UNRAVELLING THE SPIRAL OF DEBT

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Most of us take access to affordable credit for granted. But for many, this isn't straightforward. At least 4.5 million UK adults say they have been declined a financial product in the last two years. An estimated 15% of UK adults are over-indebted.[1]

Access to credit can be a major challenge for many households and lead them to turn to unaffordable alternatives that trap them in a spiral of deepening debt. Whilst 'pay day loans' have received a great deal of publicity and scrutiny, other forms of credit like home credit, doorstep loans and rent-to-own (hire purchase), as well as credit cards and unauthorised overdrafts exist more under the radar and are a familiar sight on our high streets.

Our year-long mixed-methods study carried out in Wales on 'high cost credit' found that **almost two thirds of people (65%) turned straight to such forms of credit.**[2]

Characterised by high-pressure sales tactics, poor affordability checks, and aggressive repayment collections, these practices lead to borrowers becoming stuck with unmanageable debts. **More than 70% of these customers reported that this type of borrowing was normal because they had no other choice.**[3]

Other factors such as brand familiarity and loyalty, perceptions that certain lenders are not for 'people like me' and low financial capability impede the propensity for customers to shop around for the best deal. Buying a microwave in a rent-to-own store will mean paying 52% more than at a high street retailer.[4] This is a gross example of the poverty premium.

The impact is pernicious. Half of those taking out the loans we explored in our study in Wales reported experiencing anxiety and stress as a result of this debt. Many people told us about times when their repayments had to take precedence over activities like holidays and trips out with their children, adversely affecting their wellbeing.

Whilst there is no silver bullet which can transform the poverty premium, we are calling for appropriate steps towards expanding the affordable finance market, with new consumer credit and savings products.

There are encouraging signs of this happening across the sector. For example the Financial Conduct Authority's (FCA) Project Innovate and regulatory sandbox is helping to lower the barriers to entry and innovation, particularly for smaller charitable or social enterprise operations. Our 'Credit Where Credit's Due?' research influenced The Finance Innovation Lab's recent Fellowship programme, which supports innovations working to improve financial health.

After launching this research in parliament, we brought together a range of stakeholders including financial innovators, such as Fair for You, Pariti, Leeds Money Buddies and Uberima, investors, regulators and government representatives, to explore what the opportunities and barriers to innovation are in this sector.

One of these barriers is that they have to compete with the big marketing budgets of the larger, more established for-profit lenders. Therefore these **innovations will need greater support from the wider social investment community to be able to operate at scale.** We also very much welcome the work of the Inclusive Economy Partnership addressing access to affordable credit as one of their first areas of focus. But **to create a more sustainable and inclusive economy, we must not underestimate the power of people**; the importance of local networks and peer influence in people's financial decision-making. Our research in Wales showed that family and friends' recommendations is the top cited reason for choice of credit. We must therefore also engage more deeply with how people make decisions about where and when they seek credit, and trial interventions which can most effectively enable them to choose the solutions that are likely to serve them best.

1 Financial Conduct Authority (2017). Understanding the financial lives of UK adults: Findings from the FCA's Financial Lives Survey 2017. Available at: <https://www.fca.org.uk/publication/research/financial-lives-survey-2017.pdf>

2 The Young Foundation (2016). Credit Where Credit's Due? Available at: <https://youngfoundation.org/wp-content/uploads/2016/05/Summary-Report-V Final3.pdf>

3 Ibid.

4 Based on repayment at 69.9% annual fixed/representative APR for 156 weeks at £4.00 per week for a Samsung combination microwave costing £299.99 from a high-street store purchased outright.