Directorate General Health and Consumers

THE OVER-INDEBTEDNESS OF EUROPEAN HOUSEHOLDS: UPDATED MAPPING OF THE SITUATION, NATURE AND CAUSES, EFFECTS AND INITIATIVES FOR ALLEVIATING ITS IMPACT

Summary document for stakeholder workshop

CIVIC
CONSULTING

Title	The over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact
Conducted for	Directorate General Health and Consumers (DG SANCO)
Prepared by	Civic Consulting of the Consumer Policy Evaluation Consortium (CPEC)
Document finalised on	17.01.2013
	This document does not reflect the views of the European Commission. Any interpretations or opinions expressed in this report are those of the authors alone.

Civic Consulting
Potsdamer Strasse 150, D-10783 Berlin

www.civic-consulting.de

PRELIMINARY KEY FINDINGS OF THE INTERIM REPORT

This document presents preliminary findings of the study on the over-indebtedness of European households, commissioned by the Directorate General for Health and Consumers of the European Commission. Stakeholders are welcome to submit comments at latest by 6th February 2013 to francesco.gaetano@ec.europa.eu.

The study aims at providing a systematic and comparable snapshot of the situation of households' over-indebtedness in all EU Member States. It analyses the causes and nature of over-indebtedness and its effects on citizens' daily lives and financial institutions, as well as its wider socio-economic consequences. Finally, it covers the measures in place across the European Union to alleviate the effects of over-indebtedness and the organisations that are active in this field.[1]

1.1 DEFINITION OF OVER-INDEBTEDNESS

It is clear from stakeholder interviews that the situation with regard to a common definition of over-indebtedness is little improved since 2008 - when a study conducted for the European Commission[2] and considered by the TOR to be a key reference for the present study showed that none of the 27 EU Member States had a single official way of defining and measuring households' over-indebtedness and many had no definition at all.

Despite the lack of clarity, the report was able to identify some common elements in the definitions used across countries. These were:

- Focus on household level finances;
- All contracted financial commitments covered, including mortgage and consumer credit commitments, utility and telephone bills as well as rent payments and other recurring contracted expenses;
- An inability to meet recurring expenses (payment incapacity);
- A persistent inability to meet recurring expenses (structural problems);

[1] The study is conducted by Civic Consulting of the Consumer Policy Evaluation Consortium, in cooperation with the University of Bristol's Personal Finance Research Centre. This summary document presents preliminary findings and is based on the analysis of 234 stakeholder interviews in all Member States (covering financial industry, civil society organisations, public authorities, and independent experts), a total of 120 face-to-face interviews with over-indebted households in six countries (France, Hungary, Germany, Slovenia, Spain, and the UK), desk research and analysis of available statistical data, an analysis of specific aspects in selected Member States through country experts, and an EU27 survey of organisations active in addressing instances of over-indebtedness, debt counselling and guidance services.

[2] European Commission, *Towards a common operational European definition of over-indebtedness*, European Commission: Directorate-General for Employment, Social Affairs and Equal Opportunities, 2008.

- Inability to meet recurring expenses without reducing the living expense below the national minimum standard (standard of living);
- Inability to remedy the situation by recourse to assets (illiquidity).

These common elements were not distilled into a definition in 2008, therefore one was composed for the purposes of this study:

> *Households are considered over-indebted if they are having – on an on-going basis – difficulties meeting (or are falling behind with) their commitments, whether these relate to servicing secured or unsecured borrowing or to payment of rent, utility or other household bills. This may be indicated by, for example, credit arrears, credit defaults, utility/rent arrears or the use of administrative procedures such as consumer insolvency proceedings.*

This definition was provided to interviewees in advance as a reference for the discussion about their own specific definitions. Keeping these definitional issues in mind, the term 'over-indebtedness' is understood broadly in this study, and is used interchangeably with the term 'financial difficulties', or referred to as households 'having on-going difficulties with meeting their financial commitments'.

1.2 LEVEL OF OVER-INDEBTEDNESS

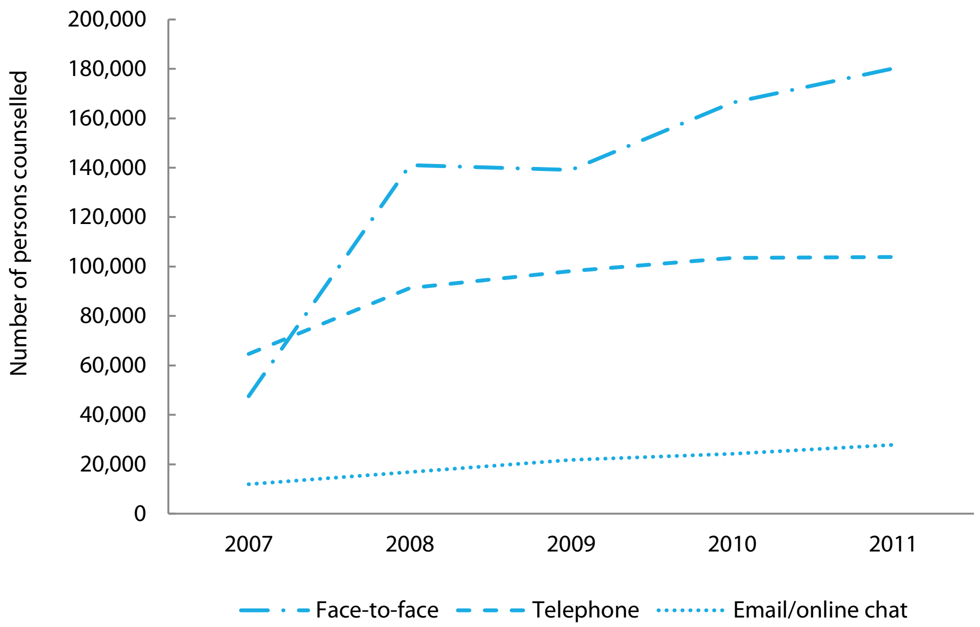
Key findings of the study concerning the levels of households' over-indebtedness are:

1. EU-SILC survey data shows that, in 2011 and across the EU area as a whole, one in almost nine households (11.4%) were in arrears with payments on rent/mortgage, utility bills and/or hire-purchase/loan agreements. These averages conceal a wide variation in the levels and nature of the financial difficulties being faced by households in individual countries.
2. At one extreme, in 2011 more than three in ten households in Bulgaria, Greece and Romania were in arrears. A further four countries had overall arrears levels that were at least one and a half times the EU average: Cyprus, Latvia, Hungary and Slovenia. At the other extreme, in three countries 6% or fewer households were in arrears, namely Germany, the Netherlands, and Luxembourg.
3. The share of households in arrears on utility bills in the EU (at 8.8%) was the highest among the overall arrears on key commitments. The highest levels of arrears on utility bills, however, tend to be in the EU12 (the countries that acceded to the EU in 2004 and 2007).
4. Data on debt-write offs by creditors is only available to a limited extent and not readily comparable, therefore it is presented for only some countries in this study in regards mortgage default rates. The total value for arrears for this period was increasing for several countries; in Ireland, for example, the ratio of existing arrears to total outstanding residential loans nearly doubled from 2009-2010.

5. Regarding households' ability to make ends meet with its combined total income, respondents to the EU-SILC agree that this is only with difficulty or great difficulty in Bulgaria, Greece, Latvia, and Hungary, all with levels approaching or exceeding 60%. At the lower end of the scale are Finland, Sweden, Luxembourg, Denmark, and Germany, all with figures of less than 10%, again in concordance with earlier measures.
6. When considering the development of the overall level of arrears between 2005 and 2011, the majority of countries had experienced an increase in overall levels of arrears, for the most part since the onset of the financial crisis.
7. In correspondence with the data presented there was a general consensus among interviewed stakeholders that the situation had significantly worsened in the past five years. 49% stated that the numbers of households that are over-indebted or have on-going financial difficulties had increased significantly in the last five years, with another 22% saying that it had increased moderately. Another 21% did not know or had no answer; only 8% of all stakeholders stated that in their view this level had remained the same or decreased.
8. This worsening situation is reflected in the debt counselling figures collected as part of the study from debt advice/counselling agencies. Trends show a clear increase over the time period for number of people counselled on debt issues in the EU. Face-to-face counselling remained the most popular, while telephone based counselling increased less rapidly. The trend for email/online chat, while lower than the others, is shown to be constantly increasing (see graph below).

Figure 1. *Persons counselled on issues of debt in the EU*

Source: Civic Consulting, survey of debt service providers, stakeholder interviews, and desk research, data as of January 2013. Note: Some reporting organisations only became active during the observed period. In some organisations the change in the number of cases was due to stafffing or other resource-related reasons. For more information concerning data used and related limitations, see final report of the study.



9. When looking at individual countries, it can be observed that countries where households reported a high overall level of arrears tended to also report high levels of households' difficulty making ends meet. For the 27 EU Member States (excluding Ireland due to lack of data availability), the correlation was very strong; consumers therefore appear to suffer greater financial difficulty as levels of arrears increase. The relationship of levels of arrears with the overall levels of borrowing (as expressed in the macro-economic indicator of household debt-to-income ratio) were however, less clear, as is illustrated in the following table.

***Table 1.** Overview of indicators for indebtedness and financial difficulty*

Source: Civic Consulting based on Eurostat, SILC. Note: Level of household arrears: High is value over EU average of 11% in 2011; very high is above 21%; moderate is below EU average in 2011, low is below 6% in 2011. Inability to make ends meet: High level is value over EU average of 26% in 2011; Very high is above 36%; moderate is below EU average in 2011, low is below 16% in 2011. Very high household debt to disposable income ratio is value over 140% in2011; high is a value between 100-140%, moderate is a value between 60-100%, low is value below 60%. * Latest year for which data is available.

Level of household arrears	Household's inability to make ends meet	Household debt to disposable income ratio	Member State	Member of Eurozone
Very high	Very high	n.a	EL	Yes
	Very high	n.a	RO	No
	Very high	n.a	CY	Yes
	Very high	Moderate	LV	No
	Very high	Moderate	HU	No
	Very high	n.a	BG	No
High	Very high	Moderate	IT	Yes
	High	Low	SI	Yes
	High*	Very high	IE	Yes
	High	Low	LT	No
	High	Low*	PL	No
	Moderate	Moderate*	EE	Yes
Moderate	Very high	High	PT	Yes
	Very high	n.a	MT	Yes
	High	High	ES	Yes
	High	Low	CZ	No
	High	Low	SK	Yes
	Moderate	High	UK	No
	Moderate	Moderate	BE	Yes
	Moderate	Moderate	FR	Yes
	Low	Very high	DK	No
	Low	High	FI	Yes
	Low	Moderate	AT	Yes
Low	Low	Very high	NL	Yes
	Low	Very high	SE	No
	Low	High*	LU	Yes
	Low	Moderate	DE	Yes

10. Looking at the key indicators in the table, a very high level of household arrears combined with a very high inability to make ends meet leads to a cluster of six countries: Greece, Romania, Cyprus, Latvia, Hungaria and Bulgaria. These are mostly non-Eurozone countries that have acceded to the EU in 2004 or 2007 (with the exception of Greece), and have a moderate household debt to disposable income ratio for those two countries for which data is available.
11. The second cluster of countries identified is a cluster of countries that combine a high level of household arrears with a mostly high inability to make ends meet. These are Ireland, Lithuania, Poland, Estonia, Slovenia and Italy. Again, the household debt to income ratio is mostly low or moderate, with the notable exception of Ireland, which has a very high ratio. Four of these six countries belong to the Eurozone.
12. The third cluster of countries combines countries defined by a moderate level of household arrears but with an inability to make ends meet ranging from very high, to low. The household debt to income ratios are also varied, running from very high (Denmark) to low (Slovakia). Eight out of the eleven countries in this group are part of the Eurozone.
13. The final cluster of countries identified - the Netherlands, Sweden, Luxembourg, and Germany - includes countries defined by a low level of households in arrears and mostly low levels of households unable to make ends meet. However, levels of household debt to income ratios tend to vary from moderate to very high; these countries are almost all (with the exception of Sweden) part of the Eurozone and older members of the EU.

1.3 TYPES OF HOUSEHOLDS IN FINANCIAL DIFFICULTIES

Key findings of the study concerning types of households in financial difficulties include:

1. Previous research finds income to be one of the strongest predictors of over-indebtedness - the lower the income, the greater the risk, even after controlling for other factors. This was also the view of stakeholders, who identified households with low incomes as one of the most common types with on-going difficulties meeting their financial commitments. This analysis was supported by analysis of EU-SILC and Eurobarometer data, and results from consumer interviews.
2. Research also shows a strong link between financial difficulties and age, with younger people being at greatest risk. These findings were supported through EU-SILC data analysis in the present study.
3. However, changes have been recorded due to the financial crisis, with more over-indebted people in the 30-45 age group than before, and with some evidence of increasing household over-indebtedness in older age groups. Also, since the crisis

growing numbers of middle income households are reported to have fallen into financial difficulties.

4. Traditionally, financial difficulties have tended to be concentrated among people renting their home. By contrast, owner-occupied housing seems to be linked with a lower risk of over-indebtedness, though this is more pronounced for those who own their home outright than those with mortgages. However, in certain countries this relation is reversed - for example in Ireland and Spain, where home owners face increasing levels of financial difficulties.
5. Research that found that the number of children in a household significantly increases the risk of being in financial difficulties was supported through analyses performed in the present study. Using EU-SILC data, it was found that households with no dependents had less than half the level of total arrears than households with dependents.
6. Lone parents are at greater risk than two parent families. They are particularly disadvantaged, since they face the same (childcare) costs as two-person families but can only rely on their own income, perhaps with some level of social transfers.
7. Consistent with previous research, level of education is also related to over-indebtedness, but the effect is weaker and more complex when other factors are taken into account.
8. Previous research finds that though migrants and non-EU citizens are a small part of the population, they face greater risk of being over-indebted.

1.4 CAUSES OF HOUSEHOLDS' OVER-INDEBTEDNESS

The key findings of the study concerning the causes of households' over-indebtedness are:

1. Statistical analysis conducted for this study supports the view of nine in ten of the stakeholders interviewed that macro-economic factors are one of the important causes of financial difficulties. Macro-economic factors relevant for over-indebtedness were also seen by stakeholders to have undergone significant change in the last five years. Preeminent among these was unemployment, which most interviewees indicated as one of the most important macro-economic causes of household over-indebtedness, followed by wage levels, levels of social welfare, movements in interest rates, and movements in exchange rates. A similar picture emerges from the consumer interviews conducted in six countries.
2. For arrears over time, increases in unemployment from 2008 were associated with an increase in all types of arrears. When examining the changes in real disposable income of households from the start of the financial crisis, decreases in real incomes were seen in multiple countries, concurrent with rises in levels of arrears.

3. Rises in the cost of living were mentioned as a significant cause of financial difficulties by eight in ten stakeholders. The main areas of concern were utility bills, followed by housing costs, and other costs including food, and transport. Other areas of expenditure were seen as less important. Overall, the costs of living that were referred to most frequently by consumer interviewees as causes of their financial difficulties were utility costs, the general costs of living, housing costs and childcare or child related costs (in descending order).
4. Research carried out for this study confirmed that a minority of countries have seen increases in the cost of living well above the EU average. These include Latvia, Romania, Bulgaria, Hungary, Lithuania, Estonia, and Greece. Almost all of these have very low average incomes. Results from analysis of key indicators of income and living costs showed that from the pre to post crisis periods, increases in cost of living outstripped income by several percentage points. In a second step, these increases were found to be strongly correlated with increased arrears in 2011, in particular arrears on utilities.
5. In the view of almost nine in ten of the stakeholders interviewed some type of credit or loan taken out by households was among the most important causes of financial difficulties in their country. More specifically, close to six in ten stakeholders were of the opinion that some type of 'regulated consumer credit with high interest rates' was among the most important causes, and a similar share considered this to be the case for 'home loans/mortgages'. Slightly less, namely close to half of the interviewed stakeholders suggested 'credit/loans from regulated lenders with average interest rates' as a most important cause (multiple answers were possible). Other categories, such as 'predatory or usurious types of credits/loans' or 'other specific practices or easy to obtain products in the financial services industry, such as doorstep or SMS loans' were mentioned less frequently, if overall figures for the interviews conducted in all Member States are considered (both categories were chosen by less than three in ten stakeholders). However, stakeholders in several Member States (such as Belgium, Bulgaria, Estonia, Finland, Greece, Ireland, Italy, Slovenia, Sweden and the UK) reported a rise in the use of high-cost short-term credit in the form of SMS loans, payday loans or unlicensed lending, which they considered to be a particular cause of concern.
6. Previous research[3] finds that the use of unsecured credit is positively associated with the likelihood of arrears. The more credit commitments households had, and the larger proportion of their income they spent on repaying them, the more serious was the level of arrears. In contrast, the total amount of money borrowed had a much less pronounced effect. Looking at macroeconomic data on consumer credit outstanding, it is hard to discern a relationship between levels of borrowing and levels of arrears. Nor are there high levels of default on either

[3] Summarised in European Commission, 2008.

consumer credit or more generally in Denmark, Germany or Sweden where consumer borrowing is high.

7. In terms of personal circumstances, interviewed stakeholders considered drops in income caused by unemployment or business failure to be among the most important causes of household over-indebtedness. In consumer interviews, a drop in income as the result of unemployment or illness was the personal circumstance most commonly referred to by interviewees. Other causes for a drop in income, such as divorce, business failure or the death of a family member also came up frequently.
8. As the 2008 study on over-indebtedness showed, approaches to money management and financial decisions can play an important role whether or not individuals of households experience financial difficulties. There is a growing body of research to support this conclusion and it was specifically referred to by seven in ten stakeholders.
9. A majority of stakeholders (close to six in ten) believe that there is a relationship between the cultural attitude towards debt and the actual level of household over-indebtedness. Stakeholders who observed a change in cultural attitudes noted that historically a lot of significance used to be attributed to being debt-free as restrained spending along with savings were generally considered desirable. This attitude has changed recently with the development of financial sector and the introduction of a variety of new financial products accompanied by cultural valorisation of consumption. However, there is a tendency among stakeholders from some countries to believe that consumers are becoming more careful in terms of willingness to take credits in the wake of the financial crisis.

1.5 CONSEQUENCES OF OVER-INDEBTEDNESS

The key findings of the study regarding the consequences of households' over-indebtedness include:

1. Research and the qualitative evidence from the household interviews conducted for the study in six Member States have shown there to be a strong association between over-indebtedness and what might be termed deprivation, that is going without basic necessities as a consequence of inadequate disposable income after the repayment of debts. Deteriorating health and wellbeing can be both a cause and a consequence of financial difficulty. Several studies have identified an association between the onset of over-indebtedness and ill-health, and there can be negative effects on physical health, on mental health and on wellbeing - in some cases, these can be very serious indeed. However, research also highlighted exclusion from basic banking services as one of the most serious consequences.
2. Interviewed households most frequently mentioned reduced standard of living and a deterioration of well-being and/or mental health as consequences of

financial difficulties. They commonly mentioned cutting down on all non-essential items, such as holidays or eating out. In addition, several interviewees indicated that they had problems finding money for essential needs, such as food or healthcare. Generally, many interviewees were upset about the effect of their reduced standard of living on their children. In terms of well-being and mental health, households interviewed frequently referred to depression, anxiety and stress. In some cases this was extreme enough that they sought medical attention. Several interviewees reported that they had been forced to give up working or looking for a job, or that the stress had led to arguments with their partners.

3. According to stakeholders, the consequence for over-indebted households judged as being of greatest relative importance was also reduced standard of living followed closely by deteriorating well-being. The next most highly rated consequence was that of financial exclusion, followed by the categories of deteriorating mental health, family breakdown, and home repossession. Reduced labour market activity and utility disconnection were considered to be slightly less important.
4. For the EU as a whole, costs of defaults for creditors were seen as most important overall consequence of over-indebtedness for the financial services industry. Other consequences, such as costs of arrears, more restrictive lending practices, and increased costs for financial service providers were all seen as more or less equally important.
5. Loss of consumer confidence in the financial services industry was seen as the greatest consequence of over-indebtedness for society as a whole, followed by reduced productivity at work and legal costs associated with over-indebtedness.

1.6 MEASURES TO ALLEVIATE THE IMPACT OF OVER-INDEBTEDNESS

Key findings of the study regarding measures to alleviate the impact of households' over-indebtedness are as follows:

1. Only in some Member States did most stakeholders consider measures to identify households at risk of becoming over-indebted at an early stage to be common. The most commonly reported measure is to require lenders to comply with responsible lending provisions in order to assess the creditworthiness of prospective borrowers. In addition, ratios of loan to income have been recommended or enforced in some markets, especially for mortgage credit.
2. Research conducted for this study confirmed that there seems to be less provision of debt advice in EU12 than in other EU Member States. It also confirmed that debt counselling is available from different types of organisations, representing the public and the private sector (including both non-profit and for-profit organisations). The main types of debt advice providers are presented in

the table below. Note that individual organisations can belong to more than one category (for example, consumer organisations can operate as non-governmental organisations and be publicly funded).

Table 2. *Main types of organisations providing debt advice*

Source: Civic Consulting based on Eurofound 2012, stakeholder interviews, debt advice mapping survey, country reports.

Type of organisation	Description
Non-governmental organisations	Non-profit, non-governmental organisations, including religious charities. Some are specialised for debt advice provision (organisations as a whole or special departments) whereas others provide advice sporadically, in the context of their overall activities.
Consumer organisations	General consumer organisations (i.e. covering a broad range of consumer protection issues) as well as specialised ones (e.g. focusing on banking services or utilities), ranging from local or regional to national geographic scope of coverage.
Public services	In several countries (including Finland, Sweden, the Netherlands and Hungary) local authorities are legally bound to provide debt advice services. In some cases advice is provided by national-level public bodies, such as the Consumer Ombudsman in Greece (focusing on assistance with out-of-court proposals for debt settlement). Debt advice can also be integrated in the broader social welfare services.
Publicly funded organisations at some distance from public administration	Some debt advice providing organisations are detached from the public administration but they are completely or partially publicly funded. Such example is the Money Advice and Budgeting Service (MABS) in Ireland, where the statutory body Citizens Information Board has a statutory responsibility for these services and they are entirely publicly funded. In the UK the Citizens Advice Bureau, operating in England and Wales through a network of registered charities, is largely funded by government grants.
Private for-profit companies	In some countries, such as Ireland, the UK and Portugal, debt advice has been available from for-profit (fee-charging) companies. Multiple financial industry stakeholders participating in this study reported that they provide debt advice as well, although this is mostly focused on recovering debts from their clients.

3. The 2008 study on over-indebtedness, published at the outset of the financial crisis, noted the need for adequate (public) funding of debt advice services in order to meet demand in a timely manner and to provide the comprehensive geographical coverage that many Member States lacked. Several years on, the situation does not appear to have improved and the funding of debt advice continues to be a major concern among stakeholders across Member States. In the context of high and rising demand for debt advice, it was rare for stakeholders to think that debt advice funding was sufficient (less than two in ten thought so). About half of stakeholders considered funding for debt advice to be insufficient. The rest did not know or they did not wish to respond.
4. In 17 Member States, most stakeholders considered funding not to be sufficient. This spanned a range of countries, from those with relatively widespread coverage of advice services to those with little or no provision. There were mixed views about the adequacy of funding among stakeholders in Austria, Cyprus,

Germany, Denmark, Finland, France, Ireland and the Netherlands, which generally have at least some publically funded advice provision. Where debt advice services were more widely available, public funding was nonetheless considered barely sufficient or insufficient to meet the needs of people in financial difficulty. In Ireland, this was despite a fairly recent injection of additional government funding for debt advice. In the UK, public funding for debt advice services had been cut, and further cuts were due.

5. In the consumer interviews, interviewees tended to report positive outcomes as a result of seeking advice or taking measures to alleviate their difficulties. In the interviews with stakeholders it was assessed that in most Member States informally brokered arrangements were available to help people sort out their debt problems. Formal out-of-court debt settlement procedures were somewhat less common. Court-based consumer insolvency procedures were reported to be available in most Member States, but some seem to lack any legal procedures for dealing with consumer debt. Financial support for households in debt was reported to be relatively rare.
6. The most commonly reported changes in response to over-indebtedness related to legislative steps to make insolvency proceedings more readily available to consumers in financial difficulty. This involved changes to the eligibility criteria and/or improvements to make the process quicker and more efficient.
7. Best practices identified by stakeholders and through complementary research in the framework of this study include: financial education; resource/income adequacy; responsible lending; good practice guidance; early engagement of creditors/lenders; debt advice; temporary suspension of debt servicing; preventing evictions; out-of-court procedures for debt settlement; collective debt settlement; legal procedures for the discharge of debts; responsible debt collection; prevention of financial exclusion; and other practices and measures.
8. An important question when considering best practices is whether measures can be implemented effectively in isolation from one other, or whether such measures are more likely to be successful if they are co-ordinated or joined up in some way. The 2008 study stressed the importance of addressing the multi-dimensional problem of over-indebtedness by way of a combination of complimentary preventative, curative and rehabilitative policy measures. In this context, it has been proposed that the creation of a policy framework, incorporating a national strategy, is the best way of ensuring the implementation of an effective, co-ordinated policy response within a Member State. This finding has been reconfirmed by research conducted for the present study.