



Debt and Money Advice

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“This briefing paper provides an overview of the development of money advice as one response to growing levels of indebtedness.”

Key Points

- Over the last decade levels of personal debt in the UK have soared and credit is part of day-to-day life. At the same time, demand has grown for advice to deal with debt or other financial difficulties.
- The main reasons why households get into financial difficulties are: adverse financial shocks; persistent low income; poor money management; and over-commitment and over-spending. Views differ on the relative importance of poor financial management.
- A series of government initiatives in the UK, Scotland and Wales addresses the need for consumers to be better able to manage their financial affairs, and the need to address over-indebtedness through more money advice provision.
- Funding for money advice includes a focus on reaching excluded groups and the development of better practice and work across traditional organisational boundaries to reach excluded groups more effectively.
- Not enough is known about the size and nature of advice services, but there is a growing fee-charging sector. There are concerns that the ‘credit crunch’ combined with the new money guidance service may undermine the capacity of the free-to-client money advice sector.
- A more strategic approach to money advice should consider funding, particularly the finance industry’s contribution, and whether more regulation, in a similar vein to that for independent financial advisers, may be necessary.



Debt and Money Advice

Over the last decade credit has become part of most people's day-to-day lives and debt levels in the UK have soared. The growth of credit reflects a cultural change in society, and rising consumption is a feature of the significant rise in living standards in the UK over recent decades¹. Despite the recession and 'credit crunch', household borrowing in the UK continued to rise in 2008 and over the year to 30 September 2008: "total indebtedness increased by 5.4 per cent. . . reaching almost £1.5 trillion"². Secured lending such as mortgages accounts for much of this, but 16 per cent is for unsecured credit.

At the same time, demand has grown for advice or support to deal with debt or other financial difficulties. However, the development of advice services has been piecemeal. Recognition that the capacity to deliver debt and money management advice was insufficient to meet demand led to a series of financial inclusion initiatives, including increased provision of debt and money advice. The UK Government has monitored over-indebtedness and taken steps to encourage more responsible lending and borrowing.

The word 'debt' is often used as a generic term to include borrowing and credit. Many people have loans which can be managed without difficulty, and borrowing can be a useful tool to help households smooth out the effects of temporary fluctuations in their incomes.

However, it is unmanageable debt or over-indebtedness that is key to rising demand for money advice. Over-indebtedness is a complex issue and there are various definitions of it. For example, the government considers someone is 'over-indebted if they are struggling to keep up with payments and are suffering real financial hardship as a result'³. Citizens Advice defines problem debt as when an individual is "unable to pay their current credit repayments and other commitments without reducing other expenditure below normal minimum levels"⁴. The UK Government uses 'a basket of indicators' to monitor over-indebtedness, including the extent of arrears and the characteristics of people affected⁵.

Debt and its impact

A recent survey of CAB debt clients in Scotland showed that, on average, the participants had 6.3 debts and owed a total debt of £20,193, 50 per cent higher than in a survey 5 years earlier. They owed almost £28 for every £1 of monthly Credit card and personal loans were the most common types of debt⁶.

Several qualitative studies provide a consistent picture of why households get into financial difficulties⁷. The main reasons are: adverse financial shocks; persistent low income; poor money

management; and over-commitment and over-spending. These causes can be over-lapping and cumulative.

A recent European study argued that such studies tend to externalise the causes of problem debt, and financial mismanagement plays a much larger role than people seem prepared to admit⁸. However, this view may not reflect sufficiently well the position of people living on a low income and the fact that an adequate income is necessary for good money management. People living on a low income often have good budgeting skills through necessity and an increase in income can make money management easier and contribute to improved quality of life⁹. So money advice, including income maximisation work, can be important in helping low income groups with financial problems.

The current financial and economic climate is likely to generate new groups of clients for advice services. Macro-economic factors such as inflation, interest rates and levels of employment have a strong influence on people's ability to maintain repayments on credit or household bill commitments. One study suggested changing conditions for UK consumers could create 'the perfect storm'. Key factors included: record debt levels; an end to mortgage special interest rates; the 'credit crunch'; rising household bills; limited savings; and falling house prices¹⁰.

Another study identified that some groups face a greater risk of financial stress from financial shocks. For example, the impact of rising fuel bills was greatest for people with low household incomes, people aged over 60, social tenants, single adults living alone and lone parents. Most people struggling on a low income or struggling and over-indebted had fallen into arrears following a drop in income, and many experienced multiple arrears. Current levels of financial stress were strongly linked with whether people thought they would be able to make ends meet following the loss of the main wage¹¹.

Consumer credit and personal debt are rising among all income groups. Although this is not necessarily a problem in all cases, over-indebtedness can be caused by and contribute to poverty and social exclusion. Two studies explored the relationship between poverty and indebtedness and who is affected:

- Research using the British Household Panel Survey examined the long-term relationship between poverty and debt. It found that people in poverty in 2000 tended to have debts relative to their incomes that were 20 to 25 per cent higher than for the population as a whole¹².
- Research on the characteristics of families in debt used several datasets to show some were at more risk of being in arrears than others, including: lone parent, younger and larger families; families living as tenants; and those with very low incomes or without access to a current account¹³.

The risk of debt amongst low income groups is heightened because they are less likely to have access to low interest mainstream credit. Instead, they rely more on higher cost credit options such as home credit and doorstep loans, mail order, sub-prime credit cards, pay day advance and cash converter lenders¹⁴.

Despite the impact of current policy, there remain groups of people who cannot take full advantage of the benefits of using bank accounts and other financial services, particularly low income groups¹⁵. This includes people with learning disabilities or mental health problems for whom lack of knowledge, capacity or confidence to manage their financial affairs can lead to over-indebtedness or financial loss.

Government Responses to Debt

The UK Government has supported advice to address two key areas of concern about credit and debt: the need for consumers to be able to manage their financial affairs better and choose appropriate financial products, and the need to address problem debt. The first focuses on financial wellbeing and consumer confidence, while the second – money or debt advice - is viewed as providing 'crisis' support.

The Financial Services Authority established 'generic financial advice' - also referred to as 'money guidance' - as a key priority¹⁶. The aim was to ensure greater access to high-quality, affordable, 'sales-free' financial advice for those most vulnerable to the consequences of poor financial decision-making. The Thoresen review recommended a 'generic financial advice' service funded equally by the Government and the financial services industry. Pathfinder projects are running at present to explore the practical operation of this proposal¹⁷.

Developments in Money Advice

Much of the advice work done by Citizens Advice Bureaux and other advice agencies on debt and money management problems is to advise people about rights and options and provide related casework support and advocacy. Money advice is a complex and growing part of advice work. In response to growing concerns about debt and financial exclusion and the lack of resources available to address these concerns, increased public investment across the UK has been directed towards financial inclusion measures, including additional resources for money and debt advice. For example:

- The UK government funds 16 national and regional projects in England and Wales and 500 new advisers have been recruited, trained and deployed and over 143,000 clients seen and helped¹⁸.
- The Legal Services Commission funds advice services in England and Wales and, working with funding partners, has jointly commissioned Community Legal Advice Centres and Networks to provide a range of advice services, including debt and money advice, for defined areas of England and Wales¹⁹.
- In Scotland the Financial Inclusion Fund included support for around 120 money advice posts. Although initially ring-fenced, the Financial Inclusion Fund is now part of the Fairer Scotland

Fund allocated to all 32 local authorities. There is now local discretion on spending for money advice²⁰.

Some of these initiatives have focused on reaching excluded groups. Several reports highlight that there is not a 'one size fits all' approach to advice for low income and disadvantaged groups, but that services need to be delivered in ways that are appropriate for individuals to achieve access to services and gain advice that enables them to make fully informed decisions. People may have trusted sources of support other than advice services, so services need to work across traditional boundaries to reach excluded groups more effectively²².

Recent estimates show that more than 4,000 paid and volunteer advisers across the UK deliver money advice to over one million clients each year. Public services, particularly local government, provide most of the funding for such services. There is evidence of growing pressure amongst services and unmet demand for advice. This comes not only from traditional client groups, including people on low incomes, but also groups less likely to use services in the past, including owner-occupiers²³.

Conclusions

There remain gaps in knowledge about the size and nature of money advice services. Increasing debt arrears and mortgage possessions suggest the front-line support of money advice remains essential and demand is likely to grow, but the adequacy of resources and the short-term nature of funding, despite the initiatives referred to above. The national money guidance service will refer clients for advice if they have debt or 'crisis situations'. However, in the advice sector resources are limited and often short-term. The prospects are already for a more difficult financial environment because of the credit crunch and tighter public spending. As a result advice services will face increased demands for debt advice, greater competition for limited resources and there remains a need for better guarantees for advice services to ensure they can meet demand.

Much more is known about over-indebtedness: project evaluations help to develop knowledge of what works, and ongoing research will add to our understanding of the role and limits of money advice. The free-to-client sector is developing better practice and targeting disadvantaged groups and communities.

Money advisers have not been regulated closely in the past. The growing fee charging sector has different drivers from the not-for-profit sector, including generating income from debt solutions. The operation of such providers requires further analysis.

Given the scale of ongoing and potential demand and provision of money advice, governments need to consider more strategic approaches in future to ensure the quality, comprehensiveness and accessibility of advice. Key questions for the future include: how the finance industry can contribute more to addressing the problems it has helped to create; and whether fully informed advice can be achieved across all types of providers, or is greater regulation, in a similar vein to that for independent financial advisers, necessary²³.



About the Author

Morag Gillespie is a Research Fellow at SPIU. Morag's main research interests are financial inclusion, welfare rights and advice and gender and equality mainstreaming. She can be contacted at Morag.Gillespie@gcal.ac.uk

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