Personal Over-indebtedness

3 working papers to better understand the phenomenon so to better design systemic prevention and treatment strategies

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EFIN

- An EU network with a Think Tank Spirit : a forum to exchange knowledge and data & document solutions ;
- A large range of different types of stakeholders (+/-30 organisations : consumer protection organisation, debt advisers, microfinance institutions, trade unions, , / +/- 18 countries + individual experts/researchers) ;
- A network you too can join ! **www.fininc.eu**

EFIN Research

Personal Over-indebtedness

a national and EU issue studied by EFIN members

3 working papers for 3 strategies to be implemented by stakeholders :

Indicators to monitor what is happening

Early detection and helpful response to support households with financial difficulties

Identifying unfair lending practices and toxic loan products

State of the art: key elements

Over-indebtedness : causes and consequences for debtors and creditors are rather well documented, mostly at micro-economical level.

EU Commission, DG Employment and Equal Opportunity funded 2 EU programs to document financial exclusion in a large set of EU countries;
"Financial services provision and prevention of financial exclusion » 2007 / 2008
14 national reports :
http://www.fininc.eu/study-on-financial-services-provision-and-prevention-of-financial-exclusion/

BUT

- No real perception of the macroeconomic impact, across all stakeholders, no coherent action to combat the phenomenon (competition between actors);

- A persistant **lack of an agreed set of relevant and polically useful indicators across the EU,** up-dated on a regular basis;

BUT

- Unclear on the definition of effective measures which can limit:
  - major « avoidable » causes of over-indebtedness; (unfair products, irresponsible lenders,…)
  - A slide into over-indebtedness (when debt collection proceedings increase (multiply) the level of the initial debts)

Paper n°1
Indicators

- Why does household debt matter?
- Why do we need indicators?
- What do we need to know about indebtedness?

  The four major questions include:
  - What is the indebtedness level?
  - What are the symptoms of over-indebtedness?
  - What are the products/services that drive financial difficulties?
  - What are the companies that generate the higher level of financial difficulties?

Paper n°1

Indicators

- Potential data sources for monitoring indebtedness
- The importance of good quality data from administrative sources
- The importance of good quality data from surveys

Paper n°1

Indicators

- The Indicator paper includes two dedicated annexes on EU SILC annual and specific survey :
  - An analysis of EU SILC 2008 Module question-naire and effective proposition for a second round;
  - Recommandations for the EU SILC annual module

Paper n°1

Indicators
Ways forward

Short-term solutions

The immediate action : the adjustment of a few indicators in the **Eurostat's SILC module**.

Mid-term solutions

The mid-term solution is the up-dated and improved « in-depth survey » carried out periodically (**EU SILC special module**) which will analyse the complex aspects of debts & financial inclusion.

Long-term solutions

Data from administrative sources should be made available for monitoring over-indebtedness : on the model of the credit data across the EU countries currently developed (AnaCredit), but adjusted to consumer credits.

Paper n°2

Early detection & helpful response about households' financial difficulties

What should be done?

Employment, stability with sufficient guaranteed incomes /savings when you go through a rough time is key to combat on a long term o-i. Unfortunately, these factors are not easily accessible …

What can be done?

Some practices can bring great impact in the fight against o-i for the benefit of the whole range of stakeholders :

- vulnerable people, -creditors,
- public authorities;

Theoretical background

- Overindebtedness is not an suddden change
- Seeking for a solution means understanding the situation
  - Lack of vision
  - Lack of skills
  - General over optimistic attitude about the futur
  - No radical adjustment of the expenditures level

Debt counsellors acknowledgement :

- the situations are dettered, complex and urgent ;

- the treatments are long, costly and not so effective.

A paper to explore, document and learn about…

- **Early detection of financial difficulties:**
  - Mainly implemented by the « suppliers »:
  - New role, new method, new partnership…
  - Before arrears and defaults!

- **Constructive and rehabilitative approach for people in financial difficulties**

The paper explores innovative practices

Looking for efficiency

The contributors, members of EFIN, demonstrate a large range of innovative practices from compagnies, credit providers, building society, social services, debt advice providers, public authorities... seeking for better process, improved efficiency

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Part 1:

Early detection of financial difficulties

is a technique that allows the identification of people with a significant risk to meet severe difficulties, but who did not reach this level yet!

This innovative approach has already been experimented and implemented by a range of stakeholders

Early detection of financial difficulties

Some examples in the paper:

- **France**, by la Banque Postale and Cetelem, two credit providers;

- **Poland**, a business oriented approach has been developed by the authorities, named the “Rapid Response Instrument”;

- **The Netherland**, by the City of Amsterdam and building society

and the results are positive: better results at lower cost !

Part 2:

A constructive and rehabilitative approach for people in difficulties

Idea: explore methods that will not deter the financial situation via financial sanctions, extra costs or penalties when arrears occur. This approach is appropriate for the situation where the client is willing to pay its debt but his incomes are really restricted.

Part 2…

For these situations we have first explored the origin of the “punitive treatment” for debtors in a chapter dedicated to the evolution of debt collection practices during the last centuries – simply enlightening…

Then, we have identified a range of innovative practices developed by stakeholders that were looking for better performance

Part 2…

Presentation of innovative practices:

UK local authority strategy to propose a holistic analysis of any citizen in difficulty (**City of Solilhul**) the combat against detrimental debt collection practices via a regulation (some EU Member states have developed an important and effective regulation against such practices - UK illustration). **A UK Water company** developed a new constructive approach in arrears collection, that has proven its efficiency as well as a **UK hospital debt collection company**. Example of new approaches in debt collection from the United States of America has been also reported (from the CFS II Company). **Debt collection by NGOs and non for profit institutions**, some of them funded by big companies, **have also proven better efficiency** thanks to the supportive approach they are providing to their clients (Citizen Advice bureau, and StepChange Debt Charity)

MAIN LESSON

A fair and balanced process brings benefit for all stakeholders

- Reduces the costs of administrative follow-up (non profit debt counsellors);
- Increases the amount collected during the debt settlement plans ;
- Reduces legal and Court costs ;
- Reduces the duration of repayment period and accelerates the benefit of having second chance ;
- Provides for a balanced treatment of the creditors ;
- Protect human dignity of the debtors…

Paper n°3 :

Unfair lending practices and toxic products

Definitions

Unfair lending practices

Unfair lending practices covers several types of practice:

- Use of misleading or oppressive behavior when advertising, selling, or enforcing a credit agreement;
- Lack of or poorly done creditworthiness assessment to check whether a borrower can repay their loans;
- Lack of or insufficient explanation on key features of a credit agreement preventing borrowers from making an informed choice.

definitions…

Toxic loans

Loans that are designed in such a way that it is almost impossible for the borrower to not be brought, sooner or later, into a default of payment.

Predatory lending benefits where the lender and ignores or hinders the borrower’s ability to repay the debt. All the risks are passed onto the borrowers.

Profits increase with customers difficulty to repay on time

Foreign currency loans
Definition…

Foreign currency loan (hereafter ‘FX loan’) is

> *“a credit agreement where the credit is (a) denominated in a currency other than that in which the consumer receives the income or holds assets from which the credit is to be repaid; or (b) denominated in a currency other than that of the Member State in which the consumer is resident.”*

Foreign currency loans
... and problem description

During the 2000s, **millions of consumers** in Central and Eastern Europe took **personal loans and home loans denominated in FX**.

At the time, interest rates of home loans in Swiss francs and euro were significantly lower than those in national currency.

For example, in 2013, in Hungary, Romania, Bulgaria, Croatia, Serbia, and Latvia, between 60% and 88% of the outstanding loans to the households were denominated in a foreign currency, mainly Swiss franc (CHF) and euro.

But in 2008 the Swiss franc rose sharply, while other currencies, like forint and zloty, have been devaluated.

Illustration:

Slovenia: a representative example of a consumer who borrowed EUR 100 000 (in CHF) for 20 years in June 2006: initial monthly instalment of EUR 612 would grow to EUR 739 by the end of 2008 and to EUR 855 by January 2015. The remaining debt, starting at EUR 100 000, would still be at the level of EUR 99 004 in January 2015 despite high debt service. A consumer who would borrow the same amount on the same day in EUR would be owing only EUR 68 670 to the bank.

EU law and actions by Member States

The EU Mortgage Credit Directive Art 23 contains provisions on FX loans:

depending on the transposition in each individual Member State, FX borrowers will have the right to convert their loan under certain conditions into an alternative currency or will be protected by alternative arrangements (e.g. caps, warnings), or both.

However, it will enter into force in March 2017, plus it will not address the problem of the existing contracts.

National urgent actions

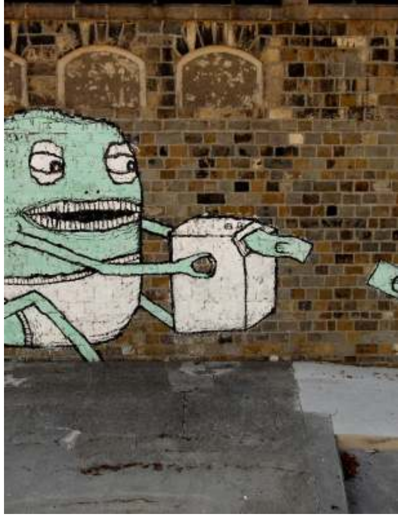
The Hungarian government fixed the Swiss franc-forint exchange rate at 180 until the end of 2014, thus allowing borrowers to convert their loans into local currency at a favourable rate.

In France, the Consumer Law amended in 2013 prohibits selling FX loans to consumers, unless at least 50% of the borrower’s income is in this foreign currency, or if this borrower owns at least 20% of his assets in this currency.

In 2010, the Austrian Financial Market Authority urgently recommended banks not to grant foreign currency loans to households Art L. 312-3-1 du code de la consommation.

…

Pay day loans



Definition and problem description

Payday loans are small short-term single-payment high-interest loans intended to carry the borrower through a temporary cash deficit.

As it is described by the payday lenders themselves, they are quick one-time loans expected to cover unexpected expenses, such as sudden medical costs or a breakdown of a car used for commuting.

BUT,…their business model seems to actually heavily depend on borrowers’ inability to afford the loan and their subsequent necessity to borrow again, multiple times

Creditworthiness assessment – the weakest link

An appropriate assessment of creditworthiness should ensure that the borrowers do not experience substantial discomfort when returning the credit…

BUT

a research conducted by the Office of Fair Trading (OFT) in the UK found that **most payday lenders do not actually assess affordability in an appropriate way.**

Rolling Over, Refinancing and Repeat Borrowing

These loans:

- **are not used the way they are said to be supposed to**:
  they are often extended (rolled over) or refinanced numerous times.
- **"Rolling over" beyond the original repayment** date so the duration of the credit is extended but the amount of the credit and the terms and the conditions are unchanged **while extra fees are charged**.

Profiting from the Misfortune

Evidence exists to prove how payday lenders go out of their way to build customer loyalty and turn them into high-frequency borrowers.

Rolling over increases incomes and reduces costs… because:

- The loss ratios are lower for repeat borrowers;
- The operating costs are lower. Verification of a new customer (validation of identity, of a bank account, of a telephone number) might be rather expensive but it can be excluded for the repeat customers.

Possible solutions

- Restrict simultaneous loans
- Cap the size of loans
- Coolings off period
- Roll over limitations
- Minimum and maximum term limits
- Extended repayment
- Price caps…

Recommandations

Banning foreign currency loans to borrowers who do not receive income or do not have no assets in that currency (e.g. French consumer law)

Capping the consumer loans' interest rates

Banning teaser loans in which the borrower pays a very low initial interest rate, which increases after a few years; such loans try to entice borrowers by offering an artificially low rate and small down payments.

Recommandations

As regards prevention and financial inclusion:

Implement asset building oriented policies in order to limit the temptation of having to resort to banks with unfair practices.

Promote community-based initiatives such that would act as firewall for vulnerable collectives while constraining external dependence.

Of courses, much more to learn in the papers…

Available on the website: www.fininc.be

Thank you for your attention