



Save the Children

A bleak winter in store for Britain's poorest families

Policy brief

The impact of debt on the UK's lowest income families

Many low-income families will be forced to take on debt in the coming months as a result of the current recession. According to recent research commissioned by Save the Children, as many as 65% of families earning less than £30,000 a year will struggle to get by this winter (for more details about this poll, please see 'Background' on page 5).

The recession has also caused an estimated 5.2 million households to be classed as 'sub prime', blocking their access to mainstream credit. An estimated 25,000 consumer credit applications are turned down every day.¹

People on low incomes often have to borrow to cover unexpected costs such as a broken washing machine, or essentials like heating or winter coats for their children. They have fewer opportunities than better-off people to access affordable credit. Many have no choice but to take on high interest debt courtesy of catalogues, rent-to-own shops, doorstep lenders and loan sharks.

Our survey shows that 55% of families earning £12,000 or less a year will have to turn to high-interest lenders to get through this coming winter.

Efforts to eradicate child poverty in the UK have rightly focused on improving low-income families' lives through tax credits and benefits. It is unacceptable that this money is falling into the hands of high-interest lenders and debt collectors, rather than helping families to escape poverty.

The UK financial sector has received enormous levels of state support over the last year. Save the Children thinks the sector should now return the favour by ensuring financial support is available to low-income families and disadvantaged communities.

While the government looks at how to regulate financial services through the Financial Services Bill, Save the Children is concerned that there is a lack of policy focus on how the poorest families can avoid getting sucked into high-interest debt.

We believe action in three key areas by the government and the financial sector would effectively put poor families back in charge of their finances and their futures.

These key action points are:

1. Implementing a Community Reinvestment Act to boost low-interest lending to the poorest families.
2. The government boosting and extending its Social Fund to directly help the poorest families.
3. Developing a voluntary code of practice for high-interest lenders that will tackle high-interest and high-cost credit.

The details of why and how these points should be addressed will be explored in more depth below.

1. Introducing a Community Reinvestment Act

Save the Children is calling on the government to introduce a Community Reinvestment Act, similar to US legislation. In the US, such a move has had a major impact on banks' lending policies. It has increased the finance available to people from disadvantaged neighbourhoods, and made financial institutions more accountable.²

It is wrong that UK banks are still failing to meet the needs of disadvantaged communities, especially considering that the government recently used public money to bail the banking sector out of a crisis.

Save the Children is calling for an Act that:

- Eliminates any discrimination in making financial services available to people on low incomes.
- Provides for the right to challenge a bank's failure to comply with such legislation.
- Rates financial institutions on their actions to meet disadvantaged communities' needs, and which will make those ratings public.
- Results in mainstream financial institutions investing in services that cater for low-income communities, either by providing those services directly themselves or through third sector lenders such as credit unions and community development finance institutions (CDFIs).

Third sector lenders provide an ethical and affordable alternative to high-interest credit providers and can help meet the needs of low-income families and disadvantaged communities. However, the UK's credit union sector is small compared to other countries', and capacity and coverage are a real challenge.

In developing a Community Reinvestment Act for the UK, we would like the government to set out how they will build on the success of the Growth Fund.³ It should outline how credit-union and CDFI-sector development can be best supported in relation to back-office and technological support. It should also set out how it plans to market these services as part of the drive to increase the financial awareness of people on low incomes.

The banking industry has acknowledged its role in supporting affordable third sector lending (as opposed to lending to the sub-prime market itself).⁴ Placing obligations on banks to meet the needs of low-income families would require banks to take action when necessary, and not just when it suits them. Thanks to the US Act, third sector lenders have thrived as banks have invested in credit unions and CDFIs to meet their legal obligations.

“The Act has had a major impact on banks' lending policies, increased the availability of finance into neighbourhoods and supported the growth of a strong community development finance sector in the US. The CRA has also strengthened accountability and scrutiny by providing a right to challenge a bank's failure to comply with the legislation and by publishing CRA-ratings of institutions.”

Urban Forum, May 2009, Community Reinvestment Report

The US Act does not compel banks to make credit available to poor communities. Instead it ensures that data is published regarding how well the banks are doing in providing finance to third sector lenders.

Because the CRA affords certain freedoms to institutions that invest in poor communities – particularly in mergers and acquisitions – the banks have strong incentives to provide funds for credit unions and other third sector lenders.

2. Boosting the Social Fund

The Social Fund currently serves many of the country's poorest families by giving them access to emergency grants and low-interest loans. However, the Social Fund hasn't been reformed quickly enough to effectively meet people's increased needs during this recession.

But it is not too late. The Social Fund is a ready-made system that, if boosted now, could deliver the support people on low incomes need to avoid getting into high-interest debt.

Save the Children is calling for the government to increase the Social Fund's resources, and extend eligibility to all families on working tax credits. The latter would make around 4.3 million low-income families with children eligible for Social Fund support.⁵

Save the Children is also calling on the government to improve the Social Fund's reach and delivery in the following ways:

- Ensuring that Job Centres signpost unsuccessful Social Fund applicants to other sources of advice and assistance.
- Allowing parents working 16 hours or less, who are not eligible for Working Tax Credit or Social Fund assistance, to apply for at least one Social Fund grant to help them buy children's clothing or essential household goods. This could be done for a time-limited period.
- Expanding the Social Fund's grants provision to reach low-income families with children and ensuring they stay out of debt. This should be done at least for a time-limited period (as has previously happened with winter fuel payments). For example, the government could announce the expanded grants provision in the Pre-Budget Report for the April 2010 to March 2011 financial year.
- Guaranteeing all low-income families moving into unfurnished accommodation at least one grant to help them buy a fridge, a cooker, curtains or carpet. At the very minimum, all low-income parents setting up a new home with their children after fleeing domestic violence should be guaranteed one such grant.

3. A voluntary code of practice for high-interest lenders

Save the Children is calling on doorstep lenders and rent-to-own retailers to sign up to a voluntarily code of fair practice and to set out how they are meeting the code. If the code is not implemented by the industry, Save the Children will call for the government to make the measures below mandatory.

Save the Children's code calls on doorstep and rent-to-own retailers to:

- Make their prices more transparent through clearer labelling and presentation.
- Display the total cost of credit to customers, either by clearly quoting the total amount payable, or by making sure the APR quoted includes all charges and fees.
- Oblige employees to treat their customers fairly, both before and throughout their contract, and make all codes of practice publicly available to employees to ensure codes are properly implemented, monitored and enforced.
- Agree not to punish customers with administration fees or higher interest rates if they miss payments.
- Take into account customers' financial circumstances and needs.
- Signpost customers to financial advice and support services.

Background

In November 2009, Save the Children commissioned YouGov to ask a representative sample of parents earning less than £30,000 or £12,000 per annum about their finances during the coming winter.

For those whose family income is less than £30,000 we found that:

- 65% are going to struggle to get by this winter.
- 29% are going to borrow money to provide a Christmas celebration for their children.
- 20% are going to borrow money to pay their fuel bill, 16% to pay for winter clothing and 16% to afford food.
- A majority of these families expect to get into debt up to £500, and 19% say it could take them more than a year to pay it back.

For those whose family income is less than £12,000 we found that:

- 55% will be taking out high-interest debt from catalogues, store cards and doorstep lenders.
- 60% intend to cut back on heating or will limit it to a few hours a day.
- 48% intend to cut back on their food budget.
- 57% will not buy new winter clothes and shoes.

Extortionate credit

Our survey also shows the impact on low-income families across the UK of different types of high-cost or extortionate credit. Credit should be deemed extortionate when:

- High credit costs are associated both with APR rates and borrowers being charged excessive, often hidden, fees.
- Loans are granted without regard to a borrower's ability to repay them.
- High-pressure tactics – or deception – are used to sell credit.
- A borrower's lack of understanding about loan terms is taken advantage of.
- There is a lack of transparency in the agreement (eg in terms of total cost of credit or terms and conditions of credit)
- Illegal or unethical debt recovery methods are used.⁶

How the costs mount up

1. Rent-to-own retailers

Rent-to-own retailers' services are widely used in the UK, and are often the only option for families on low incomes. Save the Children is very concerned about these retailers' business practices and the levels of interest they charge.

Rent-to-own retailers, such as HomeBuy (typical APR 39.9%), BrightHouse (typical APR 29.9%) and Buy As You View (typical APR 49.9%) provide household items such as washing machines and other white goods to customers who would fail normal credit checks. Customers pay rental weekly until the contract term ends (up to three years). The total amount customers pay over the term of the contract is several

times higher than the normal retail price of the goods rented, and the customer does not own the goods until the rental period ends.

Rent-to-own retailers have been criticised for hiding the true costs to customers by over-inflating the initial face value of goods and encouraging customers to take out damage and service cover.

For example, a refrigerator from HomeBuy costing £499, paid back over a 156-week period, would cost the customer a total of £794.04, or up to £993.72 with maintenance cover. A £299.99 washing machine from Buy As You View, paid back over the same period, would also result in customers paying well over the odds, at a total cost of £552.24 or £736.32 with maintenance.

How the costs mount up

At face value, BrightHouse's 29.9% APR would not necessarily qualify as 'extortionate'. For example, doorstep lender Provident Financial's typical APR on a loan is 189.2%.

However, BrightHouse strongly encourage customers to take out Optional Service Cover and Damage Liability Cover on their purchases. BrightHouse say that around 90% of their customers have cover attached to their agreement. Some customers have reported being misled when they have been sold cover, and it can dramatically add to the total amount repaid. It is reportedly difficult to make a claim on the basis of these covers, and their value is questionable. An extended manufacturer's warranty would give similar cover for a fraction of the price.

BrightHouse has also been criticised for giving products an over-inflated initial face value, with costs up to 50% higher than those of other retailers. Once the inflated initial price and optional cover has been included the total cost of credit would be 182.2%.⁷

In addition to a high total cost of credit, BrightHouse operates a late payment charge of £2.70 per week per agreement to reinstate the contract. Unlike some other high-cost credit sources, they offer very little flexibility when payments are missed.

2. Doorstep lenders

Doorstep loans provided by companies such as Welcome Finance and Provident are an extremely expensive form of credit. Vulnerable families welcome the low weekly repayments offered by doorstep lenders, but the high APRs mean that families often face a long-term reduction in their weekly finances.

Shopacheck (a trading name of Welcome Finance) offers cash loans of up to £500 with an APR of 254.5%. Greenwood (part of the Provident group) advertises a typical


loan of £200 with an APR of 433.4%. If paid back over 33 weeks this loan would cost the customer £330.

3. Loan sharks

People who are unable to access legitimate credit, or who are unaware of the services they are eligible for, are often forced to turn to illegal lenders. The costs of borrowing from loan sharks can be limitless and can put vulnerable families at great risk. The average sum paid by loan shark customers is three times the cost of the highest high-cost lenders and penalties for late payment can lead to threats and violence to frighten people who can't pay back their loan.

References

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- ¹ www.creditaction.org.uk/debt-statistics/2009/october-2009.html
 - ² www.urbanforum.org.uk/background/calling-for-community-reinvestment
 - ³ The Growth Fund is a Department for Work and Pensions fund aimed at increasing the availability of affordable personal loans via third sector (not-for-profit) lenders. www.dwp.gov.uk/other-specialists/the-growth-fund
 - ⁴ See details of the Barclays Community Finance Fund at www.transact.org.uk/cff
 - ⁵ Based on HMRC April 2009 tax credit figures
 - ⁶ US National Predatory Lending Taskforce (2000) and 'Extortionate credit in the UK', Kempson and Whyley (1999).
 - ⁷ Profiting from Poverty, NEF (2003).



We're the world's independent children's charity. We're outraged that millions of children are still denied proper healthcare, food, education and protection. We're working flat out to get every child their rights and we're determined to make further, faster changes. How many? How fast? It's up to you.

Save the Children UK
1 St John's Lane
London, EC1M 4AR
Telephone +44 (0)20 7012 6400
Fax +44 (0)20 7012 6963

savethechildren.org.uk

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