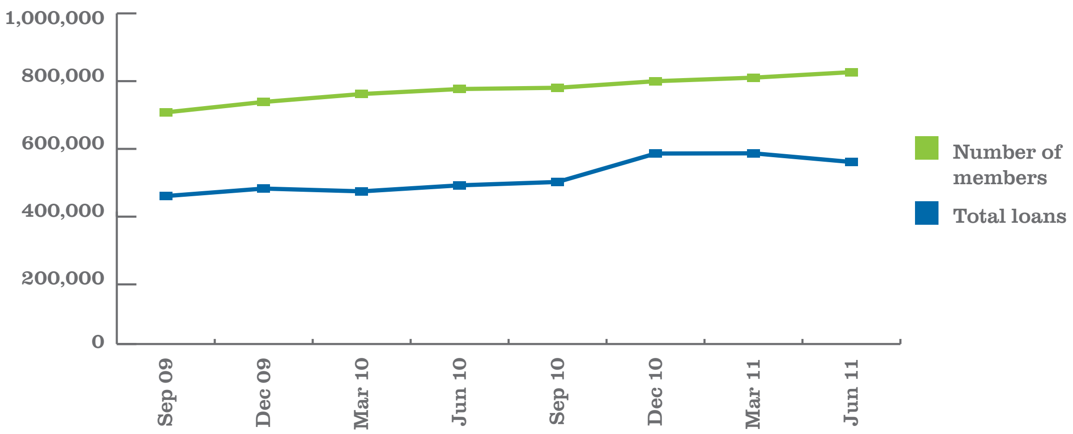
Credit unions are a key part of the financial safety net for low income families, but there is a long way to go before they can challenge the dominance of high-cost credit amongst these families. The credit union sector is growing, but it is important to keep this in context. Between September 2009 and June 2011 total loans from credit unions increased by around £100m and members grew by around 120,000.[67] However, the OFT estimated that in 2008 there were around £1.26bn worth of home credit loans, and this number is likely to have risen since.[68] Credit unions are still dwarfed by other high-cost providers.

There has been good progress across the UK in promoting credit unions but more can be done. Barnardo's welcomes the extending of contracts with Growth Fund credit unions in England, Scotland and Wales until March 2012.[69] It also welcomes the laying, and subsequent approval, of a legislative reform order[70] to allow credit unions to reach out to more people, by extending membership to new groups such as community groups, social enterprises and businesses. A key element of reforming credit unions is ensuring that they have the geographical coverage to challenge the presence of high-cost credit. Although credit unions are concentrated in low income areas, coverage is far from universal.

Barnardo's believes that now is a critical time for the future of the credit union movement. The DWP is due to announce its intentions on the modernisation programme for credit unions by the end of 2011 and has already stated that it would ideally like to provide access to credit unions over Post Office counters.[71] This builds on proposals originally outlined by the BIS in November 2010 to expand affordable and accessible financial services through Post Offices.[72] Making credit union services available through Post Offices could dramatically increase access to affordable credit, safe savings and other financial services for millions more people. This would mean that customers could walk into any of the one 11,500 UK Post Office branches and join their credit union. Cautious estimates suggest that 1.4m new loans over a five year period could save consumers over £336m in interest payments over five years.[73]

64 www.publications.parliament.uk/pa/cm201011/cmhansrd/cm110126/debtext/110126-0001.htm#11012654000012 – accessed 25/11/11
65 Internal modelling based on £500 loan, APR of 29.9 per cent from rent-to-buy provider paid over 156 weeks, APR of 26.8 per cent from credit union paid over 52 weeks.
66 Collard et al. (2010) *Evaluation of the DWP Growth Fund: Revised Final Report.* Personal Finance Research Centre, University of Bristol, Bristol.
67 Financial Services Authority - Note: These statistics are based on unaudited figures and can therefore not be relied upon as giving an accurate snapshot of the sector at any given time.
68 OFT (2010) *Review of High-cost Credit* – Annex EOFT, London.
69 The Welsh Government has made a commitment to continue supporting the expansion of the credit union network in Wales with £3.4m of funding until 2013.
70 www.publications.parliament.uk/pa/ld201011/ldhansrd/text/111020-0002.htm#11102033000336 – accessed 28/11/11.
71 www.dwp.gov.uk/other-specialists/the-growth-fund/latest-news/ – accessed 28/11/11.
72 www.abcul.org/media-and-research/news/view/67 – accessed 28/11/11.
73 www.abcul.coop/media-and-research/briefings/postoffice – accessed 28/11/11.

Number of credit union members and total value of loans



Source: Financial Services Authority. Note - these statistics are based on unaudited figures and can therefore not be relied upon as giving an accurate snapshot of the sector at any given time.

This should now be translated into a firm policy commitment with detailed timescales for implementation. The Post Office is one of the few organisations with the geographic coverage to be able to reach low income customers and offer a credible alternative to expensive, doorstep credit.

Debt advice

Adequate debt advice is a key part of the safety net for those who have unmanageable levels of debt. In 2010 around five per cent of households accessed free debt advice.[74] Evidence has shown that the right advice can stop people from falling deeper into debt[75] and turn around their situation, so they can begin to keep up with repayments.[76]

Debt advice is essential for low income households. The move to web based and telephone advice could be a barrier for families who do not have internet access or for whom English is not a first language, so it is critical that face-to-face advice remains an option. A previous evaluation of the Money Advice Service found that 77 per cent of users coming for face-to-face advice were vulnerable, and 50 per cent of enquiries related to social security and budgeting.[77]

In February 2011 the Coalition Government announced that it would commit £27m to extend face-to-face debt advice until March 2012. It has also committed to extending funding beyond this. This future commitment should be made clear, to ensure stability and avoid the persistent debate over prospects for the face-to-face debt advice in the future. However, this money for face-to-face debt advice is only a small component in the overall provision of debt advice. Between May 2006 and March 2008 around 82,000 people had appointments with the Citizens Advice Bureau as a result of money provided through the Financial Inclusion Fund by the previous

74 Gathergood, J (2010) *Demand, capacity and need for debt advice in the United Kingdom.* Money Advice Trust, University of Nottingham, Nottingham.
75 Ministry of Justice (2007) *Twelve Months Later: Does Advice Help? The impact of debt advice – advice agency clients study.* MoJ, London.
76 Orton, M (2010) *The Long Term Impact of Debt Advice on Low Income Households: The Year 3 Report.* Friends Provident Foundation, London.
77 Consumer Finance Education Board (2010) *The money guidance pathfinder: key findings and lessons learned.* CFEB, London.

Government.[78] The demand for free money advice was estimated to be in excess of 1.2m cases every year between 2006 and 2008.[79]

Free debt advice is a scarce commodity – particularly when times are toughest. Any increased demand for free debt advice can lead to severe pressure on providers. During 2009, as demand for free debt advice soared, the proportion of calls that the main debt advice providers were able to answer fell dramatically. For example, at the end of 2008, the National Debtline was able to answer around 70 per cent of calls, but by the middle of 2009, as demand doubled, the amount of calls answered fell to 40 per cent.[80]

Peaks in demand for debt advice are closely associated with increased interest rates, higher unemployment or declining wages. A one percentage point increase in unemployment[81] is associated with 60,000 more debt advice enquiries per quarter. As previously shown, unemployment is a critical time when people with outstanding commitments can suddenly find themselves struggling to keep up. There is a need for a new model of practice that responds flexibly to tough economic conditions. Demand for free debt advice is expected to fall between now and 2013, before rising again beyond this, as interest rates and the cost of borrowing are projected to increase.[82] However, there is a real risk that if unemployment increases substantially before then, there will be strong demand both in the immediate future and beyond.

From April 2012 the Money Advice Service will have responsibility for coordinating debt advice, and has stated that it is looking to develop a new model to ensure sustainability of debt advice in the long term.[83] Any new model should prioritise funding towards the times of highest need, by automatically increasing funding when individuals and the economy are struggling. This should also be supplemented with a clear plan to provide extra capacity when it is needed most.

Insolvency

Evidence from previous economic downturns in the 1980s and 1990s has shown that the early stage of economic recovery is a critical time for people holding personal debt. Research has shown that the number of personal insolvencies peaked at a significant time after both of these recessions had finished. During the recession of the early 1990s personal insolvencies peaked 18 months after the recession had finished. This phenomenon is explained by creditors acting more aggressively in pursuing outstanding debt as the economy recovers, and seeking to compensate for any losses or diminished reserves as a result of the recession.[84] Recent data on personal insolvencies shows a peak in 2010, before falling back again.[85] However, if patterns of previous recessions are repeated, insolvencies may rise again.

Barnardo's believes that it is important that action in this area takes place now and it welcomes the move by the Coalition Government to consult on increasing the personal insolvency limit[86] in England and Wales.[87] An increase from £750 to £3,000 would provide important protection for individuals as the economy begins to improve.

78 www.citizensadvice.org.uk/index/partnerships/face_to_face_debt_advice.htm – accessed 28/11/11.
79 Gathergood, J (2010) *Demand, capacity and need for debt advice in the United Kingdom.* Money Advice Trust, University of Nottingham, Nottingham.
80 Ibid.
81 Based on the International Labour Organisation (ILO) definition.
82 See note 78.
83 www.moneyadviceservice.org.uk/about/mediacentre/corporatenews/article.aspx?a=20110719_debt – accessed 25/11/11.
84 Association of Business Recovery Professionals (2010) *The "Insolvency Lag": risks for 2010.* http://www.epolitix.com/fileadmin/epolitix/stakeholders/Insolvency_Lag_January_2010.pdf – accessed 28/11/11.
85 The Insolvency Service.
86 The personal insolvency limit is the level of debt after which a creditor can apply to make somebody bankrupt should they be failing to keep up with their debt. This is currently set at £750.
87 Insolvency law is different in Scotland and not subject to this consultation process.

Chapter three:
A strategy to reduce demand for high-cost credit

Intervening early is crucial to prevent short-term financial strains becoming long-term debt problems. Encouraging saving in low income households and providing high quality money advice at the right moment, to stop people even entering the trap of high-cost credit to begin with, is essential. Barnardo's believes that the Coalition Government has the opportunity to make good progress in this area – something that is particularly important, given that proposed changes to the Social Fund could leave some without the vital safety net they need.

Saving

'Greater saving and more responsible borrowing will help households smooth their expenditures and ensure a sustainable and balanced economic recovery. The Government is therefore considering ways to help people improve their financial planning. Policies to achieve this will be measured against the Coalition Government's three principles of freedom, fairness and responsibility, whilst providing lasting affordability and measurable effectiveness.'[88]

Saving can be difficult, if not impossible, for those on very low incomes. The barriers to saving for those on the lowest incomes are complex and wide-ranging. Low income households often face geographical barriers to accessing banking services – living far away from a bank can act as a disincentive, particularly for people who wish to save small amounts of money. Many people on low incomes feel that banking services are not set up to cater for the small sums of money that they would wish to deposit.[89] Evidence shows that people on low incomes can also mistrust some savings providers.[90][91] Saving that does occur is often done through informal methods, such as supermarket stamps schemes, Christmas hamper schemes or entrusting money to family or friends.[92]

In a previous study Barnardo's found that from the 16 families interviewed only four families were able to save even the smallest amounts of cash. Three did manage to save a little cash for each week. For example, Ralph, a widowed lone parent with five daughters, saved £10 a week from April for the school uniforms he needed to buy in September.

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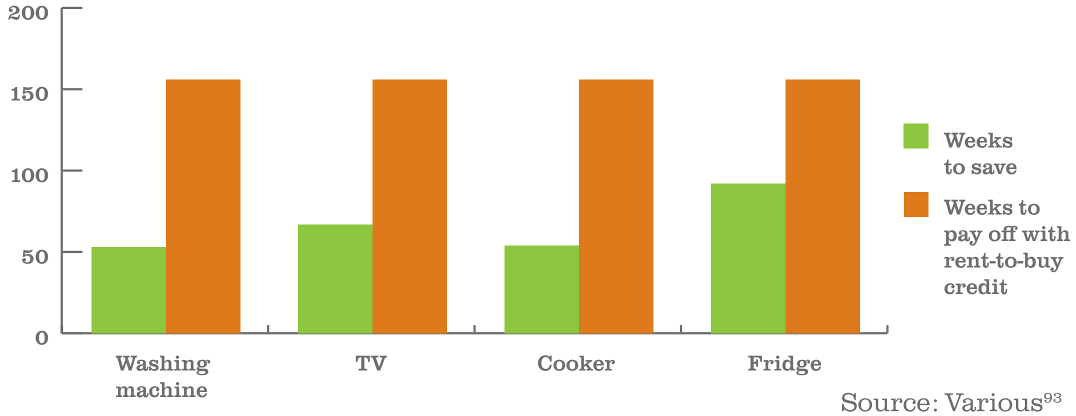
However, the benefits of saving are obvious when compared to the alternatives of taking out high-cost credit. Barnardo's looked at four common household goods and compared, with exactly the same weekly payments, how long it would take to save for these goods, compared to how long it would take to purchase using rent-to-own credit. Across the goods looked at, saving reduced the amount of time needed to purchase the goods by between 12 and 24 months each. For some people who are able to set aside a small amount each week, saving could change their financial position dramatically.

88 www.bis.gov.uk/assets/biscore/consumer-issues/docs/m/10-1185-managing-borrowing-call-for-evidence.pdf – accessed 28/11/11.
89 Kempson, E; Finney, A (2009). *Saving in Lower Income Households: A Review of the Evidence.* Personal Finance Research Centre, Bristol.
90 Finney, A; Davies, S (2010) *Towards a nation of savers*. Personal Finance Research Centre, Bristol.
91 See note 88.
92 See note 89.

Number of weeks to pay for common household items: saving versus rent-to-own credit



Source: Various[93]

The introduction of the Saving Gateway by the previous UK Government, on the back of two trials, was aimed at tackling some of these barriers by offering a financial incentive – initially set at fifty pence for every one pound saved – for low income households to set money aside. However, in 2010 it was announced that this scheme would not be pursued by the Coalition Government. It is estimated that this will save the Coalition Government around £310m by 2015.[94] Evidence on the success of the Saving Gateway was mixed. Seven out of ten people saved enough to receive the maximum matched contribution – but there was limited evidence that the pilot actually generated new savings and evidence suggested that saving may actually just have been reprioritised from other areas.[95]

A new savings product is needed to address the barriers faced by low income households – specifically one that addresses the geographical and trust issues that households face. Barnardo's believes that the Post Office could be a key player in establishing a product that meets the needs of low income customers. Ninety-nine per cent of those living in towns and cities – and 93 per cent of people overall – live within one mile of a Post Office.[96] Few providers are in a better position to overcome both the barriers that individuals on low incomes routinely face when saving small amounts of money.

As part of its Welfare Reform proposals the Coalition Government will introduce Universal Credit (UC) in 2013 (See glossary, under Welfare Reform, for more information). All payments will need to be paid into a Post Office or bank account. This is an ideal opportunity for the Coalition Government to ensure that more people become financially included by extending the facilities of the Post Office card account. It is also an opportunity for the banks to explore how savings could be encouraged. For example, people could choose through a simple opt-in process to have small amounts automatically deducted from UC into a savings account linked to their current account. This could be linked to advice on financial planning so that as people move into work they are encouraged to increase the amounts they save.

93 See note v in the notes section at the end of this report for further information.
94 Budget 2010: cdn.hm-treasury.gov.uk/junebudget_complete.pdf – accessed 28/11/11.
95 Harvey, P et al. (2007) *First Evaluation of the Saving Gateway 2 Pilot: Main Report.* HM Treasury, London.
96 BIS (2011) *Building a Mutual Post Office*. BIS, London.

Case study

Barnardo's teenage pregnancy support team – Northumberland

Barnardo's teenage pregnancy support team provides advice and support to pregnant teenagers and young parents, on areas including benefits and housing rights, parenting and childcare, health and wellbeing, and access to education, employment and training. Naomi was referred to the service when she was aged 16, and five months pregnant. She had a difficult relationship with her parents and was asked to leave the family home. Naomi and her partner lived in a homeless hostel for three months while they struggled to find accommodation of their own. The couple was then offered an unfurnished flat and Barnardo's helped Naomi to apply for a Community Care Grant to pay for a fridge freezer, a washing machine, a cooker and a second hand bed. However the couple did not have enough money to pay for carpets for their home, which has a concrete floor. Naomi and her partner receive £93 per week in benefits. Out of this they spend:

Gas & electric	£25
Water	£7
Food (incl cleaning)	£40
Transport	£15
Total	£87

This leaves the couple with £6 to save for when their baby arrives. Barnardo's was able to offer Naomi £300 to pay for carpets for their living room and bedroom. This has made an enormous difference to Naomi's wellbeing and is helping to keep her home warm. Naomi is waiting until her baby is born to receive her Sure Start Maternity Grant which will enable her to purchase a carpet for the nursery that she and her partner have prepared.

Proactive money advice

In a survey conducted by the OFT for its review of high-cost credit, around 62 per cent of high-cost credit users had not considered any other options before taking out their agreement, compared to only 15 per cent who had proactively investigated alternatives.[97] It is too easy for people to consider high-cost credit without being fully clear of alternatives that are available. Barnardo's believes in the need for proactive money advice for people who may need to take out high-cost credit.

This is backed up by Barnardo's experience of working with children, young people and families. Barnardo's administers an emergency fund, which provides grants for people in dire financial difficulty or great need to be able to purchase essential goods and services, which will improve their situation. In 2010/11 Barnardo's provided nearly £370,000 to 1,600 people facing financial difficulty. Feedback from recipients has revealed that many would have turned to high-cost credit as a first resort, were it not for Barnardo's staff advising them about the Barnardo's emergency fund.

97 Office for Fair Trading (2010) *Review of High-cost Credit.* OFT, London.

Case study

Sungate Parenting Service in Sunderland

Sungate is a Barnardo's parenting service working across Sunderland, Gateshead and South Tyneside. The service supports parents and carers of children and young people aged 8 to 17 years who are engaged in or at risk of youth offending, non-school attendance or antisocial behaviour.

Sharon is a single mother with two young sons; one of her boys has been diagnosed with Attention Deficit Hyperactivity Disorder (ADHD) and the other is on the autistic spectrum. She was referred to Sungate Parenting to receive support to manage her children's behaviour and access relevant local services. The family lives in a small village on the outskirts of Gateshead where Sharon is currently unemployed and receiving benefits. Recently her fridge freezer broke. After discussion with her Barnardo's project worker, it emerged that Sharon was on the verge of going to a local money lender to borrow £200. The high interest rate meant that she would have to pay back £500 on this amount. Sharon openly admitted to being unsure whether she would be able to maintain the weekly repayments; however she was so desperate that she was prepared to take the risk of paying back far more than she borrowed. Barnardo's was able to advise Sharon about the dangers of high interest lenders, and provided an emergency grant to pay for the fridge freezer. Sharon was delighted and extremely relieved at not having to rely on debt to pay for this essential item.

The Money Advice Service has been asked by the Coalition Government to promote understanding of the financial system and raise levels of financial capability across the UK.[98] It provides free and impartial information and advice on money matters and is available to all online, over the phone and face-to-face.[99] This service can make a real difference in helping people to manage their money better, plan ahead and avoid high levels of unmanageable personal debt.

However, it is essential that this service does not miss the people who need it most. The Thoresen Review stated that advice needs to be proactive, to help people make informed decisions before accessing high-cost credit, as well as reactive, to deal with the consequences.[100] Now that the Money Advice Service will play a central role in coordinating debt advice, Barnardo's believes that its success should be further evaluated in the future on the extent it works with those in the lowest income households. It should also be evaluated on its effectiveness in diverting individuals away from using high-cost lenders and offering services such as debt consolidation.

'One day I saw an advertisement for a home catalogue offering me £500 credit. I didn't know much about finance or interest rates, it just seemed like I could get lots of clothes for my child for almost nothing. I'd just need to pay back a few pounds per month.

'The credit limit kept going up, so my spending went up as well, and before long my account had peaked at more than £1,000.

'Most of my repayments seemed to be paying off the interest, and I remember the day I realised the debt was never going down.

'I couldn't afford to pay them back so they started threatening to send bailiffs to take all of my stuff. I was terrified. All of my neighbours were really nice and I didn't want them to see how I was struggling – I wouldn't be able to look them in the eye anymore…'

Lucy, service user from one of Barnardo's services in the South West

98 www.hm-treasury.gov.uk/fin_consumer_advice.htm – accessed 28/11/11.
99 www.moneyadviceservice.org.uk/ – accessed 28/11/11.
100 www.thefsforum.co.uk/upload/ContentImages/FSFThoresen.pdf – accessed 28/11/11.

Chapter four:
A financial fair deal for all

Equal access to credit and alternative credit histories

Barnardo's believes that people who can prove their ability to make credit repayments should not be unfairly excluded from accessing more affordable credit. Barnardo's is particularly concerned about products that can trap people with thin or poor credit histories into long-term use of more expensive credit products, even though they could afford repayments to lower-cost providers.

Of particular concern are financial products which encourage low income customers to take on more sub-prime credit, on the basis that they will help to repair damaged credit histories, or build thin credit histories. For example, credit cards offered by Vanquis Bank, a subsidiary of Provident Financial, charge interest at 39.9 per cent APR and are specifically marketed to help people with poor or limited credit histories. Credit limits start at around £150 and can increase every four months if people keep up with payments, up to a limit of £3,000. In the first six months of 2011 they had 610,000 customers – up nearly 130,000 on the same six months last year, and profits have grown by 93.4 per cent in the same time period.[101]

Products that help customers with poor or no credit histories to prove themselves as reliable borrowers are important. These high-cost products highlight the scale of potential demand from people wanting to prove their credit worthiness. However, the concern is, that by allowing the build up of substantial sums of debt, low income customers may prove their ability to repay credit, but will struggle to ever move to using cheaper credit with lower interest rates.

Including new information in credit scores could help improve the situation for those who could potentially repay debts but have no way of demonstrating this to credit companies. A study led by Big Issue Invest examined how alternative data could improve the situation for people on low incomes.[102] Big Issue Invest performed a detailed analysis of 50,000 social housing rental accounts and explored whether including social housing rent-payment data in credit scoring could help to increase access to affordable credit for those living in social housing. Around 30 per cent of tenants (over 1.5 million people) could be affected by improvements in credit if rent payment data was shared, and up to 40 per cent who currently fail an electronic identity check would pass if rent data were included.

The Coalition Government has an important role to play in establishing alternative ways for people to prove their credit worthiness, rather than using more expensive credit products. A joint BIS and Treasury Review is currently considering this issue[103] and the Coalition Government has consulted specifically on whether it should work with credit reference agencies to explore ways in which payday lenders and rent-to-own suppliers could provide suitable information to credit reference agencies about the payment performance of their customers. This would allow those with good payment records to use cheaper credit when they might potentially need it in the future. Proposals should now be brought forward to encourage the use of alternative data in credit histories as a step to help people avoid taking out high-cost credit purely to build

101 Provident Financial Group (2011) *Meeting the need for credit in the real world – interim report 2011.* Friends Provident, Bradford.

102 www.friendsprovidentfoundation.org/reports.asp?itemid=281&itemTitle=The+impact+of+social+housing+rent%2Dpayment+data+on+credit+scoring&section=24&sectionTitle=Reports – accessed 28/11/11.

103 www.bis.gov.uk/assets/biscore/consumer-issues/docs/m/10-1185-managing-borrowing-call-for-evidence.pdf – accessed 28/11/11.

their credit history. This could start with firm plans to implement the OFT's recommendation that rent-to-own credit providers should share data on payment histories with credit reference agencies.[104]

Bank accounts

Good progress has been made in getting access to bank accounts for those on low incomes. In 2008/09 seven per cent of households in the bottom fifth of the income distribution did not have a bank account compared to 20 per cent a decade earlier.[105] However, it is still the case that those on low incomes are much less likely to have a bank account than those with higher incomes. For example, around one in ten households with an income between £100 and £200 per week do not have a bank account (excluding Post Office Card Account) compared to only around one in 50 with incomes between £500 and £600 per week.[106] Those left without a bank account are amongst the poorest and most deprived households.[107]

Our analysis of the *Living Costs and Food Survey* found that of those with the lowest 20 per cent of incomes, only around one-third paid their gas and electricity bills by direct debit, compared to nearly 80 per cent of households in the top 20 per cent.[108] Analysis by the Financial Inclusion Taskforce found that the people opening a bank account have saved between £125 and £215 per annum on utility bills. This is an indication of the substantial premium associated with not having a bank account. However, these savings are offset by an average loss of £140 per annum in penalty charges[109] – which are likely to be associated with unarranged overdrafts and having insufficient funds for direct debits. This demonstrates that whilst getting a bank account is important, being able to avoid the charges that can be associated with bank accounts can be just as important. Banks can play a central role in providing good information about how penalty charges occur, and clear advice on how best to avoid them that is specifically tailored to those on low incomes.

'I pay (gas and electricity) in cash…I get charged £280 a year more for having them there meters (card/key). People that pay by direct debit get a discount. But I pay in cash …I never get a bill so I should get a discount. People that can't afford to pay standing orders because they haven't got bank accounts, they're the people who get shafted.' Gary

Barnardo's – *Below the breadline*

In Barnardo's experience, some families we work with have been unable to open a bank account despite many attempts. They were told that the only acceptable forms of identification were a passport or a driving licence, neither of which the families had access to, or could afford.[110] Money laundering regulations require that banks find ways to confirm the identity of applicants for bank accounts, but there is no requirement that this is in the form of a passport or driving licence. In the 2010 Budget, the previous Government made a commitment to force the banks to allow anyone with proof of address to open a bank account. This policy was not taken forward by the Coalition Government. This decision should be revisited and a Universal Service Promise through the

104 OFT (2010) *Review of High-cost Credit*. OFT, London.
105 Parekh, A (2010) *Monitoring Poverty and Social Exclusion 2010.* Joseph Rowntree Foundation, York.
106 DWP (2010) *Family Resources Survey.* DWP, London.
107 HM Treasury (HMT) (2010) *Banking Services and Poorer Households.* HMT, London.
108 Office for National Statistics (2011) *Living Costs and Food Survey 2009.* ONS, London.
109 See note 106.
110 Harris, J et al (2009) *Below the breadline*, pp 23 and 34. Barnardo's, Barkingside.

Banking Code should be introduced. This would make use of the existing voluntary framework to encourage greater flexibility in the identification that is accepted.

In October 2010 the Coalition Government outlined its vision for the future of the Post Office[111] which did not include details of any plans to reform the Post Office Card Account (POCA). However, plans to enable account holders to pay bills by direct debit from their account were clearly outlined in the coalition agreement.[112] The reasons for this backtrack are unclear but Barnardo's believes that the Coalition Government should strongly reconsider its decision. We do accept however, that this needs to be supported by appropriate advice, to minimise the risk of people incurring penalty charges when starting to use direct debit payments.

The introduction of UC is a significant opportunity to help low income families access and use banking products on a regular basis. UC will be paid on a monthly basis, in contrast to the current fortnightly payments. There will also be a requirement for individuals to have their benefits paid into a bank account. Barnardo's believes that in the run up to the introduction of UC the Coalition Government should review the POCA to ensure that it will be fit for purpose once the new benefit is introduced. If wages cannot be paid into the POCA, as currently, this would undermine the Coalition Government's commitment to ensure a seamless transition when moving from unemployment into work. Barnardo's believes that the Coalition Government should ensure that either the POCA becomes a fully functioning bank account, with full direct debit access, or that there is a clear strategy for moving people to such bank accounts.

111 BIS (2010) *Delivering for the Future: A universal mail service and community post offices in the digital age.* BIS, London.

112 www.cabinetoffice.gov.uk/media/409088/pfg_coalition.pdf – accessed 28/11/11.

Chapter five:
Conclusion and recommendations

The case for tackling financial exclusion is overwhelming and financial security is a key component of a decent childhood. Material deprivation in childhood impacts negatively on children's well-being, excluding them from the experiences that their peers take for granted.[113] Any progress on tackling child poverty will, Barnardo's believes, be impossible without addressing the burden of high interest debt carried by poor families. And as the analysis in this report shows, the disposable income of the poorest families can be put under severe pressure as a result of high loan repayments.

Now is a crucial time for the Coalition Government to establish a clear strategy for financial inclusion and credit use that will help protect the most vulnerable families over the course of this parliament – and specifically reduce demand for high-cost credit.

The need for action is particularly pressing as demand for debt advice is likely to increase in the next few years and the introduction of UC in October 2013 is a substantial opportunity for the Coalition Government to take this agenda forward.

This report makes a number of proposals as to how the Coalition Government and the devolved National Governments can tackle debt and financial exclusion for families living in poverty.

Barnardo's makes the following recommendations:

1. On a financial safety net

The Social Fund

- The reform of the Social Fund must not result in increased take up of either home credit or rent-to-own credit. The Coalition Government should put in place plans to monitor and evaluate Social Fund localisation, including plans for comprehensive information collection from local authorities. Similar processes should take place in Scotland and Wales once their plans for replacing the Social Fund are clear.
- The Coalition Government should review its decision not to have a post implementation review of Social Fund localisation and should instead have a formal review one year after implementation.[114] Similar processes should take place in Scotland and Wales once their plans for replacing the Social Fund are clear.
- The 26 week rule for Budgeting Loans should be reviewed and processing of loans speeded up so that those recently unemployed have recourse to a safety net to prevent them going into arrears on existing debts.
- Those applying for larger loans from the Social Fund should be signposted toward the Money Advice Service so that they are provided with financial advice.

Credit unions

- As part of the plans for the modernisation programme for credit unions, the Coalition Government, alongside the Devolved Administrations in Scotland, and Northern Ireland, should put in place a robust strategy to extend access to credit unions through the Post Office. Wales has its own action plan for the credit union movement 2010-13.[115] With 11,500 Post Office branches this could dramatically increase access to affordable credit and other financial services.

Debt advice

- The Coalition Government must give a firm commitment that the

113 www.childrenssociety.org.uk/sites/default/files/tcs/Images/missing_out.pdf – accessed 28/11/11.
114 The changes to the Social Fund will be implemented from April 2013.
115 'Raising the profile: meeting the challenges' wales.gov.uk/docs/dsjlg/feature/101206cuactionplanen.pdf – accessed 28/11/11

funding for face-to-face advice will be continued until the end of this spending review period in 2015.
- In its consideration of a new model for debt advice, the Money Advice Service should look at how provision can be increased in times of most need – such as when the economy is struggling and putting extra pressure on the poorest families.

The high-cost credit sector in general

- The Coalition Government should take steps to improve data collection in the high-cost credit sector – specifically it should investigate whether it is possible to expand the YouGov DebtTrack survey to improve the reporting of high-cost credit use.
- In its role as regulator of high-cost credit the OFT should compel rent-to-own credit providers to be transparent about the models that they are providing – particularly on their websites – to make price comparisons easier.
- The OFT should revisit whether home credit providers are making excessive profits and it should reach firmer conclusions.
- Drawing on the findings from their own review, the OFT should compel rent-to-own credit providers to report the average high street and internet cost of the products that they are selling and of optional service cover, in order to make the true cost of credit clear to customers.
- As part of its consultation on the personal insolvency limits, the Coalition Government should increase the individual limits from £750 to £3,000 in England and Wales.

2. On a strategy to reduce demand for high-cost credit products

Savings

- The Coalition Government should work with the Post Office to develop a new savings product which meets the needs of low income families.
- The Coalition Government must take the opportunity afforded by the introduction of UC in 2013 by extending the facilities of the Post Office Account and the basic bank account to encourage savings. For example, through automatic deductions from UC into a savings account linked to a current account.
- Banks should offer a generic savings plan to customers who intend to receive benefits into their account, accessible through a simple opt-in on account opening.

Proactive money advice

- Priority must be given to providing proactive money advice to people before they take out high-cost credit. The Money Advice Service should be evaluated so that the impact of its services on diverting people from high-cost lenders, including those offering debt consolidation, is monitored.

3. On a financial fair deal for all

Credit histories

- The Coalition Government should play a key role in establishing alternative ways for people to build up a credit history, for example through rent payment data, so they do not have to resort to using expensive credit products to do so.
- In particular firm plans should be set out to allow data from the rent-to-own sector to be incorporated into credit scores.

Banks

- Anyone should be able to open a bank account with a proof of address. A Universal Service Promise through the banking code should be established to clearly define acceptable forms of identification for opening bank accounts.
- The Coalition Government should adhere to the commitment in the Coalition Agreement and extend access, through the POCA, to accounts which allow low income families to pay their bills by direct debit.
- The Coalition Government should support the roll-out of UC so that payments can be made into bank or PO accounts with facilities to help during the transition period – for example, access to overdraft facilities. It would also support people to move into work as employers can pay salaries by direct debit.

Since Barnardo's published *Counting on credit* in 2009 too little has changed. High-cost credit is still a prominent part of the lives of low income families. At the same time, no clear strategy to tackle the underlying demand for high-cost credit has emerged. The Coalition Government must take action now to establish a clear strategy for financial inclusion and credit use that will help protect the most vulnerable families over the course of this Parliament.

Notes

i. A household is classed as living in poverty if their income, adjusted for the size of their household, is less than 60 per cent of the median (or middle) income of all households. In order to get a full reflection of the extent of poverty this figure is examined both before housing costs have been deducted from income and after housing costs have been deducted. Barnardo's takes the view that after housing costs (AHC) is a better measure of poverty than before housing costs (BHC) as it reflects what households have left to spend (or their disposable income) after they have paid for the basic necessity of housing. A household is defined as being in poverty if their weekly income (before or after they have paid for housing costs) is below the following poverty lines:

	Before Housing Costs	After Housing Costs
Lone parent, one child under 14	£216	£167
Lone parent, one child over 14	£248	£214
Lone parent, one child under 14, one child over 14	£298	£257
Couple, one child under 14	£298	£257
Couple, one child over 14	£330	£304
Couple, one child under 14, one child over 14	£379	£347

ii. Assumptions used for cost of credit modelling are as follows:

Social Fund Loan	Repaid at 10 per cent of Income Support income – this is the middle rate of social fund repayment, and is applicable to individuals with some (but not substantial) existing financial commitments. Other repayment rates are five per cent and 12 per cent and depend on existing commitments.
Credit card	Based on credit card with APR of 17.9 per cent. Individual makes minimum repayments every month of interest plus one per cent of capital (in line with new rights for credit users agreed in 2010 between BIS and credit card/store card companies)
Credit union	Based on credit union loan over 52 weeks with interest of two per cent per month (26.8 per cent APR).
Pawnbroker	Based on 52 week loan from pawnbroker with monthly interest of seven per cent. Seven per cent figure taken from OFT review of high-cost credit as typical interest rate charged by pawnbroker. Note – pawnbroking are generally for less than 52 weeks, 52 weeks chosen for comparison purposes – a loan of less than 52 weeks would incur less interest.
Rent-to-own	Based on APR of 49.9 per cent paid over 156 weeks, as charged by buy-as-you-view. Note other companies charge lower APRs of around 29.9 per cent – however the cost of credit is inflated by high initial prices for goods provided.
Home credit	Based on 52 week loan with fixed yearly interest of 82 per cent (as charged by Provident Financial).

iii. These figures are average debts held for different types of credit. Barnardo's has chosen these categories because they are types of credit which are common in low income households. Unfortunately it is not possible to break down these debt figures by income – so the average figures may not be completely representative of debt held by low income households in each area. Median values are the amount of debt where 50 per cent of all debts in that category are below. 10th percentile values are the amount of debt where 10 per cent of all debts are below.

iv. Calculations were based on an out of work lone parent with one child aged under 14, living in social housing, with an AHC income of £147 per week, £20 below the poverty line of £167 per week.

v. Specific products used for comparisons are as follows (comparisons retrieved 4/11/11):

Type	Model	Weekly spend/save	Rent-to-own	Online retailer
Washing machine	Beko WM5121W	£3.57	www.bayv.co.uk/content/products/kitchen-laundry/washing/beko-5kg-washing-machine.ashx	www.appliance-sonline.co.uk/product/wm5121w-beko-washing-machine-white-23401.aspx
TV	Sharp LC22DV510K	£3.35	www.bayv.co.uk/content/products/tv-dvd-audio/televisions/sharp-22inch-leddvd.ashx	www.dixons.co.uk/gbuk/sharp-lc22d-v510k-22-full-hd-led-tv-with-built-in-dvd-player-10149177-pdt.html?srcid=867&cmpid=comp~Google~~10149177&istCompanyId=4be69b13-f6de-4a80-8d9b-22e0185f57a7&istItemId=irlxtxwr&istBid=t
Cooker	Beko DG-582SP si	£4.79	www.bayv.co.uk/content/products/kitchen-laundry/cooking/beko- 50cm-gas-cooker1.ashx	www.365electrical.com/DG582SP.html?referrer=GoogleBase
Fridge	Hotpoint FFP187MP	£3.90	www.bayv.co.uk/content/products/kitchen-laundry/fridges/hotpoint-60-cm-2-doors.ashx	www.electricaldiscountuk.co.uk/itfx_product_details.php?pid=11484&PHPSESSID=719320bf6dc100ad8ec930aaa26ff7b0

Glossary of terms

Annual Percentage Rate (APR) – a figure that represents the yearly cost to the borrower of borrowing money. Lenders are required to report the APR of any loans that they offer.

Social Fund – the Social Fund is a government run fund administered by the Department for Work and Pensions through Jobcentre Plus. It offers loans on an interest free basis under a variety of circumstances. It is comprised of a regulated part (consisting of Sure Start Maternity Grants, Cold Weather Payments and Funeral Payments) and a discretionary part (comprising Community Care Grants, Budgeting Loans and Crisis Loans). In Northern Ireland the Social Fund is administered by the Department for Social Security.

Budgeting Loans – an interest free loan provided through the Social Fund to help people in receipt of benefits who would otherwise have limited credit options to manage one-off expenditure – such as buying new household items. These cannot be accessed for 26 weeks after accessing benefits.

Community Care Grants – are non-repayable grants, primarily awarded to vulnerable people to help them return to the community, who are in receipt of (or soon to be in receipt of) income related benefits. They can be awarded for a range of expenses including household equipment.

Crisis Loans – an interest free loan provided through the Social Fund to support people who cannot meet their immediate short-term needs as a result of a disaster or emergency.

Credit union – Credit unions are non-profit making organisations. Members save into the credit union and are able to take out loans in return. Interest rates charged are restricted to a maximum of two per cent per month.

Growth Fund – a fund initially set up by the previous UK Government to provide financial support to the credit union sector and encourage more affordable loans.

Home collected credit/doorstep lending – a loan which is typically taken out, then repaid every week to an agent who will call at the borrower's home to collect the money.

Illegal lending – businesses that lend money to consumers, or offer credit on a rent-to-own basis are required to be licensed by the Office of Fair Trading. Illegal lending refers to lenders who operate without a license from the Office of Fair Trading.

Pawnbroking loans – a type of secured loan where an individual gives an asset to a pawnbroker in order to borrow a set amount of money. Once the loan has been repaid the item is returned to the individual.

Payday loans – a type of credit which is typically taken out over very short time periods, often 15 days, and repaid in full on a fixed date in the future.

Personal insolvency limit – the level of debt after which a creditor can apply to make somebody bankrupt should they be failing to keep up with their debt. This is currently set at £750.

Post Office Card Account (POCA) – a basic bank account used to receive benefit payments. Housing Benefit cannot be paid into the account and no other deposits can be made. Direct debits and standing orders cannot be taken from the Post Office Card Account.

Rent-to-own credit – a type of credit usually used to purchase household items such as fridges and washing machines. The borrower pays a set amount every week to 'rent' the goods. At the end of their rental agreement the ownership of the goods passes from the company to the borrower.

Retail credit – typically refers to loans offered by retailers – for example, store cards offered by high street fashion companies are a form of retail credit.

Sub-prime credit – generally taken to refer to credit which is offered to lenders with poor or limited histories of credit repayment. Typically this type of lending will have higher interest rates to compensate for the increased risk associated with lending to these people.

Unsecured credit/loans – with an unsecured loan a borrower does not pledge any asset to act as collateral for the loan. Borrowing on credit cards is an example of an unsecured loan, where the credit card lender can not repossess any of the borrower's assets for failing to keep up with repayments.

Secured credit/loan – with a secured loan a borrower pledges an asset as collateral for the loan. In the event of the borrower defaulting on the loan the lender can repossess the asset that the borrower has pledged. Mortgages are examples of a secured loan, where the mortgage issuer can repossess the borrower's house if they fail to keep up with repayments.

Welfare reform – in February 2011 the Coalition Government published the Welfare Reform Bill. This will introduce Universal Credit (UC) to replace a range of existing means-tested benefits and tax credits for people of working age starting from 2013. There will also be changes to the way in which the Social Fund is delivered.

A vicious cycle
The heavy burden of credit on low income families

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The report was written by
Ivan Mathers and Neera Sharma

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www.barnardos.org.uk

Tanners Lane, Barkingside
Ilford, Essex, IG6 1QG

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