Snakes and ladders
A longitudinal study of financial difficulty

**Adele Atkinson, Elaine Kempson
and Sharon Collard**

**Personal Finance Research Centre
University of Bristol**

October 2008

PERSONAL • FINANCE • RESEARCH • CENTRE

Contents

Acknowledgements

This was a joint project undertaken by the Personal Finance Research Centre, Henley Centre Headlight Vision (HCHLV), and BMRB with funding from the Financial Services Authority. The authors would particularly like to thank Alex Thornton of BMRB for his help with the telephone sift, and Becky Rowe of HCHLV for managing and conducting the fieldwork in a professional and timely manner. We would also like to thank Simon Sarkar and Steve Nuttall for commissioning this work and for their support, guidance and feedback at all points in the project.

Above all, though, we would like to thank the people who agreed to be interviewed and their willingness to discuss their circumstances both candidly and in detail. Without this we would not have been able to gain the insights that are reported.

The authors take full responsibility for the content of this report.

Executive Summary

There is increasing concern about the high levels of borrowing in the UK, and the risks of financial difficulty and over-indebtedness.

This longitudinal study revisited people who had shown some sign of financial stress when they were interviewed for the Financial Services Authority's Baseline Survey of Financial Capability in 2005. The research was designed to explore the causes of financial difficulties and the changes to people's financial circumstances in the following two years. The original Baseline Survey was analysed quantitatively to identify those with varying degrees of financial difficulty, (see Kempson and Atkinson, 2006), whilst this latest study used qualitative methods to explore the circumstances of 35 of the original respondents two years after their original interview[1].

Circumstances in 2005

By design, the majority of those interviewed in this follow-up study had shown signs of financial difficulty in 2005. It was not uncommon for them to have fallen behind with one or more of their financial commitments.

The main reasons that people had faced financial difficulties in 2005 were:

- A sudden reduction in income (an income 'shock', most commonly following separation or divorce, or ill-health);
- Persistently low or fluctuating income; and
- Poor money management (particularly over-spending).

Changes since 2005

There was a fairly even spread of participants whose situation had deteriorated, those whose situation had improved, and those who had seen no change since they were interviewed in 2005.

Those whose **situations had worsened** were largely, but not exclusively, people who were already in arrears in 2005. They fell into three types:

- <u>Low income spenders</u>, who were single and had generally spent long periods of time on state benefit;
- A group of <u>middle income spenders</u>, who typically lived with a partner and had moderate, stable incomes from work or benefits; and
- Good money managers who faced <u>financial demands from family</u>.

---

[1] The fieldwork was conducted in August and September 2007.

Few of the participants whose situation had worsened were buying their own home, and there was no evidence to suggest that mortgage holding had been a particular cause of deteriorating financial situations.

The low income spenders had no savings they could draw on and were not actively saving at the time of the interview. They each had a number of credit commitments, including loans from doorstep lenders, catalogues, credit cards and overdrafts.

They often blurred the distinction between needs and wants, and were therefore prone to make spending decisions that made their financial situation worse. Despite this apparent lack of control, they were cutting back on expenditure on food and social activities. They were all in arrears with some, if not all, of their credit commitments and some were also behind with household bill payments.

The middle income spenders included some participants who held savings, and some active savers. However, some (including some of the savers) had outstanding arrears to pay. Even though they knew they were making poor decisions these poor money managers were unable to get sufficient distance from their situation to see any alternative.

This group seemed unwilling to give up certain ‘wants’, such as satellite or cable TV subscriptions in order to make inroads into their debts. They were also less likely than the lower income group to have cut back on day-to-day items, although some had missed bill payments to meet other commitments.

Like the low income group discussed above, these participants had several credit commitments to manage. Reflecting their higher incomes, credit was more likely to be from credit card companies and banks than doorstep lenders. It was not uncommon for them to use their credit card to withdraw cash, indicating a heavy and unhealthy reliance on borrowing.

Those who faced financial demands from family exhibited very good money management skills. This group was characterised by a lack of work (they were neither working, nor looking for work) and having grown-up children living at home. Some also faced additional financial burdens from their wider family.

These participants were in difficulties despite being very controlled spenders. They budgeted carefully, but their low incomes were impacted heavily by unexpected or fluctuating expenses and increasing costs such as the rise in food prices.

Credit was used less amongst this group than the others whose situation had deteriorated. They appeared to prefer the control provided by pay-as-you-view TV and pay-as-you-go mobile phones.

The improvements in the situations **of those who showed some improvement** were relatively small-scale: only one or two of them could be said to be managing reasonably well in 2007. The rest were typically struggling to manage; some had either repaid their arrears or were in the process of doing so, but at least one person still had outstanding arrears.

We have identified three groups of people whose situation appeared to have taken a (modest) turn for the better.

- Young people whose situations had improved as a result of significant financial help from their parents;
- Those who received help to restore financial order; and
- Some who had benefited from an increased household income as well as financial help from their families.

The young people who had found themselves in trouble were not in arrears, but had become heavily committed through over-spending. Their situation had been improved when their parents repaid their credit commitments on their behalf. However, it seems that it was unusual for them to have learned any money management skills from this process, and for this reason they may well face future difficulties.

The participants who received help to restore financial order appear to have received active encouragement to improve their money management skills as well as significant financial help. This support came from a variety of sources including partners, and grown-up children.

While increased income undoubtedly eased the pressure of some participants' financial difficulties, this group also had, at some time, received financial assistance from their families. They had also negotiated lower payments with creditors, and were reducing their credit use and non-essential spending.

Finally, those participants whose **situations had stayed about the same** had been facing financial strain in 2005 but had not actually fallen into arrears. They included two very different types of people:

- Those with higher incomes who had a tendency to over-spend and use consumer credit heavily; and
- People who were living carefully on a low income and who had adjusted their expenditure (unlike their counterparts who had faced a worsening of their situation).

Those with a tendency to over-spend were in the same position in 2007 as they had been two years previously despite their circumstances making them ripe for improvement. Increased income and family support had not been sufficient to lift these households out of financial stress, and in some cases this was almost certainly because they had unrealistic ideas of how far their money would stretch.

Overdrafts and credit cards were used regularly by this group. Most had been given automatic credit limit increases on their credit cards. They appreciated this, seeing it as a sign that they had a good credit score. Some were stretched with mortgage repayments. Even where they had already remortgaged to consolidate credit payments they were still happy to consider remortgaging again to try and solve their current financial difficulties, and did not seem at all worried about the potential consequences of heavy mortgage borrowing.

The people who were <u>living carefully on a low income</u> were typically parents of school-age children. They were keeping their situation under control although they were unable to escape financial difficulties entirely.

This group were all savers by nature, and those who had built up substantial savings had been able to draw on them whilst living on a low income. They were also cautious food shoppers and only bought essential items of clothing. Furthermore, it was not unusual for them to comment that they knew not to 'want' things.

In contrast with their counterparts on a low income whose situation had worsened, these people were very credit averse. None of them was using an overdraft, and only one used a credit card – which was paid off virtually every month, and was never used up to its limit. They would always try to save for things they needed, such as a replacement washing machine or fridge, rather than using credit.

Conclusions

This research identified a number of triggers to falling into financial difficulties and key reasons for becoming trapped in such difficult circumstances. The main causes of the original problems appear to be reduced incomes; living long-term on a low income; and injudicious money management.

Those who had improved their financial situation had rarely done so alone. Family support and increased incomes had helped people to start the slow process of reducing their financial problems. In contrast, some of those with worsening situations had clearly spent their way into greater difficulty using credit to access a lifestyle that was otherwise beyond their means.

There are some important lessons to be learned from this research that will be of interest to those developing financial capability initiatives. The first is the value of excellent money management skills during times of financial stress. People need to know how to deal with an income shock or unexpected expense, and they need to realise the potential dangers of relying on credit. They also need information about which expenditure to prioritise when money is tight. Those who reacted to reduced incomes by budgeting and reining in spending were more likely to cope with their financial situation. The second lesson of particular interest is the variety of places that people go to seek information and guidance. Some were heavily influenced by adverts on TV and in the newspapers, whilst others turned to face-to-face help through organisations such as citizen's advice bureaux. Still others preferred to undertake their own research online. It would be good if initiatives such as Money Guidance could target those who are currently influenced by information that is designed to sell them a service rather than help them to improve their circumstances.

At the same time, this research highlights the importance of responsible lending and of the work undertaken by the FSA, the Banking Code Standards Board and the Finance and Leasing Association to raise the standard of lending decisions. The good news is that, on the whole, creditors are sympathetic when people make contact to discuss their financial difficulties and are willing to consider reduced payments. There is, however, a need for more of them to take a pro-active response to arrears management.

Notwithstanding these developments, there will be a strong demand over the foreseeable future for free-to-client debt advice services that are easily accessible. The Government has provided a substantial sum of money to increase the availability of debt advice, which it has committed to continuing until 2011. Help around financial management (over and above that provided through the debt advice process) could also play a major role in reducing future over-indebtedness among consumers. Plans for this type of help and support are included in the joint FSA/HM Treasury initiative to offer consumers money guidance, which aims to help people budget as well as provide guidance and information on other areas such as saving and retirement planning and understanding tax and welfare benefits.

1 Introduction

There is considerable concern about the levels of credit use in the UK, both secured and unsecured, and it has become a frequent topic of discussion in the media. Whilst it is acknowledged that the economy can benefit from the additional spending power, it is also apparent from recent events in the USA and here in the UK that certain lending practices, alongside excessive amounts of credit can create a risk to individuals, the financial services industry and the country as a whole.[2]

Together with awareness of the potential for problems caused by high levels of borrowing, there is also policy level recognition of the financial difficulty faced by some people who are socially or financially excluded, and those living in poverty. Whilst some people in such situations may be borrowing money to help them make ends meet, others face financial pressure from trying to meet their commitments with insufficient income. Such people are very likely to fall into arrears on household bill payments, or go without basic items such as food or outdoor clothes, in order to meet their commitments.

With these concerns in mind the Personal Finance Research Centre (PFRC) undertook secondary analysis of the Baseline Survey of Financial Capability in 2006 (Kempson and Atkinson, 2006). This showed that whilst most people were coping financially, many people were showing signs of financial stress and some were in difficulties. Three indicators of financial stress were considered:

1. The extent to which people struggled to pay their bills or commitments (including their mortgage)
2. The frequency with which people were overdrawn
3. Regular use of a credit card that was not paid off in full each month to pay for essential items, or to withdraw cash.

Cluster analysis indicated that people fell into one of five groups. The largest of these groups appeared to be 'financially sound' (58 per cent), the second largest group was 'managing reasonably well' (25 per cent) although they did face occasional difficulties. The three remaining groups were struggling financially, and two of these groups were showing signs of being over-borrowed. Group 3 was 'showing signs of financial stress' (nine per cent), group 4 was 'struggling on a low income' but not over-borrowed (six per cent) and group 5 were 'struggling and over-indebted' (two per cent).

The baseline survey recorded the financial situation of people in 2005. A great deal can be learned from revisiting the same people and interviewing them in depth to find out about their experiences, strategies and circumstances in the intervening years. That is the focus of this report.

---

[2] The economic climate was uncertain when this research took place in 2007, but has since worsened considerably.

1.1 Aims and objectives

The main aim of this research was to revisit those people who showed some sign of financial stress in 2005 to find out what had happened since the original survey was conducted, whether their financial status had changed and the reasons behind any changes that had occurred.

Within this, the study had a number of specific objectives:

- To describe the factors that had contributed to people's financial situation when they were interviewed in 2005.
- To identify the extent to which individuals' financial situation had improved or worsened in the two years since the summer of 2005.
- To explain why some people's situation had improved while others' had worsened or stayed the same.
- To identify the challenges, triggers and barriers that had impacted on behaviour and on changes in financial situations.
- To explore the relative importance of factors that were beyond the control of the individuals (e.g. income loss, mortgage interest rate rises) and those over which they might have been expected to be able to influence (e.g. further borrowing, cutting back expenditure).
- To identify whether and how external influences, such as access to advice, automatic credit increases or direct marketing, played a role in people's changed situations.

1.2 Study method

The research was based on depth interviews with 35 people who had participated in the 2005 Baseline Survey of Financial Capability (BSFC). Fieldwork was conducted in August and September 2007. Interviews took place in the participant's home, and typically lasted around one and a half hours. Participants were assured that their information would remain confidential. All interviews were recorded, and participants were given payments as a thank you for taking part.

Participants were happy to participate and comfortable talking about their financial affairs, having participated in the Baseline Survey of Financial Capability. Many had prepared notes or collected together their financial details in readiness for the interview even though no requests were made for them to do so. All participants who were clearly in financial difficulty were given the name and address of a local agency that offered money advice.

The 35 people interviewed in depth were identified through a process of screening. First, people who were originally classified as 'financially sound' were screened out as was anyone who had not agreed to be re-contacted. Telephone interviews were then conducted with a sample of approximately 200 people to establish any changes in their financial situation since the 2005 interview. The final sample of 35 people was then selected, based on their replies to the questions in the telephone survey. This was a purposive sample to include people with differing levels of financial difficulty as identified in the earlier re-analysis of the 2005 data – that is people ‘showing signs of financial stress; people ‘struggling on a low income’ but not over-borrowed, and people who were ‘struggling and over-indebted’. Within each of these three groups we selected roughly equal numbers of people whose situations appeared to have worsened; and those whose situations appeared to have either stayed the same or improved. A small number of people who, in 2005, were assessed to be ‘managing reasonably well’ were also interviewed[3].

The depth interviews were undertaken by experienced staff from Henley Centre Headlight Vision (HCHLV). They were guided by a short discussion guide plus a detailed topic guide[4]. The discussion guide gave interviewers an overview of the important aspects of the research, whilst the detailed topic guide included specific aspects that might need careful prompting or probing. These were created by PFRC in discussion with colleagues at the FSA and HCHLV. Interviewers were also fully briefed by PFRC staff and provided with a briefing guide to refer to before each interview.

All interviews were audio-recorded and verbatim transcriptions were prepared by HCHLV. These were augmented by the completion of a detailed calendar of events for each participant for the period 2005 -2007. These recorded events that might have been expected to influence levels of financial difficulty, such as the birth of a child, taking on a new loan, repaying credit cards or losing a job, and were designed to help us analyse the likely causes and effects of any changes.

1.2.1 Analysis

Key information from the interview transcripts was entered onto analytical grids in order to allow comparisons to be made across participants. The grids also included information from the 2005 baseline survey and the 2007 telephone screener. These were used to aid detailed analysis of the interview data, including grouping people with broadly similar experiences since 2005 and identifying factors that contributed to changes in their financial situations.

It should be stressed that the 35 people who were interviewed were not intended to be representative in any way. They were selected to be illustrative of different situations. As a consequence the analysis was not designed to assess the extent of change across the population as a whole, but merely to look at the changes that had affected individuals and the factors that had impacted on their financial situation.

1.3 Characteristics of those interviewed

Almost all of the people interviewed (31 out of 35) had been in financial difficulties in 2005, indeed in many cases their problems were long-standing even at that time. All of these were still showing signs of difficulty in 2007.

[3] The intention was that these should be people whose situations had worsened. In fact due to misspecification they also included some whose situations had remained unchanged.

[4] The discussion guide can be found in Appendix 1, and the full topic guide is available on request.

The people interviewed were aged between 21 and 61; most were working in 2007 or in receipt of out-of-work benefits, a few were either retired or full-time students. They had a diverse range of family circumstances; slightly more were single, separated or divorced than living with a partner. Almost half of the households included children under the age of 18 – seven of which were lone parent families. Only a handful lived entirely alone; indeed around half lived in a household with at least one other adult who was not their partner (including their parents, their own grown-up children and the partners of their children).

Whilst most of the people interviewed rented their home, 14 were paying mortgages. One of these was paying a mortgage on his ex-partner's house, two were paying mortgages on two different properties and a further two also had additional loans secured against the homes. Two participants had mortgages from sub-prime lenders.

In the report we have used pseudonyms to protect people's identity; we have also altered some of their personal details for the same reason.

1.4 Outline of the report

The next section of this report begins by recapping on people's situation in 2005 and the factors that had caused them to fall into difficulty, before summarising the changes that had occurred in the following two years.

This is followed by three further sections, looking in turn at people whose situations had improved, those where they had worsened and people who were still in much the same position as they had been two years previously. In each of these we identify sub-groups of people with broadly similar experiences, drawing out the key influences on their situation over the previous two years.

The report ends with a section that provides an overview of the key evidence relating to each of the objectives of the research, followed by a more detailed discussion of key themes that emerged from this study.

2 Circumstances in 2005 and beyond

By design, 31 of the 35 people interviewed in depth for this research had been showing some signs of financial difficulty in the summer of 2005. These included 16 people who had been struggling to meet their financial commitments but had not been in arrears. For the most part, their situation remained unchanged in 2007, although a few of them had seen their situation improve and a few had seen it worsen. The other 15 participants showing signs of financial difficulty had all fallen behind with payments – most with more than one creditor. Two years on, rather more of these had seen their situation worsen than had seen a change for the better, but in no case did it remain the same. The remaining four people who were interviewed were all people who had exhibited no signs of financial strain in 2005 and were still in that position two years later.

2.1 Situation in 2005

As noted above, most of the people we interviewed in 2007 were already showing signs of financial difficulty when they were first interviewed in 2005. Indeed, for some of them the problems were fairly long-standing even then. Three main reasons explained why people were in this situation: income shocks, living long-term on a low or fluctuating income and poor money management, including over-spending and over-commitment. Other research also indicates that these are amongst the main reasons for financial difficulty (see for example, Kempson 2002; Elliott, 2005).

The three main reasons were not, however, mutually exclusive. Poor money management was often a compounding factor both following a fall in income and also when people had lived on low incomes for long periods of time. Consequently, taking into account those whose difficulties were caused entirely through over-spending or over-commitment, poor money management was an important factor in the majority of cases. Careful money managers were in the minority.

2.1.1 Income shocks

The most common income shocks prior to 2005 had resulted from separation and divorce. As might be expected, given the economic climate at that time, job loss was relatively rare except through ill-health. New babies were also a contributory factor in some cases, especially when accompanied by a reduction in income.

Separation and divorce
All the participants that we interviewed who had been through a separation had previously lived in a household with children. When families with children separate the financial situation is particularly complicated. Some participants were responsible for children they no longer lived with, whilst others were bringing up children with no support from their ex-partner. One separated family also included step children, who

did not legally require financial support but who the step-father nevertheless felt financially responsible for.

Separation could reduce the financial pressure where one partner was more of a spender than the other, as in Joe's case.[5] But it led to serious financial difficulty for participants who did not have the means to support themselves and even those who managed their money carefully had fallen into arrears if they were living on social security benefits. It was made worse still when they did not adjust their pattern of spending and money management to reflect their new circumstances. Deon, for example, had been brought up in a family that was relatively well off. She had never really learnt how to manage money and when she separated from her husband she had no skills to fall back on. Her spending continued unabated and led to large balances on her overdraft and credit cards as well as arrears on her mortgage and loans.

It is very difficult to uncover the true cause of relationship breakdown and we did not attempt to do so in this study. However, it was apparent from the interviews that in some cases money management and financial stress had played a part. For example, it was certainly true that his wife's spending habits had fuelled arguments and bitterness in Joe's case and it was hard for him to talk about his own financial situation without discussing her behaviour as well.

The complex links between separation and financial difficulties just described are corroborated by a quantitative study of mortgage arrears, which showed that in half the cases arrears pre-dated the separation (and may, therefore, have contributed to it) in the other half they had occurred after the separation (and presumably resulted from it) (Ford et al, 2005).

Loss of earned income

Amongst the participants, ill health was a more common reason for loss of earned income than either redundancy or dismissal. Liz, for example, was in financial difficulty after she had to stop work due to ill health. Her wages had not been especially high, but her income fell from £275 a week to just over £88 when she started to claim Incapacity Benefit. Despite receiving Child Tax Credit for her three children and being a careful money manager she had built up arrears on her Council Tax and water bills. Tom and his wife had also been hit by health problems causing a very large reduction in their income. His wife had given up work permanently due to poor health, while Tom was unable to work for more than a year because of his own health problems. This left them with mortgage and consumer credit repayments that exceeded their income and even though they had always been very careful with money they had defaulted on a number of their commitments, including their mortgage.

In a small number of cases, the birth of a new baby had precipitated financial difficulties. Even when planned, a baby can put strain on the household budget. In Craig's case he and his wife did not adjust their spending during the period when she was not working. As a consequence they, too, had built up heavy credit commitments which eventually caused them to fall into arrears.

[5] All names have been changed to protect the identity of participants.

2.1.2 Low and fluctuating income

Many people manage to live on very low incomes and yet avoid falling into financial problems. But the longer they are poor the harder it can become to make ends meet. Grace, for example, had long-term health problems and was receiving Incapacity Benefit. She made every effort to live within her means, but occasional extended visits from her family who lived overseas, put one strain too many on her finances. Dyllis's careful budget had been disrupted by a pension over-payment which she had to repay.

A fluctuating income can also be difficult to manage. Good money managers in this position often put money aside during the better-paid periods to see them through. However, some of the participants of this research found themselves in difficulties when they continued the same level of spending after an income downturn, relying on consumer credit to make good the shortfall. Sandra, for example, was a childminder whose income was low and fluctuated a good deal because of her flexible charging policy; for example, she did not charge parents whilst they were on holiday with their children or if children were sick. Her situation was compounded by her reliance on credit cards and loans from doorstep lenders to make ends meet.

2.1.3 Over-spending and over-commitment

It is clear that poor money management often compounded other difficulties such as a drop in income or living long term on a low income. In a number of instances, though, it was the sole cause of difficulties.

This was certainly the case amongst a number of young, single participants who had greatly over-spent, using consumer credit to do so. As other recent research has noted, many young people feel strong pressures to consume and keep up with the celebrity culture and live beyond their means in order to do so (Finney et al, 2007). Among the participants we interviewed, this had resulted in large and mounting balances on student loans, overdrafts and credit cards.

Other, older, participants had continued over-spending after they had set up home with a partner and started a family – particularly if their partner was also inclined to spend. Lisa's husband earned £1,600 a month, on top of which they received Child Benefit for their two children. But their lifestyle meant that they regularly over-spent by frittering money away. Dinesh was another over-spender. He had been married in 2005 and both he and his partner spent freely, relying on their overdraft and credit card when their wages ran out. Indeed, they were constantly in overdraft, built up balances on their credit cards and owed money on loans and goods bought through mail order catalogues. With repayments to make on a £90,000 mortgage they were constantly struggling to keep up with their regular commitments.

2.2 Changes since 2005

The screening process that was used to recruit participants to this research was designed to ensure that we had an approximately equal mixture of people whose situation had improved, stayed the same or deteriorated. Information given in the depth interviews was then used to form a final view of whether people's overall financial situation had changed. Of the 31 people who had been facing financial difficulties of some kind in 2005, nine had experienced an improvement in their situation; 12 had seen it get worse and ten were in much the same position as two years previously.[6] In addition, there were four people who had been managing reasonably well in 2005 and were still doing so in 2007. These people are largely excluded from the remainder of the analysis.

Those whose **situations had worsened** were largely, but not exclusively, people who were already in arrears in 2005. They fell into three broad groups. First, there were people who lived on low incomes, were good money managers, but their financial difficulties had worsened because of financial strains that were put on their budgets by the need to support relatives. Secondly, there was a group of poor money managers with low incomes who had failed to adjust to a drop in income. The third broad group included people with about average incomes who were poor money managers, tended to over-spend and consequently made heavy use of credit. This had caused their situation to worsen.

Financial help from relatives was a common thread running through the interviews with people whose **situations had improved**. Indeed, in almost all cases, it is unlikely that they would have turned things round without it. In contrast, participants whose financial situations had worsened or stayed the same had received little in the way of family help. These included similar numbers of people who had been in arrears with commitments in 2005, and those who were struggling but managing to avoid ongoing arrears.

Finally, participants whose **situations had stayed about the same** had all been facing financial strain in 2005 but had not actually fallen into arrears at that time. They included two groups. One was made up of people who had a tendency to over-spend and made heavy use of consumer credit. The only obvious difference between them and participants on middle incomes whose situation had got worse was that they had slightly higher incomes. This suggests that it is, perhaps, only a matter of time before their finances take a downturn. The second group of participants whose situation had stayed the same were living on a low income, but had adjusted their expenditure in response to a drop in income (unlike their counterparts just described who had faced a worsening of their situation). The main difference between these respondents and those whose situation had worsened was their approach to spending and money management.

[6] These counts of participants in different circumstances are given only to provide factual information about the sample, it would not be appropriate to attempt to generalise from such information.

3 Worsening situations

The financial situation of some households had clearly deteriorated in the two years from 2005 to 2007. We identified 12 people in all who showed clear signs of a worsening situation, although some had fallen much further than others. All had been either struggling or in arrears in 2005; two of those who had been struggling were in arrears by 2007.

The original causes of the problems faced by these households were varied, but typically included a lack of money management skills. Other causes included low and/or changing incomes and relationship breakdown.

Given that poor money management appeared to be responsible for some of the original problems it is perhaps unsurprising that it also seemed to contribute to worsening situations in a number of cases. Most of the households that faced increasing difficulties showed signs that they did not manage their money well, and poor money management was an issue both for participants who also struggled to make ends meet on a low income, and those whose income need not have been a contributing factor.

Whilst a lack of money management skills did contribute to worsening situations, some participants with excellent skills still showed clear signs of deterioration in their financial situation. Two characteristics had combined to precipitate their worsening situation. They were all struggling on low incomes, which in itself made it difficult to improve their situation. However they also faced additional demands from their own families through a combination of supporting grown-up children, caring responsibilities and funding extended visits from family overseas. All had adult children at home. Such family responsibilities were in stark contrast to the (younger) households described in section five who had been supported by family members and had turned their situation around.

3.1 Low-income spenders

Living on a low income and being a poor money manager had resulted in deteriorating financial circumstances amongst some participants, all of whom were single.

Most had spent long periods of time living on state benefits. Those who were working at the time of interview were in low-paid jobs such as care work or supermarket shelf-stacking, with no long-term prospects for improvement. In contrast with the other poor money managers whose situation had got worse, none of them had savings that they could draw on.

CASE STUDY OF A LOW-INCOME SPENDER - SANDRA

Sandra is single and a childminder. She has a very low, fluctuating income, and no realistic prospect of improving it in the near future. She is paid weekly by cash or cheque and prefers to budget in cash, but she still finds it difficult to remember which bills she has paid. Sandra is often ill and her financial situation is creating a great deal of stress.

On one occasion when Sandra's income took a downturn she spent £200 on a credit card, but she now owes almost £400 and is not making any repayments. She also borrows money from three doorstep lenders. She refers to two of these lenders simply by the day of the week they collect their money. She knows that she pays them an additional £47 for every £100 they lend her, but she likes the flexibility of making reduced payments if she is struggling. She prioritises her telephone bill and her catalogue repayments, because she feels her phone is essential and the catalogue is run by her sister. Sandra is desperate for someone to solve her problems and has been very taken by adverts on television promising to clear her debts. On calling one, she was surprised to be told that she did not owe enough money to qualify for assistance.

3.1.1 Money management and decision making

These low-income spenders exhibited behaviour that, given their dire financial straits, suggested they were not taking full control of their situation. To put it more starkly, their financial difficulties, whilst originating from specific situations that may have been out of their control, were made worse by their own decisions. Examples of decisions that were making things worse include signing up to satellite television because the Freeview box did not pick up digital television, paying for individual prescriptions despite knowing that 'season tickets' represented a significant saving and admitting to spending money on non-essentials despite knowing that bills needed paying. This type of behaviour is typical of people who blur the distinction between 'needs' and 'wants'. It perhaps also indicates that inertia is preventing some people from improving their own situation.

In some cases, situations had deteriorated because of 'no-win' decisions. Participants had been forced to make choices, but the choice had no clearly positive option. Chloe discussed a good example of this when she left an unsatisfactory job. She could either risk losing her child's nursery place and possibly slow down her return to work, or keep the nursery place and continue to pay the fees herself (whilst working she had received help with the nursery fees through Working Tax Credit). She chose to keep the place but did not find work for two months. As a result she fell behind with bills and accumulated a large amount of credit which she subsequently found impossible to repay.

Despite choosing to continue paying for some optional services (including satellite television and broadband access), this group had cut back on day-to-day expenditure. Typically they had cut out socialising, and were spending as little as possible on food. None of them was saving.

When you're getting next to nothing, you can't save a penny. (Evan)

Their decision to cut back on basics suggests that they were aware of the need to be more financially responsible, but it seems that they were unwilling to make sufficient changes to their living standards to make a substantial difference.

3.1.2 Credit use and payment arrears

One of the characteristics shared by the low-income spenders was that they had a number of credit commitments. Given their poor financial skills, this put them at an increased risk of missing payments or borrowing more than they realised. As we would expect given their low income, their creditors typically included doorstep lenders and catalogue companies. However, small credit card balances and overdrafts were also discussed. There was a sense that, a few years ago, credit had been readily accessible to this group, even if they had not been working.

> *The bank offered me a grand credit card and I took it.* (Chloe talking about how she was offered a credit card with a £1,000 credit limit at the age of 18 as a lone parent living on Income Support)

John was unusual among the low-income spenders in that he had a mortgage; he also had a secured loan with a sub-prime lender. He was in an extremely precarious situation, as he had fallen behind with mortgage payments and had stopped paying anything to the loan company despite being taken to court.

All of these low-income spenders were in arrears with some, if not all, of their credit commitments and some were also behind with household bill payments. Some were not paying, whilst others were trying to repay what they owed in instalments. Despite the widespread problems, Chloe was the only person who discussed trying to talk to any of their creditors. She had called her catalogue company when she realised that she had overstretched herself, but they insisted on a repayment of £200 a month, which was more than she could afford.

These participants had been tempted to borrow money to ease their situation in the past. This included taking out credit cards to pay off their bills or protect their living standards and taking out loans to pay off credit cards. None of them had managed to clear the debt, and some had tried to borrow again in a vain attempt to improve their situation. At the time of the interview none of them was in a position to access more credit through mainstream lenders, and the mortgagor, John, was unable to remortgage (his preferred solution).

3.1.3 Help and advice

In contrast with those whose situation had improved, the low-income spenders had to take responsibility for their own circumstances because they were all single, and did not have people to turn to for help. It was uncommon for them to have received support from their family, but those who did were most likely to receive loans. Those who had borrowed from their parents commented that their family had financial difficulties of their own, and really needed the money themselves.

These participants were clear that they wanted *help* rather than advice to improve their situation, which for some seemed to reflect their inability to make changes autonomously. They were as likely to have turned to their bank for support as they were to go to an advice agency, and the services advertised on daytime TV had appealed to one. Not everyone had sought guidance, even if they had thought about doing so.

Some of these low-income spenders had reacted very negatively to advice that had included an element of helping them to understand their situation and take responsibility for themselves. Examples include a participant who felt that his local citizen's advice bureau had been unhelpful in the past, using overly-complicated 'legal' words and appearing disinterested. Interestingly, this participant commented that the bailiffs had been supportive, calling other companies on his behalf.

There were complaints that banks had been unsympathetic, in Sandra's case because they had told her that she *had* to have a bank account to manage her money. She was reluctant to use a bank account because she had previously been charged for holding a negative balance, and felt that this increased her difficulties.

However, Chloe had received advice from a free-to-client advice agency and had subsequently received an administration order[7]. She had been sent to the debt adviser by the local authority rent office after being unable to pay her rent on her council home. This had reduced the pressure on her from creditors and it seems likely that it may help her to improve her situation over the coming years.

3.2 Middle-income spenders

The second group of participants whose financial situation had deteriorated in the two years since 2005 ranged from those who described their own situation as 'desperate' to a household with sufficient savings that they could pay off the majority of their loans if they chose to do so. Nevertheless they all had several characteristics in common, not least a lack of financial capability.

All of them showed signs that poor money management had contributed to their original situation. Some had faced additional pressure through job loss, the birth of new babies or relationship change, and all had been responsible for children in 2005.

In contrast to the group of low-income spenders discussed in section 3.1, these participants had moderate incomes when they were interviewed in 2007. Some had stable jobs (such as teaching or administrative work) and were also entitled to

[7] An administration order can only be applied for if an individual is taken to court for non-payment of money owed. It is an agreement between an individual and a County Court, in which the Court helps the individual to make arrangements to pay manageable amounts to creditors (providing that the total owed is not more than £5,000). Whilst the order is in place, no creditor included in the order is allowed to take action against the debtor without the leave of the court. Debt collection procedures and letters are also stopped.

additional support through Tax Credits, whilst others received a range of benefits and Tax Credits. Some also received small contributions to the family budget from grown-up children living at home.

Whilst this group included participants from a range of household types, they tended to live with a partner and to have children. They included some large families.

CASE STUDY OF A MIDDLE-INCOME SPENDER - DINESH

Dinesh recently separated from a long-term partner. His separation and poor money management skills have caused his financial situation to deteriorate. When he was in a relationship he found it hard to refuse his partner's requests for money, and he has subsequently been left with outstanding credit commitments in his name for items that his ex-partner bought. He is now only making minimum payments on these.

Dinesh describes his own attitude to money as varying: sometimes 'a bit frivolous' but sometimes 'careful'. He has never had savings.

Dinesh is buying the home he shared with his partner. He has a mortgage of just under £100,000. He is fortunate that his mortgage is fixed for a few more years, and he has managed to meet his repayments. He works full time, and also has a second job in the evening, which provides a fluctuating income, whilst also maintaining his social life to a certain extent.

Dinesh has made several attempts to sort out his financial situation by borrowing more money. He previously remortgaged and he has also taken out loans to pay off his overdraft. He has since been refused an increase in his overdraft limit and has also been turned down for zero per cent credit card deals. He does not have any additional equity in his home and so cannot opt to remortgage again. He feels that he therefore has no option but to use his credit card to keep his overdraft down, whilst also using his current account to pay the minimum balance on his credit card, even though he knows this is unsustainable.

He is finding his situation stressful, but believes that things will improve, and he intends to try to increase his income to make things easier. He has followed some advice to reclaim bank charges and is also trying to reclaim the premiums paid for protection insurance that he does not think he needed.

3.2.1 Money management and decision making

Some of the middle-income spenders were actually keeping track of their finances – using telephone banking or the internet for example to check their balance – but they did not seem to translate this information into a budget or plan of action. Indeed, they showed signs that they simply watched their money situation rather than actively managing it. Examples include Helen, who appeared to rely on creditors to remind her to pay, and Robert, who set up different accounts to manage his money but did not find them helpful. Robert was also paying £6 each month to access his credit report from a credit reporting agency, behaviour that may appear sensible except that he was making the payment with a credit card that had a large outstanding balance.

There was a sense with middle-income spenders that even though they knew they were making poor decisions they were unable to get sufficient distance from their situation to see any alternative. So it was not uncommon for them to use their credit card to withdraw cash, and some even paid cash from their credit card into their current account so that they did not go over their overdraft limit.

This group seemed unwilling to give up certain ‘wants’, such as satellite or cable TV subscriptions in order to make inroads into their debts.

> *I think if I got rid of the [satellite TV] I'd be very miserable so I think there’s no point in that.* (Rachel)

However, their treats were often more expensive than those enjoyed by lower-income households and included meals out and weekends away. Conversely, they were far less likely to have talked about cutting back on day-to-day items such as food. Rather some mentioned cutting back on certain bill payments to meet other expenditure or to pay off arrears elsewhere (often described as ‘robbing Peter to pay Paul’). Given their general expenditure on ‘wants’, it is unsurprising that those who had received lump-sums or windfalls (including a Tax Credit repayment) had spent the money on non-essential items rather than using it to pay off debts.

Several of these middle-income participants were actively saving despite the fact that they had credit card balances or even outstanding arrears to repay. The decision to save could indicate a desire to plan for the future, although it may equally illustrate a failure to grasp the reality of their situation. Robert provides a good example of someone who wanted to protect his family from future difficulties despite being in serious problems at the time of the interview. He had recently bought life insurance despite being in arrears on his rent and Council Tax as well as owing money to a doorstep lender and his mobile phone company.

3.2.2 Credit use and payment arrears

As with the low-income spenders in section 3.1, each of these middle income households had several credit commitments to manage. Credit use varied, reflecting characteristics such as the type of income that each household was living on. All of them had credit card balances (ranging from £750 to £4,000), and only Lisa was avoiding using her overdraft. It was unusual for them to have borrowed money from doorstep lenders or bought items from catalogues and hire purchase companies.

It was not unusual, though, for people to talk about a long history of credit use, and some mentioned previous attempts to consolidate credit card and loan payments. Dinesh had consolidated by remortgaging and was still in difficulty; he now faced the difficult decision of selling his home and paying a large redemption penalty or trying to meet his repayments (see case study above).

Several middle-income spenders had made attempts to impose controls on their own credit use. Some had cut up their credit cards, whilst others had insisted that their bank reduce their credit limit on a credit card or overdraft. This implies that they have little faith in their own ability to resist the temptation of spending on credit.

They included participants whose situation was now so bad that they were in arrears on various credit commitments or household bills and others who were not falling behind but were only just managing to keep their heads above water. All of those in arrears were behind with rent (one owed £12,000 and had been threatened with eviction), and several owed money to credit card or store card companies too. Nobody was behind with mortgage payments.

None of these participants had spoken to their creditors to try to negotiate reduced payments or alternative terms. Sandra had been called by her credit card company to query her weekly reduced payments and she had explained why her payments had changed, but she did not feel that they had taken on board her comments.

It was common for these participants to comment on their poor credit scores. After being sufficiently good risks that they had accessed credit, they found themselves unable to switch credit cards or borrow more money because of their current situation. Helen had also had her current account frozen, which she felt made money management much more difficult.

3.2.3 Help and advice

Perhaps reflecting their slightly higher incomes and the fact that most were partnered, these middle-income spenders were more likely to have friends and family that could offer financial help than the lower-income households discussed above. However, financial support from family came in the form of loans, and it was unusual for these participants to feel able to wait until their situation had improved before beginning to repay the money.

These participants seemed to believe they had the skills, and could acquire the knowledge, to help themselves. Unlike those on low incomes, they were unlikely to have sought out someone to solve their problems for them. Rather, some had looked at self-help websites such as moneysavingexpert.com and uSwitch.com. There was some indication that the participants were cautious of acting on the information they could access: Dinesh commented that he was wary of making any of the changes he had read about in case they made his credit score worse, whilst Robert noted that he preferred online information to newspaper advice because he was wary of the adverts that he saw in newspapers for ‘solutions’ such as property buy back schemes.

Several participants had used a citizen’s advice bureau and commented about the length of time they waited to be seen, which they found unacceptably long. They had typically given up and sought alternative help.

> *I've tried phoning, the Citizens Advice Bureau you go down, you've got to get there like at 8.00 am before they open at 9.00 am, otherwise you can't get in. I tried in the past doing it, and never.. to no avail at all.* (Helen)

Dinesh recognised that this was because of a lack of funding, and had found alternative support through work.

> *But they just, Citizens Advice are great, it’s just for the fact that they’re so under resourced that it’s just, it becomes sometimes a bit too much of a pain to go and do that.* (Dinesh)

Robert was also concerned that he had spoken to someone who did not seem to know what they were doing – which may of course be a way of expressing frustration that they could not solve his problems.

As noted above, these participants were happy to keep track of their finances without being good money managers. It is entirely possible that, similarly, their willingness to seek relevant information may be the extent of their actions to solve their problems. If their knowledge is not translated into behavioural change then it cannot be expected to have a positive impact. Indeed, they appeared reluctant to change their behaviour and were of the opinion that their problems stemmed from a lack of money.

3.3 Financial demands from family

In contrast with the two groups described above whose worsening situation was partly caused by their lack of money management skill, a third group of participants faced worsening financial situations despite exhibiting very good money management skills. Their original difficulties all related to income – either persistent low income or income shocks. It appears that their situations continued to deteriorate due to a combination of low household income and financial demands from family; none was in work, and whilst the participants were typically well- qualified or trained they were not actively job seeking. All had grown-up children at home. Some of these participants were also legally responsible for the financial affairs of another member of their family.

Several participants in this group (not just those in difficulties) spoke of the additional burden of adult children living at home, particularly given that child-related benefits stopped and lone parent households lost their single-adult Council Tax discount once their children left full-time education. The low income households discussed in this section found it particularly difficult to cope with this additional burden. Despite this, not all parents asked their teenagers to help with household bills even when they started work.

Extended families also put a strain on some household incomes, particularly when family members lived abroad. Relatives staying with the participant for weeks at a time, family weddings and remittance payments to family abroad all caused problems for these low income households. Some participants also had caring responsibilities which almost certainly impacted on their ability to gain an earned income.

CASE STUDY OF SOMEONE WITH FINANCIAL DEMANDS FROM FAMILY - DYLLIS

Dyllis is a homemaker, who lives with her husband and her grown-up daughter in a council flat. Her daughter has a long term limiting illness and is therefore financially dependent. Her husband took early retirement through ill-health and they are living on his small pension. They received a small lump sum from her husband’s retirement but this is earmarked for a replacement car in three years time and is therefore tied up in a long-term bond so that they are not tempted to spend it.

The additional demands of supporting her daughter make it more difficult for Dyllis to manage on a low income, despite her careful money management.

Dyllis uses direct debits to make sure her regular commitments are met and then budgets in cash for food. She scrimps to make ends meet, and has recently switched energy suppliers to save £20 a month. She can usually live within her means, but when a pension overpayment was reclaimed over a short period of time the household was left unable to manage. Dyllis chose to cut down on the amount that she spent at Christmas but still missed some payments on household bills.

Dyllis does not use credit cards, as she is scared that she wouldn't be able to repay the money. She is also scared of doorstep lenders because of stories of violent extortion tactics, although she does keep a credit line open with one doorstep lender who she considers to be from a reputable company and life-line. As someone without family support, Dyllis is very careful to keep her credit rating up so that she can access funds and try to stay on an even keel.

3.3.1 Money management and decision making

This group of participants were controlled spenders who found it hard to allow themselves anything that was not strictly necessary. Money should be 'used wisely and not wasted' according to Grace. Indeed Grace typified this group by commenting that she wished she could be impulsive; it simply wasn't in their nature. Those who had received windfalls (such as demutualisation shares or redundancy payments) had saved them for a rainy day rather than spending the money on a whim, and this attitude to savings had, in some cases, helped prevent a faster deterioration of their circumstances.

Because they budgeted carefully and controlled their spending wherever possible, these participants really noticed the shortfalls they faced when their children were home from school and needed feeding during the day, or food prices increased.

> *You can't afford to do two good meals, it's just an impossible probability, it just doesn't stretch, it doesn't stretch.* (Susan, talking about coping without free school meals in school holidays)
>
> *The[price of] food has gone up but our money hasn't gone* up to catch up with *the way the food has gone up*. (Dyllis)

These careful money managers had strategies for making sure they could afford a few special occasions each their year without breaking their budget. These included buying saving stamps for Christmas food, buying presents in the January sales, and saving special offer tokens from a national newspaper to enable them to buy a low-cost holiday.

Given their careful planning, it is unsurprising that this group of participants were nervous of decisions that might cost them money and expenditure that they couldn't predict in advance. For example, Grace found it hard to cash her windfall shares because of the fluctuating price whilst Susan commented that she did not dare to use her electric fire because she was sure it would cost too much.

Pay-as-you-view (a TV with a coin meter attached that could be adjusted to collect payments for a range of goods) was liked amongst these people as it met their need to be in control. Indeed Dyllis kept a record of all the money that she had put into the meter, and so knew exactly what she was paying.

> *It was the answer to my prayers at the time, because we couldn't afford a new TV, couldn't go out, say go to Curry's and say, look, here's £500.* (Dyllis)

Similarly, pay-as-you-go home telephones and mobiles were being used to manage expenditure.

Several strategies were discussed for getting the most out of a current account, but Susan faced difficulties because her bank would not allow her a debit card. When her local cash point was out of operation, or out of cash, she was sometimes left with no means of payment. Grace explained how she worked hard to manage her account in a way that would not alert the bank to the fact that she was not working, because she felt that they would withdraw her overdraft limit. As a lone parent with nobody to turn to for support, she felt that her overdraft was her safety net in a financial emergency.

3.3.2 Credit use and payment arrears

This group of participants generally had fewer credit commitments than others whose situation had deteriorated, except in Susan's case where much of the outstanding credit had been taken out before her partner left. Susan commented that her borrowing was against her better instinct. She was a cash budgeter and hadn't increased her borrowing significantly since separating (although she had used a gift card scheme from a doorstep lender, which she liked).

Credit cards were seen as something to be treated with varying degrees of caution. Some thought it was acceptable to use a card during the zero per cent period and then switch when this ended whilst others believed that if you could not afford to repay the full amount then they should not be used at all.

As a long-term benefit recipient, Grace, the only mortgagor in this group, received support with her mortgage interest payments. She had a variable interest, repayment mortgage. If she could not afford the repayment she contacted the company to let them know that her payment would be a little late; she had not fallen into arrears.

Despite their careful money management these participants were close to the edge, although rainy day savings were keeping some above water. Whilst they tended not have credit commitments, some were finding it difficult to pay household bills.

Susan's circumstances were made worse by her outstanding credit. She had already negotiated reduced payments on her unsecured credit commitments but was still finding it difficult to meet the lenders demands, and they were trying to get her to pay more.

> *I phoned them up and said, "Look my money's gone down…I'm prepared to pay you £5 a month". And to begin with yeah they were fine, they were*

> *absolutely fine with it, but now they're saying that it's not enough, they need £10 a month.* (Susan)

Bailiffs had been in contact with her about her Council Tax payments and she was also paying an overdue water bill through debt collectors.

3.3.3 Help and advice

These participants were not big advice seekers. They felt competent to make decisions, and they knew what they were doing.

> *At the end of the day I can advise myself on what to do, so it's not like I don't know what I'm doing.* (Susan)

However, they did discuss the difference between help and advice, reflecting the attitude of the low-income spenders in section 3.1. It was felt that places like citizen's advice bureaux would offer advice, but not be able to provide help. Some people suggested that adverts offered 'help' but only to people with mortgages, or that mortgage companies could help to lower repayments, but only for earners. They consequently felt outside the help available, and obliged to carry on as they were.

4 Improving situations

Of the 31 participants who had shown signs of financial stress in 2005, nine seemed to be in somewhat better financial shape in 2007. These people divided about evenly into those who were struggling to manage in 2005, and those who were in arrears with household bills and/or consumer credit commitments. The improvements in their financial situations were relatively small-scale: only one or two of them could be said to be managing reasonably well in 2007. The rest were typically struggling to manage; some had either repaid their arrears or were in the process of doing so, but at least one person still had outstanding arrears.

The financial difficulties faced by these participants largely stemmed from over-spending financed by unsecured credit use, often but not always compounded by poor money management. In some cases, things were brought to a head by a loss of income such as a drop in earnings, which even for careful money managers could make existing commitments unmanageable.

A number of factors contributed to the improvement in people's financial situations since 2005. **Family support** was the most common factor – all but one of the participants in this group had received support from their family, in the form of financial and/or practical help. **Debt resolution** played a part in the case of a few participants, who sought to bring their over-borrowing under control either by negotiating lower repayments with their creditors, taking out a debt consolidation loan, or remortgaging. As we go on to discuss in section 6.4, for some people strategies such as debt consolidation, remortgaging or transferring credit card balances were part of the problem rather than an effective solution. Other factors in evidence among this group were **increased household income** and **better money management**.

It is possible to identify three groups of people, based on the predominant factors that explain the improvement in their financial circumstances. The first group comprises young people whose situations had improved as a result of significant financial help from their parents. The second group also received family support, but of a different nature – rather than a simple financial bail-out, a family member or partner intervened to bring their finances back under control. The third group were in better financial shape mainly because they had experienced an increase in household income, along with some financial help from their families. Whether or not these improvements could be sustained in the longer term is likely to depend on two things – spending behaviour and money management. These groups are described in detail in the following sections.

4.1 Financial help from parents

This group comprised young people in their early 20s who were living on fairly low incomes, either as students or in low-paid work. At the time of the interview in 2007, they were either living at home with their parents or had recently set up home with a partner.

In 2005 they were struggling to manage, although none of them was in arrears. The root of their financial difficulties was over-spending, financed mainly by credit cards, overdrafts and student loans. In each case, financial help from their parents had led to an improvement in their finances by 2007.

For Layla and Anthony, this help involved their parents repaying unsecured credit commitments on their behalf. On the advice of her bank, Layla had taken out a £5,000 debt consolidation loan in 2005 to repay her overdraft and credit card balances. She had continued, however, to use her overdraft and credit cards. She was bailed out financially towards the end of 2005 by her parents, who paid off her consolidation loan and her overdraft. Similarly, having previously paid off a loan for him, Anthony's parents had recently paid his mounting credit card bill.

Jasmin, a full-time student, had received 'loans' from her parents totalling £1,500. Some of this money had been used to repay her overdraft; Jasmin did not trust herself to have credit cards. She had struggled to manage living independently, and her financial situation improved considerably when she moved back home during 2006, to live rent-free and bill-free.

Despite their experiences, Jasmin and Anthony seemed to have learned little in the way of money management since 2005. In particular, neither of them appeared to have curtailed their spending. Jasmin was not using any credit (although she still had an overdraft facility), but had more disposable income because of her greatly reduced living costs. Anthony was £600 overdrawn.

Influenced by her parents and husband, Layla felt that she now had more control over her finances. She had made an effort to cut back on spending and intended to start saving. She was still using her credit card but paying it off in full each month.

4.2 Help to restore financial order

Like the young people described above, the participants in this group had seen their financial situation improve somewhat since 2005 because of help and support from a family member or partner. This extended beyond financial help, however, to actively encourage better money management.

In 2005, both Deon and Barbara were in arrears. Previously a two-earner family, Deon's financial situation had deteriorated when she separated from her husband. It was made worse by heavy borrowing and poor money management. The turning point for Deon came in early 2006, when her husband moved back into the family home. While his earnings provided a welcome boost to the household finances, more important was his influence in bringing Deon's spending under control. He paid off the outstanding rent and Council Tax arrears, and took responsibility for paying these and other household bills. In 2007, Deon sought advice about her unsecured credit commitments and subsequently took out a debt consolidation loan to repay her overdraft, credit cards and personal loans. She had found it difficult, however, to meet the repayments and successfully arranged to reduce the monthly amount she had to pay. Even so, she was concerned about being able to manage when she went on extended maternity leave in the near future.

Like Deon, Barbara was a poor money manager. However, she was not a credit user. Her financial difficulties dated back some years to when she had to stop work because of ill-health. Single and reliant on social security benefits, by 2005 she was in arrears with her household bills. Barbara's financial situation improved significantly when her adult daughter came to live with her during 2006. Once she discovered the financial muddle that Barbara was in, her daughter quickly took steps to sort things out. She made arrangements to repay Barbara's utility and Council Tax arrears, and took control of the household budget. Barbara paid her daughter a fixed amount every week to cover rent and food; her daughter paid most of the other household bills herself, out of her part-time wages.

4.3 Increase in income

An increase in earned income had helped to improve the financial situations of several participants since 2005. For two of them (Jane and Tom), their financial difficulties dated back to past income fluctuations that had resulted in arrears. Rashid's inability to manage was rooted in over-spending.

While increased income undoubtedly eased the pressure of their financial difficulties, it was combined with a range of other factors. All of them, for example, had at some time received financial assistance from their families, to help smooth income fluctuations or to pay bills for them when money was tight.

In addition, Jane and Tom had managed to negotiate lower repayments with their creditors, Tom following the advice given to him by a citizen's advice bureau, Jane on her own initiative. Even so, Tom still found things a struggle. He had made one or two late payments, and in one instance this had led to the account being passed to a debt collector.

Like the group described in section 4.2, there was evidence of changes to credit use and money management. Although Jane continued to use home credit, Tom and Rashid had stopped using credit and were paying down their outstanding balances. Jane and Tom talked about being better money managers, which for Jane meant paying bills on time and for Tom and his wife meant sticking to a budget. Rashid had made a deliberate effort to cut back significantly on non-essential spending.

Another participant had seen his situation improve but seemed to fall outside these three groups. Craig had been struggling to manage in 2005, as a consequence of continued spending and borrowing following a drop in income some years before. Like others discussed above, Craig had taken out a debt consolidation loan since the interview in 2005 to repay his unsecured credit commitments, and remortgaged in 2006 for the same reason. He and his wife were no longer using unsecured credit, and had reined in their spending. In contrast to all the other participants whose situations had improved, Craig did not mention any family support or assistance.

5 Situations that stayed the same

Four of the participants interviewed were managing reasonably well in 2005, and their situation had not changed substantially in 2007. As this paper focuses on financial difficulty, we will not discuss them further.

We have identified two other types of participant who had managed to keep their situation stable since 2005: those with a tendency to overspend and those who managed their money well, and careful money managers with low incomes.

It should be noted that virtually none of those who had kept their situation stable had been in arrears in 2005. Rather, they had been struggling, and were continuing to do so. Their original situation had been caused by a range of situations, separation and job loss through ill-health among them.

Those with poor money management skills were in difficulty in the first place because of their lack of careful management compounded with negative events, and only kept their heads above water through making major changes in their life or receiving help from family. The careful money managers had adjusted well to low incomes, but in contrast to their counterparts who were in a worse situation by 2007 they did not have heavy financial commitments, and indeed they often had support from family.

In addition to these two broad groups, there were two people, Kendon and Paul, whose situations were stable but less common. Paul was difficult to categorise because he had learning difficulties and required some help from others; he subsequently found it difficult to discuss his personal situation in detail. He lived with his parents and they helped him to manage his money; nevertheless he was occasionally using a credit card to withdraw cash and he had a large, unsecured loan with repayments taking more than a third of his monthly income.

Kendon appeared to have the same level of financial stress in 2007 as he had two years previously, but was in a period of flux with his health, employment, relationship and housing. These things combined made it difficult to draw firm conclusions about his overall situation.

5.1 A tendency to over-spend

These poor money managers with a tendency to over-spend, whose situation had remained the same since 2005, included younger adults through to those in their mid-fifties. All lived in households that had a good overall income and at least one earner (in Pauline’s case, her grown-up children shared their income with the household, whilst she cared for her husband who was disabled).

It is quite clear from hearing their stories that some of the poor money managers were in the same position in 2007 as they had been two years previously despite their circumstances making them ripe for improvement. Increased income and family support had not been sufficient to lift these households out of financial stress, and in some cases this was almost certainly because they had unrealistic ideas of how far their money would stretch.

CASE STUDY OF A TENDENCY TO OVER-SPEND - CHERYL

Cheryl works part-time as a teaching assistant. She has been a lone parent for the last two and a half years and has two children. Her household income includes Tax Credits, Child Benefit and child support payments.

Cheryl's bank increased her overdraft facility at her request when she told them of her financial difficulties after separating. She subsequently paid her overdraft off when she received a large Tax Credit payment. However, she is now in overdraft at the end of each month until she gets paid.

Prior to her separation, she and her partner had financial difficulties. They had been long-term users of a bill-payment company. Cheryl has also remortgaged with a sub-prime lender to pay off her credit card balance and free up some money to decorate the house. She has since built up a new balance on her credit card with a near-prime company, currently owing around £3,000. This balance includes expenditure on essentials such as food, petrol and other items including Christmas presents and a holiday. She has no other loans.

Cheryl hopes to be in a position to move to a high street mortgage lender when she gets out of her fixed rate period, but she is tied in with an early redemption penalty for another year.

Cheryl sees herself as being cautious with money. She talks about making money last, but in reality she is using credit to keep up her living standard, and she does not appear to be taking full control of her situation. In addition to her back payment of Tax Credits she has also received a sizeable windfall, much of which she spent on an expensive holiday.

She sought help from National Debtline[8], but did not take their advice to stop using the bill-payment service, although she did phone her bank and credit card company on their suggestion. She feels that her situation is slightly better than it was two years ago because she has a higher income, but she recognised during the interview that her borrowing has also increased in that time.

[8] National Debtline is a national telephone helpline for people with debt problems in England, Wales and Scotland. They offer a free, confidential, independent service.

5.1.1 Money management and decision making

This group tried to manage their money in various ways, but did not succeed in controlling their expenditure or making effective decisions. Cheryl's reliance on a bill-payment company to pay all household bills is a good example of this dichotomy. Such services take a single monthly payment and then pay all creditors, but they charge for this service, and the amount collected can vary month by month, so it does not actually make it easier to plan ahead. Like the middle-income spenders described in section 3.2.1, this group also tended to watch their money (using spreadsheets or online statements) without really managing it.

Some of these participants were heavy spenders, and even those that were cautious from day-to-day liked extravagant treats such as holidays in the United States or New Zealand, funded through additional borrowing or windfall payments. Others found it hard to agree on household strategies for coping. Pauline liked to see that her bills were paid before spending anything else, but her husband preferred to delay some payments to free-up money for other things. However, neither of them were successful in managing their money and found it hard to cope with different payments cycles (weekly, fortnightly and monthly).

None of this group had money saved at the time of the interview in 2007. They either claimed to have nothing left at the end of the month to save, or reported that they saved for a specific reason such as holiday spending money but not for a 'rainy day'.

5.1.2 Credit use and payment arrears

Most of these participants made use of an overdraft facility, although Pauline had been refused access to one. She had, however, been charged for slipping into a negative balance, something she found illogical. Credit cards were used by all, and only Emma commented that she made full use of zero per cent deals – in fact credit cards offered by sub-prime lenders were appealing to others. This group had been using their credit cards to withdraw cash and make ends meet, and purchase things they could not afford from their ordinary budget, such as gifts. Those with mortgages had also paid off some credit card balances by remortgaging, only to build up new balances again and face the possibility of needing to consolidate once more.

Only Pauline had had to ask for a credit limit above the one offered, the others in this group had been given automatic credit limit increases on their credit cards.

> *They [a bank] just keep upping your credit rating and then they give me more and more, more and more money*. (Joe)

They appreciated this, and typically recognised it as a sign that their credit score was good.

Whilst these participants were all credit card users, their other borrowing varied widely both in terms of the number of commitments and the type of lender. This largely reflected the areas they lived in, their housing tenure and their access to mainstream credit. So whilst Pauline used a range of doorstep lenders to access credit (and was particularly pleased that she could make the same weekly repayments whatever she borrowed) Joe had much larger loans from banks and a credit union. Others had no other borrowing apart from their mortgage.

Some of these poor money managers were stretched with mortgage repayments (in one case owing over five times her income on a deal apparently recommended by an Independent Financial Adviser (IFA)), but even where they had already remortgaged to consolidate credit payments they were still happy to consider remortgaging again to try to solve their current financial difficulties. They did not seem at all worried about the potential consequences of being heavily mortgaged. A long mortgage holiday had also allowed Emma to fund a holiday – something she fully planned to do again.

5.1.3 Help and advice

These poor money managers had a range of experience of seeking help and advice – from the service provided by an IFA or broker when remortgaging, to advice from National Debtline or advice from parents. They had not made significant changes to their behaviour as a result of debt advice, and the advice had not always been well received. Pauline was appalled to be told to prioritise some payments and Cheryl did not want to give up her reliance on the bill-payment company, despite being told it was in her interest to do so.

Emma had used moneysavingexpert.com’s template to reclaim bank charges. She had also taken her parents’ suggestion on board to consider how much disposable income she had every week so that she would never be short for long (although as she was a risk taker this small movement towards controlling her expenditure did little to improve her overall behaviour).

5.2 Careful money managers with low incomes

CASE STUDY OF A CAREFUL MONEY MANAGER WITH LOW INCOME - TARIQ

Tariq lives with his wife and three children. He had been self employed before stopping work, but has now been unemployed for three years. His wife does not work. He is keen to get back into work and enjoy the financial security that he remembers. He speaks highly of his local Job Centre but is in despair about the types of jobs available.

He believes that the amount that he receives in benefits is the amount that it is necessary to live on, and manages accordingly. He aims to save £20 a week. He keeps tight control of his expenditure, and spends much of his time comparing prices in different shops to make sure he gets the cheapest food.

Tariq visits family in Pakistan every 18 months. This puts a major strain on their budget. They borrowed money from family for the most recent trip. He is also finding it increasingly difficult to give the children the things that they want, and it is unclear whether he will be able to sustain his stable financial situation as they get older.

The careful money managers with low incomes were all aged between 30 and 50, and living on benefits. They were typically parents with school-age children. Eamonn (who was single) and Tessa also lived with one of their own parents.

5.2.1 Money management and decision making

This group of low-income, careful money managers were keeping their situation under control although they were unable to escape financial difficulties entirely. However, they did seem to find some sense of satisfaction from managing their money carefully.

All were resigned to their income level and did not complain about the level of their benefits even when mistakes were made that left them very short. Tessa even supported her daughter who was studying at university (but living at home) and was too credit averse to use her student loan.

This group were all savers by nature, and those who had built up substantial savings had been able to draw on them whilst living on a low income. They would try to save for things they needed, such as a replacement washing machine or fridge, rather than using credit. Tariq talked about his savings in the same way that Dyllis (whose situation was deteriorating) talked of her loan from a doorstep lender – something for emergencies when you did not have close family to turn to.

Spending habits amongst these participants were very restrained. It was clear that they were generally cautious food shoppers and only bought essential items of clothing. Furthermore, it was not unusual for them to comment that they knew not to ‘want’ things.

> *“Want” doesn’t come into it any more.* (Tessa)

> *I don’t seem like I need things if I don’t need it.* (Liz)

Whilst these good money managers knew how to be careful, they could remember a time when they did not have to watch what they spent.

> *We used to have very, very happy lifestyle then. And very, very nice lifestyle, but now it’s just limited resources*. (Tariq)

Liz admitted that she used to spend without thinking, and did not stop spending immediately when her circumstances changed. However, her turn around was fairly dramatic. She cut her food bill back by £40 a week, and said that she is now ‘quite tight’, recognising that the best advice is ‘don’t live above your means’.

Use of current accounts varied. Liz, for example, had been turned down for an account some time ago and had never tried again to access one, so budgeted entirely in cash. At the other extreme Tariq had three accounts, which he actively used to manage his money.

5.2.2 Credit use and payment arrears

In contrast with their counterparts on a low income whose situation had worsened, these people were very credit averse. Nobody was using an overdraft, and only one used a credit card – which was paid off virtually every month, and was never used up to its limit. The only loans they had were from family, and there was no urgency to repay these. Tessa commented that the only credit she used was to pay her car insurance in instalments, and even that bothered her.

Tariq also had a mortgage but, like Grace above, he had not worked for a long time and his interest payments were paid by the Department for Work and Pensions (DWP) so this was not a major concern for him.

5.2.3 Help and advice

Some of this group of careful money managers had sought help with their income and benefits but none had looked for advice about their financial position more generally. Tariq commented that there was nothing more he could cut back on and would turn to an agency such as a citizen's advice bureau if things got worse, because they were confidential. He also read the financial section of his tabloid newspaper. Others had used a citizen's advice bureau in the past for other reasons and found them helpful, but did not like the long queues that they had faced.

> *'It is helpful, but it's very time consuming, you can go for a whole day, and you just have to wait your turn to be seen, so it's not, it's not practical'* (Tessa)

6 Summary and conclusions

The participants interviewed for this research had almost all been in financial difficulty in 2005. Their difficulties pre-dated the 2005 interview and most of the people who had difficulties in 2005 still had them in 2007, indicating longstanding problems. Any improvements that had taken place were not dramatic and were more than offset by situations that seemed at best fragile and at worst deteriorating fast. This suggests that, for some people, it is much more difficult to get out of financial difficulty than it was to fall into it in the first place.

6.1 Overview of key findings

The analysis has identified a number of key triggers to falling into financial difficulties. These downward pointing 'snakes' (as in the title of the report) included: drops in income; living long-term on a low income; family demands that put a strain on the household budget; over-spending and heavy borrowing, and injudicious money management. It is interesting to note that the increases in mortgage interest rates had not played a major role in participant's financial difficulties. This is supported by previous research modelling the likely impact (Atkinson and Kempson, 2006) and also by statistics compiled by the Council of Mortgage Lenders. However, many of the participants with high mortgages relative to their income had fixed rates, some of which will have since ended, whilst others were fixed for the next four or even five years.

There was a clear tipping point at which the fragile situations of participants had worsened. This was when they took a decision to cancel direct debits and/or to juggle payment commitments. From that point it was usually only a matter of time before arrears began to mount or credit balances to spiral.

Likewise, the research identified some important 'ladders' that helped participants get out of difficulty. Two stand out as being most important: help from relatives and an increase in income. Changes in patterns of money management, spending and credit use were also evident although it is doubtful that any of these changes alone would have been sufficient to cause a significant improvement in most cases.

The findings of this research raise the important question: were people architects of their own fate or did their financial situation depend on factors that were beyond their control?

Among the participants whose situations were worsening, some had clearly spent their way into greater difficulty using credit to access a lifestyle that was otherwise beyond their means. Equally, others had been victims of bad luck– suffering a drop in income or some other financial shock. But, in many instances, participants' financial problems had originally been caused by a financial shock, which was then compounded either by poor money management or by credit commitments they had taken out in better times. In other words, in a large number of cases participants had been architects of their own fate.

Among the participants with improving situations, outside influences were paramount; as we note above financial help from relatives and higher incomes were the chief influences on their improved circumstances, often in combination. A rise in income alone was not sufficient to bring about an improvement unless accompanied by an attempt to curb spending. Instances where participants were turning their finances around without outside help were rare and fragile.

At the same time, it was clear that careful money management could be the key to stabilising financial difficulties, especially following a drop in income.

Three main themes ran throughout the interviews: various aspects of financial capability; the influence of family; and debt consolidation. We discuss each of these in more detail below.

6.2 Financial capability

Financial capability is a key theme throughout this report. The FSA Baseline Survey of Financial Capability identified five main capabilities, four of which are of particular importance to this study; namely making ends meet, keeping track (including, but not limited to, budgeting and decision making), planning ahead and choosing products (particularly in relation to credit products, and debt consolidation). We discuss the first three of these below, and discuss the extent to which participants used and benefited from debt consolidation in section 6.4.

6.2.1 Making ends meet and keeping track

We know from the Baseline Survey of Financial Capability (Atkinson et al, 2006) that making ends meet and keeping track of finances did not pose particular problems across the population as a whole; only for a small minority. Many of the people interviewed for this study were clearly part of that minority. As we note above, injudicious money management coupled with a tendency to spend and borrow was often enough to cause participants to get into difficulties. In others, it compounded the effects of income shocks and living on a low income.

Various aspects of money management have been shown by this research to be problematic and should be included in initiatives intended to raise levels of financial capability. The first of these is dealing with income shocks. Participants who had experienced an income shock or unexpected expense and did not adjust their expenditure to take account of their new circumstances soon found themselves in financial difficulties. At a time when they needed to draw up careful budgets and control their expenditure accordingly, they relied instead on accessing additional credit or simply spending until they ran out of money. Others opted to miss payments on household bills or credit commitments; once they started to juggle in this way they found themselves tipped into ongoing arrears.

It was not all bad news, however. Some participants reacted quickly to their financial situation, and others were trying hard to improve their ways. Some had cut back on their day-to-day spending, and smaller numbers drew on savings or insurances and negotiated with creditors to try to ensure that they made ends meet.

The second area that needs addressing is the ability to recognise where financial priorities lie. There were instances where participants who were in arrears had received a windfall but had spent it on non-essentials and others where they had retained savings despite being chased by their creditors. There was a tendency among some of the people interviewed to compartmentalise their money and not see it as a common pot. This put them under unnecessary pressure as they tried to make ends meet on only a proportion of their total resources.

The third area is linked to the above and relates to curbing spending and learning to live within ones means. There was a clear indication, also evident in other research (Finney et al, 2007), that there are young people and others on middle incomes who struggle to distinguish needs from wants. They are prey to the consumer and celebrity culture and borrow freely to keep ahead of the Joneses.

It is interesting to note the triggers to participants changing their ways. For the most part this involved the intervention of relatives. In some cases relatives physically prevented the use of credit cards, and encouraged budgeting and saving. In others they tried to curb spending and showed those in difficulty how to budget.

Some poor money managers among the participants attempted to turn their finances around themselves after getting into serious difficulties. Some cut up credit cards in an attempt to resist the temptation of using more credit. Others had started to throw away direct mail that may tempt them to borrow unnecessarily. Still others had started to keep records of their spending. It was not, however, clear that this was enough to help them improve their situations (most also received help from family too) nor had most of them changed their behaviour sufficiently to be sure that they would avoid further difficulties in the future.

6.2.2 Planning ahead

Those participants who had managed to save in the past had undoubtedly been cushioned from the worst financial difficulties by their savings. However, few participants were focused on the future, they were not rainy day savers and the extent of planning ahead was consequently very limited. Most participants had spent, rather than saved, any additional income they had received such as bonuses or windfalls. They had not made provision to cover unexpected expenses, even though these are relatively common occurrences. Participants were more likely to comment that they would rely on credit cards or access to a loan than to draw on their own savings to deal with unexpected events. Saving for Christmas, or other specific events such as a wedding, were the only real exceptions to this apathy in relation to planning ahead.

6.2.3 Raising levels of financial capability

The FSA's financial capability strategy and the introduction of Money Guidance could do much to improve attitudes towards money management and planning ahead in the future. It is reassuring that the financial capability strategy targets some of the types of people that we have found to be facing difficulties and who are ill-equipped to manage, including students, new parents and the working poor.

However, targeting the other types of people interviewed for this research will require a number of approaches. Whilst some participants appeared most likely to respond to approaches at the door (evidenced by them borrowing from doorstep lenders or signing up to pay-as-you-view services) others noticed information in the forms of advertisements on television, some received advice from their bank and yet others actively sought out information online or through services such as a citizen's advice bureau. They included people in a range of circumstances, but most noticeably those with family commitments and those in poor health. This, combined with the levels of stress and depression caused by financial difficulties, suggests that healthcare professionals may offer useful inroads to reaching more of these people.

6.3 Impact of families

Like financial capability, the impact of family also runs throughout the report, with three main ways in which family members influenced outcomes for participants in financial difficulty. Two of these were positive influences – helping out financially; taking steps to improve money management – while the third –imposing financial strain – was negative.

6.3.1 Financial help from family

Relatives helped participants who were in financial difficulty in a number of ways. This included repaying credit commitments, paying off arrears and subsidising day-to-day living expenses. The form this assistance took varied. In some cases there was a clear, if sometimes implicit, understanding that the money did not need to be repaid; in others it was in the form of a repayable loan. Assistance with day-to-day living expenses was usually in kind – free accommodation or buying items that were needed – although some participants had received assistance with paying bills when they were due. On the whole, help of this kind was most effective in assisting participants out of arrears when it was not repayable and, above all, when it was accompanied by assistance with managing money (see below).

Young single participants, aged under 30, were most likely to be helped in this way; it was much less common among older participants with family responsibilities of their own. It was also less common when participants were struggling but avoiding arrears than it was when they were actually in arrears. This may well be because relatives only find out about the problems when they have become serious. Finally, some participants were denied help of this kind because either they had no relatives in a position financially to help, or their closest relatives lived overseas.

6.3.2 Family influences on money management

In some cases, relatives had intervened more directly in an attempt to prevent further difficulties in the future. At the extremes, this involved taking responsibility for money management on behalf of a participant – as had happened when Barbara's daughter came to live with her and when Deon's husband returned after a period of separation. In other instances, relatives had taken charge of credit cards so that they could only be used in an emergency.

As we have noted above, family members also intervened to teach basic money management skills, including assigning priorities for spending. This seemed to be relatively effective in encouraging a change for the better and could usefully be built into the financial capability strategy.

6.3.3 Family as a source of financial strain

Whilst some families had provided support, other families were a source of added financial strain for participants. As we have seen, there was a group of participants, whose situations had worsened in the two years since 2005, who were careful money managers but the combination of low-income and financial demands of family had caused them to get into financial difficulties. Financial support to relatives had also contributed to the difficulties faced by other participants.

There were two circumstances where such strain occurred. The first was the unavoidable situation of needing to support a relative with mental health problems or learning disabilities and help them with managing their money. Indeed, an indication of this assistance could be seen from the other perspective in the case of Paul, who had learning disabilities and whose family played a key role in advising him about his financial situation.

The second set of circumstances was, potentially, avoidable. This included: supporting children through higher education rather than letting them take a student loan; providing free board and lodging to adult children in work; remitting money to relatives overseas; having relatives to stay for extended periods without asking for a contribution to the household budget, and lending money to adult children in difficulties. All of these were problematic for participants living on low incomes. Potentially they were avoidable, but participants were either too proud to refuse and explain why or they were too generous given their circumstances.

6.4 Rescheduled borrowing

Rescheduled borrowing was relatively commonplace among the people interviewed and took three main forms: remortgaging to pay off unsecured credit commitments; debt consolidation loans (many of which are secured on homes) and taking advantage of zero per cent balance transfer offers on credit cards.

In some instances, rescheduling had contributed to the improvement in participants' finances – in particular when it was accompanied by help from family and, above all, by a reduction in spending and further borrowing.

There were, however, more instances where it offered short-term respite, at best. One participant, for example, had only made two payments on a debt consolidation loan before she had to ask for the payments to be reduced. The real problems arose when participants had rescheduled borrowing but not curtailed their spending and credit use. This included participants who built up new overdraft and credit card balances after having paid them off by remortgaging or taking out a debt consolidation loan and those who had continued to use their old credit cards after transferring the balances to new cards with zero per cent offers for balance transfers.

Despite the financial difficulties they were in, very few participants found it difficult to borrow, although a number of them had done so from sub-prime lenders who were willing to lend in circumstances where most creditors would consider it ill-advised.[9]

In March 2007, the Banking Code Standards Board (BCSB) conducted a review of lending practices among banks and credit card companies and found that '*In some cases affordability [of consolidation loans] was doubtful at the time the loan was agreed'* (Banking Code Standards Board 2007a). It is worth noting that a number of key organisations, including the BCSB and the Financial Ombudsman Service, as well as consumer bodies, have called for a strengthening of the Banking Code requirements on responsible lending which would require banks and credit card companies to undertake a full credit assessment before either making decisions to agree new lending or extending the credit limits on existing commitments. The provisions in the Finance and Leasing Association (FLA) Lending Code are more stringent in this area. The BCSB went further and proposed that a full credit assessment should also be made, and credit limits reviewed or cancelled, when a customer switches the whole of their balance to another provider.

Likewise compliance monitoring of mortgage advice by the FSA found that half of small mortgage networks and advisers *'... did not gather sufficient customer information before making a recommendation. Firms were poor when it came to assessing affordability'* (FSA 2007a). Similar concerns were expressed following mystery shopping of larger firms, especially those in the sub-prime sector (FSA 2007b).

As it seemed common for participants to reschedule without taking steps to curtail future spending or credit use, this is clearly a point at which financial education interventions are required.

6.5 Other influences

There were two other important influential factors in the ongoing financial circumstances of the people interviewed for this research: negotiation with creditors and advice and information. We summarise both of these in this section. One factor

[9] This research was undertaken before the 2007 'credit crunch'.

was less influential than we had anticipated; mortgage holding, as we discuss in the final paragraphs of this section.

6.5.1 Negotiation with creditors

A sizeable minority of participants had successfully negotiated reduced payments with their creditors, which had helped them to get their finances on an even keel even if they were still adding to their arrears. Only one person had made an unsuccessful attempt to negotiate with a creditor, but in this case her offer was far from realistic and involved offering to return the goods she had bought from a mail order catalogue. This is a marked and welcome improvement from the situation ten to fifteen years ago when successful negotiations were much rarer (Kempson and Berthoud, 1992; Ford et al, 1995) and shows how the Banking Code and the FLA Lending Code have had a major impact. Indeed a recent review of how banks and credit card companies treat customers in financial difficulties showed that, generally they did so sympathetically and positively (Banking Code Standards Board 2007b).

It is perhaps notable that more participants had not attempted to negotiate reduced payments. As other research shows, many people are reluctant to contact their creditors either because they cannot afford to pay off their arrears or because they are content to ‘lie low’ and hope the problem will go away (Lea et al, 2007). This demonstrates the importance of creditors taking a pro-active approach to managing arrears and contacting customers in the early stages when a solution is still feasible (Dominy and Kempson, 2003).

Some of the participants had received unexpected help when they had contacted their creditors. One person was referred by their local authority rent office to the debt advice service next door; another was offered a debt consolidation loan by her bank for her overdraft and credit cards to help her start to reduce the balances and a third was given advice by his bank which led him to start saving.

6.5.2 Advice and information

Where advice had been sought from a not-for-profit money advice service, such as a citizen’s advice bureau or National Debtline, this had been helpful – in one case leading to an administration order that had marked a turning point to getting her finances back under control. But as found in other studies it was clear that participants did not contact a debt advice agency until their situation was already serious, making the task of the adviser much more difficult (see for example, Lea et al, 2007). Moreover, it was clear that many participants did not contact a debt adviser because they were ill-informed or had misperceptions about the assistance that could be offered – wanting help not advice. Finally, past experience of queuing at a citizen’s advice bureau or other advice agency or waiting to see a debt adviser had deterred others. Lack of funding has meant that the need for debt advice has far outstripped supply. The large injection of Government funding for face-to-face advice from the Financial Inclusion Fund is, however, making a big difference with waiting time reducing dramatically, sometimes from many months to an average of one to two weeks. In some projects waiting lists have been closed altogether and users now have instant access to debt advice (Financial Inclusion Taskforce, 2007).

Some of the participants who were better off were reluctant to seek outside advice and instead had consulted information on websites to try and sort things out for themselves. Indeed, a surprising number had used the moneysavingexpert.com web-site to claim back bank charges and others had consulted price comparison websites such as uSwitch looking for better credit deals. In both cases, extensive publicity had clearly raised awareness. Neither, however, is likely to offer a long-term solution to the breadth of problems people faced.

6.5.3 Mortgage holding

Three of the participants whose situation had deteriorated had a mortgage. There was no strong indication that increased interest rates or large mortgage loans were responsible for deteriorating circumstances, and just one was in arrears, after missing payments when becoming unemployed.

Tariq was a careful money manager on a low income, whose financial situation was unchanged since 2005. He had a mortgage but his interest payments were covered by Income Support Mortgage Interest payments (ISMI) from the Department for Work and Pensions. So, despite being on a variable rate, the interest rate changes had not had a serious impact on him. He did comment however, that he had previously used some savings to reduce his mortgage, and he was frustrated that he now could not access that money.

Three of the poor money managers whose situation stayed the same had mortgages, and none of them was in arrears. However, these mortgages had the potential to cause difficulties, for a variety of reasons. One participant held a relatively expensive mortgage with a sub-prime lender. Another had a mortgage on the family home, but since separating he had been renting elsewhere so increasing his financial burden. The third case was the most problematic. Emma was repaying two mortgages, one of which was releasing equity from her parent’s property (this mortgage was in her parents’ names). She told us that she had been advised by an IFA, which suggests she was given very risky advice indeed – since the only way she had been able to borrow enough for her own property was to ask a friend to add her income into the multiple.

Mortgage holding was not common amongst the participants whose situation was improving. Just two were repaying a mortgage, and both were repaying arrears. Tom was in the most precarious situation, he had a sub-prime mortgage with repayments that had increased from £600 to £1,045 a month because of the combined impact of having to repay £800 arrears and an increase in interest rates. He also had a secured loan which he had mistakenly thought was for 10 years, but which he later discovered was for a 20 year period, and he was unsure how this would affect his ability to move to a prime mortgage lender in the future.

Those who were managing reasonably well in 2005 and whose situation had not deteriorated (and who we have therefore not discussed in detail in previous sections) had mortgages. All had endowment policies that were no longer expected to repay their mortgage, but they each had plans in place to meet the shortfall. Janet was one such participant. She and her husband had a mortgage on their holiday home as well as their family house and their total mortgage borrowing was over £150,000 on a fixed rate until 2011. They were not facing financial difficulty and their equity makes it unlikely that the endowment shortfall will cause problems. Those on variable rates had been able to absorb the changes in interest rates without difficulty.

6.6 In conclusion

People get into financial difficulties for a variety of reasons, some of them entirely beyond their control. In many instances, however, poor financial management is a key factor. When people reach the point where they cancel direct debits and/or start to 'rob Peter to pay Paul' mounting arrears are almost inevitable. Once in arrears it is very hard to turn the situation around and often requires outside intervention. Even then, it can be a number of years before all arrears are cleared.

It is therefore important that preventative work is undertaken with the types of people at greatest risk and with their families. In addition to the initiatives under the FSA's National Strategy for Financial Capability, this will require a co-ordinated information strategy, involving the mass media, targeting the minority of people who are heavy spenders and credit users. Other research has shown that negative messages will not have the desired effect (Finney et al, 2007). It should stress the advantages of 'making money work for you', raising awareness around the risks and consequences of over-indebtedness, as well as educating people about the advantages and disadvantages of debt consolidation. The FSA would have a key co-ordinating role to play in this.

At the same time, this research highlights the importance of responsible lending and of the work undertaken by the FSA, BCSB and FLA to raise the standard of lending decisions. The good news is that, on the whole, creditors are sympathetic when people make contact to discuss their financial difficulties and are willing to consider reduced payments. There is, however, a need for more of them to take a pro-active response to arrears management.

Notwithstanding these developments, there will be a strong demand over the foreseeable future for free-to-client debt advice services that are easily accessible. The Government has provided a substantial sum of money to increase the availability of debt advice, which it has committed to continuing until 2011. Help around financial management (over and above that provided through the debt advice process) could also play a major role in reducing future over-indebtedness among consumers. Plans for this type of help and support are included in the joint FSA/HM Treasury initiative to offer consumers money guidance, which aims to help people budget as well as provide guidance and information on other areas such as saving and retirement planning and understanding tax and welfare benefits.

References

Atkinson, A., McKay, S., Kempson, E. and Collard, S. (2006). *Levels of financial capability in the UK: Results of a baseline survey* London: Financial Services Authority.

Banking Code Standards Board (2007a) *BCSB announces findings of credit assessment.* *http://www.bankingcode.org.uk/wpdocs/Credit%20assessment%20review%20280307.doc*

Banking Code Standards Board (2007b) *Themed review of the way subscribers treat customers who are in financial difficulties.* http://www.bankingcode.org.uk/wpdocs/Financial_difficulties_-_Final_doc_for_web.doc

Berthoud, R. and Kempson, E. (1992) *Credit and debt: The PSI report.* London: Policy Studies Institute.

Dominy, N. and Kempson, E (2003) *Can't pay or won't pay: a review of creditor and debtor approaches to the non-payment of bills.* London: Lord Chancellor's Department.

Elliott, A. (2005) *Not waving but drowning: over-indebtedness by mis-judgment.* London: Centre for the Study of Financial Innocvation.

Financial Inclusion Taskforce (2007) A*nnual update to HM Treasury: Government's financial inclusion strategy: progress to date, recommendations for the future.* London: HM Treasury.

Financial Services Authority (2007a) *Good and poor practice: small mortgage networks and advisers.* http://www.fsa.gov.uk/pages/Doing/small_firms/mortgage/practice/advice/practice/index.shtml

Financial Services Authority (2007b) *Good and poor practices guides: banks and building societies.* http://www.fsa.gov.uk/pages/About/What/thematic/advice/banks/practice/index.shtml

Finney, A., Collard, C, and Kempson, E (2007) *Easy come, easy go: borrowing over the life cycle.* Edinburgh: Standard Life.

Ford, L., Kempson, E., and Wilson, M. (1995) *Mortgage arrears and possessions: Perspectives from borrowers, lenders and the courts*. London: Department of the Environment.

Kempson, E. (2002) Over-*indebtedness in Britain*. London: Department of Trade and Industry.

Kempson, E. and Atkinson, A. (2006) *Over-stretched: people at risk of financial difficulites*. Bristol: University of Bristol.

Lea, S., Mewse, A. and Wrapson, W.(2007) *Study into debtor behaviour in support of Pre-action Notice (PAN) pilot: final report.* London: Her Majesty's Court Service.

Appendix 1 Discussion guide and topic guide

Project 'Money Matters' – DISCUSSION GUIDE

Please read moderator notes and full discussion guide before commencing interview

Introduction and welcome

- Thanks for agreeing to be re-interviewed
- We are here on behalf of the Financial Services Authority to have a look at how people's circumstances have changed since the 2005 'Managing your money' survey, in which you participated
- Interview recording
- Reassurance regarding anonymity and confidentiality – looking at general themes and patterns in behaviour, not any one person's specific financial situation

MOD: Explain that we are interested in finding out about their financial situations and in particular things that have happened since they were last interviewed in 2005. As it is often difficult to remember things that actually happened, we have brought along a time line which we can try to build up over the course of the interview. I.e. plotting what happened when

Personal Circumstances

- Can you give us a brief outline of your personal situation?
- Who lives in the household?
- Has there been any change in household structure since 2005?

General Financial Circumstances

- What words would they use to describe their attitude to money?
    - Why? Have they always been like that? Or has it changed over time?
        - More of a saver or a spender? Impulsive purchaser? Organised / budgeter? Live for today?

Household income (changes in income, outgoings and unexpected expenditure)

- In what ways since 2005:-
    - Has your total household income increased / decreased?
    - Everyday / regular outgoings changed since June 2005
    - Your household been affected by financial windfalls or unexpected payments
- For each:-
    - When did it happen? (Plot on timeline)
    - How significant was the effect on their household income? How much did it increase / decrease by?
    - How did it affect their ability to make ends meet?

Borrowing

- Does anyone in the household currently have credit cards, overdrafts, loans or other borrowing?
- For each:-
    - What are they used for?
    - Does it get repaid in full each month? Why? Why not?
    - If they only pay the minimum generally, do they ever pay more than the minimum? Why? What prompts this decision?
- Have they got / changed / extended / paid off mortgage since last interview?
- Have they taken out any other loans that use the house as security?
    - What was the effect on household finances?
    - How do they feel about the decision?

Saving

- Has their level of savings changed since 2005? In what way? Why?

Financial difficultly

- Has the household had any periods of financial difficulty since June 2005? (e.g. difficulty paying household bills or credit agreements)
    - Are they currently facing any difficulties of this kind?
- Looking back, is there anything they could have done differently to try and avoid financial difficulties?
- Do they foresee any likely changes to their household's financial stability over the next 6 months?

Information and advice

- Have they received any information about money matters that was particularly relevant to them since June 2005
- Has anyone in the household sought financial advice?
    - Who did they seek this advice from? Why chosen?
    - What did they seek advice about?
    - What help, if any, were they given?
        - PROBE: agreed a payment plan, IVA, bankruptcy,
    - Did they act on the advice?
    - Were they happy with the advice and outcome

Thanks and close

Appendix 2 Telephone sift

The Baseline Survey of Financial Capability was undertaken in 2005 by BMRB. BMRB hold the contact details of those people who agreed to being re-contacted about future research.

Our target for this research was to interview 35 people who did not appear to be financially sound, using the criteria listed in the Introduction to this report. In total 1,883 such individuals agreed to being re-contacted. We were also keen to make sure that the sample included some people whose situation had improved or stayed the same and some whose situation had got worse, although we recognised that it would be difficult for those who were struggling the most to be in worse situations.

The data held by BMRB included valid telephone numbers for 61 per cent of those people who had agreed to being re-contacted.

In total 284 individuals were telephoned and asked if they would answer a brief survey. At the end of the survey 272 agreed to a follow-up interview.

On completion of the telephone survey, we identified people whose situation had deteriorated in two ways, as outlined below:

1. If, in 2007, they were showing indications that their situation was problematic (such as being constantly overdrawn) that they had not shown in 2005.
2. If their answer to Q5 below suggested that their situation was worse in 2007 than it had been in 2005.

Interviews were subsequently booked with 35 individuals in various financial situations.

Telephone sift: questionnaire

Introduction: You may remember taking part in **the 'UK money survey'** back in 2005. At the end of that survey you indicated that you would be happy for us to re-contact you. We are now re-contacting some of the people who were interviewed to find out how their financial circumstances have changed over the last 2 years.

Would you mind answering a few questions over the phone? **I can reassure you that your answers will remain confidential.**

IF ASKED: This will only take about 5 minutes
IF ASKED: The Financial Services Authority promotes public understanding of financial matters and protects consumers when buying financial products (for example current accounts, savings accounts and home insurance). By agreeing to take part in this survey, you will help us to understand how people manage their money now and how we can better help them to do so in future

IF NO – ask whether they would be willing to answer a single question and filter to Q4 if they agree
----

Q1 Can I check, do you (or your partner if you have one) use a current account to manage your money day-to-day?

1. Yes
2. No
3. [Refused]

Q1_i [IF YES at Q1] **Is there an agreed overdraft on this account?**

1. Yes
2. No
3. [Don't know]
4. [Refused]

Q1_ii [IF YES at Q1] **And is this account overdrawn at present (whether or not there is an agreed overdraft)?**

1. Yes
2. No
3. [Don't know]
5. [Refused]

Q1_iii [IF YES at Q1] So overall, **Which of these statements would you say best describes how often you (or your partner if you have one) are overdrawn on this account?**
READ OUT
(Please choose the option that *best* describes your circumstances)
A. I am constantly overdrawn
B. I am usually overdrawn by the time I get paid/receive my income
C. I am sometimes overdrawn by the time I get paid/receive my income
D. I am hardly ever overdrawn
E. I am never overdrawn
F. Too hard to say/varies too much to say
[Refused]
[Don't know]

Q2 And can I just check: are you (or your partner) currently repaying a mortgage on your home?

1. Yes
2. No
3. [Refused]

Q2_i [IF YES at Q2] **And, in the last 2 years** (that is since June 2005), **have you increased the amount you borrowed on this mortgage or borrowed additional money against your home?**

1. Yes
2. No
3. [Refused]

Q2_ii [IF YES at Q2_i] **Which of the following, if any, was the extra borrowing actually used for?**
READ OUT (Code all that apply)
A. To pay for home improvements
B. To pay bills
C. To re-finance other borrowing or pay off other debts
D. To make ends meet
E. To finance your own business
[Refused]
[Don't know]
[None of these]

Q3 Do you (or your partner if you have one) have any credit cards with balances that you don't repay in full each month?

1. Yes
2. No
3. [Refused]

Q3_i [IF YES at Q3] **And thinking about credit cards that you do not pay off in full each month, in the last 2 years** (that is since June 2005)**, have (either of) you used these cards to….?**
READ OUT (Code all that apply)
A. pay regular bills
B. withdraw cash
C. pay for food or everyday spending (that is to make ends meet)
D. refinance other borrowing
E. pay off other debts
[Refused]
[Don't know]
[None of these]

Q3_ii [IF YES at any A>E at Q3_i] **And still thinking about the list I just read out (question Q3_i above), how often have you used your credit card(s) in any of those ways. Would it be….?**

1. Almost every month
2. Every other month on average (that would be about 6 times a year)
3. or less frequently than that?
4. [don't know]
5. [Refused]

Q4 So, summing things up, which of the following best describes how your household is managing financially at present
(Please choose the option that best describes your circumstances)
READ OUT
A. I am/we are keeping up with all of our bills and credit commitments without any difficulties
B. I am/we are keeping up with all of our bills and credit commitments , but struggle to do so from time to time
C. I am/we are keeping up with all of our bills and credit commitments, but it is a constant struggle
D. I am/we are falling behind with some of our bills or credit commitments
[Refused]

Q5 Which of the following phrases best describes your financial position at the moment compared with how it was 2 years ago (that is when we last interviewed you) (If necessary add in: by financial position I mean how well you are keeping up with bills and credit commitments)
READ OUT
A. I/we had no financial difficulties 2 years ago and still have none
B. I/we had no financial difficulties 2 years ago, but I am/we are experiencing them now
C. I/we were in financial difficulty 2 years ago, but I/we have none now
D. I/we were in financial difficulty 2 years ago, and things are much the same now
E. I/we were in financial difficulty 2 years ago, and things are even worse now
[Refused]
[Don't know]

Thanks. That's all the questions I need to ask you today!

However, our sister company the Henley Centre may be interested in contacting you again on behalf of the Financial Services Authority. This would be to ask you to take part in some more research we are conducting on behalf of the FSA. Anyone who agrees to take part in the research will be given £50 as a thank you for taking part. Would it be OK for them to contact you?
IF ASKED: Saying yes doesn't commit you to taking part. You are just agreeing to being recontacted by the company

1. Yes
2. No

RECONFIRM CONTACT DETAILS:

- Name
- Address
- Telephone number