

Over-indebtedness in Britain: A DTI report on the MORI Financial Services survey 2004

Executive Summary

In Spring 2004, the DTI commissioned MORI Financial Services to undertake one of the largest surveys to be carried out on consumer over-indebtedness in Great Britain. This survey identified a minority of individuals meeting a variety of different indicators of over-indebtedness.

The survey provides evidence that the number of individuals taking on a high level of debt service has increased over the past two years, reflecting the strong growth in consumer borrowing. However, the evidence also suggests that this increasing debt service is not causing significant problems at present. The number of individuals who consider their household's borrowing to be a heavy burden is low and has remained constant over the past two years. The proportion of individuals in arrears on repayments on credit or domestic bills is also low.

Those individuals that are identified on the indicators of over-indebtedness are in line with the findings of similar surveys, with those on low incomes, those with children and those in their 20's and 30's being over-represented.

Key Findings

- 9% of surveyed individuals are spending more than half of their income on total credit repayments and 8% are spending more than a quarter of their income on unsecured credit repayments.
- Only 4% of individuals have been in arrears on credit commitments or domestic bills for more than 3 months and only 5% of debtors considered their household's borrowing repayments a heavy burden.
- A simulated 10% fall in the gross income of all respondents identifies only a small amount of additional individuals on the debt service- income indicators of over-indebtedness.
- Individuals performed relatively worse on the unsecured debt service than on total debt service. Half of those spending over 50% of their income servicing total borrowing are also spending over a quarter of their income servicing their unsecured borrowing alone.
- Those who are over-represented on the over-indebtedness indicators are typically those who earn less than £9,500 a year; are in their 20's or 30's; have children; and/or are renting accommodation.
- A surprising lack of overlap between the over-indebtedness indicators is identified and demonstrates the need to consider several measures when conducting analysis in this area.

1. Introduction

On 20th July 2004 the Government launched “Tackling Over-indebtedness: Action Plan 2004”¹. This strategy coordinated action across Government with the aim of minimising the number of people who become over-indebted and improving the support and processes for those whose borrowing is unsustainable. As part of this strategy, the DTI is committed to monitoring the level and profile of consumer over-indebtedness.

The DTI produces a quarterly monitoring paper, which summarises publicly available sources to form a high level view of consumer over-indebtedness. However, examining the characteristics of those who become over-indebted and identifying those who are at risk from over-indebtedness requires detailed survey data. The DTI is working with the Office of National Statistics to secure a longitudinal survey of wealth and assets, which is in the initial stages of development. To examine over-indebtedness in the short term, the DTI commissioned Market & Opinion Research International (MORI) Financial Services to undertake a survey of consumer over-indebtedness in Great Britain.

This document highlights the most important results from the MORI Financial Services survey in relation to consumer over-indebtedness.

2. Details of MORI Financial Services 2004 survey conducted for the DTI

Surveys with large sample sizes are necessary to improve the confidence that the results obtained accurately reflect the experience of the overall population. This is particularly relevant when looking at consumer over-indebtedness because such a small percentage of the population is under scrutiny. When such a small amount of people are identified, it is difficult to pick out any statistically significant characteristics that they may have. The large sample size is therefore a particularly attractive feature of the MORI Financial Services (MFS) tracking survey. In total, the survey includes the responses of 9,892 individuals. This makes the survey one of the largest to be carried out on consumer over-indebtedness in Great Britain.

The MFS survey bears a resemblance to a number of recent surveys (See Annex A for information on existing evidence) but the questions asked relate to *individuals’* personal situation².

MFS conducted interviews within Great Britain once a month for the last five months of 2004. Each wave of data consists of approximately 2,000 different adults (aged above the age of 16) who are interviewed face-to-face in their homes. Quotas are set to reflect the distribution of the GB population by age, sex, class and working status.

3. Results

There are a large number of hypotheses that could be tested using the data but we will focus on 6 main themes:

- **How can we identify ‘over-indebtedness’?** The results for a number of indicators are examined and the degree to which they overlap explored.
- **Who is over-indebted?** The characteristics associated with over-indebtedness are identified with respect to each of the five indicators.
- **Is the situation getting worse?** We will look at how the results from the MFS data compare with those from recent studies.

¹ Available at <http://www.dti.gov.uk/ccp/topics1/pdf1/overdebt0704.pdf>

² With the exception of the question regarding burden of debt where individuals were asked respond on behalf of their household.

- **How many people are at risk from over-indebtedness?** The sensitivity around the indicator thresholds is explored. What impact would a 10% reduction in personal income have on the levels of over-indebtedness?
- **Who has got what type of credit?** What are the most popular forms of consumer credit, both for the sample as a whole and for those with a high level of debt service?
- **Do people know how much they owe?** Are people aware of the extent of their borrowing commitments?

These themes will now be discussed in turn.

3.1 How can we identify 'over-indebtedness'?

Of the 9,892 people interviewed in the MFS survey, 5,095 individuals (52% of the sample) had some form of borrowing, 4,033 individuals (41% of the sample) had some form of unsecured borrowing and 3,479 individuals (35% of the sample) had a mortgage. For the majority, this borrowing represents a rational means of managing differences between consumption and income or spreading the cost of expensive goods and services such as a house. However, for a small minority, the repayments on such borrowing are problematic. This could be because of an unforeseen deterioration in the individual's finances (e.g. loss of income), a change in personal circumstances (e.g. separation), or financial mismanagement which makes keeping up with existing commitments more difficult (e.g. financial incapability).

The Government is committed to helping those who are having problems repaying their borrowing and minimising the number of people who could face problems in the future. But how do we identify these individuals who are currently over-indebted or are in danger of becoming over-indebted?

There is no universal agreement on the definition of consumer over-indebtedness. OXERA³ suggest a definition of 'those households or individuals who are in arrears on a structural basis, or are at a significant risk of getting into arrears on a structural basis.' In order to measure over-indebtedness, it is therefore necessary to specify a threshold of a relevant variable that is consistent with 'a structural basis'. This can be done objectively, where the analyst assumes the threshold, or subjectively, where surveyed individuals directly declare the state of their own indebtedness. This report looks at both types of indicator, giving us an indication of the absolute size of the problem and individuals' perceptions. We use four indicators that are objective and one that is subjective in nature:

Objective Indicators:

Consumer Credit Indicators:

- *Those individuals spending more than 25% of their gross monthly income on unsecured repayments*
- *Those individuals who spend more than 50% of their gross monthly income on total borrowing repayments (secured and unsecured)*
- *Those individuals with 4 or more credit commitments*

Arrears Indicators:

- *Those individuals in arrears on a credit commitment and/or domestic bill for more than 3 months*

³ 'Are UK households over-indebted?' Oxera, April 2004. Commissioned by the Association for Payment Clearing Services, British Bankers Association, Consumer Credit Association and the Finance and Leasing Association.

Subjective Indicator:

- *Those individuals declaring their household's borrowing repayments to be a 'heavy burden'*

The objective indicators include the three consumer credit indicators set out by Kempson⁴ and an additional indicator on persistent arrears. The subjective measure asks individuals about the burden of their household's borrowing repayments; this gives us a base to compare to recent work conducted by the Bank of England⁵.

This gives us five different indicators with which to appraise consumer over-indebtedness in Great Britain which are consistent with the preferred measures suggested by OXERA. These indicators cannot perfectly identify those individuals who are over-indebted but each sheds light on a different part of the picture and much can be learned from examining each of them in turn and the degree of overlap between them.

3.1.1 Consumer Credit Indicators:

These indicators report on the extent of individuals' credit commitments. The two debt service-income ratios reveal the financial extent of an individual's repayments on consumer credit⁶ whilst the third indicator selects those individuals with a certain number of credit commitments. To give us an indication of how many individuals are over-indebted, an assumption has to be made on the thresholds associated with over-indebtedness.

It is important to stress that it is the distributions of individuals over the debt service-income ratios that are most important (Figures 5 and 6). Assuming a threshold is relatively arbitrary, but it allows us to report on those individuals at the extreme end of the distribution i.e. those most associated with over-indebtedness. In 2002, Kempson used thresholds of 25% of gross household income for unsecured borrowing repayments, 50% of gross household income for secured and unsecured borrowing repayments and 4 or more for the number of credit commitments at a household level. For simplicity, we have applied the same thresholds as Kempson at the individual level to allow a partial comparison with her results. Neither of the distributions is particularly sensitive around these thresholds.

It is quite possible that an individual could satisfy one or more of these indicators without being over-indebted. However, the individuals who do satisfy these indicators, particularly the debt-service ratios, will have exposed themselves to a considerable level of borrowing and hence the consumer credit measures provide a valuable *indication* of the level of over-indebtedness.

Table 1: Consumer Credit Indicators

Indicator	Kempson 2002 % of total households	MORI 2004 % of total individuals
Those with monthly repayments on unsecured borrowing > 25% of gross income	5%	8%
Those with monthly repayments on secured and unsecured borrowing > 50% of gross income	6%	9%
Those with credit commitments \geq 4	7%	6%

Our results cannot be directly compared to those from Kempson 2002 due to the difference in the measurement base. However, because the number of individuals meeting the debt

⁴ Though Kempson considered these at a household level. 'Over-indebtedness in Britain' Kempson, 2002

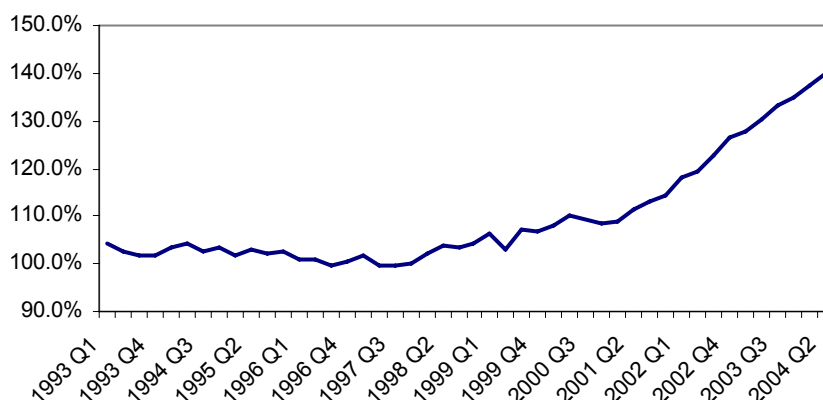
⁵ 'British household indebtedness and financial stress: a household level picture' Bank of England Quarterly Bulletin – Winter 2004. <http://www.bankofengland.co.uk/qb/qb040401.pdf>

⁶ It would be useful to report interest repayments as a proportion of disposable income but unfortunately this information is not available.

service indicators is higher than the number of households in 2002, it is likely that the number of individuals meeting these thresholds has increased over the past two years⁷.

This is not entirely surprising. Consumer borrowing has been growing at record levels over the past two years, outstripping income growth and as a result the average total household borrowing to income ratio has been rising steadily. There are other factors that affect the level of debt-service e.g. interest rates and movements in income, but it is likely that the recent growth in borrowing is the main driver behind the rise in debt service.

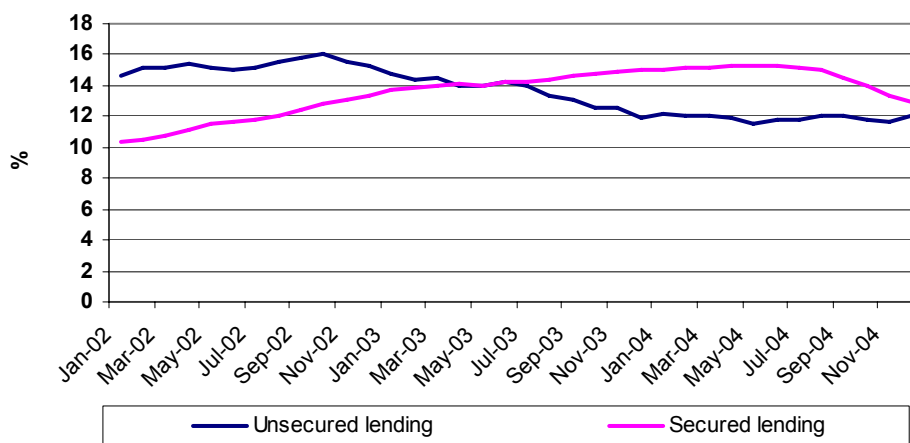
Figure 1: Total Household Borrowing to Income Ratio (secured and unsecured borrowing)



Source: ONS (VZRD/RPQK*4)

The results also show relatively more individuals satisfying the debt service-income threshold on unsecured borrowing than total borrowing. This is an interesting result, especially given that secured credit has been growing much faster than unsecured credit over the past 2 years.

Figure 2: 12 month growth rate of Net Lending



Source: Bank of England: LPMVTYO and LPMVTYI

The increase in house prices over the past 2 years has released increasing amounts of equity, allowing homeowners to consolidate unsecured borrowing against their home. Consolidating borrowing in this manner should, theoretically, make unsecured borrowing repayments less burdensome for homeowners. However, the survey results show that

⁷ There is a possibility that the debt-service income indicators have identified individuals who have little or no income but who have borrowing that is repaid by their partners or family. Unfortunately, these individuals cannot be separated from those who are experiencing high levels of debt service that they themselves are accountable for. This is a disadvantage of analysing debt-service at the individual level.

mortgagors still make up over half of those who have unsecured debt service- income ratios over 25%, indicating that many may not be taking advantage of this flexibility.

Another point to note is that the percentage of individuals with 4 or more credit commitments has almost reached that for households in 2002. This implies that individuals are taking on more credit commitments than two years ago.

3.1.2 Arrears Indicator:

As well as including information on credit commitments, the arrears indicator also covers domestic bills. This makes it a more inclusive indicator as almost all individuals will be required to pay domestic bills whereas the number of individuals with a credit commitment will be substantially lower (around half of those surveyed in the MFS sample have a credit commitment). It also identifies those individuals who are actually experiencing problems servicing their commitments rather than those whose debt service levels suggest that they are having problems. Respondents were asked if they had been in arrears on either domestic bills or credit commitments for more than 3 months in order to identify those individuals who were structurally rather than temporarily in arrears.

Of the total sample of 9,892 individuals, 6% were currently in arrears on at least one credit commitment or domestic bill and 4% had been in arrears for more than 3 months. Individuals were more likely to be in arrears on domestic bills than credit commitments. This is not surprising because more individuals face payments on domestic bills than credit commitments and individuals also have to pay interest on credit.

The most common payment to be behind on was council tax, followed closely by rent, water and gas/electricity bills. Over a quarter (26%) of those in arrears for more than 3 months had no credit commitments at all i.e. they were in arrears on domestic bills only. Individuals were not just in arrears on one bill in isolation, 44% of those behind with rent were also behind with council tax and 33% of those behind with gas/electricity were also behind with water repayments.

Of those in arrears for more than 3 months on any repayments, 33% were in arrears on council tax whereas only 14% were in arrears on a credit card (the most common credit product to be in arrears on). Those who were in arrears on their credit commitments were a substantial amount behind; an average of £1526 on personal loans and £1494 on credit cards.

Table 2: Arrears on credit commitments/domestic bills

Type of Payment	% of sample currently in arrears on at least one credit commitment/ domestic bill	% of sample currently in arrears on at least one credit commitment/ domestic bill for more than 3 months	Average amount behind
Any payment	6%	4%	£868
Gas/Electricity	1%	1%	£181
Water	1%	1%	£325
Rent	2%	1%	£377
Council Tax	2%	1%	£338
Credit Cards	1%	1%	£1494
Personal Loan	1%	*	£1526

*Figure less than 1% and too small to be significant. This was the also case for arrears on Mortgage, Hire Purchase, Car finance and Other loan

3.1.3 Subjective Measure:

The subjective question asks respondents to categorise the burden of their borrowing repayments as either a 'heavy burden', 'somewhat of a burden' or 'not a problem'. This avoids

the need to make an assumption on the threshold of over-indebtedness. However, peoples' opinions about what constitutes a burden are clearly likely to differ.

The results from the subjective indicators show that the vast majority of individuals (81% of the sample and 75% of those with a credit commitment) do not consider their household's borrowing repayments to be a problem. Only a small minority (4% of the sample and 5% of those with a credit commitment) consider their household's borrowing repayments to be a heavy burden. The result implies that individuals are comfortable with the increasing level of borrowing that they are taking on.

Table 3: Burden of borrowing repayments

Level of Financial Burden	MORI 2004 % of the total sample ⁸ who find their secured and unsecured repayments:	MORI 2004 % of debtors ⁹ who find their secured and unsecured repayments:
Heavy burden	4%	5%
Somewhat of a burden	15%	20%
Not a problem	81%	75%

3.1.4 Overlap between the indicators: Individuals may satisfy more than one of the over-indebtedness indicators. If there is a large overlap between the indicators, it shows that they are capturing elements of the same problem. Table 4 shows a surprising *lack* of overlap.

Introduction to Table 4

Table 4 shows the amount of people who satisfy *two* of the over-indebtedness indicators. These individuals can be expressed as a percentage of either indicator base. For example, there are 268 people whose unsecured borrowing repayments are greater than 25% of their income **and** whose total borrowing repayments are greater than 50% of their income. These 268 people represent **61%** (268/441) of those whose unsecured borrowing repayments are greater than 25% of their income and **49%** (268/542) of those whose total borrowing repayments are greater than 50% of their income.

Table 4: Overlap between measures of over-indebtedness*

	<i>Sample size</i>	Unsecured borrowing repayments >25% income	All borrowing repayments >50% income	≥4 credit commitments	Borrowing repayments not a burden	Borrowing repayments a heavy burden	In arrears >3 months
<i>Sample size</i>	-	441	542	312	4481	222	215
Unsecured borrowing repayments >25% income	441	-	61%	25%	58%	11%	6%
All borrowing repayments >50% income	542	49%	-	16%	64%	9%	3%
>4 credit commitments	312	35%	29%	-	44%	12%	8%
Borrowing repayments not a burden	4481	6%	8%	3%	-	0%	1%
Borrowing repayments a heavy burden	222	22%	23%	17%	0%	-	35%
In arrears >3 months	215	12%	9%	12%	21%	36%	-

* Figures in bold are referred to in the commentary

⁸ Answering sample of 8,302

⁹ Answering sample of 4,106. This question was used in the last four waves of the sample, hence the lower base.

Only a small percentage of those who find their household's borrowing a heavy burden are picked up on the objective indicators of individual over-indebtedness¹⁰. Of those individuals finding their household's borrowing a heavy burden, just 23% have total borrowing repayments in excess of half their income and only 22% have unsecured borrowing repayments in excess of a quarter of their income. The overlap of the burden indicator with the arrears indicator is slightly larger but the latter still only accounts for around a third (35%) of those finding their borrowing a heavy burden.

Of greater concern perhaps, is that the majority of those satisfying the debt service indicators do not consider their household's debt service problematic. Around three in five (58%) of those satisfying the unsecured debt service-income indicator and two in three (64%) of those satisfying the total debt service-income indicator did not consider their household's borrowing repayments to be a problem.

Only 9% of those with unsecured borrowing repayments in excess of a quarter of their income and only 11% of those with total borrowing repayments in excess of half their income consider their household's borrowing repayments a heavy burden. Given the extent of these debt service thresholds one might have expected more individuals to declare their household's borrowing a heavy problem.

The lack of overlap is a concern because it suggests that a large proportion of those with a high level of debt service are unaware of the burden of their borrowing. It also implies that something else is accounting for the burden of a household's borrowing repayments other than the financial extent of an individual's borrowing repayments and whether or not the individual is in arrears.

Possible explanations are:

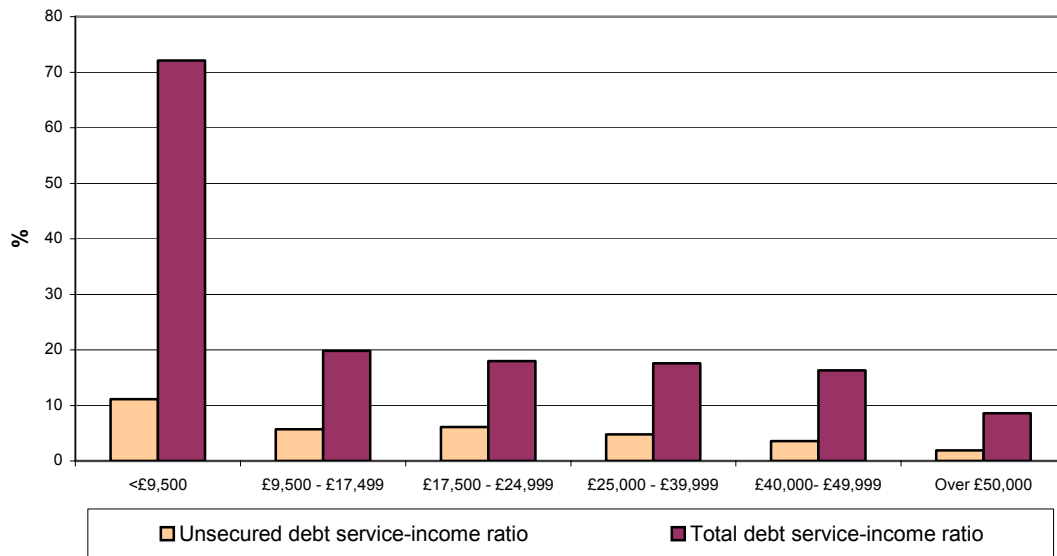
- **Other incomes within the household.** Individuals may be less concerned about their individual borrowing if they have a partner with whom they share the financial burden. The evidence supports this hypothesis. Of those who satisfy the debt service-income indicators and declare their household's credit repayments unproblematic, the vast majority were either married or co-habiting (75% unsecured debt service, 90% total debt service).
- **The level of savings.** This would not effect an individual's performance on the debt service-income ratios but having savings would be likely to give the individual some reassurance that they could meet their credit repayments/domestic bills in an emergency. People who have some savings may be less worried about borrowing repayments than those who don't. 37% of individuals in our sample did not have any savings, yet they accounted for 56% of those reporting their household's borrowing a 'heavy burden'.
- **Expectations of higher future income.** Individuals, especially recent graduates, may be willing to accept a high level of debt service on the understanding that their earnings profile will increase in the near future.
- **Differing levels of financial capability.** A given level of debt service would be likely to be considered much less of a burden for someone who is highly financially capable than by someone who has difficulty understanding and organising repayments.
- **Other life pressures.** Individuals who have other financial commitments in addition to credit commitments (associated with children perhaps) or have less time to organise their finances may consider their borrowing more of a 'burden'.
- **Differences between peoples perception of what is a 'heavy burden'.** For some, income may be irrelevant and owing even a small amount constitutes a heavy burden. Others may be happy owing large amounts on a small income.
- **Individuals are not aware how burdensome their borrowing is.** It is possible that those individuals who are highly geared and do not think their borrowing is a problem

¹⁰ We need to be careful when interpreting the overlap of the burden indicator with the other indicators because of the difference in base. However, we assume that an individual's finances would be closely related to those of their household.

have underestimated the burden of their borrowing and are unaware of the potential problems this may cause in the future.

- **Disposable income net of credit repayments.** Individuals may be untroubled by a high debt service if they earn a substantial income. For example, someone earning £5,000 a month could afford to pay 80% of their income on credit repayments and still have £1,000 a month to live on. The same level of debt service for someone earning £500 a month would leave them with only £100 to last them a month. Figure 3 shows both debt service-income ratios actually declining with income, implying that those from lower incomes are disproportionately burdened compared to those on higher incomes. The difference between average unsecured debt service-income and total service-income is particularly notable for those earning less than £9,500¹¹.

Figure 3: Average individual debt service-income ratios by income bracket



There is also a lack of overlap between the consumer credit indicators and the arrears indicator. Only a minority of those identified on the debt-service indicators (6% unsecured debt service, 3% total debt service) are in arrears on a structural basis. The difference is likely to be explained by a number of the personal characteristics explained in the next section. Of these, the lack of savings stands out, the 37% of the sample that do not have any savings are under-represented on the debt-service indicators yet account for 66% of those who had been in arrears for more than 3 months.

By calculating the average debt service-income ratios for those who consider their borrowing repayments a heavy burden, we can discover the level of debt service associated with a heavy burden. For unsecured credit the average borrowing repayments to income ratio for these individuals is 22% and for unsecured and secured borrowing it is 69%. This represents a slight difference from the thresholds that Kempson suggested were associated with over-indebtedness in 2002. This reinforces the premise that peoples opinion of what constitutes a 'heavy burden' is likely to differ considerably.

It is also worth noting that 49% of those spending over half their income servicing total borrowing spend over a quarter of their income servicing their unsecured borrowing alone. This means that a large proportion of highly committed mortgagors are substantially committed on unsecured borrowing. This proportion could be considered high, especially given that the equity released as a result of increasing house prices has allowed homeowners to consolidate unsecured borrowing against their home.

¹¹ The high debt-service income ratios for the <£9,500 income group may be partly driven by non-earners who have declared some borrowing and/or those individuals whose debt service is high due to a recent fall in income e.g. as a result of unemployment.

3.2 Who is over-committed?

The next section looks specifically at the characteristics displayed by those individuals picked out by each indicator.

Introduction to Table 5

The sample consists of 7,087 respondents¹². Each of the over-indebtedness indicators selects a small subset from this overall sample. Table 5 seeks to identify the characteristics that are over-represented in the subsets of individuals that are selected by each of these indicators. It does this by comparing the proportion of each characteristic in each subset to that of the overall sample - if the proportion in the subset **exceeds** that of the overall sample then the characteristic in question is over-represented and is therefore likely to be associated with over-indebtedness. To ease interpretation, the characteristics that are over-represented and are statistically significant are shown in bold.

¹² See Statistical Annex for more sample information.

Table 5: Characteristics of individuals satisfying the over-indebtedness indicators

	Percentage of answering sample ¹³	% of respondents whose repayments on unsecured borrowing > 25% income	% of respondents whose repayments on secured & unsecured borrowing > 50% income	% of respondents who have ≥ 4 credit commitments	% of respondents who find keeping up with bills and credit commitments a 'heavy burden'	% of respondents who have been in arrears for more than 3 months
All	100	8	9	6	3	4
Age						
18-20	5	3*	2	2	6*	8
21-24	6	8*	5*	10	7*	11
25-34	20	27	29	29	27	30
35-44	20	25	29	30	22*	24
45-54	17	19*	22	19*	27	18*
55-64	13	11*	10	8	9	4
>65	19	5	3	2	3	4
Gender						
Male	47	31	23	42	39	41
Female	53	69	77	58	61	59
Family type¹⁴						
Single retired	12	3	1	1	3	3
Retired couple	11	6	4	2	1	1
Single, not retired, without children <16	21	16	7	18	23	28
Single, not retired, with children <16	9	8*	4	15	24	31
Couple, not retired, without children <16	21	21*	25	21*	18	12
Couple, not retired, with children <16	28	47	58	43	31	25
Ethnicity						
British	89	91	92	92	86	85
Life changes over the last 12 months						
New baby	5	7*	9	7*	7*	11
Separation	3	3*	2*	7	9	6
Individual or their partner made redundant	2	4	5	6	6	6
Any life change	52	68	66	71	58	56
Housing tenure						
Mortgagor	36	53	82	51	36*	13
Outright owner	27	15	7	7	7	4
Social tenant	27	21	6	29*	44	62
Private tenant	10	10*	4	12*	13	19
Economic activity						
FT work	42	37	28	60	40	28
PT work	12	20	23	16	11*	11*
Unemployed	5	6*	5*	4*	13	18
Retired	23	8	5	3	4	4
Housewife	11	19	31	11*	18	24
Gross Income						
<£9,500	45	62	71	33	56	64
£9,500 - £17,499	29	26	18	33	26	27*
£17,500 - £24,999	9	8*	4	13	5	5
£25,000 - £39,999	11	4	5	15	9*	3
Over £40,000	5	0	1	6*	4*	1

* Result not significantly different from their share of the survey population at the 5% confidence level.

¹³ Answering sample consists of 7,087 individuals. See Statistical Annex for more sample information.

¹⁴ 'Couple' can be married or co-habiting.

Age: It is the younger and middle generations that seem to be having the most problems. 25-44 year olds are significantly over-represented on almost all indicators. Ages 21-34 do particularly badly on the arrears indicator. The 45-54 age group is notably over-represented on the subjective indicator. The data suggests that borrowing repayments are much less problematic for those over 55 but this is mainly because this age group does not take on much borrowing (they account for only 20% of debtors but 32% of the total sample).

Sex: Women are over represented on all types of over-indebtedness indicator. This is most pronounced on the borrowing income ratios; this could be explained by women's lower average incomes and/or the fact that women are more likely to be non/part-time working partners who share their borrowing commitments with working partners.

Family type: The data show that individuals or couples with children are more likely to be over-indebted than those without children. Single parents, though under represented on the debt services indicators, are significantly over represented on the arrears and burden indicators. This group accounts for 9% of the sample but makes up 31% of those in arrears and 24% of those declaring their household's borrowing a burden. Couples with children are most over represented on the debt service to income indicators. Retirement does not appear to be correlated with over-indebtedness, retired singles and couples are under represented on all five indicators compared to other family types.

Ethnicity: Individuals who classify their ethnicity as British are over-represented on the consumer credit indicators but under-represented on the arrears and subjective indicators. This implies that the opposite is true for those individuals from ethnic minorities.

Life changes over the past 12 months: The data show that those who have experienced a significant life event in the past 12 months are over represented on all over-indebtedness indicators. 5% of respondents had had a child in previous 12 months but they accounted for approximately 11% of those in arrears. Separation from partner was over represented on 3 out of the 5 indicators, accounting for only 3% of the sample yet 9% of those finding their borrowing repayments a heavy burden. Redundancy has a relatively large impact on the indicators. Those who were made redundant (or whose partners were made redundant) make up 2% of the sample but account for 4% of those paying more than 25% of their income repaying unsecured borrowing and 6% of those in arrears and those finding their households' debt a heavy burden.

Housing Tenure: It is not surprising that mortgagors make up over 80% of those whose borrowing repayments are greater than 50% of income. Although they are more highly geared they do not appear to be having the same level of difficulties with their borrowing as tenants. The data show that renters, though under represented on the debt service-income ratios, struggle with their borrowing repayments and domestic bills with both social and private tenants being significantly over-represented on the burden and arrears indicators. Social tenants account for 62% of those in arrears for more than 3 months and for 44% of those who declare their borrowing a heavy burden even though they only form 27% of the overall sample.

Economic Activity: There will be a large degree of overlap with income here. It is not surprising that more of those working full time have at least four credit commitments, as they will be more likely to qualify. Those in part time employment are over represented on all three of consumer credit's indicators but not on the burden or arrears indicators. Unemployed individuals are substantially over-represented on the burden and arrears indicators, making up only 5% of the answering sample but accounting for 13% of those finding their borrowing repayments a heavy burden and 18% of those in arrears for more than 3 months. Housewives are also over-represented on all these indicators particularly on the burden and arrears indicators.

Income: As may be expected, those individuals in the lowest income bracket are considerably over-represented on all indicators (other than the number of credit agreements), with individuals in the higher income bands only featuring on the number of credit commitments indicator.

The debt service indicators can only be analysed for those who have declared their income, however it is worth noting that those who refused to disclose their income were under represented on the other indicators. They made up 29% of the total sample but accounted for only 23% of those who found their borrowing repayments a heavy burden and 19% of those in arrears for more than 3 months.

Other characteristics:

The **lack of savings** is associated with those having problems with the repayments on their borrowing. Those with savings less than £1,000 account for 54% of the answering sample but make up 89% of those in arrears and 84% of those finding their borrowing repayments a heavy burden. Those with savings less than £1,000 are over-represented to a greater extent on the consumer credit indicators than those with no savings, presumably because people in this category have greater access to sources of finance.

Region: England was over represented on all the over-indebtedness indicators compared to Scotland and Wales with the exception of arrears. This was the only indicator for which Scotland was over-represented.

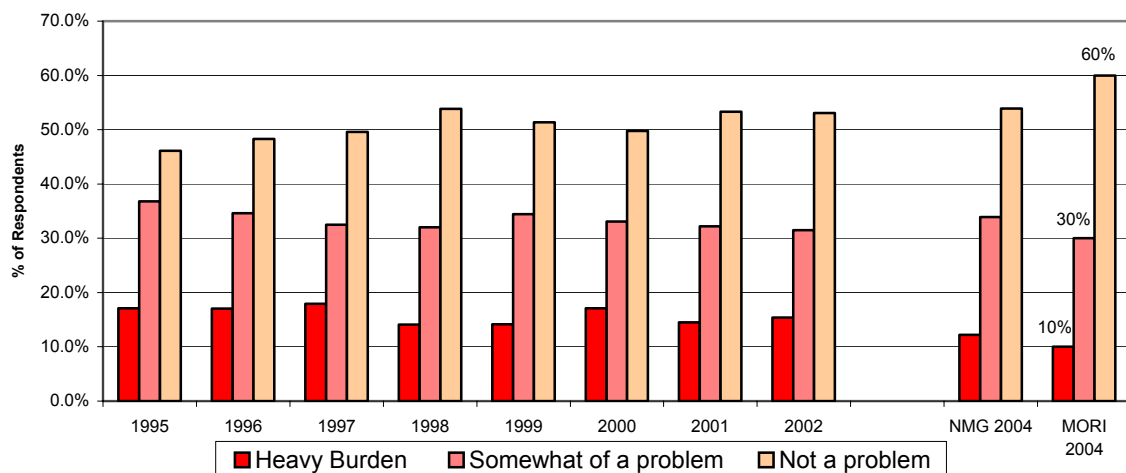
Disability of self or others does not appear to have an effect on an individual’s performance on the consumer credit indicators but those who are affected by disability are more likely to find their borrowing a heavy burden and be in arrears than individuals who are unaffected.

3.3 Is the situation getting worse?

The increase in the level of over-indebtedness as measured by the objective indicators could be interpreted as a slight worsening of the situation. However, results from the subjective indicator suggest that households are no more worried about their unsecured borrowing repayments than at any point over the over the last 10 years. This points to the fact that the level of borrowing which is considered to be a ‘heavy burden’ has eroded over time as overall borrowing levels have increased.

The BHPS and NMG Research surveys ask different questions about unsecured and secured borrowing. The MFS survey included the burden question for unsecured borrowing so that the surveys could be compared on unsecured borrowing for renting households. The MFS survey found that 10% of renting individuals considered their household’s unsecured borrowing to be a heavy burden, which is a marginally lower percentage than comparative results over the last decade. This result is consistent with NMG research for 2004.

Figure 4: The Burden of Unsecured Borrowing Repayments for Renting Households¹⁵



¹⁵ BHPS, NMG Research survey and Bank calculations

3.4 How many people are at risk?

The impact of interest rate rises on mortgage holders has been looked at in some detail by the Financial Services Authority¹⁶. They found that a one percentage point increase in interest rates would cause 7% of mortgage holding households to struggle with at least one form of credit, though not necessarily falling behind with repayments. The MFS survey does not allow us to conduct similar sensitivities on interest rates, however it does allow us to observe the impact on over-indebtedness of an unexpected fall in income.

One way to consider how many people might be at risk is to check the sensitivity around the thresholds we have used. We can do this by considering the distributions of individuals over the two debt service ratios.

Figure 5: Distribution of Unsecured borrowing repayments/income ratio

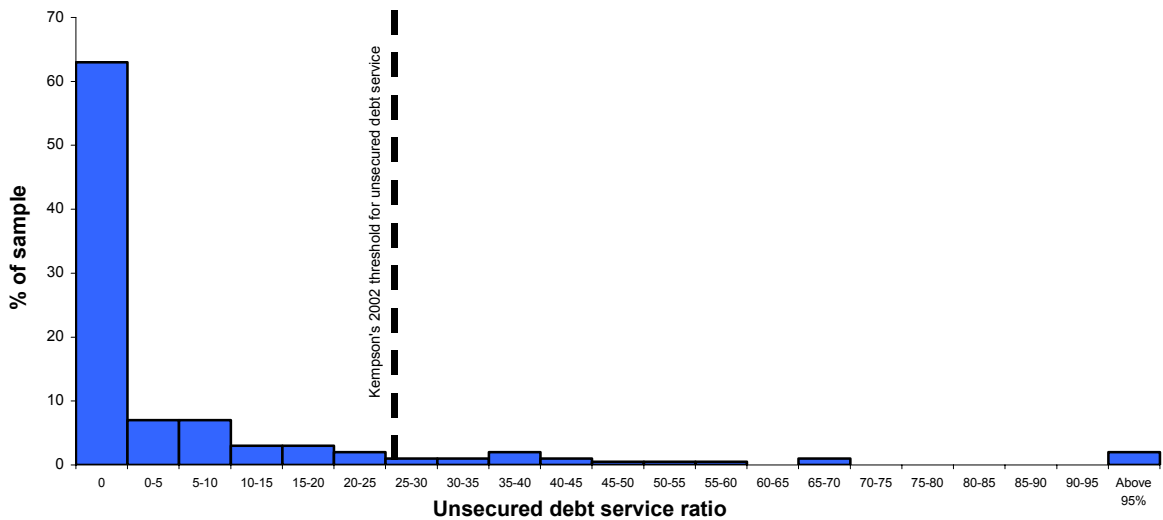
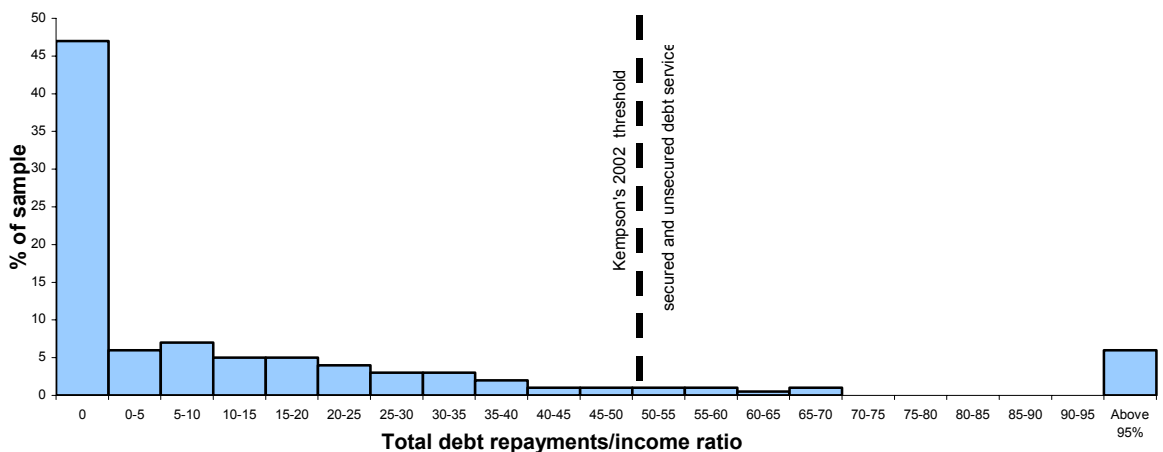


Figure 6: Distribution of Secured and unsecured borrowing repayments/income ratio



It is worth noting that both distributions have a surprisingly large amount of individuals with debt service-income ratios above 95%. This could be a result of analysing the data at the individual level. Non-earning individuals who rely on their partner to repay borrowing would have debt service- income in excess of 100% if they declared even a small amount of borrowing. Thus the sharing of commitments between partners may over-estimate an individual's level of total debt service. This argument is less relevant for unsecured borrowing which must be in the individual's name.

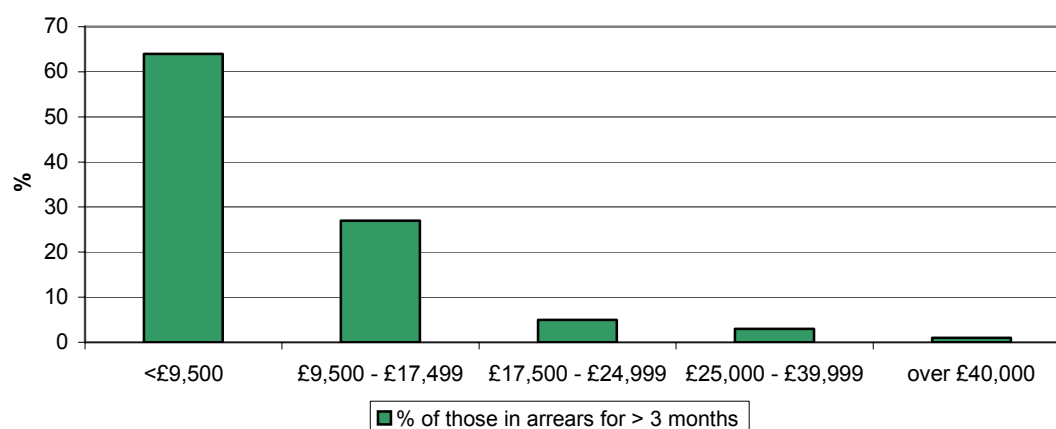
¹⁶ FSA Financial Risk Outlook 2004

For a 20% *proportional* reduction in the debt service-income thresholds (i.e. threshold on unsecured borrowing reduced from 25% to 20% and the threshold on total borrowing reduced from 50% to 40%), the percentage of individuals captured by the unsecured debt service-income ratio increases from 8% to 10% whilst the percentage captured by the total debt service-income ratio increases from 9% to 11%. Thus the distributions are not particularly sensitive. It is difficult to specify under what conditions such a change to the debt service-income ratio might take place, however we can model the effects of a small shock to individuals' gross income.

The Citizens Advice Bureau reported in 2003¹⁷ that a fall in gross income of as little as 10% could induce problems for their clients with debt related problems. We can investigate this hypothesis for the MFS sample by reducing the income of all the respondents by 10% and observing how many more individuals are captured by the debt service-income indicators¹⁸. When the simulation is run, we see that the amount of additional individuals identified by the debt-service indicators is small. The number of individuals with unsecured debt service in excess of 25% of their income increase by half a percent from 7.6% to 8.1%. The number of individuals with total debt service in excess of 50% of their income increases from 9.2% to 10.2%.

Whilst we cannot model the effect of a fall in income on the likelihood of falling into structural arrears, the distribution of those in structural arrears by income (shown in Figure 6) shows a significant rise in the percentage of individuals in arrears as gross income falls below £17,500. A fall in income that brought individuals into these lower income brackets could therefore be expected to increase the incidence of arrears.

Figure 7: Income distribution of those in arrears for > 3 months over income



3.5 Who has got what type of credit?

The survey shows the prevalence of credit cards. Almost one in five (19%) people do not pay off the full balance on their credit cards, on which they owe an average of £1,555. Overdrafts are also popular (used by 16% of the sample) although individuals owe a lot less on average (£355) than other credit commitments. The commitments on which individuals owe the most on average are car finance (£5,869), personal loans (£5,270), government student loans (£5,165), bank/building society loan (£4,815), hire purchase (£3,270) and loans from friends and family (£2,663). Individuals owe substantially more on these six commitments than on alternative forms of credit.

The combinations of some of these credit holdings are also notable. Almost half (48%) of those individuals with a personal loan also owe money on credit cards and exactly half of

¹⁷ Report by the Treasury select committee 2003, 'Transparency of credit card charges.'

¹⁸ These individuals are not necessarily the most likely to become over-indebted, evidence (such as that from Table 5) shows that those experiencing life events have a high likelihood of becoming over-indebted due to the associated reduction in income, which can be substantial, in the case of job loss this can be as much as 100%. Unfortunately, it is not possible to identify those individuals who are about to experience such life events.

those owing money on store cards also owe money on credit cards. The survey also showed a prevalence of home collected credit use amongst those with other types of sub-prime borrowing. 44% of those who have a DWP/Social security loan also had home collected credit.

As expected, those individuals spending more than a quarter of their income on unsecured borrowing repayments have a higher incidence of credit use than those whose unsecured debt service is lower. Certain types of credit product are more prevalent amongst this group than amongst the sample as a whole, however we must stress that this increased prevalence does not imply causation. Just over three fifths (62%) of individuals spending more than a quarter of their income on unsecured borrowing repayments have an outstanding balance on a credit card, almost half (47%) have an overdraft, around a third (32%) have a personal loan and a quarter have an outstanding balance on a store card.

Table 6: Credit Commitments percentage with and amounts owed on

Type of credit commitment	% of Total Sample ¹⁹ with	Average Amount owed ²⁰	Individuals spending >25% income on unsecured borrowing repayments	
			% of sample with	Average Amount owed on
Credit Card*	19%	£1,555	62%	£2,230
Overdraft	16%	£355	47%	£365
Personal Loan	9%	£5,270	32%	£6,443
Store card*	7%	£268	25%	£447
Mail order catalogue	5%	£315	11%	£701
Home collected credit	4%	£305	7%	£306
Car Finance	3%	£5,869	8%	£4,610
Hire Purchase	2%	£3,270	5%	£3,667
Cheque Trading Loan	2%	£471	2%	£183
Government Student Loan	2%	£5,165	3%	£4,848
Bank/Building Society loan	1%	£4,815	3%	£6,049
DWP/Social security loan	1%	£367	1%	£275
Loan from family/friends	1%	£2,663	2%	£6,623

* Only includes those who do not pay off their balance in full

3.6 Do people know how much they owe?

As part of the survey, individuals were asked to give a single figure that represented all the monthly repayments on their unsecured borrowing. To test the reliability of individuals' estimates, we compared the amount that they declared to the amount which we calculated they would be required to repay from the information on each of their credit commitments.

The comparison was carried out for those with non-mortgage borrowing and for those who found their household's borrowing a heavy burden. In both cases, there was little evidence of systematic under-reporting of monthly borrowing repayments. Only 12% of those with non-mortgage borrowing and only 7% of those who found their household's borrowing a heavy burden reported a figure that was lower than that which we calculated.

¹⁹ This includes those without any borrowing.

²⁰ By all debtors declaring the value of their borrowing.

4. Conclusions

- 4.1 The MFS survey provides evidence that the amount of individuals with a high level of debt service has increased over the past two years.** This increase reflects the record growth in consumer borrowing over the same period. 8% of surveyed individuals were spending more than a quarter of their income servicing their unsecured borrowing and 9% were spending more than half of their income servicing all their borrowing.
- 4.2 There is little evidence to show that the increase in debt service is causing problems at present.** Only 4% of individuals had been in arrears for more than 3 months whilst the proportion of households that declared their borrowing repayments a heavy burden was low and static.
- 4.3 The survey shows only a small increase in the number of individuals becoming over-indebted due to a small shock to income.** A simulated 10% fall in income caused only a marginal deterioration in over-indebtedness as measured by unsecured and total debt service indicators.
- 4.4 There are several indications that unsecured borrowing repayments are causing more problems than secured borrowing repayments.** The relative performance of individuals was worse on the unsecured debt service-income indicator than on total debt service-income indicator. Half of those spending over 50% of their income servicing total borrowing repayments were also spending over a quarter of their income servicing their unsecured borrowing alone.
- 4.5 The survey identifies several characteristics that are disproportionately associated with over-indebtedness.** Amongst those who are over-represented on the over-indebtedness indicators are those who; earn less than £9,500 a year; are in their 20's or 30's; are single parents; are renting accommodation or have savings less than £1,000.
- 4.6 The overlap between the over-indebtedness indicators is small.** Something else accounts for the burden of a household's borrowing repayments other than the financial extent of an individual's borrowing repayments and whether or not the individual is in arrears. Over half of those satisfying the debt service-income indicators do not consider their household's borrowing repayments to be a problem. Consumer over-indebtedness should not be analysed by one set of indicators in isolation.

References

- 'Tackling Over-indebtedness: Action Plan 2004', A joint DTI/DWP publication. <http://www.dti.gov.uk/ccp/topics1/pdf1/overdebt0704.pdf>
- 'Over-indebtedness in Britain: A report to the DTI' Elaine Kempson, 2002.
- 'British household indebtedness and financial stress: a household picture' Bank of England Quarterly Bulletin – Winter 2004. <http://www.bankofengland.co.uk/qb/qb040401.pdf>
- Treasury Select Committee 2003, 'Transparency of credit card charges.'
- FSA Financial Risk Outlook 2004
- '*Are UK households over-indebted?*' OXERA, April 2004. Commissioned by the Association for Payment Clearing Services, British Bankers Association, Consumer Credit Association and the Finance and Leasing Association.
- 'Characteristics of Families in debt', Kempson, McKay and Willits, Report for DWP, 2004.

Annex A – Review of Existing Evidence

The MFS survey joins a number of similar surveys/studies in recent years looking at consumer over-indebtedness in the UK and Great Britain.

2002, MORI Survey for DTI

In 2002 MORI conducted a detailed survey on over-indebtedness in Great Britain for the DTI²¹. In the survey, 1,647 individuals were asked questions related to their household's borrowing. The resulting report was completed by Elaine Kempson from the Personal Finance Research Centre²² who identified a small minority of households that were heavy credit users summarised by their performance on three indicators:

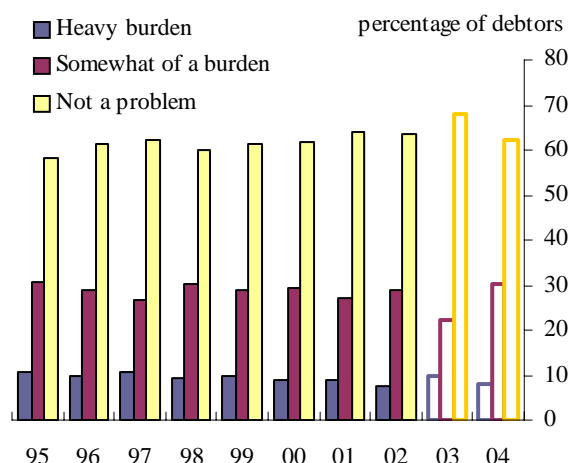
- *Those households with 4 or more credit commitments*
- *Those households spending more than 25% of their gross monthly income on unsecured repayments*
- *Those households spending more than 50% of their gross monthly income on total borrowing repayments (secured and unsecured)*

These percentages were 7%, 5% and 6% respectively for the MORI data in 2002. These indicators were used in the Consumer Credit White Paper to define those households likely to be over-indebted. Kempson also found that 7% of households were struggling financially and 13% had fallen into arrears on either credit commitments or household bills, giving a total of 20% that were in financial difficulty.

2004, NMG Survey for the Bank of England

In September 2004, the Bank of England commissioned a survey from NMG Research to look at the burden of household borrowing in the UK²³. NMG asked 1,838 individuals to report on their household's borrowing using questions that were consistent with the British Household Panel Survey to allow a comparison over time. The survey showed that the proportion of households that regard the repayments of their unsecured borrowing as a 'heavy burden' fell marginally over the past year from 10% to 8%, whilst those regarding it as 'somewhat of a problem' rose from 22% in 2003 to 30% in 2004. The heavy burden figure has remained fairly static over the last decade, on or around 10%.

Figure 8: Trends in the burden of unsecured borrowing



Note: Figures up to 2002 are calculated using the BHPS, 2003 and 2004 figures are from NMG Research surveys
Source: BHPS, NMG Research and Bank calculations

²¹ 'Over-indebtedness in Britain' Kempson, 2002

²² Based at University of Bristol

²³ 'British household indebtedness and financial stress: a household picture' Bank of England Quarterly Bulletin – Winter 2004. <http://www.bankofengland.co.uk/qb/qb040401.pdf>

2004, Kempson Survey for DWP

In 2004 Kempson et al²⁴ looked at those households suffering 'financial difficulty'. The report found a significant incidence of arrears amongst young, poor, lone parent families. The level of arrears was found to be higher amongst tenants than families buying a home and the likelihood of arrears was increased with falls in income and the use of consumer credit. When other factors were taken into account, having children was not associated with being in arrears.

2004, OXERA Report

In April 2004, Oxford Economic Research Associates (OXERA) reported on the level of over-indebtedness experienced by UK households²⁵. The report defines over-indebtedness as 'those households or individuals who are in arrears or are at a significant risk of getting into arrears on a structural basis.' To get an indication of over-indebtedness the report suggest three preferred measures:

Debt-service income ratios

Number of households in arrears

Subjective measures of borrowing too much

OXERA recommend the measurement of ratio of interest rate payments as a proportion of disposable income whilst stating that there is no public domain for this information.

²⁴ Kempson, McKay and Willits 'Characteristics of Families in debt', March 2004.

²⁵ 'Are UK households over-indebted?' Oxera, April 2004. Commissioned by the Association for Payment Clearing Services, British Bankers Association, Consumer Credit Association and the Finance and Leasing Association.

Annex B – Statistical Annex

In total, 10,219 individuals were interviewed in five waves between August and Dec 2004. It was decided to remove those individuals ages 16 and 17 because they cannot qualify for formal credit products. They could, theoretically, have loans from family and friends but their inclusion would have been more misleading than their exclusion. The total sample aged greater than 18 was 9,892.

Table 5 uses a base sample of 7087 individuals. This is the number of respondents above the age of 18 who have declared their personal income. The burden and arrears questions did not require an income to be specified, their bases so their bases were larger, 8,302 and 9,892 respectively. For the sake of simplicity the burden and arrears questions are shown for all those declaring income so that the five indicators can be compared across a single base. The characteristics were run separately on the other two bases and the results were not statistically different from those obtained from looking at those who specified income.

Department of Trade & Industry
Consumer and Competition Policy Directorate

June 2005