

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

Final Report

Part 2: Country reports

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1 AUSTRIA

Document The over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact - Country report Austria

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Final report

Over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact

1.1 DEFINITION OF OVER-INDEBTEDNESS

The lowest common denominator across definitions provided by Austrian stakeholders is that over-indebtedness is the sustained¹ inability (mostly of an individual) to meet due financial obligations. This core definition more or less exhaustively reflects those proposed by the financial industry stakeholders and most providers of debt advice. Notably, it is also in line with the terminology used in Austrian insolvency procedures (*Insolvenzordnung*, Articles 66 and 67), which cover cases in which a debtor is unable to pay. Inability to pay is indicated by the non-payment of (some) due debt. Some Austrian stakeholders also consider more subjective and prospective criteria for over-indebtedness, in addition to the core criteria. The main question is whether the perception of a debt burden and/or the inability to meet unexpected financial expenses² also constitute indicators of over-indebtedness as was suggested by one of the interviewed experts. One interviewee working for a government agency pointed out a need to not only focus definitions on debt but to also bear in mind income and wealth. Considering a more inclusive financial picture could facilitate measuring over-indebtedness.

In contrast to definitions of over-indebtedness, hardly any Austrian stakeholders (only 2 out of 10 interviewees) were able or willing to provide a definition of the 'risk of being over-indebted'.

Overall definitions provided by Austrian stakeholders are narrower than the definition used in this study. Instead of using the broader term difficulty, the term inability better reflects the general gist of definitions cited in Austria. Another important distinction is the level of analysis. Austrian stakeholders nearly exclusively talked about over-indebtedness at the level of the individual rather than the household. This is tightly linked to the person-centred personal insolvency legislation. Interestingly, only 3 out of 10 interviewees saw a need to improve existing definitions, primarily to enhance clarity (either among those concerned or across stakeholders).

1.2 LEVEL OF OVER-INDEBTEDNESS

The most recent EU statistics available suggest that the extent of over-indebtedness among Austrian households is fairly close to the EU average. This holds for most subjective³ and objective⁴ indices of over-indebtedness. While this may not seem noteworthy at first glance, it becomes so if we look into the past (i.e. prior to the financial crisis of 2008).

¹ The time span that is necessary to make it a sustained issue varies or is ill-defined in both the law and stakeholder interviews.

² This was part of a wider definition suggested by an interviewed expert.

³ See the Eurobarometer figures on households that feel at risk.

⁴ See the EU SILC data on objective, actual arrears in Annex A.

Even though past data cannot be readily compared to the Eurobarometer statistics,⁵ they nonetheless draw a convincing picture of above average deterioration. For example, in 2006 EU-SILC data on perceived over-indebtedness suggested that Austrians were much less likely to consider themselves over-indebted than the EU average: 1.3% compared to 3.9% EU-wide.⁶ By 2010 the subjective debt burden of Austrians as measured in the Eurobarometer survey slightly exceeded the EU average: 28% in Austria compared to 25% EU-wide.⁷ Objective indicators of over-indebtedness similarly suggest that Austria has experienced an above average increase in over-indebtedness. In 2006 8.8% of Austrians with debt were in arrears whereas the EU average was considerably higher at 15.4%. In 2010 the percentage of Austrians in severe arrears was (for most types of debt) at European average levels. As evidenced by EU-SILC statistics (see Annex A), the number of people in arrears has doubled for most types of obligations since 2007. Since the marked increase in over-indebtedness in 2008, EU figures suggest that the situation has roughly stabilised.

As was pointed out in a stakeholder interview, one type of debt is specific to the Austrian banking scene and is a commonplace, default form of debt for many people in Austria: namely bank account overdrafts. Upon opening a checking account consumers are usually automatically provided with an overdraft facility. There is no need to request an overdraft as is more common in other European countries. Other indicators of debt problems that some of the interviewees referred to⁸ suggest that although over-indebtedness continues to rise, the pace is slowing. One such indicator is the number of people seeking help at debt advice institutions. Figures published by the Austrian debt advice service (ASB)⁹ show that between 2007 and 2008 the number of people seeking help increased by approximately 6,000 to 47,525. Since then, there has been a less pronounced but steady rise: a total of 54,324 people sought help in 2011. In addition, the ASB's most recent 'debt report' (*Schuldenreport*) indicates that debt problems have become more complex, necessitating more counselling sessions per client.

Another indicator signalling a continued increase in over-indebtedness is the number of people going through the process of consumer insolvency. The number of new proceedings has seen a steady increase over the last years¹⁰ and the Austrian credit

⁵ Different measures of over-indebtedness were used in different surveys.

⁶ Angel, S., Einböck, M., Heitzmann, K., *Politik gegen und Ausmaß der Überschuldung in den Ländern der Europäischen Union*, Working Paper 01/2009, Institut für Sozialpolitik/ WU Wien.

⁷ Special Eurobarometer 355, Poverty and Social Exclusion Report, 2010, p. 42.

⁸ Note that in contrast to EU statistics these indicators also account for wealth and consequently debt absorption potential.

⁹ See ASB *Schuldenreports* for 2009 and 2012, available at: <http://www.schuldnerberatung.at>.

¹⁰ For example, based on data obtained from the Austrian Ministry of Justice the ASB *Schuldenreport 2012* reports an increase of 6.5% in the number of new personal insolvency proceedings from 2010 and 2011.

protection agency¹¹ estimates that it will, for the first time, cross the 10,000 cases threshold in 2012.

To conclude, 2008 saw the demise of Austria as a country with comparably low levels of private over-indebtedness. Since then the situation has not dramatically deteriorated, but several figures suggest that the problem continues to grow, albeit at a slower rate. The comparably healthy position that Austrian households were in at the beginning of the 21st century is currently out of reach.

1.3 NATURE AND DRIVERS OF OVER-INDEBTEDNESS

1.3.1 Most common types of households that are over-indebted

As in most European countries over-indebtedness is particularly pronounced among those with lower incomes, those with lower levels of education, those living in rented accommodation and the unemployed. This is evidenced in the respective European statistics (see Annex A), in stakeholders' responses and in published reports on the debt situation in Austria.¹² At particular risk are single parents and divorced or separated individuals. Naturally there is considerable overlap between the two groups. Another factor that is directly related to the likelihood of debt problems is a person's origin. People with migration background (especially from outside the EU) are particularly likely to be over-indebted; this is probably the result of their increased likelihood of having lower incomes, lower levels of education and being unemployed.¹³

1.3.2 Causes of households' over-indebtedness

Macro-economic factors

On a macro-economic level unemployment and low wage levels are by far the most important causes of debt identified by stakeholders. A related issue is failed self-employment. According to one stakeholder, many unemployed people were encouraged to become self-employed in 2004/5, but were often ill-prepared for such a step. One third of consumer insolvency cases are caused by failed self-

¹¹ See KSV Insolvenzzstatistik 2012, available at http://www.ksv.at/KSV/1870/de/pdf/statistik/2012/KSV1870_Insolvenzzstatistik-Private_HJ-2012.pdf.

¹² See in particular Angel, S., Einböck, M., Heitzmann, K., and Till-Tentschert, U., *Verschuldung, Überschuldung und finanzielle Ausgrenzung österreichischer Privathaushalte*, Ergebnisse aus EU-SILC 2008, Statistische Nachrichten, 12/2009, pp. 1104-1116.

¹³ See e.g. the Viennese Integration Monitor, available at: <http://www.wien.gv.at/menschen/integration/grundlagen/monitoring/>.

employment,¹⁴ which is also the third most important driver of over-indebtedness reported by the ASB.¹⁵

Another macro-economic issue that concerns some house owners are movements in exchange rates. As one financial industry stakeholder reported:

In Austria almost 50% of outstanding mortgages are denominated in foreign currency ... because the interest rates of Swiss Franc loans were very low. But when those interest rates increased, some people got into trouble and could not repay their loan.

Cost of living

Since 2007 the rise in housing and utility costs has continuously exceeded average inflation figures by more than 10%.¹⁶ Considering that low income groups and thus groups at risk are spending a considerable part of their income on these types of expenses, it is not surprising that interviewees nearly unanimously agreed that this rise in costs is a considerable force behind over-indebtedness.

Types of credit/loan taken out by households

Considering that most over-indebted households rent their accommodation,¹⁷ it is no surprise that consumer debt rather than mortgages constitutes the primary source of problem debt. Stakeholders agreed that Austria does not have pronounced problems due to predatory or usurious types of credit.

Personal circumstances

Although causalities are not always clear, personal circumstances are without doubt the main driver or catalyst of over-indebtedness as evidenced in stakeholder interviews and in reports on the debt situation (e.g., the *Schuldenreport*). Though critical life events such as losing a job or health issues are often relevant, a qualitative study on the biographies of Austrian debtors¹⁸ suggests that the roots of the problem often precede critical incidents and that the subjective importance of critical events

¹⁴ See KSV Insolvenzstatistik 2012, available at: http://www.ksv.at/KSV/1870/de/pdf/statistik/2012/KSV1870_Insolvenzstatistik-Private_HJ-2012.pdf.

¹⁵ See *Schuldenreport* 2012.

¹⁶ See 'VPI 2000 Jahresdurchschnittswerte der COICOP-Hauptgruppen 2002 bis 2012', category 'Wohnung, Wasser, Energie', at http://www.statistik.at/web_de/statistiken/preise/verbraucherpreisindex_vpi_hvpi/hauptgruppen_und_details/022141.html.

¹⁷ See for example Angel, S., Einböck, M., Heitzmann, K., and Till-Tentschert, U., *Verschuldung, Überschuldung und finanzielle Ausgrenzung österreichischer Privathaushalte*, Ergebnisse aus EU-SILC 2008, Statistische Nachrichten, 12/2009, pp. 1104-1116.

¹⁸ Einböck, M. and Heitzmann, K., *Überschuldungsverläufe und Überschuldungstypen: Ergebnisse einer explorativen Untersuchung überschuldeter Personen in Wien*, Forschungsbericht 01/2011, Institut für Sozialpolitik/WU Wien.

may be overestimated. Interviewees and scientific literature¹⁹ agree that the causes of over-indebtedness are often associated with a drop in income, perhaps caused by unemployment, separation or single parenthood, and/or lack of money management skills.

1.3.3 Changes relevant for levels of over-indebtedness

Changes noted by the interviewed stakeholders are in line with the causes listed above and include: an increase in the cost of living and utilities, a rise in unemployment and a change in interest rates affecting foreign currency credit holders. However, some changes also counteract a rise in over-indebtedness; these include more restrictive lending practices that were enforced by the Consumer Credit Directive of 2010.

Another frequently noted change is an increase in debt prevalence among young consumers, mostly due to telecommunication-related costs (in particular through the acquisition of smartphones),²⁰ but also to a presumed liberalisation in attitudes towards debt.

1.3.4 Cultural attitude towards debt and actual level of households' (over-)indebtedness

Like many places in the world, Austria seems to be facing a recent change in attitudes towards credit and debt, with attitudes becoming more liberal. Most interviewees consider this change as a cause of increasing debt levels, in particular among the young.

However, being debt-free (with the exception of mortgage debt) is a common Austrian aspiration and having debt problems is a source of shame.²¹ One indicator of this cultural attitude is an observation made by Angel, Einböck and Heitzmann (2009) when analysing the EU-SILC database of 2006. While the level and prevalence of consumer debt in Austria was considerably below European average, the subjective debt burden reported was relatively high; this shows the stigma attached to consumer (rather than mortgage) debt at the time.

¹⁹ See for example Kamleitner, B., Hornung, B., and Kirchlner, E., "Over-indebtedness and the interplay of factual and mental money management: An interview study," *New Zealand Economic Papers*, 45(1), 2011, pp. 139-160.

²⁰ As one interviewee explained: "There are more and more telephone companies which offer people... smart phones for no down-payment, but only on the basis of a 2-year contract according to which the person has to pay, for example, 60 Euro per month. We encounter 19-year-olds with two such contracts and [an] inability to pay for them every month. And if you cannot pay from month to month, you are required to pay the total sum owed... so these young people end up with a 3000 Euro debt because they have signed two contracts for new phones."

²¹ Einböck and Heitzmann, 2011.

1.4 CONSEQUENCES OF OVER-INDEBTEDNESS

1.4.1 Consequences for affected households

Most data available only shows a household's situation at one point in time and does not enable us to see how it develops over time. Therefore it is notoriously difficult to ensure that what is considered a consequence of over-indebtedness is not also a preceding cause that has been aggravated.²² It is hardly surprising that the consequences of over-indebtedness which stakeholders considered most important (awarded >6 on a 10 point scale) show remarkable similarities with the causes. Among the most important consequences are the reduced standards of living, deteriorated mental health and well-being, social and interpersonal strain up to the point of divorce, separation, and loss of social networks, and reduced labour market activity. All these factors can result from – but also cause – debt problems.

Reduced labour market activity warrants a particular mention in the Austrian context. According to several stakeholders, it is tightly linked to the garnishing of wages. Austrian creditors have comparably easy access to debtors' wages,²³ which have to be garnished through employers; employers may then be more reluctant to employ those whose wages are more difficult to process. Another important consequence is financial exclusion, which is an issue for a significant minority of debtors.

1.4.2 Consequences of over-indebtedness for the financial services industry

All other consequences pale in comparison to those suffered by affected householders. However, as one financial industry stakeholder stated, debt problems certainly cause costs beyond the non-recovery of funds because they constitute an administrative burden. Considering that default rates are low and that the interest rates cover those additional costs, most other stakeholders did not consider these costs to be important.

1.4.3 Economic and social consequences of over-indebtedness for society

Stakeholders did not provide uniform answers concerning the most important consequences of over-indebtedness for society as a whole, but they did agree that there are numerous wider consequences at play. The only consequences that were generally considered fairly important are: the broader issues associated with health problems and reduced labour market participation. Stakeholders thought that both

²² See for example Kamleitner, B., and Kirchlner, E., "Consumer credit use: a process model and literature review," *Revue Europeenne de Psychologie Appliquee/European Review of Applied Psychology*, 57(4), 2007, pp. 267-283, for a review of broader issues, including the causality debate.

²³ The so called 'Drittschuldnerauskunft' is regulated in the *Exekutionsordnung*; see for example: http://www.jusline.at/Exekutionsordnung_%28E0%29_Langversion.html and <http://www.justiz.gv.at/internet/html/default/2c9484852308c2a60123ec387738064b.de.html>, for information about an employer's duties by the Ministry of Justice.

have costs for society, including loss of tax income and increased demands on the social security system.

1.4.4 Debt collection practices

Some interviewees reported having noticed an increase in aggressive debt collection practices. Public authorities reported an increase in opaque and usurious practices, as well as breaches of data protection rules. One civil society stakeholder also reported more bad loan packages being sold to debt collection companies. This encumbers the process of negotiating solutions. Over-indebted people may end up not knowing who to negotiate with since their primary creditors may have sold on their debt.

1.5 MEASURES IN FORCE TO ALLEVIATE THE IMPACT OF OVER-INDEBTEDNESS

1.5.1 Early identification of households at risk

Institutional lenders (in particular banks) usually keep track of their customers' borrowing history and will remind customers when they are in arrears. Defaults (on several types of payment) are also automatically tracked in a debtor database kept by the credit protection agency, the KSV1870 Group²⁴ (which focuses on credit bureau business, debt collection and insolvency proceedings, and acts as the biggest business information provider in Austria). Whether debtors are actually alerted when they are potentially 'at risk' is down to the discretion and procedures of their financial institution(s). There is no nation-wide warning system in place; in particular when debtors borrow from non-institutional lenders.

1.5.2 Advice offered to over-indebted households

Availability and costs

Most debt advice services focus on the provision of face-to-face advice, including help in determining the extent of debt problems and advice on how to potentially reduce these problems. This advice is readily available in all major urban areas, mainly by the official debt advice service (www.schuldenberatung.at), a country-wide network of state-funded debt counselling offices. Phone numbers of debt advice institutions can be easily found but face-to-face meetings generally offer an enhanced level of service. This is also the case for online contacts, which are generally more difficult to find. Some institutions provide tools on the web such as household plans and templates for creditor lists.²⁵ However, these are not always easy to find or

²⁴ See <http://www.ksv.at/KSV/1870/>.

²⁵ See for example: <http://www.schuldnerberatung-wien.at/hilfsmittel/> and <http://ooe.schuldnerberatung.at/>.

geared towards individual cases. Since printed information is provided at likely touch points for over-indebted consumers (e.g. unemployment services, some banks) it is also widely available to those who are seeking help.

Most services generally operate free of charge, including the more widely known public services. Some private providers (mostly financial advisors and lawyers) charge clients for their services. These providers tend to target particular sections of the population (e.g. self-employed or the middle class) and are less prevalent than the free public services.²⁶ Apart from the potential costs for phone calls (no toll-free hotlines are available), over-indebted consumers using the public services would not usually incur any costs.

Demand for debt advice as assessed by stakeholders

The demand for face-to face advice was assessed by most stakeholders as high.²⁷

The demand for help from debt advice providers has increased in recent years (see also Section 1.2), not only in terms of the number of people but also in terms of the time it takes to provide advice to an individual. According to one civil society stakeholder, the increase in demand has been matched by an increase in resources provided to public advice institutions.

Effectiveness as assessed by stakeholders

Many debtors only seek debt advice after already having had prolonged debt problems.²⁸ Nonetheless, most stakeholders agreed that face-to-face advice is effective in alleviating the impact of over-indebtedness.²⁹

Funding of debt advice

Public debt advice services are funded by the state. Some stakeholders consider this as sufficient, but more interviewees indicated that it was not. Interviewees from different stakeholder groups called for more involvement by the financial services sector, in particular banks.³⁰

²⁶ Note that the use of the term debt counsellor is not restricted and there are no statistics about these private enterprises available.

²⁷ Assessments for other forms of debt advice were only rarely provided.

²⁸ See also the subjective trajectories described by Einböck and Heitzmann, 2011.

²⁹ Most debt advice services aim at helping their clients with debt settlement procedures and, where possible (see eligibility criteria summarised in Section 1.5.3), with private insolvency proceedings.

³⁰ One independent expert also highlighted that there is no systematic funding for preventive measures.

1.5.3 Key measures in place to alleviate the impact of over-indebtedness

Availability and costs

As one interviewee working for public authorities reported, "informal arrangements between [the creditor and all debtors are a] precondition for being able to go to court for bankruptcy". The majority of stakeholders considered these arrangements to be available. However, civil society stakeholders almost unanimously reported that creditors are not usually willing to agree to such informal arrangements. This is one of several reasons why not many people are actually able to declare personal bankruptcy.

Unwillingness to engage in non-regulated agreements stretches to more formal procedures. According to one interviewee, creditors have more trust in – and hence prefer – legal courses of action (such as garnishing of wages). Consumer insolvency proceedings are generally available, but not all debtors manage to live up to the minimum criteria (i.e. the availability of sufficient funds to cover the cost of insolvency proceedings, ability to repay at least 10% of debt over seven years, and the agreement of a majority of debtors to the repayment plan). Many stakeholders noted that the current legislation with regard to insolvency is too restrictive and that the procedure is too long.

Financial support for households to repay debts/arrears was reported as not available in Austria. One type of help that financially deprived Austrians can access is social aid, but this is not specifically geared towards problem debtors.

Based on stakeholders' responses it seems that more formal measures are more likely to come at a cost to the debtor. With regard to insolvency proceedings, the current practice differentiates between people who have been self-employed and have to pay for legal procedures and other "private" problem debtors.

In general financial costs are of secondary concern. More important issues are eligibility, availability and non-monetary costs such as waiting times. As one interviewee reported, the Austrian "insolvency proceeding is one of the longest in Europe".

Effectiveness as assessed by stakeholders

Stakeholders were of mixed opinions regarding the effectiveness of informally brokered arrangements and formal procedures. Legal procedures were considered to be very effective. But as with other key measures there is one big potential problem: creditors (and other factors) can prohibit debtors from being able to access them in the first place.

1.5.4 Changes in response to over-indebtedness

All stakeholders who provided an answer indicated that there had been no changes in responses to over-indebtedness (in terms of measures to alleviate its impact) during the previous five years. One interviewee working for public authorities reported that negotiations about a change in the insolvency law have been taking place, but no concrete outcomes have been realised.

One less recent development might, however, be noteworthy. In order to combat the specific consequence of financial exclusion the so called "Zweite Sparkasse",³¹ a play on the well-established Erste Sparkasse, was launched in 2006. It is run by bank employees on a *pro bono* basis and aims to provide financially excluded individuals (often referred by a debt advice service) with basic financial facilities such as a bank account.

1.5.5 Types of households of over-indebted consumers not reached by current measures

The main issue raised by the stakeholders is the already highlighted fact that some debtors are too poor to declare bankruptcy. Another issue is the limited demand for help due to the stigmatisation of problem debt, despite the recent liberalisation of attitudes toward debt. This is particularly true for the Austrian middle class which is in a position to access credit and consequently accrue problematic debt. As one stakeholder put it, it might simply be that these people are overlooked because they do not ask for help.

Other issues arise due to basic problems in bringing help to those concerned. These problems comprise issues of physical access (in particular the homeless but also remote rural areas are harder to reach) and of communication (immigrant families struggle to take on board advice due to language problems).

1.5.6 Best practices

Those few stakeholders who indicated that there are some measures in place that could be considered best practices referred to private insolvency proceedings (despite the above-described deficiencies).

1.6 OUTLOOK

On the whole stakeholders expected the situation to deteriorate somewhat more before stabilising. Actual developments were mostly considered to be dependent on the economic situation (in particular unemployment and the prolonged consequences of the financial crises). Stakeholders unanimously agreed that new

³¹ See: <http://www.sparkasse.at/diezweitesparkasse>.

challenges need to be addressed. The main challenge mentioned in the interviews is the need to increase access to and also facilitate insolvency proceedings. Other points mentioned cover the perceived need for a wider range of reactive and preventive measures; stakeholders pointed to the need for combating the rise in debt among young people and increasing cost transparency (e.g. through a better enforcement of advertising restrictions).

Concerning credit and lending practices, most stakeholders saw a need to improve the regulation and provision of financial products and services. Some interviewees also indicated the need for additional changes regarding utility companies. One civil society stakeholder suggested that there should be "some minimum amount of electricity provided under all circumstances". Regarding housing, another civil society interviewee proposed a "directive to calculate rents based on national income levels".

Beyond these measures, stakeholders agreed on the need for an increased focus on preventive measures; the specific measure mentioned was financial education. The identification of a lack of money management skills as the second most important cause of over-indebtedness in the most recent Austrian *Schuldenreport*³² adds weight to this call.

1.7 REFERENCES

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³² See ASB Schuldenreport for 2012, available at: <http://www.schuldnerberatung.at>.

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Over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact

ANNEX A: STATISTICAL DATA FROM EU SOURCES

Final report

Over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact

Austria

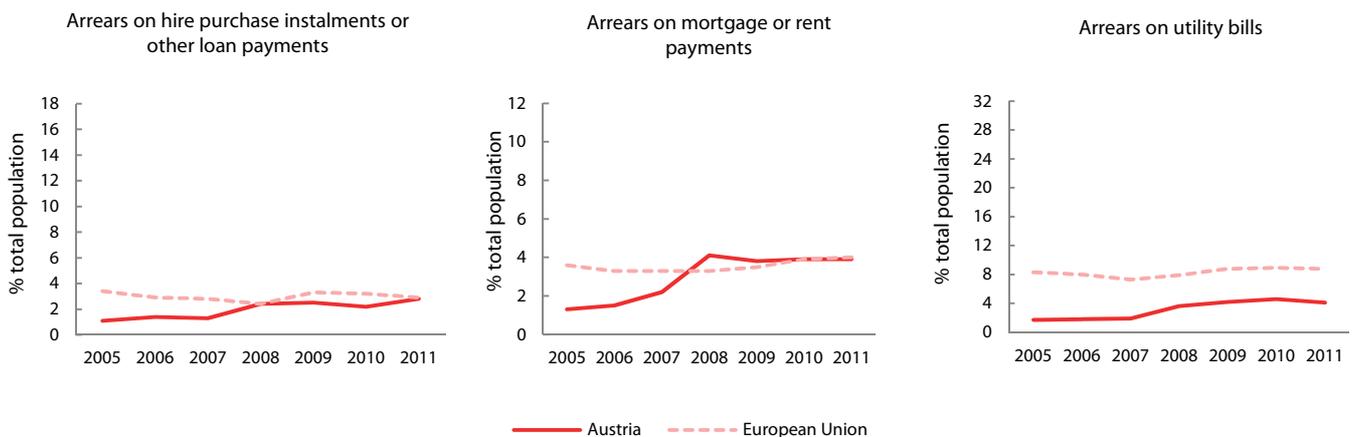
I. Eurobarometer¹

	Austria	EU average	Lowest EU value	Highest EU value
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Households *at risk* of being over-indebted

Respondents feeling at risk of over-indebtedness <u>in 2010</u>	↗ 28%	25%	7%	52%
Respondents feeling at risk of over-indebtedness <u>in 2009</u>	↔ 27%	27%	9%	53%

II. EU SILC standard survey data²



III. EU SILC 2008 module: Over-indebtedness and financial exclusion³

	Austria	EU average	Lowest EU value	Highest EU value
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Proportion of people in households with bank overdrafts, outstanding balances on credit cards or in arrears on other loans of over 100% of household disposable income

Overdrawn bank account (% of people in households overdrawn)	↗ 5.3%	2.2%	0.0%	7.7%
Credit or store card (% of people in households with outstanding balances)	↘ 0.2%	1.1%	0.0%	8.6%
Other loan/credit payments (% of people in households in arrears)	↗ 0.8%	0.3%	0.0%	1.1%

Proportion of people in households in arrears in servicing housing-related loans and bills and in paying other bills of over 100% of household disposable income

Housing bills (% of people in households in arrears)	↗ 0.6%	0.5%	0.0%	2.9%
Other payments (% of people in households in arrears)	↗ 0.6%	0.4%	0.0%	1.7%

Households living with outstanding debts and/or arrears of over 100% of household disposable income

Total (% of households with outstanding debts/arrears)	↗ 6.7%	4.6%	0.0%	11.8%
Income above 60% median (% of households with outstanding debts/arrears)	↗ 6.2%	4.2%	0.0%	11.3%
Income below 60% median (% of households with outstanding debts/arrears)	↗ 9.9%	7.0%	0.2%	13.7%
Materially deprived (% of households with outstanding debts/arrears)	↗ 27.4%	9.0%	0.1%	27.4%

Proportion of those in broad age groups with outstanding debts of over 100% of household disposable income

Households with all adults aged 25-39 (% of households with outstanding debts)	↗ 8.4%	6.3%	0.0%	17.2%
Households with all adults aged: 40-64 (% of households with outstanding debts)	↗ 7.3%	5.8%	0.0%	10.9%
Households with all adults aged: 65+ (% of households with outstanding debts)	↗ 1.9%	1.2%	0.0%	2.8%

Proportion of those in different types of household with outstanding debts of over 100% of household disposable income

Living alone (% of people in households with outstanding debts)	↗ 6.5%	4.3%	0.0%	8.2%
Single parent (% of people in households with outstanding debts)	↗ 15.7%	9.5%	0.0%	27.1%
Other (% of people in households with outstanding debts)	↗ 6.2%	4.8%	0.0%	12.1%

Proportion of those in households with outstanding debts of over 100% of household disposable income by marital status

Never married (% of people in households with outstanding debts)	↗ 7.0%	5.0%	0.0%	15.4%
Married (% of people in households with outstanding debts)	↗ 5.3%	4.1%	0.0%	9.7%
Separated/divorced (% of people in households with outstanding debts)	↗ 12.0%	7.5%	0.1%	13.9%
Widowed (% of people in households with outstanding debts)	↗ 2.9%	1.7%	0.0%	4.3%

Proportion of those in households with outstanding debts of over 100% of household disposable income by housing tenure

Owner occupied without mortgage (% of people in households with outst. debts)	↘ 1.5%	3.2%	0.0%	9.6%
Owner occupied with mortgage (% of people in households with outst. debts)	↗ 7.7%	6.3%	0.0%	16.1%
Market rent (% of people in households with outstanding debts)	↗ 10.9%	8.2%	0.0%	16.0%
Subsidised rent (% of people in households with outstanding debts)	↗ 9.4%	8.7%	0.0%	17.9%
Rent-free housing (% of people in households with outstanding debts)	↘ 2.2%	2.3%	0.0%	15.1%

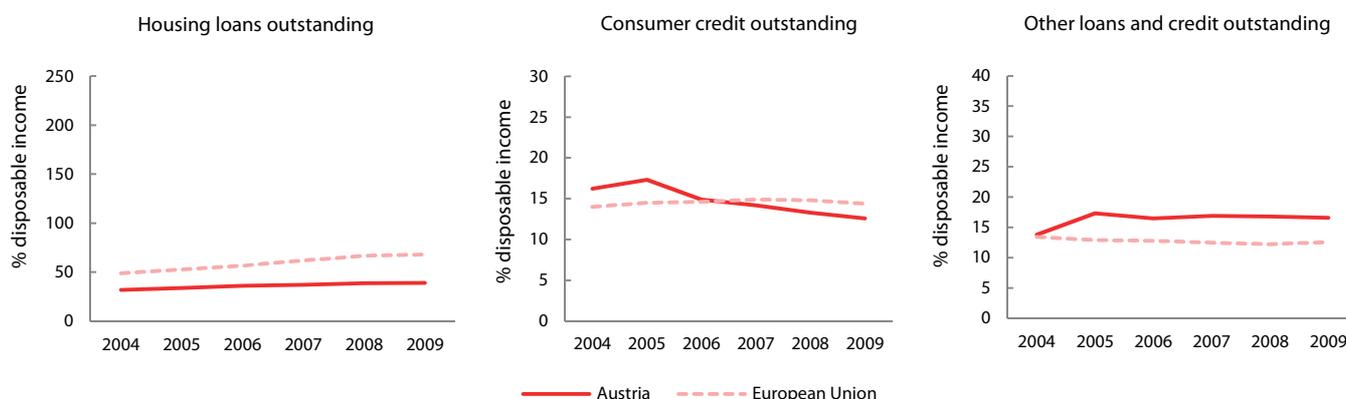
Proportion of those in households with outstanding debts of over 100% of disposable income by work intensity

Work intensity of 0 - 0.19 (% of people in households with outstanding debts)	↗ 8.2%	5.7%	0.0%	10.6%
Work intensity of 0.20 - 0.50 (% of people in households with outstanding debts)	↗ 8.2%	5.7%	0.0%	15.3%
Work intensity of 0.51 - 0.74 (% of people in households with outstanding debts)	↗ 9.5%	5.4%	0.0%	13.5%
Work intensity of 0.75 - 1.0 (% of people in households with outstanding debts)	↗ 5.7%	5.3%	0.0%	14.3%

Proportion of those in over-indebted households that experienced a major drop in income over the preceding year

Over-indebted (% of people in households that experienced drop in income)	↘ 31.2%	33.3%	0.0%	77.6%
Other (% of people in households that experienced drop in income)	↘ 18.2%	19.2%	5.9%	32.5%

IV. Loans and credit outstanding⁴



Notes:

(1) Eurobarometer 72.1 (2009) and Eurobarometer 74.1 (2010). Note: Those who answered 'very at risk' or 'fairly at risk' to the question 'Please tell me how much you feel at risk of being over-indebted'.

(2) Eurostat, SILC. Data as of December 2012.

(3) European Commission, Research Note 4/2010, Over-indebtedness new evidence from the EU-SILC special module.

(4) European Commission, Research Note 4/2010, Over-indebtedness new evidence from the EU-SILC special module. European Credit Research Institute (ECRI), Lending to households in Europe, 1995-2009 and Eurostat, National accounts.

ANNEX B: COMPLEMENTARY NATIONAL STATISTICAL DATA

Table 1. Consumer price index for select categories, 2007-2011

Source: Statistik Austria.

	2007	2008	2009	2010	2011
Average across categories	114.6	118.3	118.9	121.1	125.0
Food and non-alcoholic beverages	117.2	124.5	124.8	125.4	130.7
Housing and utilities	125.4	128.8	131.1	134.5	138.9

Table 2. Number of persons counselled by debt counselling institutions, 2007-2011

Source: ASB Schuldnerberatungen.

	2007	2008	2009	2010	2011
Number of persons counselled	41,681	47,525	52,613	52,450	54,324

Table 3. Number of new private insolvency procedures and estimated total liability

Source: KSV 1870.

	2007	2008	2009	2010	2011
Number of new procedures	7,357	8,480	9,007	9,028	9,596

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2 BELGIUM

Document The over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact - Country report Belgium

Prepared by Michiel De Muynck

Finalised on 15 October 2012

Final report

Over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact

2.1 DEFINITION OF OVER-INDEBTEDNESS

When asked whether they use a specific definition of over-indebtedness, nearly all stakeholders interviewed in Belgium mentioned the definition included in the chapter on personal insolvency schemes of the Code of Civil Procedure¹ and stated that a better definition is not needed.

To be eligible for a personal insolvency procedure, a consumer (that is, a natural person) needs to be unable to pay his or her debts for a significant period of time.² The sustainable character of a consumer's financial difficulties is essential and having difficulties in meeting payments is therefore insufficient in the context of the existing legal framework. Whereas an actual arrears is not formally required, the mere risk of becoming over-indebted is also an insufficient threshold for the Belgian personal insolvency procedure. Note, furthermore, that traders are excluded³ and that debts are not aggregated at the household level (but only at the individual level) for the purposes of the Belgian personal insolvency procedure.

2.2 LEVEL OF OVER-INDEBTEDNESS

Most stakeholders interviewed for this study assessed that the number of over-indebted households had increased over the previous five years.

Data from EU-SILC supports this assessment and shows that the percentage of the total population in Belgium with arrears increased from 6.1% in 2007 to 7.8% in 2011 (remaining, however, below the EU average of 11.4%).⁴

The same period saw an increase in the percentage of households with difficulties making ends meet from 15.3% to 20.9%.⁵ The Eurobarometer indicates that in 2010 almost one in three respondents in Belgium felt at risk of over-indebtedness, which is above the EU average.⁶

In 2011, there were 17,544 applications for a personal insolvency procedure in Belgium. This is fewer than in 2010 (17,864 applications) but considerably more than

¹ One interviewee working for a public authority, however, defined households with at least one arrears in the past year for mortgage or rent payments, utility bills, hire purchases or other loans as those that are over-indebted.

² The Belgian Code of Civil Procedure (Article 1675/2) states that any natural person in Belgium, who is not a trader and is not in a position to pay their due or expected debts in a sustainable way, and has not deliberately organised insolvency, can apply to the court for a collective settlement of their debts.

³ The Belgian Code of Civil Procedure (Article 1675/2) refers in this regard to Article 1 of the Belgian Commercial Code (10 September 1807) that defines traders as those who professionally, as chief or complementary occupation, perform transactions qualified by law as acts of commerce.

⁴ Eurostat, 'Arrears (mortgage or rent, utility bills or hire purchase)' (code: ilc_mdcs05).

⁵ Eurostat, 'Inability to make ends meet' (code: ilc_mdcs09)

⁶ Special Eurobarometer 355, 'Poverty and Social Exclusion Report', 2010, p. 41.

the pre-crisis years (for instance, there were 12,778 applications in 2007 and 12,900 in 2008).⁷ The total indebtedness of Belgian households in 2011 amounted to 53.3% of the GDP (compare with the Euro zone: 65.9% of GDP).⁸ Although the total number of debts had increased, the average amount of debt was reported in the interviews to be lower. Data from the Central Credit Register for Consumers confirms that consumers are taking out smaller loans.⁹

The total number of credit agreements registered at the Central Bank's Central Credit Register for Consumers with (at least one) default has increased in recent years. No less than 319,092 consumers were registered with at least one default in 2011,¹⁰ representing a 3.3% increase from the previous year. Young people (between 25 and 44 years old) in particular have difficulties in repaying their credit.¹¹

Data from the EU-SILC special research module on over-indebtedness, however, indicate that in 2008 significantly fewer Belgian households than the EU average had outstanding debt and arrears on loans, credit, store cards or bank accounts (see Annex A). Slightly more Belgian households than the EU average, by contrast, were in arrears with their housing-related loans and/or bills and other bills.

Consumers indeed face increasing difficulties in paying their utility debts. While no aggregated national data exists, some regional observations can be made. For instance, in 2011 approximately 105,000 Flemish households had a debt repayment plan in force with their energy provider. Almost 88,000 Flemish households purchased energy from the network administrator after their utility agreement was dissolved upon default.¹² In a similar vein, 89,000 debt repayment plans (or 6% of the total number of consumer contracts for electricity in the Walloon region) were granted by providers of electricity in the Walloon Region in 2010. This is slightly fewer than in 2009 (when 109,000 payment plans were granted or 7% of the total number of consumer contracts for electricity in the Walloon region).¹³

⁷ See Banque Nationale de Belgique, *Centrale des crédits aux particuliers: Statistique 2011*, Banque Nationale de Belgique, 2012, p. 61.

⁸ *Ibid.*, p. 10.

⁹ *Ibid.*, p. 19.

¹⁰ *Ibid.*, p. 17.

¹¹ *Ibid.*, p. 35.

¹² When (private) utility agreements are dissolved, the (public) network administrator serves as last-resort provider of energy. See press release VREG (the Flemish energy regulator) from 18 June 2012.

¹³ See the report of the Walloon energy regulator: Commission Wallonne pour l'Energie (CWAPE), *L'exécution des OSP à caractère social imposées aux fournisseurs et gestionnaires de réseau*, 2011, pp. 19 and 23.

2.3 NATURE AND DRIVERS OF OVER-INDEBTEDNESS

2.3.1 Most common types of households that are over-indebted

Over-indebtedness affects all age groups. Although the situation is difficult to assess (accurate national statistics are lacking on this point; note also the above-mentioned focus on individuals rather than households), it seems that households consisting of people between the ages of 25 and 39 (particularly those households consisting of people between 30 and 39)¹⁴ or younger are more likely to be affected by over-indebtedness. Where individuals below the age of 35 only accounted for 18.7% of new borrowers in 2011, not less than 36.1% of all borrowers with a new default in 2011 belonged to the same age group.¹⁵ One-person households are more at risk of becoming over-indebted than couples. Having children seems to be another risk-factor. In particular, one-person households with children suffer financial difficulties.¹⁶

Renting accommodation also seems to correlate with the likelihood of over-indebtedness. Of all possible housing tenures, households living in rented accommodation clearly dominate the statistics. Homeowners are less likely to suffer from over-indebtedness. Note that Belgium had an owner occupied housing rate of 78% in 2010 (the EU27 average in 2010 amounted to 68.9%).¹⁷ It might be interesting to mention in this regard that in 2011 mortgage credits only constituted 6.3% of the total number of registered credit agreements with a default but represent 23.7% of the total credit contracts.¹⁸

Unemployment is another significant factor. Households with two unemployed persons in particular suffer financial difficulties and over-indebtedness. Finally, there seems to be a minor correlation between over-indebtedness and education: individuals with a lower level of education are more likely to suffer financial problems.¹⁹

The Central Bank's statistics on credit and personal insolvency procedures focus on the individual, and stakeholders indicated difficulties in categorizing over-indebted households. This also holds true for identifying changes; several respondents did not provide (or know) an answer to the question of whether the types of over-indebted households had changed over the previous five years. A majority of the interviewees, however, noted a fairly significant change. The impact of the recent economic and

¹⁴ See Vlaams Centrum Schuldenlast, Basisnota Schuldpreventie 2011. This source indicates that individuals between the age of 25 and 29 suffer considerably less from difficulties in meeting their financial commitments.

¹⁵ See Banque Nationale de Belgique, 2012, p. 11. See also EU-SILC data on Belgium in Annex A.

¹⁶ See Vlaams Centrum Schuldenlast, Basisnota Schuldpreventie 2011, p. 29.

¹⁷ ,HYPOSTAT 2010 A Review of Europe's Mortgage and Housing Markets, *European Mortgage Federation* . 2010, pp. 23-24.

¹⁸ See Banque Nationale de Belgique, 2012, p. 20.

¹⁹ On the relation between over-indebtedness and education, see for instance: L'Observatoire du Cr dit et de l'Endettement, Pr vention et traitement du surendettement en Wallonie: Rapport d' valuation 2010, December 2011, p. 56.

financial crisis (leading to, among other things, increased unemployment) was cited as a factor. More specifically, middle class households run an increased risk of becoming over-indebted.

Lastly, the number of over-indebted households varies with the geographical region.²⁰

2.3.2 Causes of households' over-indebtedness

Determining the exact causes of households' over-indebtedness is a difficult exercise. As was pointed out in the stakeholder interviews, it is often the case that there are several causes (relating the debtor's income, pattern of spending and skills) interact with each other.²¹

Macro-economic factors

The level of unemployment is – unsurprisingly – a dominant cause of financial difficulties and/or over-indebtedness in the view of the interviewed stakeholders. Wage and, to a lesser extent, social welfare level,²² are other important macro-economic causes for financial difficulties that were highlighted in the interviews.²³ Social welfare levels are, for a significant part, situated below the poverty line (60% national median income).²⁴

It is noteworthy that while the unemployment level (at 7% in the second quarter of 2012)²⁵ is below the EU27 average, no less than 20% of the Belgian population was at risk of poverty or social exclusion in 2010.²⁶

Cost of living

Housing, utility and (to a lesser extent) healthcare costs were commonly cited by stakeholders as the underlying causes of over-indebtedness. Several interviewees explicitly pointed out the (increasing) costliness of renting property in Belgium.²⁷

²⁰ Although Ghent (with its approximately 248,500 inhabitants) is considerably larger than for instance Liège (approximately 197,000 inhabitants), it counted significantly fewer ongoing personal insolvency procedures in 2011 (6,102 versus 10,435). A geographical overview of the number of credit agreements in arrears confirms the regional variability. See Banque Nationale de Belgique, 2012, for an overview of the number of credit agreements in arrears per geographical region (pp. 38-39) and figures about personal insolvency procedures per region (p. 58).

²¹ See also Vlaams Centrum Schuldenlast, Basisnota Schuldpreventie 2011, p. 14.

²² Two respondents explicitly cited the low government allowance (for those people who do not benefit from unemployment benefits).

²³ Many respondents indicated – unsurprisingly – that households at risk of poverty (those households with less than 60% of the median disposable income) are more likely to be hit by over-indebtedness.

²⁴ See Interfederal Poverty Barometer: https://enquete.mi-is.be/armoedebrometer/pages_fr/1_3_socialeUitkeringen.html#

²⁵ For the official statistics, see Statistics Belgium: <http://statbel.fgov.be/fr/statistiques/chiffres/travailvie/emploi/trimestriels/>.

²⁶ See Eurostat, 'Proportion of population being at risk of poverty or social exclusion' (code: tdsc100).

There is no official national data on the distinct debt components, but a survey implemented in the Walloon Region has identified housing, energy, healthcare and telecommunication as the most common types of debt (apart from public debts such as unpaid taxes and not considering consumer credit).²⁸

Types of credit/loan taken out by households

Regulated consumer credit types, especially forms with higher interest rates (for instance overdraft facilities and retailer credit), were most frequently indicated by stakeholders as causes of financial difficulties.²⁹ In 2011 the number of overdraft facilities in arrears increased at a relatively higher rate than other types of credit.³⁰ In particular, overdraft agreements concluded with non-credit institutions incur arrears.³¹ One should however note that over-indebtedness is broader than the regulated forms of credit: 36.9% of the individuals applying for a personal insolvency procedure were not registered in the negative credit register of the Central Bank.³²

Mortgage credit was less frequently indicated as a cause of over-indebtedness. Unlike some other European countries, the Belgian housing market has not gone through severe adjustments and housing prices are increasing steadily over the longer term. With an outstanding amount of residential mortgage credit of approximately 163.4 billion Euro at the end of 2010, Belgium reached its highest mortgage lending level ever.³³

A few stakeholders pointed to predatory or usurious types of credit or loans and easy-to-obtain products in the financial services industry as important causes of over-indebtedness.

No research could be identified on the (illegal) predatory lending market in Belgium. The offering of usurious types of credit is prevented by the Belgian Consumer Credit Code, which imposes interest-rate caps.³⁴

²⁷ Some stakeholders associated the expensive character of rented accommodation with the large proportion of Belgians who own their own house and the limited availability of social housing.

²⁸ See L'Observatoire du Crédit et de l'Endettement, *Prévention et traitement du surendettement en Wallonie, Rapport d'évaluation 2010*.

²⁹ One respondent working for a public authority highlighted, however, that there is no data available on the exact interest rate nor on the use of the borrowed funds.

³⁰ See Banque Nationale de Belgique, 2012, p. 20.

³¹ *Ibid.*, p. 27.

³² This includes 21.3% without any contract and 15.6 % with no defaulting credit agreement. See Banque Nationale de Belgique, 2012, p. 60. It is to be noted that not all consumer credit agreements are included in the Central Register.

³³ See for this and other data: European Mortgage Federation, HYPOSTAT 2010 A review of Europe's mortgage and housing markets, pp. 23-24.

³⁴ Recently, however, a foreign SMS-credit provider entered the Belgian market, granting credit of up to 200 Euro for a period up to two months and presenting this as 'interest free' while requiring an 'administrative fee' of more than 40 Euro, thereby (ab-)using an (already adapted) exclusion for these kind of credits under the Belgian Consumer Credit Code.

Personal circumstances

Primary personal circumstances identified by the stakeholders as causing over-indebtedness are related to a drop in income (due to unemployment, business failure, illness, divorce, etc.). Poverty (a low level of income) and an increase in living expenses while income is stagnant or decreasing were also common explanations provided in the interviews, as were a lack of money management skills and an inability to deal with financial products. Young people in particular seem to show risky spending patterns.³⁵

2.3.3 Changes relevant for levels of over-indebtedness

Most respondents noted macro-economic changes that increased the level of over-indebtedness in Belgium. Increased unemployment seems to be the most important driver for growing financial hardship. The rising cost of living was pointed out by some interviewees as a trigger for the accumulation of utilities, telecommunication services and rent debts.³⁶ No mitigating macro-economic factors were cited.

While a majority of respondents shared the opinion that creditors had not restricted access to credit,³⁷ one financial industry stakeholder mentioned tightened lending conditions. Households are apparently taking out more small loans.³⁸ As some interviewees pointed out, overdraft facilities are often used (that could be linked to a credit or store card, i.e. a(n instalment) credit card bearing both the issuing retailer's logo and the credit card company's logo and allowing consumers to purchase goods and services on credit at the retailer). In this context, some respondents moreover emphasised new marketing practices that were perceived to be aggressive.

2.3.4 Cultural attitude towards debt and actual level of households' (over-)indebtedness

Most stakeholders shared the opinion that the cultural attitude towards debt in Belgium relates to the actual level of over-indebtedness. One interviewee said: "Belgians are used to saving lots of money." A potentially harmful attitude mentioned in the interviews is that households tend to not talk about money management (for instance with relatives or friends). One interviewee pointed out that over-indebtedness is often perceived as a personal failure.

Some respondents noted that cultural attitudes towards practices that could increase debt have been changing (for instance, a perception of credit as a 'necessity in the

³⁵ See for example Vlaams Centrum Schuldenlast, *Basisnota Schuldpreventie 2011*, p. 63.

³⁶ One respondent working for a public authority noted that an increasing number of households make use of social suppliers for utilities.

³⁷ The increased number of new credit contracts confirms this. See Banque Nationale de Belgique, 2012, p. 19 and the following.

³⁸ On the (evolution of the) average amount of newly concluded credit agreements see Banque Nationale de Belgique, 2012, p. 19.

credit society', a growing 'keeping up with the Joneses' mentality,³⁹ or an increasing tendency to blame creditors for too much credit).

2.4 CONSEQUENCES OF OVER-INDEBTEDNESS

2.4.1 Consequences for affected households

Public initiatives in the field of over-indebtedness prevent a household with arrears from being disconnected from electricity or instantly expelled from their rented home.⁴⁰ Belgium also has legislation that seeks to guarantee a minimum access to a bank account for every citizen,⁴¹ mitigating financial exclusion that can arise from over-indebtedness.

Reduced standards of living and deteriorating well-being were the most highly rated by the stakeholders as consequences suffered by over-indebted households in Belgium, followed by deteriorating mental health and family breakdown/divorce. One interviewee explicitly linked family breakdown with deteriorating mental health and well-being.

As a consequence of over-indebtedness, some of households' members may be involved in a personal insolvency procedure (which could be an amicable or - in case parties do not succeed in reaching an amicable settlement - a judicial procedure).⁴² One may discern a link between the financial crisis and the number of over-indebted households that opted for personal insolvency procedures.⁴³

2.4.2 Consequences of over-indebtedness for the financial services industry

According to stakeholders, the most direct consequences of over-indebtedness for the financial services industry are the cost of arrears or default on a credit agreement. The total credit defaults for credit registered at the Central Credit Register amounted up to 2,549 million Euro in 2011.⁴⁴

³⁹ This implies the buying of goods and/or services to keep up with 'expected standards' of society.

⁴⁰ See for instance Flemish Decree regarding general measures concerning energy policy (from 8 May 2005) and the special rules of the Civil Code that apply whenever immovable property is rented as a home.

⁴¹ La loi du 24 mars 2003 instaurant le service bancaire de base regulates the access to a bank account.

⁴² Under the amicable procedure, a debt mediator manages the debtor's budget and seeks a settlement with the creditors. The Judicial Code strictly regulates both procedures (among others the powers of the actors under both the amicable and judicial procedure, as well as the procedural aspects).

⁴³ While the number of admitted personal insolvency procedures in 2007 and 2008 amounted for instance to 12,788 (2007) and 12,900 (2008) respectively, this number amounted to 15,904 procedures (in 2009), 17,864 procedures (in 2010) and 17,544 procedures (in 2011). See Annual Report of the Central Credit Register for Consumers, p. 61.

⁴⁴ Banque Nationale de Belgique, 2012, p. 17.

In Belgium credit providers contribute to the funding of the Fund Against Over-Indebtedness (Fonds de Traitement du Surendettement)⁴⁵ in proportion to the credit default they manage in relation to their market share.⁴⁶

2.4.3 Economic and social consequences of over-indebtedness for society

Legal costs associated with over-indebtedness and costs associated with debt advisory services, assisting households to repay their debts or arrears and with other measures to alleviate the impact of over-indebtedness were commonly cited by the stakeholders as the main economic and social consequences of over-indebtedness.

2.4.4 Debt collection practices

The activity of debt collection is regulated in Belgium.⁴⁷ One independent expert commented that "there are hardly any aggressive debt collection practices".

However, some problems have occurred because "bailiffs were also active in the domain of collection of debts outside of court procedures" and they "used their legal function as bailiffs to do collection of debts outside of legal procedures", as one interviewee working for a public authority explained. As a result, the legislation has been amended to require that bailiffs' functions (officer of the court vs. debt recovery) have to be made very clear in each case.

One stakeholder noted that creditors resort more frequently to courts and another reported that there had been an increase in debts for necessities such as healthcare and education, with hospitals and schools using private companies to collect debts.

2.5 MEASURES IN FORCE TO ALLEVIATE THE IMPACT OF OVER-INDEBTEDNESS

2.5.1 Early identification of households at risk

There was no consensus among stakeholders as to whether measures for the early identification of households at risk of over-indebtedness were common in Belgium (the answers given ranged from "very common" to "not common at all").

In their explanations several interviewees referred to the requirement that creditors consult a public database in order to assess a consumer's creditworthiness in cases of credit applications and of substantial increases in amounts of credit being extended.

⁴⁵ See 'Fonds de Traitement du Surendettement' at FPS Economy SMEs, Self-Employed and Energy (available at http://economie.fgov.be/fr/consommateurs/Endettement_recouvrement_dettes/Reglement_collectif_dettes/Fonds_Traitement_Surendettement/).

⁴⁶ See Article 20 Loi relative au règlement collectif de dettes et à la possibilité de vente de gré à gré des biens immeubles saisis, 5 July 1998.

⁴⁷ See Loi relatif au recouvrement amiable des dettes du consommateur, 20 December 2002.

This is stipulated in the Consumer Credit Code⁴⁸ (which contains a number of other important provisions).⁴⁹ The database, held by the Central Bank, contains both a negative and a positive register. The negative refers to credits with at least one default and the positive to all consumer credits of an individual. Creditors should refrain from granting credit if the outcome of the creditworthiness assessment is negative.⁵⁰ Refraining from an (adequate) creditworthiness assessment could trigger both civil and criminal sanctions.

2.5.2 Advice offered to over-indebted households

Face-to-face personalised debt advice is widely available in Belgium.⁵¹ The service is offered by public centres of social welfare (i.e. CPAS⁵² in the French-speaking part and OCMWs and CAWs in Flanders⁵³) at the municipal level as well as by recognised debt mediators (lawyers, public officers and notaries). Whereas debt advice from social welfare centres is generally (at least partly) free of charge, private debt mediators charge consumers for their services.⁵⁴

Official data on the availability, demand and outcomes of debt advice by telephone, email, online chat, web-based tools⁵⁵ or printed information targeted at over-indebted households is not available. According to the stakeholders all these forms of advice are available at least to some extent and are mostly provided free of charge.

Face-to-face personalised debt advice is a fairly popular service; almost all stakeholders indicated a high demand. Furthermore, most of them assessed that demand for debt advice had increased in the previous five years. Increased waiting lists for the public debt advice are an important drawback mentioned in a number of interviews. The average waiting period in Flanders was up to three months in 2010.⁵⁶

⁴⁸ See also Article 8 Directive 2008/48/EC.

⁴⁹ Article 38, for instance, allows courts to grant respite to consumers who are suffering from a deteriorating financial situation. There are also provisions that relate to overrunning (a tacitly accepted overdraft whereby a creditor makes available to a consumer funds which exceed the current balance in the consumer's current account or the agreed overdraft facility; see Article 60). Offering credit agreements at the consumer's home or place of employment is only allowed upon an explicit and *ex ante* request of the consumer; see Articles 7-9). There is also a cap on the damages a consumer has to pay in case of default (see Article 27bis).

⁵⁰ See Article 15, paragraph 2 Belgian Consumer Credit Code. See also Article 64 paragraph 1 (with regard to credit intermediaries).

⁵¹ At the end of 2010 for instance, the Flemish Centre for Debt Mediation counted 65,606 cases with regard to debt advice (note that this is for the Flemish region only). Also in 2010, 19,149 debt mediations took place in the Walloon region. See Vlaams Centrum Schuldenlast, Basisnota Schuldpreventie 2011, p. 14 and Prévention et traitement du surendettement en Région wallonne - Rapport d'évaluation 2010, p. 32.

⁵² See for example <http://www.cpasbru.irisnet.be/index.php?perma=CPASOCMW>.

⁵³ See for instance (for the city of Antwerp) <http://ocmw.antwerpen.be/>.

⁵⁴ Article 1675/19 Code of Civil Procedure authorises the government to fix the wage scales for mediators.

⁵⁵ See for instance <http://www.budgetplanner.be> (only in Dutch), <http://www.eerstehulpbijschulden.be> (only in Dutch).

⁵⁶ See Vlaams Centrum voor Schuldbemiddeling, Cijfermateriaal basisregistratie 2007-2010, p. 10.

There was broad agreement among stakeholders that personalised face-to-face debt advice is an effective measure.

Private debt mediators administer a debtor's financial affairs and repayment plan for a period of up to five or even six years upon personal bankruptcy. It should be noted that no effective and objective indicators to measure effectiveness of the procedure are available. One interviewee regretted the curative focus and the omission to adequately strengthen consumers' money management skills during the (private) debt mediation process.

Private debt advice in the course of a personal insolvency procedure is paid for by the debtors themselves.⁵⁷ Only when a court grants a complete remission of debt or when the debtor is insolvent may private debt mediators lodge a claim to a public fund: the Fund Against Over-indebtedness.⁵⁸ As previously mentioned, this fund is financed by the financial industry. Creditors have to contribute according to the number of arrears and defaults in their credit portfolios.

Public debt advice is funded by the regional governments which have a statutory obligation to provide social assistance.⁵⁹ Most respondents assessed the funding for debt advice services as not sufficient.

2.5.3 Key measures in place to alleviate the impact of over-indebtedness

Availability and costs

Informally brokered arrangements between the debtor and creditors such as a repayment plan, a debt management plan or debt write-off that may be brokered by a debt counsellor

Informally brokered arrangements between debtors (or private debt mediators)⁶⁰ and creditors were reported by interviewees to be widely available and (partly) free of charge. However, one stakeholder pointed out that these plans largely depend on a creditor's goodwill. The provision in the Belgian Consumer Credit Code that allows courts to grant respite to consumers who suffer from a deteriorating financial situation may allow debtors and mediators to exert leverage on a creditor.⁶¹

⁵⁷ See art. 1675/19 paragraph 2 Belgian Judicial Code.

⁵⁸ See Royal Decree of 9 August 2002 and the aforementioned article 20 Loi relative au règlement collectif de dettes et à la possibilité de vente de gré à gré des biens immeubles saisis of 5 July 1998.

⁵⁹ See Article 1 Loi organique des centres publics d'aide sociale (8 July 1976).

⁶⁰ Article 67 of the Belgian Consumer Credit Code restricts the activity of debt mediation to lawyers, officers of justice, ministerial officials or institutions recognised by the government.

⁶¹ The Code contains a similar provision in its Article 1244. This could be relevant for debt other than consumer credit debt (e.g. utilities).

Formal procedures for debt settlement that do not take place in court

Formally brokered arrangements between debtors (or private debt mediators) and creditors were also assessed to be widely available and (partly) free of charge.

The Belgian Code of Civil Procedure provides for amicable arrangements.⁶² These are subject to approval by the court.⁶³ The data from the Central Credit Register for Consumers show that in the year 2011 no less than 25,594 amicable procedures were on-going (compared to 24,031 procedures in 2010, 22,251 procedures in 2009, 20,677 in 2008 and 17,300 in 2007).⁶⁴

Legal procedures that take place in court (e.g. consumer insolvency proceedings)

Legal procedures in court take place often. The 2011 report of the Central Credit Register for Consumers indicates for instance that 4,140 personal insolvency procedures were pending in court in 2011.⁶⁵

Financial support for households to repay debts/arrears (e.g. by public fund)

One respondent working for a public authority stated social welfare offices may provide financial support to over-indebted households and determine on a discretionary basis (depending on the debtor's personal situation) whether or not the support has to be repaid.

Effectiveness as assessed by stakeholders

While official data is lacking, both informally and formally brokered arrangements between creditors and debtors were judged by interviewees to be a fairly effective measure to alleviate the impact of over-indebtedness. One stakeholder criticised however Belgian lawmakers' reluctance to provide people with a real 'fresh start' (i.e. the excessive focus on the pay-off of debt). Another interviewee noted that courts are overloaded with work. One financial industry stakeholder favours amicable arrangements over courts whenever they deal with "honest" individuals, whereas one civil society stakeholder questioned the long-term effectiveness of financial support.

2.5.4 Changes in response to over-indebtedness

Some legal changes have already been mentioned in previous sections, such as the amendments regarding debt collection by bailiffs.

⁶² See Art. 1675/10 and the following Belgian Judicial Code.

⁶³ See Article 1675/10 paragraph 5 Belgian Judicial Code.

⁶⁴ See Banque Nationale de Belgique, 2012, p. 59.

⁶⁵ Ibid.

The 2010 makeover of the Consumer Credit Code restricted certain forms of advertising that may induce consumers to take irresponsible credit decisions.⁶⁶ In addition, the requirement to register credits in the Central Bank's Credit Register was expanded (prior to 2011, overdraft facilities that did not exceed the amount of 1,250 Euro and were repayable within a period of 3 months were not registered in the Credit Register).⁶⁷

Several stakeholders pointed to amendments to the Code of Civil Procedure with regard to personal insolvency procedures.⁶⁸ Besides some procedural aspects, the amendments introduced the possibility of a total cancellation of debt and moved the competence for personal insolvency to the labour courts.

2.5.5 Types of households of over-indebted consumers not reached by current measures

As previously mentioned, traders are formally excluded from the personal insolvency procedure. Among other households that are insufficiently reached by current measures – taking into account the debt stigma and the predominant curative approach – are those that are too embarrassed to take the first steps themselves and ask for help, as one interviewee pointed out.

2.5.6 Best practices

Responsible lending was prominent among the best practices mentioned by stakeholders, in terms of measures to alleviate the impact of over-indebtedness. This includes the assessment of a consumer's creditworthiness (using among other tools the Central Bank's Public Register) and refraining from granting credit in the case of a negative creditworthiness assessment. Some stakeholders also listed the personal insolvency scheme and the Fund Against Over-indebtedness as best practice.

2.6 OUTLOOK

Stakeholders' expectations regarding the number of over-indebted households in the next five years were rather grim, with the majority expecting this number to increase. This view corresponds with the trend of an increasing number of personal

⁶⁶ Article 6 prohibits advertising that (1) induces over-indebted consumers to take up credit, (2) stresses the ease and speed of obtaining credit or (3) induces consumers to centralise existing credit agreements as well as advertising that claims that existing credit agreements are not taken into account in assessing credit applications.

⁶⁷ See http://www.nbb.be/pub/04_00_00_00_00/04_02_00_00_00/04_02_02_00_00.htm.

⁶⁸ See Loi du 13 decembre 2005 portant des dispositions diverses relatives aux délais, à la requête contradictoire et à la procédure en règlement collectif de dette. See also http://economie.fgov.be/fr/modules/publications/general/le_reglement_collectif_des_dettes.jsp.

insolvencies over the past few years.⁶⁹ The impact of the financial crisis was a recurring theme in the interviews.

The majority of interviewees indicated that additional changes are needed in the regulation of credit and specific commercial practices of lenders.⁷⁰ Some interviewees assessed the need for additional changes regarding utilities and housing. One interviewee working for a public authority explained that the practices of utility companies are not confined to Belgian boundaries. Finally, the need for (additional) financial education was stressed in some interviews and several stakeholders called for a shift from curative measures to the prevention of over-indebtedness.

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⁶⁹ See Banque Nationale de Belgique, 2012, p. 61.

⁷⁰ One interviewee commented: "More and more lenders are organised on EU level and measures should be taken on that level."

ANNEX A: STATISTICAL DATA FROM EU SOURCES

Final report

Over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact

Belgium

I. Eurobarometer¹

	Belgium	EU average	Lowest EU value	Highest EU value
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Households *at risk* of being over-indebted

Respondents feeling at risk of over-indebtedness in 2010	↗ 29%	25%	7%	52%
Respondents feeling at risk of over-indebtedness in 2009	↗ 27%	27%	9%	53%

II. EU SILC standard survey data²



III. EU SILC 2008 module: Over-indebtedness and financial exclusion³

	Belgium	EU average	Lowest EU value	Highest EU value
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Proportion of people in households with bank overdrafts, outstanding balances on credit cards or in arrears on other loans of over 100% of household disposable income

Overdrawn bank account (% of people in households overdrawn)	↘ 0.8%	2.2%	0.0%	7.7%
Credit or store card (% of people in households with outstanding balances)	↘ 0.3%	1.1%	0.0%	8.6%
Other loan/credit payments (% of people in households in arrears)	↘ 0.0%	0.3%	0.0%	1.1%

Proportion of people in households in arrears in servicing housing-related loans and bills and in paying other bills of over 100% of household disposable income

Housing bills (% of people in households in arrears)	↗ 0.6%	0.5%	0.0%	2.9%
Other payments (% of people in households in arrears)	↗ 0.5%	0.4%	0.0%	1.7%

Households living with outstanding debts and/or arrears of over 100% of household disposable income

Total (% of households with outstanding debts/arrears)	↘ 2.1%	4.6%	0.0%	11.8%
Income above 60% median (% of households with outstanding debts/arrears)	↘ 1.5%	4.2%	0.0%	11.3%
Income below 60% median (% of households with outstanding debts/arrears)	↘ 5.6%	7.0%	0.2%	13.7%
Materially deprived (% of households with outstanding debts/arrears)	↗ 12.2%	9.0%	0.1%	27.4%

Proportion of those in broad age groups with outstanding debts of over 100% of household disposable income

Households with all adults aged 25-39 (% of households with outstanding debts)	↘ 2.3%	6.3%	0.0%	17.2%
Households with all adults aged: 40-64 (% of households with outstanding debts)	↘ 2.2%	5.8%	0.0%	10.9%
Households with all adults aged: 65+ (% of households with outstanding debts)	↘ 0.2%	1.2%	0.0%	2.8%

Proportion of those in different types of household with outstanding debts of over 100% of household disposable income

Living alone (% of people in households with outstanding debts)	↘ 2.2%	4.3%	0.0%	8.2%
Single parent (% of people in households with outstanding debts)	↘ 4.0%	9.5%	0.0%	27.1%
Other (% of people in households with outstanding debts)	↘ 1.9%	4.8%	0.0%	12.1%

Proportion of those in households with outstanding debts of over 100% of household disposable income by marital status

Never married (% of people in households with outstanding debts)	↘ 2.0%	5.0%	0.0%	15.4%
Married (% of people in households with outstanding debts)	↘ 1.5%	4.1%	0.0%	9.7%
Separated/divorced (% of people in households with outstanding debts)	↘ 2.4%	7.5%	0.1%	13.9%
Widowed (% of people in households with outstanding debts)	↘ 0.6%	1.7%	0.0%	4.3%

Proportion of those in households with outstanding debts of over 100% of household disposable income by housing tenure

Owner occupied without mortgage (% of people in households with outst. debts)	↘ 0.7%	3.2%	0.0%	9.6%
Owner occupied with mortgage (% of people in households with outst. debts)	↘ 2.2%	6.3%	0.0%	16.1%
Market rent (% of people in households with outstanding debts)	↘ 4.1%	8.2%	0.0%	16.0%
Subsidised rent (% of people in households with outstanding debts)	↘ 2.3%	8.7%	0.0%	17.9%
Rent-free housing (% of people in households with outstanding debts)	↗ 3.4%	2.3%	0.0%	15.1%

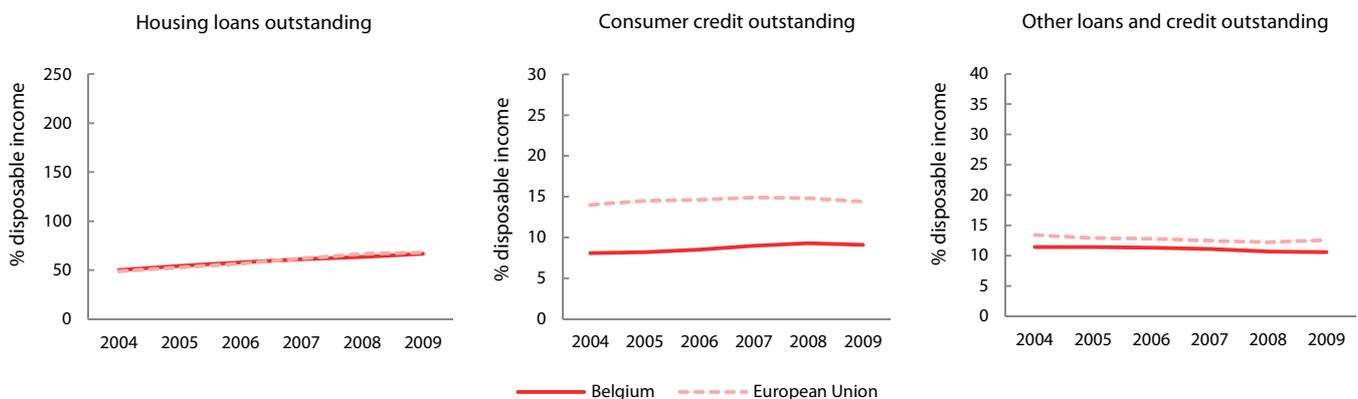
Proportion of those in households with outstanding debts of over 100% of disposable income by work intensity

Work intensity of 0 - 0.19 (% of people in households with outstanding debts)	↘ 4.6%	5.7%	0.0%	10.6%
Work intensity of 0.20 - 0.50 (% of people in households with outstanding debts)	↘ 4.0%	5.7%	0.0%	15.3%
Work intensity of 0.51 - 0.74 (% of people in households with outstanding debts)	↘ 0.6%	5.4%	0.0%	13.5%
Work intensity of 0.75 - 1.0 (% of people in households with outstanding debts)	↘ 1.3%	5.3%	0.0%	14.3%

Proportion of those in over-indebted households that experienced a major drop in income over the preceding year

Over-indebted (% of people in households that experienced drop in income)	↘ 22.0%	33.3%	0.0%	77.6%
Other (% of people in households that experienced drop in income)	↘ 10.0%	19.2%	5.9%	32.5%

IV. Loans and credit outstanding⁴



Notes:

- (1) Eurobarometer 72.1 (2009) and Eurobarometer 74.1 (2010). Note: Those who answered 'very at risk' or 'fairly at risk' to the question 'Please tell me how much you feel at risk of being over-indebted'.
- (2) Eurostat, SILC. Data as of December 2012.
- (3) European Commission, Research Note 4/2010, Over-indebtedness new evidence from the EU-SILC special module.
- (4) European Commission, Research Note 4/2010, Over-indebtedness new evidence from the EU-SILC special module. European Credit Research Institute (ECRI), Lending to households in Europe, 1995-2009 and Eurostat, National accounts.

3 BULGARIA

Document The over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact - Country report Bulgaria

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Final report

Over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact

3.1 DEFINITION OF OVER-INDEBTEDNESS

Neither a standard nor widely accepted definition of over-indebtedness is used in Bulgaria. Likewise, a clear majority of the interviewed stakeholders do not use a specific definition of over-indebtedness. Those who do, use idiosyncratic definitions, tailored primarily to serving the operational needs of the organisations they work for. For example, the industry that provides debt advice to consumers for a fee falls back on the banking industry risk management threshold for granting credit. This threshold is defined as the monthly servicing of loans equal or less than 50% of a household's disposable income and the remaining monthly income for covering living expenses no less than 100 Euro per household member. A respondent who deals with delinquent borrowers defines over-indebtedness simply as a situation in which a borrower has been in arrears for at least 30 days. Another respondent, a civil society stakeholder, uses a broad definition of over-indebtedness as a characteristic of an individual who has borrowed in excess of their capacity to repay.

When asked why they are not using a definition of over-indebtedness, respondents cited a variety of reasons. Most indicated that dealing with over-indebtedness on a case-by-case basis is adequate, while others cited the absence of a commonly accepted definition in Bulgaria.

The idiosyncratic definitions used by the stakeholders differ from the one applied in the present study, namely:

- ▶ One definition is deemed broader, although it remains unclear whether this definition encompasses arrears on utility bills or is restricted only to delinquencies on bank loans;
- ▶ Another definition concerns individuals, not households;
- ▶ Most definitions have no temporal (structural) dimension;
- ▶ Local definitions are not based on administrative or judicial procedures such as personal bankruptcy proceedings, since they are unknown in Bulgaria.

Moving from the actual over-indebtedness to the risk of falling into over-indebtedness, respondents unanimously reported that they were not using any definition to identify households at risk.

Given the gaps in defining and measuring over-indebtedness in Bulgaria, one might have expected stakeholders to agree on the need for a common definition of over-indebtedness as well as of the households at risk of becoming over-indebted. That, however, was not the case and only a minority of interviewees indicated that better definitions were needed.

3.2 LEVEL OF OVER-INDEBTEDNESS

The number of households that are over-indebted has increased over the past five years in Bulgaria according to the interviewees.

It should be noted that national data is scarce, incomplete and unfocused on the issue of over-indebtedness; but the level of over-indebtedness and the related trends as they were reported by the stakeholders in Bulgaria are broadly in line with EU data such as that presented by Eurobarometer and EU-SILC. The Eurobarometer survey identified that 26% of respondents in Bulgaria felt at risk of being over-indebted in 2010.¹⁰³ This is a slight increase from 2009 and is roughly at the EU-average level. The overall indebtedness as a percentage of disposable income in Bulgaria was 51.8% in 2009, which is below the EU average. However, the ratio has grown very rapidly from a low base of 19% in 2004.¹⁰⁴

EU-SILC data (see Annex A) paints a similar picture of moderate but rapidly growing levels of over-indebtedness. With 3.9% of households with debts/arrears above their incomes, Bulgaria is below the EU average of 4.6%. On the other hand, Bulgaria sets an EU-wide high of 2.9% of people living in households in arrears on housing bills of over 100% of household disposable income. With just below a third of the population being in arrears on utility bills, Bulgaria is well above the EU average. According to the EU-SILC data the ratio of households in arrears on mortgage and rent payments increased sharply in 2009 (to 4.1%) and surpassed the EU average. This ratio abated in 2010.

3.3 NATURE AND DRIVERS OF OVER-INDEBTEDNESS

3.3.1 Most common types of households that are over-indebted

The most common profile of over-indebted households that emerges from the stakeholders' responses can be described as follows: a couple with child(ren); aged between 25 and 39; living in their own mortgaged home. No distinctions can be made on the basis of stakeholders' responses regarding the levels of education and income.

It is worth noting that when responding to the question on the recent changes in the types of over-indebted households, respondents also emphasized the age group of 40- to 64-year-olds.

¹⁰³ Special Eurobarometer 355, *Poverty and Social Exclusion Report*, 2010, p. 42.

¹⁰⁴ European Commission, *Over-indebtedness. New evidence from the EU-SILC special Module*, Research Note 4/2010, Table 1, p. 7. It is observed in the same research note that there is a link between the ratio of debt to income and the probability of debt being a heavy burden on households; and the increase of this ratio has been found to be associated with higher levels of arrears (*ibid.*, p. 5).

A majority of the respondents indicated that there has been a very or fairly significant change in the type of over-indebted households in Bulgaria. They attributed this change to the over-expansion of credit in the years leading up to the financial crisis¹⁰⁵ and to the significant rise in unemployment.

3.3.2 Causes of households' over-indebtedness

Macro-economic factors

Stakeholders pointed to a significant contribution of macroeconomic factors to the rise of over-indebtedness in Bulgaria. Chief among these factors are the sharp increase in unemployment and rising interest rates. According to the official data published by the National Statistical Institute, the unemployment rate rose from the pre-crisis level of 5.1% in the fourth quarter of 2008 to a high of 12.3% reported in the second quarter of 2012.¹⁰⁶ The stagnating and even falling wage level was also mentioned frequently in the stakeholder interviews. One interviewee explained that following the onset of the crisis "wages are constantly being cut and I have seen cases with 40 or 50% cuts."

One stakeholder mentioned exchange rate movements as a contributing factor to over-indebtedness and referred to the appreciation of the Swiss Franc vis-a-vis the Euro and the Bulgarian Lev, respectively.¹⁰⁷

In Bulgaria, mortgage lending in Swiss Franc was offered prior to the crisis by only a few banks and for a relatively short period of time (especially in comparison with Hungary).¹⁰⁸ Therefore, relatively few households are affected by movements in exchange rates, but the effect of the appreciation of the Swiss Franc vis-a-vis the Bulgarian Lev on their monthly budgets is severe.

Cost of living

Interviewed stakeholders considered rising costs of living to be a contributing factor to increased over-indebtedness in Bulgaria. Chief among those are utility and housing costs, followed closely by other costs of living (food, transport, etc.) and healthcare costs. As one civil society stakeholder put it: "Utility costs are most important. Our consumers complain about prices, especially for electricity and central heating."

¹⁰⁵ In 2005-2008 credit to households and non-profit institutions serving households rose by between 30% and 80% annually. Since the onset of the crisis credit expansion to households has ground to a halt. See BNB, *Monetary, Deposit and Credit Indicators*, August 2012, Fig 3, September 2012.

¹⁰⁶ National Statistical Institute, *Main labour force survey results for the second quarter of 2012*, 21 August 2012.

¹⁰⁷ According to the Bulgarian National Bank data the Swiss Franc appreciated from about 1.20 Bulgarian Lev per Swiss Franc in early 2008 to 1.62 in September 2012.

¹⁰⁸ For more information on loans in Swiss Franc see Brown, M., Peter., M., and Wehrmüller, S., *Swiss Franc Lending in Europe*, Swiss National Bank, February 2009.

According to the National Statistical Institute data the annual amount spent per household for housing, water, electricity, gas and other fuels increased from 430 Bulgarian Lev (11.9% of total expenditure) in 1999 to 1,206 (14.1% of total expenditure) in 2011.

Types of credit/loan taken out by households

Mortgages and regulated consumer credit with high interest rates were mentioned by most interviewees as causes of households' over-indebtedness. Credit/loans from regulated lenders with average interest rates were also mentioned by more than one half of stakeholders. Two stakeholders pointed to predatory or usurious loans, but evidence of these loans is anecdotal and no concrete data could be found on their prevalence.

Several interviewees mentioned banks' poor conduct as a contributing factor. This view is supported by research into how banks determine interest rates on consumer and mortgage loans in Bulgaria.¹⁰⁹

One stakeholder stated that most of the people who ask for help have problems because of legislation adopted in 2010. "It is very unclear to the consumer how interest on their loans is calculated and there are several hidden [fees]," said the interviewee - this comment refers to the national level Law on Consumer Credit (enacted as of 12 May 2010), which made it legal for banks to unilaterally change interest rates on existing loans.

Personal circumstances

Among personal circumstances causing over-indebtedness, interviewees referred primarily to a drop in income caused by unemployment or business failure and to stagnant or decreasing incomes against the backdrop of the increasing cost of living. Next in importance as assessed by the stakeholders is poverty, followed by a lack of money management skills and behavioural biases such as over-optimism.

3.3.3 Changes relevant for levels of over-indebtedness

All but one stakeholder (who did not provide an answer) noted very or fairly significant changes in the macro-economic situation that increased the level of over-indebtedness. The main changes relevant to over-indebtedness have been rising unemployment, stagnant wages or outright pay cuts, and widely spread delays in the

¹⁰⁹ The issue was examined by the consumer association Active Consumers in October 2010 and findings were published on their website (see <http://www.aktivnipotrebiteli.bg/тест/26/Кредити-ли?-Вижте-как-ви-определят-лихвата>). According to those findings, 15 (out of the 18 examined) banks determine interest rates on consumer credit and mortgage loans unilaterally, in a non-transparent fashion, and can change those rates after the credit has been extended. The banks started increasing interest rates in the wake of the financial crisis in the fourth quarter of 2008. Active Consumers also reports that debtors sued at least four banks in 2010-2012 and obtained favourable judgments at the courts of first instance. The courts generally found that loan interest rates had been raised on the basis of unfair contract clauses and ordered banks to reimburse their clients.

payment of wages by companies, which, in some cases, have not been paid on time by the government for public works or services they have provided.¹¹⁰

As one interviewee working for public authorities summed it up:

(T)he sharp increase of unemployment, lower wage growth/pay cuts ... had a significant negative effect of households' disposable income and debt servicing ability.

Consistent with their views on the effects of the crisis, all seven stakeholders who provided an answer said that there has been a very or fairly significant change in terms of an increasing accumulation of debts from utilities, telecommunication services, etc.

The only circumstance that might be mitigating the effects of the crisis is the drop in rents due to abundant supply that was mentioned by one interviewee. Namely, in the years before the financial crisis there was a housing boom in Bulgaria fuelled by easy access to credit. According to the data of the National Statistical Institute the number of newly completed dwellings increased almost threefold from 2004 to 2009, while the average price per square meter more than doubled (from 540 Bulgarian Lev in 2004 to 1,363 Bulgarian Lev in 2008). Investing in real-estate became widespread and these apartments are now being offered for rent.

Stakeholders predominantly noted very or fairly significant changes in lending practices that reduced access to credit following the financial crisis. One particular change noted by an independent expert has been that while before the crisis banks did not in general carefully consider the income of the borrower, they have since become much more cautious in that regard. One stakeholder described the current situation as "credit rationing".

When asked about changes in specific practices or financial products that cause or exacerbate over-indebtedness, most stakeholders who provided an answer indicated that there have been such changes in Bulgaria and referred to foreign currency mortgages. Several interviewees also pointed to the already mentioned introduction of the possibility for banks to change (increase) interest rates unilaterally after the credit contract has been signed.

In terms of the removal of specific practices or financial products that cause or exacerbate over-indebtedness the majority of stakeholders reported no or hardly any such changes.

Stakeholders were less clear regarding other changes that may have a bearing on the level of over-indebtedness. For example, four interviewees reported very or fairly significant changes in terms of consumers increasingly using loans with high interest

¹¹⁰ There are no official statistics or other generally agreed figures available in this regard.

rates from regulated lenders, but three said that there has been hardly any change in this regard and three did not provide an answer. Similarly, three stakeholders were of the opinion that consumers were increasingly borrowing at high interest rates from unregulated lenders, while three said there has been hardly any change and four did not provide an answer. The majority of respondents did not know whether consumers have been relying increasingly on predatory or usurious types of loans. The reason may be that these types of loans are not defined in Bulgaria and the terms are not used in public discourse.

One half of all interviewees noted very or fairly significant changes in the regulatory environment. Cited among the positive changes is the introduction of a minimum amount that banks cannot withhold on the accounts of delinquent borrowers.¹¹¹ Another positive change noted in the interviews is better-regulated advance notification for increasing variable lending rates on existing loans. On the negative side, interviewees referred to the Consumer Credit Act of 2010, which allows for non-transparent and unilateral changes of interest rates for existing borrowers.

3.3.4 Cultural attitude towards debt and actual level of households' (over-)indebtedness

More than half of the interviewed stakeholders said that the cultural attitude toward debt in Bulgaria affected the actual level of household (over-)indebtedness.

When discussing the period of the last five years, most interviewees did not note significant changes in that regard, but several referred to the overall changes in consumer habits. As one stakeholder observed:

Previously we lived in a society where choices were very limited, there was no variety available in shops and we were very strict in buying things ... People are just starting to get used to the fact that we can constantly buy new things and sometimes they overbuy.

Another observation made by several interviewees was related to the variation in the attitude to indebtedness among generations, with younger generations said to be more credit-prone:

Generally, people are more willing to take consumer credit these days because of the development in financial sector where there are many new products. Especially young people tend to take credit and become indebted.

The lack of financial literacy and money management skills was also emphasised. This, coupled with a more relaxed attitude among the younger generation toward

¹¹¹ This is stipulated in article 446 (1) of the Civil Procedure Code as of 1 March 2008. Creditors cannot collect against wages, salaries and pensions below a minimum amount, which may vary from 112 Euro to 400 Euro per month, depending on the monthly wage and whether or not the debtor has dependants.

debt, makes for a combination that increases the risk of people falling into the debt trap.

3.4 CONSEQUENCES OF OVER-INDEBTEDNESS

3.4.1 Consequences for affected households

The reduced standard of living, financial exclusion and deteriorating well-being were among the most highly ranked consequences of over-indebtedness for affected households. Others with an average score above 6 (on the scale from 0 to 10) are home repossession, reduced labour market activity¹¹² and 'other consequences', where one stakeholder referred to social exclusion in general and one to gambling.

3.4.2 Consequences of over-indebtedness for the financial services industry

The loss of potential customers through more restrictive lending practices, lower demand for credit because of the higher risk premiums and the increased costs because of stricter regulation of credit¹¹³ were noted in the interviews as the main consequences of over-indebtedness for the financial services industry. One stakeholder gave the highest score to 'other effects', referring to a complete lack of confidence.

3.4.3 Economic and social consequences of over-indebtedness for society

Increased over-indebtedness, especially when seen as mainly due to the behaviour of lenders, leads to loss of confidence in the financial services industry. This is the main societal effect of the phenomenon as seen by the interviewed stakeholders. It is followed by reduced productivity at work and legal costs associated with over-indebtedness. Again, 'other effects' in fact received the highest average score, but this is due to one stakeholder who pointed out that there is an overall frustration with the political system, with people blaming politicians that they are serving the interests of the banks.

3.4.4 Debt collection practices

Eight stakeholders who provided an answer reported that there had been a very or fairly significant change in terms of increasingly aggressive debt collection practices over the previous five years. First, there has been an increase in the number of collection agencies, particularly recently. Second, banks increasingly sell their non-performing loans to third-party collectors. Some of these operate "on the edge of the law" or even beyond, according to some stakeholders. Aggressive collection practices

¹¹² Reduced labour market activity is related to moving out of the official and into the informal economy, as banks tend to block the bank accounts of delinquent customers. In some cases people leave the country in search of better opportunities abroad.

¹¹³ This is somewhat inconsistent with the earlier response that regulation has not changed much in the wake of the crisis.

include undue harassment, including contacts with debtors' family members and friends, and threats.¹¹⁴ One stakeholder, a representative of the debt collection industry, stated that this is not the case. According to a financial industry stakeholder creditors are now becoming more selective in choosing a collection agency.

3.5 MEASURES IN FORCE TO ALLEVIATE THE IMPACT OF OVER-INDEBTEDNESS

Responses to the section of the questionnaire asking about availability, demand, cost and effectiveness of measures to alleviate the impact of over-indebtedness suggest that no concerted effort is being made in Bulgaria by either the lenders or the authorities to tackle the problem of over-indebtedness. Sporadic debt advice appears to be offered by some consumer organisations and private for-profit firms but it does not seem to be widely available or well known, judging from the interviewees' responses.

There is near complete silence on the issue by both the media and the authorities; over-indebtedness is considered to be a personal matter.

Mortgage debtors have set up at least three separate groups on Facebook to exchange experiences and seek advice from other debtors. However, these are self-help discussion forums rather than a place where people can get systematic and verified debt advice.

3.5.1 Early identification of households at risk

Half of the interviewees reported measures to identify households at risk of becoming over-indebted not to be common at all. One respondent noted that banks offer modified loan agreements, but this normally happens at the initiative of borrowers who are in difficulty rather than banks' efforts to identify households at risk of over-indebtedness. The new agreement usually allows for one year of interest-only repayments, sometimes at a reduced interest. The remainder of the interest due is capitalized, so that the borrower is worse-off one year later.¹¹⁵ One interviewee emphasised that rather than alleviating the debt burden, banks are more interested in ensuring that credit agreements fall under the provisions of the 2010 Consumer Credit Act, which provides for a unilateral increase in interest rates by banks.

¹¹⁴ There are no systematic research reports but there is (anecdotal) media coverage, including articles from August and May 2012 (see <http://www.dennews.bg/news/2012/8/8/8597-vmro-sezira-glavniya-prokuror-za-subirachite-na-zaduljeniya> and <http://www.24chasa.bg/Article.asp?ArticleId=137558>, respectively). In the last report it was alleged that a 10-year-old was being given treats in exchange for exerting pressure on her mother to pay off family debt. The perpetrators were arrested but later released due to a lack of evidence of criminal behaviour.

¹¹⁵ Banks face two incentives: 1. To avoid the costs of provisioning for delinquent debt; therefore, they temporarily lower the monthly installment, so that the credit continues to be serviced; 2. To avoid principal losses; therefore they capitalize interest and principal originally due, thus exacerbating the position of the borrower in the future.

3.5.2 Advice offered to over-indebted households

Availability and costs

In terms of availability, face-to-face advice was considered to be partly or rarely available by the all seven respondents who provided answer in this regard, while advice given over the phone, email, web-based tools or printed information were predominantly assessed as not available by stakeholders who provided an answer.

In terms of costs, face-to face debt advice is generally a paid or partly paid service according to the stakeholders.

No official debt advice services could be identified. Two organisations that participated in this study (Independent Union of Consumers in Bulgaria and Bulgarian Financial Forum) reported that they provide free-of-charge personalised debt advice, but their capacities for this type of assistance are rather limited.

Demand for debt advice as assessed by stakeholders

To the extent that debt advice is available in the country, stakeholders considered it not well known to consumers; they assessed demand for such advice as very low or did not have an opinion. Half of the respondents, however, considered that demand for debt advice has lately increased.

Effectiveness as assessed by stakeholders

When assessing effectiveness of debt advice, interviewees vastly disagreed: their answers are almost evenly spread between "very effective" and "not at all effective" when it comes to face-to-face advice. Given that other modes of providing advice (e.g. by telephone, web-based, etc.) are not popular in Bulgaria, the majority of respondents declined to assess their effectiveness. The ones who did assess it, were rather sceptical as to the effectiveness of providing advice other than face-to-face.

Funding of debt advice

All stakeholders who provided an answer considered funding of debt service advice in Bulgaria insufficient. They made several recommendations for possible solutions, including increased funding for non-profit organisations; concerted efforts by all stakeholders (the government, credit institutions, non-profit organisations, etc.); a program at the EU level for funding information centres where indebted consumers may ask for help and advice. Two respondents mentioned the need to set up a Financial Ombudsman.

3.5.3 Key measures in place to alleviate the impact of over-indebtedness

Availability and costs

Informally brokered arrangements between the debtor and creditors such as a repayment plan, a debt management plan or debt write-off that may be brokered by a debt counsellor

Stakeholders disagreed on the availability of informally brokered arrangements in Bulgaria. Three were of the view that such arrangements were widely available, while two said that informal arrangements were partly available and two that they were rarely available. Again the 2010 Consumer Credit Act was mentioned, with the main motives of banks offering repayment plans allegedly being to have an updated contract that falls under the provisions of this act so as to be able to unilaterally increase interest rates in the future.

Interviewees explained that informally brokered repayment plans usually provided for extending the period of repayment (rescheduling). This may decrease the immediate monthly payment, but it leads to a larger overall repayment. Write-offs are not something banks in Bulgaria would typically offer to the over-indebted.

Assessments of costs of these arrangements were evenly split: two stakeholders said they were generally free of charge, two that they were partly free and partly paid, and two that this was generally a paid service.

Formal procedures for debt settlement that do not take place in court

Formal out-of-court procedures for debt settlement do not appear to be well known in Bulgaria. The majority of interviewees who provided an answer thought that out-of-court procedures were rarely or not at all available. An independent expert noted that "as a rule banks are not keen on out-of-court settlements".

Legal procedures that take place in court (e.g. consumer insolvency proceedings)

There is no consumer insolvency law in Bulgaria, therefore legal procedures that take place in court are not available.

Financial support for households to repay debts/arrears (e.g. by public fund)

Financial support for households to repay debts and/or arrears is not available. There is no public fund to assist in the repayment of debt or arrears.

Effectiveness as assessed by stakeholders

Interviewees mostly did not provide an answer or provided conflicting assessments so no clear picture emerged from the interviews as for the effectiveness of various measures to alleviate the impact of over-indebtedness.

3.5.4 Changes in response to over-indebtedness

Most stakeholders reported no changes in response to over-indebtedness in terms of measures to alleviate its impact. One added that: "There were no active measures. And not a single measure had been introduced [in Bulgaria]." The one change that was reported by a financial industry stakeholder was related to debt collection practices. The interviewee said that lenders "started to collect earlier" and that the collection process "got stricter, earlier and harder".

3.5.5 Types of households of over-indebted consumers not reached by current measures

Stakeholders largely declined to directly answer the question on whether there were any types of households that were not reached by current measures. However, one civil society stakeholder mentioned the Roma minority and another interviewee stated: "There are no measures. All the households' types remain out of care."

3.5.6 Best practices

Stakeholders who mentioned best practices either referred to examples outside of Bulgaria, in the rest of the European Union, or suggested measures for the future. Several interviewees pointed to the need for a financial ombudsman in Bulgaria. The purpose would be for the ombudsman to serve as a mediator between banks and consumers on the one hand and "to protect consumers from becoming financial slaves of banks for the rest of their lives", as one interviewee said. Another measure that the interviewees called for is the introduction of consumer insolvency law and procedures.

3.6 OUTLOOK

Stakeholders in Bulgaria predominantly assessed that the number of over-indebted households will increase in the next five years. This was explained by the macro-economic situation, the lack of effective regulation and the inability of public authorities to cope with the problem. One of the two stakeholders who expect over-indebtedness to decrease explained that borrowers experiencing financial difficulties at the moment will likely either resolve them or will lose their property in the next few years and many households will refrain from taking on new loans due to the lack of confidence in lenders.

The majority of interviewees think there are new challenges that need to be addressed by policy makers. Chief among those mentioned are the need for new regulations, such as a Consumer Insolvency Law, and for a better protection of consumer rights. Another challenge is the need to strictly implement EU directives without introducing national provisions that contradict the intent and the spirit of the directives. According to a civil society stakeholder: "Generally EU Directives are implemented, but with a few exceptions that turn the meaning of the Directive upside down."

Interviewed stakeholders were predominantly of the opinion that additional changes in regulating credit and commercial practices of lenders are needed. Three indicated such changes to be needed at the EU level, while four said they are mainly needed at the national level. One of those calling for more regulation at the EU level spoke about the need to break the influence of the strong banking lobby in the shaping of national regulation. Among other changes in banking practices that interviewees would like to see is the termination of the practice where banks can change the interest rate on existing loans unilaterally.

In terms of regulation of utilities and specific commercial practices of utility companies half of interviewees said that changes were needed mainly at national level. Several stakeholders referred to the current lack of transparency.

Additional changes in regulation of housing sector and specific commercial practices of housing providers should also be mainly undertaken at national level according to interviewees who provided an answer. "Speculative pricing" and "extremely high" prices were mentioned as problematic.

Half of interviewees provided an assessment regarding the need for non-regulatory measures and they mostly indicated that they were needed. Suggestions included more financial education and financial advice as well as better cooperation between the banks and over-indebted customers.

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Final report

Over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact

ANNEX A: STATISTICAL DATA FROM EU SOURCES

Final report

Over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact

Bulgaria

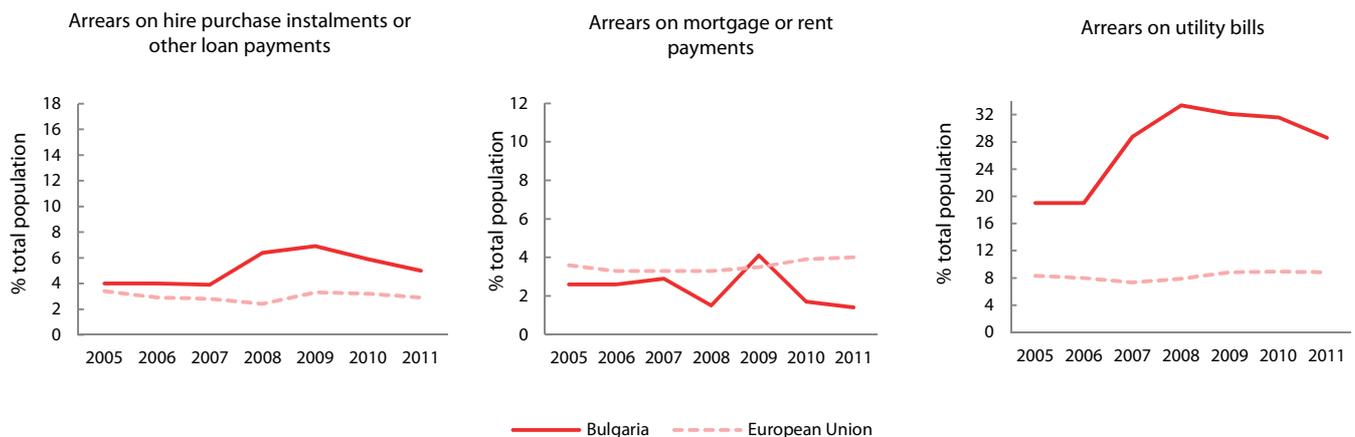
I. Eurobarometer¹

Bulgaria EU average Lowest EU value Highest EU value

Households *at risk* of being over-indebted

Respondents feeling at risk of over-indebtedness in 2010	↗ 26%	25%	7%	52%
Respondents feeling at risk of over-indebtedness in 2009	↘ 25%	27%	9%	53%

II. EU SILC standard survey data²



III. EU SILC 2008 module: Over-indebtedness and financial exclusion³

Bulgaria EU average Lowest EU value Highest EU value

Proportion of people in households with bank overdrafts, outstanding balances on credit cards or in arrears on other loans of over 100% of household disposable income

Overdrawn bank account (% of people in households overdrawn)	↘ 0.1%	2.2%	0.0%	7.7%
Credit or store card (% of people in households with outstanding balances)	↘ 0.2%	1.1%	0.0%	8.6%
Other loan/credit payments (% of people in households in arrears)	↗ 0.5%	0.3%	0.0%	1.1%

Proportion of people in households in arrears in servicing housing-related loans and bills and in paying other bills of over 100% of household disposable income

Housing bills (% of people in households in arrears)	↗ 2.9%	0.5%	0.0%	2.9%
Other payments (% of people in households in arrears)	↘ 0.2%	0.4%	0.0%	1.7%

Households living with outstanding debts and/or arrears of over 100% of household disposable income

Total (% of households with outstanding debts/arrears)	↘ 3.9%	4.6%	0.0%	11.8%
Income above 60% median (% of households with outstanding debts/arrears)	↘ 2.5%	4.2%	0.0%	11.3%
Income below 60% median (% of households with outstanding debts/arrears)	↗ 9.0%	7.0%	0.2%	13.7%
Materially deprived (% of households with outstanding debts/arrears)	↘ 6.5%	9.0%	0.1%	27.4%

Proportion of those in broad age groups with outstanding debts of over 100% of household disposable income

Households with all adults aged 25-39 (% of households with outstanding debts)	↗ 6.8%	6.3%	0.0%	17.2%
Households with all adults aged: 40-64 (% of households with outstanding debts)	↘ 4.3%	5.8%	0.0%	10.9%
Households with all adults aged: 65+ (% of households with outstanding debts)	↗ 1.3%	1.2%	0.0%	2.8%

Proportion of those in different types of household with outstanding debts of over 100% of household disposable income

Living alone (% of people in households with outstanding debts)	↘ 3.2%	4.3%	0.0%	8.2%
Single parent (% of people in households with outstanding debts)	↘ 8.6%	9.5%	0.0%	27.1%
Other (% of people in households with outstanding debts)	↘ 3.9%	4.8%	0.0%	12.1%

Proportion of those in households with outstanding debts of over 100% of household disposable income by marital status

Never married (% of people in households with outstanding debts)	↘ 3.2%	5.0%	0.0%	15.4%
Married (% of people in households with outstanding debts)	↘ 3.3%	4.1%	0.0%	9.7%
Separated/divorced (% of people in households with outstanding debts)	↘ 4.8%	7.5%	0.1%	13.9%
Widowed (% of people in households with outstanding debts)	↗ 2.3%	1.7%	0.0%	4.3%

Proportion of those in households with outstanding debts of over 100% of household disposable income by housing tenure

Owner occupied without mortgage (% of people in households with outst. debts)	↘ 3.0%	3.2%	0.0%	9.6%
Owner occupied with mortgage (% of people in households with outst. debts)	↗ 7.1%	6.3%	0.0%	16.1%
Market rent (% of people in households with outstanding debts)	↘ 1.3%	8.2%	0.0%	16.0%
Subsidised rent (% of people in households with outstanding debts)	↗ 17.9%	8.7%	0.0%	17.9%
Rent-free housing (% of people in households with outstanding debts)	↗ 5.5%	2.3%	0.0%	15.1%

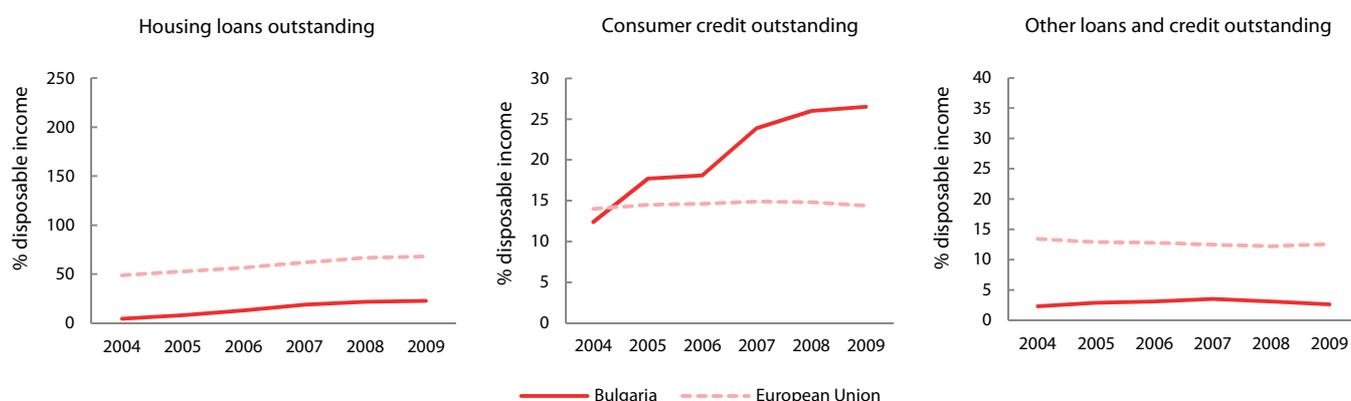
Proportion of those in households with outstanding debts of over 100% of disposable income by work intensity

Work intensity of 0 - 0.19 (% of people in households with outstanding debts)	↗ 10.0%	5.7%	0.0%	10.6%
Work intensity of 0.20 - 0.50 (% of people in households with outstanding debts)	↘ 4.8%	5.7%	0.0%	15.3%
Work intensity of 0.51 - 0.74 (% of people in households with outstanding debts)	↘ 4.0%	5.4%	0.0%	13.5%
Work intensity of 0.75 - 1.0 (% of people in households with outstanding debts)	↘ 2.2%	5.3%	0.0%	14.3%

Proportion of those in over-indebted households that experienced a major drop in income over the preceding year

Over-indebted (% of people in households that experienced drop in income)	↗ 41.1%	33.3%	0.0%	77.6%
Other (% of people in households that experienced drop in income)	↗ 20.9%	19.2%	5.9%	32.5%

IV. Loans and credit outstanding⁴



Notes:

(1) Eurobarometer 72.1 (2009) and Eurobarometer 74.1 (2010). Note: Those who answered 'very at risk' or 'fairly at risk' to the question 'Please tell me how much you feel at risk of being over-indebted'.

(2) Eurostat, SILC. Data as of December 2012.

(3) European Commission, Research Note 4/2010, Over-indebtedness new evidence from the EU-SILC special module.

(4) European Commission, Research Note 4/2010, Over-indebtedness new evidence from the EU-SILC special module. European Credit Research Institute (ECRI), Lending to households in Europe, 1995-2009 and Eurostat, National accounts.

4 CYPRUS

<i>Document</i>	The over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact - Country report Cyprus
<i>Prepared by</i>	Rémi Béteille
<i>Finalised on</i>	12 February 2013

Final report

Over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact

4.1 DEFINITION OF OVER-INDEBTEDNESS

Most stakeholders interviewed in Cyprus did not use a specific definition of over-indebtedness. Only one stakeholder used such a definition, namely a situation in which more than 35% of monthly income is spent on paying back loans. The other interviewees responded that they did not use a specific definition because there is no common definition in Cyprus or because they apply a case-by-case approach.

All stakeholders who provided an answer to the question agreed that a better definition of households being over-indebted is needed. The majority of those who commented also indicated that there was a need for a better definition of households at risk of over-indebtedness.

4.2 LEVEL OF OVER-INDEBTEDNESS

Stakeholders who provided an answer observed that the level of household over-indebtedness in Cyprus had increased in the last five years.

Although there is limited literature available about over-indebtedness in Cyprus, this assessment is supported by several indicators available at the EU level. These show that levels of over-indebtedness in Cyprus have increased significantly since the financial crisis.

For example, EU-SILC module data show that the percentage of the population in arrears on hire purchase instalments or other loan payments, mortgage or rent payments, and utility bills increased sharply after 2008, following a period of significant decrease between 2007 and 2008.¹¹⁶

Specifically, the share of the Cypriot population in arrears on hire purchase instalments or other loan payments more than halved between 2007 and 2008 (from 15.3% to 6.4%) but increased sharply in the following years, to reach 17.5% of the population in 2011, more than 2.5 times the level of this type of arrears in 2008. Levels of arrears on hire purchase instalments and other loan payments were constantly significantly above the EU average of 2.9% during this period (2007-2011).¹¹⁷

A similar pattern is visible in terms of the percentage of the population in arrears on mortgage or rent payments. This dropped from 6.1% in 2007 to 3.4% in 2008 but then increased progressively to reach 5.5% in 2011, compared to an EU average of 4.0%.¹¹⁸

¹¹⁶ Eurostat, 'Arrears (mortgage or rent, utility bills or hire purchase)' (code: ilc_mdcs05).

¹¹⁷ Eurostat, 'Arrears on hire purchase instalments or other loan payments' (code: ilc_mdcs08).

¹¹⁸ Eurostat, 'Arrears on mortgage or rent payments' (code: ilc_mdcs06).

The evolution of the share of the population in arrears on utility bills in Cyprus followed a comparable trend. After a slight decrease between 2007 and 2008, this share grew from 7.3% in 2008 to 16.2% in 2011, when it was almost twice the EU average of 8.8%.¹¹⁹

Data published by the Department of Registrar of Companies and Official Receiver indicate that the number of personal insolvencies has increased from 839 to 1329 between 2007 and 2009 (and decreased in the following years, to 561 in 2012).¹²⁰

The most recent Eurobarometer on poverty and social exclusion (Eurobarometer 74.1), published in 2010, indicates that 25% of respondents in Cyprus felt at risk of being over-indebted. This figure is identical to the EU average and remained stable compared to the previous year (see Eurobarometer 72.1).¹²¹

However, the period 2007 to 2011 did see an increase in the percentage of households considering themselves to have difficulties making ends meet. This figure increased from 45.6% in 2007 to 53.8% in 2011.¹²²

4.3 NATURE AND DRIVERS OF OVER-INDEBTEDNESS

4.3.1 Most common types of households that are over-indebted

Data from the EU-SILC 2008 module¹²³ show that 8.7% of Cypriot households with an income of less than 60% of the median lived in a household with outstanding debts and/or arrears of over 100% of household disposable income, as compared with 7.6% of those with income above this level (and above the EU average of 7%). Those among the materially deprived households had the highest probability of being over-indebted according to this indicator (15.1% of these households, well above the EU average of 9.0%).

This data also shows that younger Cypriots tend to be more likely to have outstanding debts than older people. According to EU-SILC data, 10.7% of Cypriot households comprising people between the ages of 25 and 39 years experienced such debts in 2008, as compared to 8.0% of households with people between the ages 40 and 64, and 0.8% of households where all people are older than 65 years.

¹¹⁹ Eurostat, 'Arrears on utility bills' (code: ilc_mdcs07).

¹²⁰ Data available at: <http://www.mcit.gov.cy/mcit/drcor/drcor.nsf/All/45D9E7A944B5F00FC225750E002FA83D?OpenDocument&highlight=bankruptcies> (website last consulted on 12 February 2013).

¹²¹ Special Eurobarometer 355, *Poverty and Social Exclusion Report*, p. 42.

¹²² Eurostat, 'Inability to make ends meet' (code: ilc_mdcs09).

¹²³ As reviewed in Fondeville, N., Ozdemir, E. and Ward, T., *Over-indebtedness: New evidence from the EU-SILC social module*, European Commission, Directorate-general for Employment, Social Affairs and Equal Opportunities, Research Note 4/2010, 2010.

This tendency was also reflected in the comments of the stakeholders interviewed in Cyprus. For example, several stakeholders indicated that younger households are more commonly affected by over-indebtedness because they face a higher unemployment risk than those in the older age groups. At the same time, younger people may have to pay back loans that they contracted to finance their studies or a mortgage to finance a house or apartment. This is illustrated in the following comment made by a stakeholder:

We have a high number of people who go to universities every year - almost 80% of people in high school go to universities. (...) Many people are finishing college, university, coming back and facing the problem of unemployment.

Data from Eurostat supports this statement regarding the prevalence of unemployment among young people in Cyprus. According to this source, the unemployment rate in 2012 was almost three times higher for people under the age of 25 than for people between the ages of 25 and 75 (26.8% and 10.5%, respectively).¹²⁴

However, households consisting of older people have also been facing financial difficulties, particularly in the last few years. One interviewee explained that, as a consequence of the financial crisis, employees older than 45 (often those with high qualifications and the highest wages) are sometimes replaced by younger employees to reduce companies' labour costs, especially in small family-owned companies. This stakeholder added that individuals in this age group who lose their job or earn less can experience difficulties paying their mortgage, and many have also taken on other loans, for example, to finance the education of their children.

More generally, another interviewee commented that there had been an increase in the number of middle class families affected by over-indebtedness since the crisis.

In terms of housing tenure, the EU-SILC 2008 module reveals that households in owner-occupied housing with a mortgage were most often those who had outstanding debts of over 100% of household disposable income in 2008 (14.8% of households in this group, more than twice the EU average). This was also reflected in the stakeholder assessments.

Regarding family status, EU-SILC data indicates that single parents are most frequently those who have outstanding debts of over 100% of disposable income. In 2008, 27.1% of single parents in Cyprus experienced this level of debt, the highest figure in the EU. Similarly, when looking at the marital status of households, separated or divorced individuals in Cyprus are also the most often those who had outstanding debts of over 100% of household disposable income across the EU in 2008 (13.9% of households in this group).

¹²⁴ Eurostat, 'Unemployment rate by age group' (code: tsdec460).

4.3.2 Causes of households' over-indebtedness

Macro-economic factors

Cyprus experienced a reduction in economic growth from 2.9% of real GDP per capita in 2007 to 1.0% in 2008, followed by a period of negative growth rates of GDP. The effect of the financial crisis culminated in 2009, when the real GDP per capita decreased by 4.5%.¹²⁵ The unemployment rate in the country almost tripled between 2008 and 2012, from 3.8% to 12.1% respectively.¹²⁶ The deterioration of these economic indicators since 2008 corresponds to an increase in the share of the Cypriots with arrears during the same period (see section 4.2).

This economic situation was also reflected in the responses of the stakeholders interviewed. The largest proportion of stakeholders mentioned unemployment and wage levels as being causes of households' over-indebtedness in Cyprus.

Cost of living

A consensus emerged among stakeholders concerning the types of living costs that are the most important causes of households' over-indebtedness. They all mentioned utility costs and almost all cited housing costs as a key factor affecting the ability of households to meet their financial commitments.

More specifically, stakeholders referred to an important increase in electricity prices. A stakeholder reported that the combination of an increase in fuel prices and the explosion of a power plant in 2011 resulted in significant increases in electricity prices in Cyprus.¹²⁷ This stakeholder also mentioned that education and health care costs have increased.

Statistical data on electricity prices for household consumers supports this picture. According to data published by Eurostat, these prices almost doubled between 2007 and 2012.¹²⁸

¹²⁵ Eurostat, 'Real GDP per capita' (code: tsdec100).

¹²⁶ Eurostat, 'Unemployment as a percentage of the labour force' (code: tsdec450).

¹²⁷ Stakeholders reported a price increase of 20% to 40% in the last year. The power station was restored and put in operation by August 17th 2012 but the final restoration schedule is still being developed, as the detailed damage assessment is still ongoing (.see http://www.eac.com.cy/EN/Operations/Pages/G_PowerStations.aspx).

¹²⁸ Eurostat, 'Electricity prices for household consumers' (code: ten00115). This indicator presents electricity prices charged to final consumers. Electricity prices for household consumers are defined as average national price in Euro per kWh without taxes applicable for the first semester of each year for medium size household consumers.

Types of credit/loan taken out by households

All interviewees considered credit extended by way of home loans or mortgages to be a cause of households' over-indebtedness in Cyprus. A majority also mentioned regulated consumer credit.

Stakeholders commented that people in Cyprus generally want to own their home, but that this can result in arrears on their mortgages in the case of unemployment. In 2010, the most recent year for which data is available, the owner occupation rate was 74.7% in Cyprus, above the EU average of 68.9%.¹²⁹

Personal circumstances

Concerning changes in personal circumstances causing or contributing to ongoing financial difficulties, most interviewees made reference to a drop in income caused by unemployment or business failure. Data from Eurostat supports this, as it shows that 27.4% of over-indebted households in Cyprus had experienced a major drop in income in the preceding year, compared to only 13.1% of households that were not over-indebted. It also shows that unemployment was the second most important reason for households experiencing a drop in income, although illness/disability was in fact the most frequent cause.¹³⁰

4.3.3 Changes relevant for levels of over-indebtedness

Most of the stakeholders interviewed noted significant changes in the macro-economic situation that had contributed to an increase in the level of over-indebtedness in Cyprus. These changes relate principally to higher unemployment levels and lower wages (see also 4.3.2 above).

Concerning changes in the lending practices of credit providers, it was reported that because of stricter rules concerning the granting of loans to households, people are now looking for other sources of financing (for example, from family members or from financial institutions other than commercial banks).

Furthermore, two stakeholders who expressed an opinion indicated that interest rates had increased in Cyprus. For example, a representative of a consumer organisation reported that "in the past you were able to take a loan with 4%, now you have to pay from 5.75-6.5% for the same kind of loan."

In terms of changes in the regulatory environment in the last five years, one development has been the transposition into national law of Directive 2008/48/EC on

¹²⁹ European Mortgage Federation, Hypostat, 2011.

¹³⁰ Fondeville, N., Özdemir, E., and Ward, T., 'Over-indebtedness. New evidence from the EU-SILC special module', 2010, pp. 43-4.

credit agreements for consumers, which was done in 2010.¹³¹ Among other things, this contained requirements regarding the pre-contractual information provided to the consumer and the conditions of early repayment.

Finally, several stakeholders noted an increase in the accumulation of debts resulting from the non-payment of electricity bills (see section 4.3.2 above). One of the stakeholders explained the situation as follows:

A year ago we had our power station destroyed and because of that electricity production went back to older methods, which affected the whole system and prices went up. And consumers accumulated debts because of not paying their bills.

4.3.4 Cultural attitude towards debt and actual level of households' (over-)indebtedness

Most of the stakeholders interviewed observed a relationship between the cultural attitude towards debt and the actual level of households' (over-)indebtedness in Cyprus.

In particular, it was reported that it is generally very important for people in Cyprus to live in their own house; mortgages are therefore a common phenomenon and also one of the main causes of over-indebtedness. However, one stakeholder indicated that while two to three years ago taking a loan to build or buy a house was the favourite housing option, renting may now be preferred. This stakeholder concluded that people are more prudent concerning their investment decisions: "People are scared of spending their money, there is fear of unemployment".

Furthermore, the view was expressed that the attitude towards debt differs among the different age groups. As one stakeholder commented, "older people tend to have a lot of deposits, while younger people tend to have more loans".

4.4 CONSEQUENCES OF OVER-INDEBTEDNESS

4.4.1 Consequences for affected households

The stakeholders interviewed assessed the importance of the consequences of households' over-indebtedness on a scale from 0 (not important at all) to 10 (very important). Based on an average rating of these consequences, family breakdown or divorce, financial exclusion, reduced standard of living and deteriorating well-being are the most highly rated consequences.

¹³¹ This was implemented with Law 107 (I)/2010 about consumers credit agreements. Source: European Parliament, 'Implementation of the Consumer Credit Directive', 2012.

The risk of homelessness was the consequence for households affected by over-indebtedness least highly rated by stakeholders. One stakeholder commented that, in case of home repossession, "a member of your extended family will house you", and another added "as far as I know, we have not had problems so far [concerning this issue]".

4.4.2 Consequences of over-indebtedness for the financial services industry

All consequences of over-indebtedness for the financial services industry that were suggested in the questionnaire were considered to be important by interviewees. The stakeholders interviewed identified the lower demand for credits because of higher risk premiums and the loss of potential customers through more restrictive lending practices to be the two most highly rated consequences for the financial industry.

4.4.3 Economic and social consequences of over-indebtedness for society

On average, stakeholders rated the loss in consumer confidence in the financial services industry most highly, in terms of the consequences of over-indebtedness for society. Regarding this, one stakeholder made the following comment: "The loss of trust in financial products makes financial literacy problems even worse over time as people just 'switch off' from delving into these issues".

Costs associated with assisting households to repay debts or arrears and reduced productivity at work were also rated highly by stakeholders.

4.4.4 Debt collection practices

Only one stakeholder noted an increase in the use of aggressive debt collection practices, reporting "too many calls and letters", while the other stakeholders did not indicate such a change.

4.5 MEASURES IN FORCE TO ALLEVIATE THE IMPACT OF OVER-INDEBTEDNESS

4.5.1 Early identification of households at risk

Measures in Cyprus to identify households at risk of becoming over-indebted at an early stage are hardly common or not common at all, according to most of the interviewees who provided information on the issue.

Information on the credit behaviour of consumers is collected by the First Cyprus Credit Bureau. This organisation is a joint venture between the Cyprus Chamber of Commerce and Industry and the Infocredit Group and makes information on unpaid debts available to third parties in its Defaulting Debtors Databank.

4.5.2 Advice offered to over-indebted households

Availability and costs

A representative of a consumer organisation in Cyprus reported that his organisation provides information free of charge to members and non-members, face-to-face, by phone, email, and through the organisation website. However, the organisation can only provide advice to a limited number of people, as it is a small organisation with a small number of staff members (three part time and two full time employees) and no specific department dedicated to the provision of advice to over-indebted households.

In addition, the financial sector's supervisory authorities¹³² have set up the Consumers' Training Coordination Committee, which has prepared guides and articles published on the website of the Securities and Exchange Commission.¹³³

Demand for debt advice as assessed by stakeholders

The demand for debt advice provided face-to-face or by telephone was perceived to be high by the stakeholders who provided an opinion on the issue. These types of debt advice were also considered to be effective.

A stakeholder from the financial services industry noted that the demand for debt advice has fairly increased in the last five years and commented that, "The awareness of people has increased. People now demand to know, they demand advice."

Funding of debt advice

No clear picture emerged from the interviews regarding the question of whether funding for debt advice in Cyprus is adequate. Two stakeholders found the funding of debt advice services to be fairly sufficient, whereas another was of the opinion that this was not at all the case.

4.5.3 Key measures in place to alleviate the impact of over-indebtedness

Informally brokered arrangements between the debtor and creditors such as a repayment plan, a debt management plan or a debt write-off are available in Cyprus and these were found to be fairly effective.

¹³² The website of the Central Bank reports that, "Within the context of the Memorandum of Understanding signed by the supervisory authorities of the Cyprus financial sector, the Central Bank of Cyprus, the Securities and Exchange Commission, the Cooperative Societies' Supervision and Development Authority and the Insurance Companies' Control Service of the Ministry of Finance have jointly decided to contribute towards the training of consumers on financial matters". See: http://www.centralbank.gov.cy/nqcontent.cfm?a_id=11909&tt=article&lang=en.

¹³³ See http://www.cysec.gov.cy/investors_en.aspx.

In terms of legal procedures to alleviate over-indebtedness, there exists in Cyprus a procedure for consumer insolvency.¹³⁴ According to the legislation, a debtor may file for insolvency if he/she has debts amounting to at least €8540.¹³⁵ In this case, a decision will be made by the court whether to accept the petition or not. However, the legislation is over 50 years old and in recent years there have been questions raised as to whether it is adequate, particularly in the light of the financial crisis and the increase in insolvency applications.¹³⁶

4.5.4 Changes in response to over-indebtedness

Concerning changes in responses to over-indebtedness in terms of measures to alleviate its impact, most stakeholders interviewed responded that they did not have any opinion on the issue. The only stakeholder who expressed a view on this aspect indicated that responses have not changed over the past five years.

4.5.5 Types of households of over-indebted consumers not reached by current measures

Stakeholders were asked whether there are specific types of households of over-indebted consumers that are not reached by current measures but none of them could comment on the issue.

4.5.6 Best practices

Stakeholders were also asked whether they could identify specific measures in place to alleviate over-indebtedness that they consider to represent best practices. The only stakeholder who provided information in this respect referred to the advice provided by not-for-profit organisations.

4.6 OUTLOOK

The majority of stakeholders expected the number of over-indebted households to increase in the next five years, as a result of the deteriorating economic situation (real GDP per capita is expected to shrink by 4.4% in 2013 and 2.3% in 2014).¹³⁷ For example, one public authority stakeholder commented:

¹³⁴ As regulated in Bankruptcy Law, Cap 5 and Bankruptcy Rules, Cap. 6.

¹³⁵ Antonis Paschalides and Co LLC, 'Bankruptcy of Natural Persons under Cyprus Law', <http://www.paschalides.com/ru/articles/litigation/100-bankruptcy-of-natural-persons-under-cyprus-law.html>.

¹³⁶ Kyriacou, M. and Neocleous, E., 'Cyprus', in Leonard, B. (ed.), *Restructuring & Insolvency in 53 jurisdictions worldwide*, 2011.

¹³⁷ Eurostat, 'Real GDP per capita', (code: tsdec100).

The economic crisis is likely to become more severe and there might be more reductions in wages and welfare benefits that will increase the level of over-indebtedness.

In particular, stakeholders referred to an expected increase in unemployment levels as an aggravating factor.

Stakeholders who provided an opinion on the issue indicated that additional changes in the regulation of credit and specific commercial practices of lenders were needed. One stakeholder indicated that this should be done mainly at EU level, as explained in the following comment:

If we want a common market in the EU, we need to have regulations at EU level and the banking sector and other companies must work under a specific EU level law, so as to have the same regulations in Cyprus, Germany and everywhere, in each Member State. In my opinion this would help the development of one single economy.

When asked about the need for changes in the regulation of utilities, one stakeholder reported that the pricing of products for public sector monopolies is an issue in Cyprus.

4.7 REFERENCES

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Final report

Over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact

ANNEX A: STATISTICAL DATA FROM EU SOURCES

Final report

Over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact

Cyprus

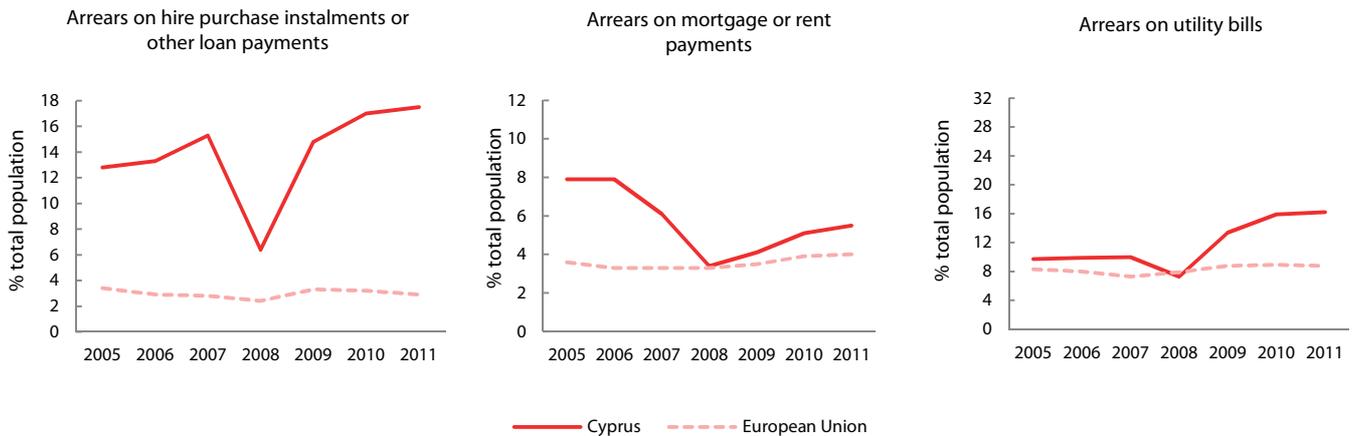
I. Eurobarometer¹

Cyprus EU average Lowest EU value Highest EU value

Households *at risk* of being over-indebted

Respondents feeling at risk of over-indebtedness in 2010	➔ 25%	25%	7%	52%
Respondents feeling at risk of over-indebtedness in 2009	➔ 25%	27%	9%	53%

II. EU SILC standard survey data²



III. EU SILC 2008 module: Over-indebtedness and financial exclusion³

Cyprus EU average Lowest EU value Highest EU value

Proportion of people in households with bank overdrafts, outstanding balances on credit cards or in arrears on other loans of over 100% of household disposable income

Overdrawn bank account (% of people in households overdrawn)	➔ 2.9%	2.2%	0.0%	7.7%
Credit or store card (% of people in households with outstanding balances)	➔ 1.0%	1.1%	0.0%	8.6%
Other loan/credit payments (% of people in households in arrears)	➔ 1.0%	0.3%	0.0%	1.1%

Proportion of people in households in arrears in servicing housing-related loans and bills and in paying other bills of over 100% of household disposable income

Housing bills (% of people in households in arrears)	➔ 0.7%	0.5%	0.0%	2.9%
Other payments (% of people in households in arrears)	➔ 0.4%	0.4%	0.0%	1.7%

Households living with outstanding debts and/or arrears of over 100% of household disposable income

Total (% of households with outstanding debts/arrears)	➔ 7.8%	4.6%	0.0%	11.8%
Income above 60% median (% of households with outstanding debts/arrears)	➔ 7.6%	4.2%	0.0%	11.3%
Income below 60% median (% of households with outstanding debts/arrears)	➔ 8.7%	7.0%	0.2%	13.7%
Materially deprived (% of households with outstanding debts/arrears)	➔ 15.1%	9.0%	0.1%	27.4%

Proportion of those in broad age groups with outstanding debts of over 100% of household disposable income

Households with all adults aged 25-39 (% of households with outstanding debts)	➔ 10.7%	6.3%	0.0%	17.2%
Households with all adults aged: 40-64 (% of households with outstanding debts)	➔ 8.0%	5.8%	0.0%	10.9%
Households with all adults aged: 65+ (% of households with outstanding debts)	➔ 0.8%	1.2%	0.0%	2.8%

Proportion of those in different types of household with outstanding debts of over 100% of household disposable income

Living alone (% of people in households with outstanding debts)	↗ 5.4%	4.3%	0.0%	8.2%
Single parent (% of people in households with outstanding debts)	↗ 27.1%	9.5%	0.0%	27.1%
Other (% of people in households with outstanding debts)	↗ 7.3%	4.8%	0.0%	12.1%

Proportion of those in households with outstanding debts of over 100% of household disposable income by marital status

Never married (% of people in households with outstanding debts)	↗ 6.4%	5.0%	0.0%	15.4%
Married (% of people in households with outstanding debts)	↗ 6.4%	4.1%	0.0%	9.7%
Separated/divorced (% of people in households with outstanding debts)	↗ 13.9%	7.5%	0.1%	13.9%
Widowed (% of people in households with outstanding debts)	↗ 4.3%	1.7%	0.0%	4.3%

Proportion of those in households with outstanding debts of over 100% of household disposable income by housing tenure

Owner occupied without mortgage (% of people in households with outst. debts)	↗ 6.9%	3.2%	0.0%	9.6%
Owner occupied with mortgage (% of people in households with outst. debts)	↗ 14.8%	6.3%	0.0%	16.1%
Market rent (% of people in households with outstanding debts)	↘ 4.4%	8.2%	0.0%	16.0%
Subsidised rent (% of people in households with outstanding debts)	↗ 12.3%	8.7%	0.0%	17.9%
Rent-free housing (% of people in households with outstanding debts)	↗ 5.0%	2.3%	0.0%	15.1%

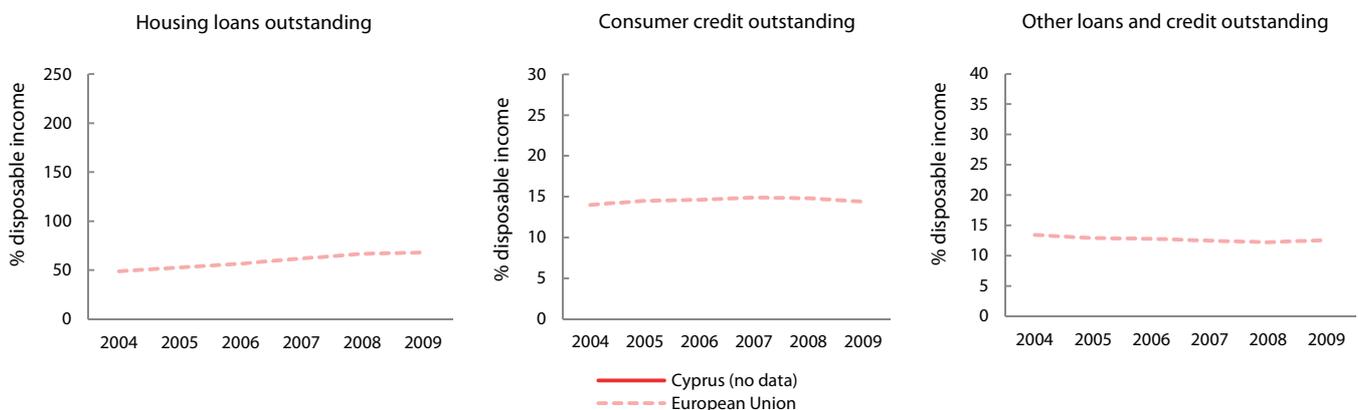
Proportion of those in households with outstanding debts of over 100% of disposable income by work intensity

Work intensity of 0 - 0.19 (% of people in households with outstanding debts)	↗ 8.1%	5.7%	0.0%	10.6%
Work intensity of 0.20 - 0.50 (% of people in households with outstanding debts)	↗ 9.6%	5.7%	0.0%	15.3%
Work intensity of 0.51 - 0.74 (% of people in households with outstanding debts)	↗ 7.0%	5.4%	0.0%	13.5%
Work intensity of 0.75 - 1.0 (% of people in households with outstanding debts)	↗ 8.4%	5.3%	0.0%	14.3%

Proportion of those in over-indebted households that experienced a major drop in income over the preceding year

Over-indebted (% of people in households that experienced drop in income)	↘ 27.4%	33.3%	0.0%	77.6%
Other (% of people in households that experienced drop in income)	↘ 13.1%	19.2%	5.9%	32.5%

IV. Loans and credit outstanding⁴



Notes:

- (1) Eurobarometer 72.1 (2009) and Eurobarometer 74.1 (2010). Note: Those who answered 'very at risk' or 'fairly at risk' to the question 'Please tell me how much you feel at risk of being over-indebted'.
- (2) Eurostat, SILC. Data as of December 2012.
- (3) European Commission, Research Note 4/2010, Over-indebtedness new evidence from the EU-SILC special module.
- (4) European Commission, Research Note 4/2010, Over-indebtedness new evidence from the EU-SILC special module. European Credit Research Institute (ECRI), Lending to households in Europe, 1995-2009 and Eurostat, National accounts.

5 CZECH REPUBLIC

<i>Document</i>	The over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact – Country report Czech Republic
<i>Prepared by</i>	François Lejeune, Dominique Spaey (Van Dijk Management Consultants)
<i>Finalised on</i>	30 November 2012

Final report

Over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact

5.1 DEFINITION OF OVER-INDEBTEDNESS

It appears from stakeholder interviews that there is no common definition of over-indebtedness in the Czech Republic, nor of risk of over-indebtedness. However, some relevant definitions were reported in the interviews.

The first, developed by the Czech National Bank, considers the ratio of a household's repayments to its income, reduced by essential expenditures on food, housing, energy, health and transport. If this ratio is over 50% the household is considered over-indebted. The second definition cited by stakeholders concerns insolvency and is provided by the Insolvency Act 182/2006 Coll. Under this definition, a debtor goes bankrupt if "he/she has several creditors, if he/she has financial obligations that have not been met even upon the lapse of 30 days after maturity, and if he/she is unable to settle these obligations".¹³⁸ Two other interviewees referred to their own definitions. One defined an over-indebted person as "a person who is already unable to pay commitments when due, or is going to get in such situation, according to circumstances, when payments are due," And the other defined over-indebtedness "an inability to meet the household's financial obligations".

There is no generally recognised need for a specific definition of these terms. Their use may vary from one stakeholder to another; for example the definition of over-indebtedness provided by the Czech National Bank might be too precise for NGOs.

5.2 LEVEL OF OVER-INDEBTEDNESS

According to the Czech National Bank,¹³⁹ 38% of households have loans and these are frequently higher-income households. The ratio of household debt to gross disposable income reached 56.8% in 2012. Yet over-indebtedness in the Czech Republic concerns mainly lower-income households. This has been verified by a stress test carried out by the national bank.¹⁴⁰ Whereas the average over-indebtedness in the stress scenario was 14.9% in 2012, this proportion rises to 33% when focus is on lower-income households.¹⁴¹

Generally, recent trends are not reassuring. An interviewee working in public sector reported that all households' debt ratios have risen since 1999. Recent stress tests¹⁴² showed that in 2010, average over-indebtedness was 10.3%. By 2012, this had risen

¹³⁸ Section 3 of the Insolvency Act (act No. 182/2006 Coll.).

¹³⁹ Czech National Bank, *Financial Stability Report 2011/2012*, 2012, p. 34.

¹⁴⁰ *Ibid.*, p. 38.

¹⁴¹ Households are divided into income quintiles. Lower-income households are not defined by a fixed level of income but in relation to the total population. They belong to the two lowest quintiles.

¹⁴² Czech National Bank, 2012, p. 38.

by more than 4%. The proportion of over-indebted lower-income households increased by 12% in three years.

Previous research into the evolution of the debt burden ratio (debt to disposable income) and the adjusted debt burden ratio (debt to disposable income minus essential expenses) showed that both significantly increased between 2000 and 2008.¹⁴³ The average debt burden ratio rose from 7.3% to 12%, and average adjusted debt burden ratio from 16.7% to 19.2% during that period.

Interviewees shared a similar view, predominantly assessing the number of households that are either over-indebted or have ongoing difficulties meeting their financial commitments to have significantly increased.

EU SILC¹⁴⁴ data demonstrates the same trends (see Annex A). Arrears on key commitments decreased in the Czech Republic between 2005 and 2008. Between 2009 and 2010 these rates increased. However, they stayed at a lower level than 2005 and lower than the EU average. Outstanding loans and credit (defined in ratio to disposable income) rose during the same period. Whereas outstanding housing loans only slightly increased, there was a significant increase in outstanding consumer credit (while EU average was quite stable in the same period).

Finally, 26% of respondents to the Eurobarometer in the Czech Republic felt at risk of being over-indebted in 2010, while 22% had done in 2009. This differs from the development at the EU level: on average, lowest value and highest values all decreased in the same period.¹⁴⁵

The number of private insolvencies was reported by Creditreform to have risen "dramatically – from around 10,600 in 2010 to 17,600 in 2011, an increase of 66.7 per cent".¹⁴⁶

5.3 NATURE AND DRIVERS OF OVER-INDEBTEDNESS

5.3.1 Most common types of households that are over-indebted

The stress test developed by the Czech National Bank showed that over-indebtedness depends not only on income but also on demographic characteristics.¹⁴⁷ Young families and people who attended secondary school but do not have a school-leaving certificate are more often over-indebted than other segments of the Czech

¹⁴³ Bičáková A., Prelcová Z. and Pašaličová, R., *Who borrows and who may not repay?*, CERGE-EI working paper series, 2011 (ISSN 1211-3298), p. 15.

¹⁴⁴ European Union Statistics on Income and Living Conditions.

¹⁴⁵ Special Eurobarometer 355, *Poverty and Social Exclusion Report*, 2010, p.42.

¹⁴⁶ Creditreform, *Insolvencies in Europe 2011/2012*, A survey by the Creditreform Economic Research Unit, p. 32.

¹⁴⁷ Czech National Bank, 2012, p. 38.

population. In 2012, over-indebtedness reached 16.3% for young families and 15.8% for people with secondary education but without a school-leaving certificate.

It appears from stakeholder interviews that households most likely to be over-indebted in the Czech Republic are: those consisting of young people (up to 39 years old), one-person households with one or more child, households in rented accommodation or with a mortgage, households with two unemployed people, households in which the highest level of education does not exceed primary school, and households at risk of poverty (which have less than 60% of median disposable income). This confirms the findings of the stress test performed by the Czech National Bank. One interviewee added that self-employed people are also most frequently in danger of over-indebtedness, especially those "who are not highly qualified".

Finally, the majority of interviewees who provided an answer noted a fairly significant change in types of over-indebted households. One stakeholder described this as a "shift from low income households to middle income ones" and another as a shift to more "white-collar workers".

5.3.2 Causes of households' over-indebtedness

Macro-economic factors

The main macro-economic factor pointed out in the stakeholder interviews as a cause of over-indebtedness was unemployment level, followed by wage level and social welfare level. According to interviewees, it is more difficult to find jobs, and wages have declined with the crisis. One civil society stakeholder noted that unemployment is not an equally important driver of over-indebtedness in all regions of the country.

Eurostat data for July 2012 shows that the Czech Republic in fact had one of the lower unemployment rates in the EU (6.6%), and was below the EU average of 10.4%.¹⁴⁸ However, the level of unemployment was higher than before the financial crisis. As the Czech National Bank pointed out, despite a fall in the unemployment rate (compared to 2010), the "income situation of households deteriorated".¹⁴⁹

Cost of living

Housing costs (especially in Prague) and utility costs were singled out by the stakeholders as the most important causes of over-indebtedness. As noted above, most households that face problems in meeting their financial commitments rent an apartment or have a mortgage. EU SILC data show that cost of living has been

¹⁴⁸ See Eurostat, 'Euro area unemployment rate at 11.3%', *Eurostat news release*, 124/2012, 31 August 2012, at http://epp.eurostat.ec.europa.eu/cache/ITY_PUBLIC/3-31082012-BP/EN/3-31082012-BP-EN.PDF.

¹⁴⁹ Czech National Bank, 2012, p. 34. The latest financial stability report provides further details: "Although wages rose by 2.2% in nominal terms, the real growth of 0.3% was among the lowest in recent history ... and was accompanied by a decline in real money income of 2.2%." (ibid.).

increasing,¹⁵⁰ and that certain costs, such as electricity, gas and other fuels, saw a significant increase in recent years (these costs have been above EU average since 2008, whereas they were consistently lower before).¹⁵¹

Types of credit/loan taken out by households

Predatory or usurious types of credit/loans were identified by all but one stakeholder as a major driver of over-indebtedness in the Czech Republic.¹⁵² When banks refuse to give credit to people, the latter may turn to predatory lenders that try to benefit from customers' defaults, according to one interviewee, who referred to the "subsequent imposition of high contractual penalties and obtaining enforcement orders in distraint proceedings in order to satisfy a loan claim. Very often the terms and conditions of such loans are not quite clear from the very beginning."

This is likely related to the lack of financial literacy that seems to characterise the over-indebted population in the country.¹⁵³

Regulated consumer credit with high interest rates and non-usurious credit/loans from unregulated lenders were also identified as important causes of over-indebtedness by more than half of the stakeholders interviewed.

Personal circumstances

Previous research in the Czech Republic showed that people tend to underestimate their debts.¹⁵⁴ In the interviews for this study, all stakeholders reported both drop in income caused by unemployment or business failure and lack of money management skills as causes of over-indebtedness.

5.3.3 Changes relevant for levels of over-indebtedness

The financial crisis has brought major changes to the Czech economy. Unemployment rose from 4.4% in 2008 to 7.3% in 2010¹⁵⁵ while real wages and social benefits decreased.

¹⁵⁰ See Eurostat, 'Cost of living index' (code: prc_hip_aind).

¹⁵¹ See Eurostat, 'Electricity, gas and other fuel index' (code: prc_ppp_ind).

¹⁵² One interviewee reported: "If you go outside on the street you will find advertisements on lamps, on dustbins, everywhere. 'Are you in a situation where a bank will not provide you with a loan? Call us! We will give you money.' It's hard not to come across such offers of alternative loans. And the conditions are sometimes really strict. You can have 500% interest. This is legal, as long as it is written somewhere in the contract. And most consumers don't read it. The first time they find out about it is when they get into problems."

¹⁵³ Lux, M. and Mikeszová, M. 'The Role of a Credit Trap on Paths to Homelessness in the Czech Republic', forthcoming.

¹⁵⁴ Lux, M. and Mikeszová, M., forthcoming.

¹⁵⁵ See European Commission (DG Employment, social affairs and inclusions), The European Social Fund in the Czech Republic 2007-2013, 2011, available at <http://ec.europa.eu/esf/main.jsp?catId=374&langId=en> (20 November 2012).

It also emerges from the stakeholder interviews that banks have become more cautious and have strengthened their risk management as a consequence of the crisis. For the most part stakeholders noted that access to credit has been reduced and that people have been increasingly turning to unregulated lenders with high interest rates and to predatory or usurious lenders. Opinions regarding the relevance of changes in the regulatory environment were evenly split. Reference was made to directive 2008/48/ES which introduced the assessment of creditworthiness.

5.3.4 Cultural attitude towards debt and actual level of households' (over-)indebtedness

All but one stakeholder indicated that there is a relationship in the Czech Republic between the cultural attitude toward debt and the actual level of households' over-indebtedness.

A difference in perception of debt can be observed between older and younger generations. This is due to the fact, as one interviewee explained, that loans were virtually non-existent during the communist era. Since then, an accumulation of factors has led to a significant increase in consumption, which has made credit more socially acceptable. Two interviewees agreed that the Czech population wants to access the living standards of Western European and American countries. As some interviewees explained, social status in the Czech Republic seems to now be defined according to amounts and quality of consumed goods and services. Another recent change observed by some stakeholders is an increase in aggressive marketing campaigns by lenders and shops. "This, together with the poor financial skills of large segments of society, led to a steep increase of over-indebtedness in the last decade," stated the financial regulator. A civil society stakeholder and an independent expert also identified poor financial literacy as a driver of over-indebtedness in the Czech Republic.¹⁵⁶

5.4 CONSEQUENCES OF OVER-INDEBTEDNESS

5.4.1 Consequences for affected households

Interviewees¹⁵⁷ identified the main effects of over-indebtedness as the deterioration of both living standards and well-being. These are followed by home repossession, reduced labour market activity, and family breakdown/divorce. The lowest-ranked

¹⁵⁶ This point has also been raised in the National Reform Programme of the Czech Republic, *Investing into European Competitiveness: Contribution of the Czech Republic to Europe 2020 Strategy*, 2011, p. 41, available at http://ec.europa.eu/europe2020/pdf/nrp/nrp_czech_en.pdf.

¹⁵⁷ Several interviewees emphasised that they did not have the data to properly assess this issue and they were providing merely personal assessments.

consequence is homelessness. On the other hand, Lux and Mikeszová¹⁵⁸ have showed that over-indebtedness is a major driver of homelessness.¹⁵⁹

5.4.2 Consequences of over-indebtedness for the financial services industry

Costs of defaulted credits and costs of arrears and agreed repayment/debt management plans have an important impact on creditors according to the predominant stakeholders' assessment. However, as some interviewees pointed out, the risk of a higher level of over-indebtedness for the financial sector is low, as is the level of non-performing debts.

5.4.3 Economic and social consequences of over-indebtedness for society

Stakeholders predominantly assessed that over-indebtedness does not have a strong impact on society. As summarised by one interviewee: over-indebtedness is not one of the biggest problems in the country, and thus its economic and social effects are not perceived as critical. However, according to an independent expert, over-indebtedness may increase the gap between income groups and ethnic groups and may stimulate right-wing extremist activities.

5.4.4 Debt collection practices

According to the majority of interviewees, debt collection practices have not become more aggressive during the last five years. The financial regulator spoke about a code of conduct adopted by the industry association (the Association of Debt Collectors) and about incoming suggestions regarding regulatory interventions, i.e. rules for debt collectors on how to contact debtors. However, some stakeholders observed some aggressive debt collection practices among lenders, and one reported that the largest energy company operating in the Czech Republic has been investigated by police for "tough debt collection".

¹⁵⁸ Lux, M. and Mikeszová, M., forthcoming.

¹⁵⁹ According to the 2011 census carried out by the Czech Statistical Office (CSU), more than 11 thousand homeless people use the relevant social services. "The real number of homeless people in the 10.5 million Czech Republic may be up to three times higher, a CSU representative said, as the count did not include people who live on the street, in squats or in inadequate structures rented privately, for example. According to the data, a typical homeless person is a man aged 45 to 49 who is a Czech citizen. Women account for about 21.5% of the shelter users. About a half of the people counted (47.2%) had done an apprenticeship or had followed secondary education without finishing the leaving exams ... Almost half of the homeless people are single, another 38% are divorced and 9.5% are married." (FEANTSA, 'Czech Republic: Census Results on Homelessness', 10 January 2012, at http://www.feantsa.org/code/en/pg.asp?Page=24&pk_id_news=5894).

5.5 MEASURES IN FORCE TO ALLEVIATE THE IMPACT OF OVER-INDEBTEDNESS

5.5.1 Early identification of households at risk

There is some agreement that measures to identify households at risk of becoming over-indebted are common in the Czech Republic. However, stakeholders only mentioned cases of regulated lenders, such as banks. It is worth mentioning that one financial services provider considers these measures to not be common at all in the country but adds that it has "a unique opportunity to spot any difficulties a customer may be facing as [its] agents call on a weekly basis".

Among the measures mentioned by stakeholders was banks' evaluation of the creditworthiness of future debtors in order to meet the criteria of the risk management plans elaborated within banks. This can be done by talking with customers and by checking credit registers. A second identification of households' risk level can be performed after credit has been contracted by a household. Banks call debtors to try to understand customers' situations, and subsequently propose adapted refunding solutions.

5.5.2 Advice offered to over-indebted households

In a recent overview of debt advisory services in the EU Eurofound pointed out that the Czech Republic is one of the countries where "a consumer association is the principal provider of debt advisory services", complemented by "private (for-profit and non-profit) organisations".¹⁶⁰ The Czech Consumer Association was the co-founder (together with the Česká spořitelna Bank) of the debt advisory centre Counselling in stringency (Poradna při finanční tísni), which was launched in 2007. Other relevant providers include members of the association Citizens Advice Bureau (Asociace občanských poraden); as well as some other NGOs, such as the regional organisation SPES.¹⁶¹

According to another overview of debt advice provision in the EU, providers of debt advice, such as the staff of consumer organisations, do not have the possibility to represent debtors in insolvency proceedings.¹⁶²

Availability and costs

According to the majority of interviewees who answered this question, face-to-face advice, personalised advice by telephone, and personalised advice by email/online

¹⁶⁰ Eurofound, *Household debt advisory services in the European Union*, 2012, p. 9.

¹⁶¹ See Eurofound, *Managing household debts: Social service provision in the EU*, Working paper, 2010, p. 10.

¹⁶² See Die Forschungs- und Dokumentationsstelle für Verbraucherinsolvenz und Schuldnerberatung, 'Debt advice in Europe', n.d., at <http://www.sfz.uni-mainz.de/2626.php>.

chat are the most prevalent types of advice in the Czech Republic. These services are relatively available across the country. Printed information was reported to be generally available across the country whereas web-based tools do not seem to be widespread. Most stakeholders agreed that advice services are generally free of charge.

Demand for debt advice as assessed by stakeholders

According to the majority of respondents, consumers are fairly well aware of the existence of face-to-face advice and advice by phone. Other solutions seem to be less known. While the current level of demand for advice is difficult to assess, a majority of respondents agreed that demand had increased in the past five years due to increasing numbers of over-indebted households. According to one stakeholder, NGOs that provide this kind of advice have been overwhelmed by the demand.

Funding of debt advice

Funding for debt advice was deemed to be insufficient. As one interviewee explained, funding for NGOs that provide debt advice originates from two sources: private entities and public authorities. Among the possible solutions for the perceived insufficiency of funding that were proposed by respondents is increasing government subsidies. But due to the crisis public authorities have already cut budgets.

In the opinion of one civil society stakeholder, the funding of debt advice services could also be improved by establishing a system to certify these services, by the government training people who work for them, by testing their programs, and through better collaboration between government and social services.

5.5.3 Key measures in place to alleviate the impact of over-indebtedness

Availability and costs

Legal proceedings were recognised by a majority of stakeholders as the measure most widespread across the Czech Republic. Legal proceedings for households consist in a discharge of debt procedure that can be initiated by the debtor. The debt might be discharged by the court if the debtor fulfils some conditions, including the repayment of at least 30% of the debt.¹⁶³ As an NGO explained, this procedure is not free of charge and includes the cost of an insolvency officer or preparation by private companies. Stakeholders mostly agreed that legal procedures are effective, but several interviewees also pointed out that this solution is not suitable for all over-

¹⁶³ See Kilborn, J., 'Expert Recommendations and the Evolution of European Best Practices for the Treatment of Overindebtedness', 1984-2010, inaugural lecture at the Radboud University Nijmegen (The Netherlands), 2010, pp. 26, 37.

indebted households. Namely, in consumer insolvency proceedings, some people are not able to satisfy the requirement that at least 30% of the debt be repaid.

Stakeholders reported arrangements between the parties involved to be also relatively available. However, some point out that they depend on the willingness to reach an agreement. Again, these solutions do not appear to be free of charge.

5.5.4 Changes in response to over-indebtedness

Changes in responses to over-indebtedness observed during the previous few years mainly concern the Insolvency Act.

According to the International Association of Insolvency Regulators¹⁶⁴ new insolvency legislation came into force in 2008, replacing the bankruptcy act from 1991. The essential aims of the new regulation were reported to be: ensuring more transparency and foreseeability of insolvency proceedings; confirming the status of creditors; motivating the debtor to commence dealing in a timely manner; discharging debtors if appropriate; speeding up and improving the effectiveness of insolvency proceedings overall. Šedová¹⁶⁵ recently summarised that the new Insolvency Act introduced new methods of resolving insolvency; an on-line insolvency register; an improved position for secured creditors; and new rules regarding the financial collateral. The newly introduced publicly accessible insolvency register contains information regarding insolvency proceedings commenced on or after 1 October 2008 and it "substantially increases third party access to information".¹⁶⁶

5.5.5 Types of households of over-indebted consumers not reached by current measures

All interviewees who provided an answer indicated that there are some types of households that are not reached by current measures. According to one interviewee, unemployed people, those with a commercial criminal record, and pensioners with a low pension are not reached. Another interviewee pointed to those who are not able to reach the 30% debt-repayment required for eligibility for personal insolvency proceedings.

¹⁶⁴ See 'Czech Republic' at *International Association of Insolvency Regulators*, n.d., accessed at: http://www.insolvencyreg.org/sub_member_profiles/czech_republic/index.htm.

¹⁶⁵ Šedová, J., 'Consumer Insolvency in the Czech Republic,' *World Academy of Science, Engineering and Technology* 60 2011, accessed at <https://www.waset.org/journals/waset/v60/v60-35.pdf>.

¹⁶⁶ Osicka, T., Kucerova, I., and Mestanek, P., 'The modernisation of Czech insolvency law', Prague, 8 July 2008, at <http://www.linklaters.com/Publications/Publication2051Newsletter/PublicationIssue20080708/Pages/PublicationIssueltem3327.aspx>. According to the same source: "Insolvency proceedings are opened once the petition is filed with the court and the court must publish the filing of a petition to open insolvency proceedings in the insolvency register within two hours of receipt of the petition (if received within business hours)."

5.5.6 Best practices

Two solutions are considered as best practices by a large share of stakeholders: non-governmental debt advice services (which are free of charge) and financial education.

5.6 OUTLOOK

All stakeholders who provided an assessment predicted that the number of over-indebted households will increase by a fair amount in the next five years. There were two main reasons advanced by stakeholders. First and foremost was the macro-economic situation (low net income growth, persistent unemployment, austerity measures, and Eurozone instability). To a lesser extent, the behaviour of younger generations was cited.

According to the majority of stakeholders, there are specific new challenges that need to be addressed by policy makers. However, no consensus emerged from the interviews regarding the nature of these challenges. Among those mentioned are:

- ▶ Tackling advertising that promotes credit and debt;
- ▶ Tackling the growing number of mortgages with variable rates;
- ▶ Tackling loans under 200 Euro, which are not covered by legislation;
- ▶ Improving counselling;
- ▶ Preparing for the impact on Czech households of a possible Eurozone break-up;
- ▶ Regulating debtors' fees (such as recall cost of unpaid reimbursements, etc.).

There was a call from a large proportion of stakeholders to improve the regulation of credit and the commercial practices of lenders at a national level. Solutions proposed by interviewees were various:

- ▶ Introducing a license for lenders;
- ▶ Limiting interest rates (very high interest rates are currently legal as long as they are written in a contract);
- ▶ Extending the assessment of creditworthiness and preventing lenders from granting credit if the assessment is not positive;
- ▶ Reducing the costs of insolvency proceedings.

As identified by two stakeholders, some regulations are needed in the Czech housing market. For example, housing advisors usually act in their own interests (e.g. commissions paid by consumers) instead of in consumers' interests. This means people may buy houses that are too expensive for them and take out significant loans. Certification for housing advisors may be helpful in preventing this. According to an NGO, it is also necessary to develop social housing in the Czech Republic.

Some regulations are also needed in the Czech energy market. As explained by one stakeholder, the country's largest energy provider holds a monopoly and seems to have aggressive debt collection practices.

Last but not least, as already mentioned in this report, stakeholders in the Czech Republic emphasised the importance of improving financial education.

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Final report

Over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact

ANNEX A: STATISTICAL DATA FROM EU SOURCES

Final report

Over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact

Czech Republic

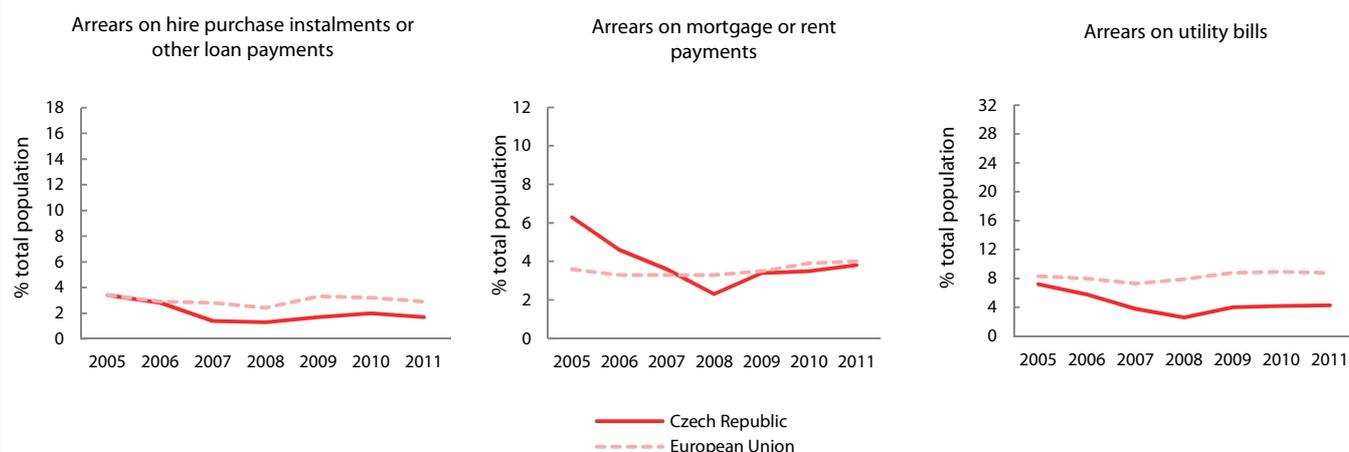
I. Eurobarometer¹

	Czech Republic	EU average	Lowest EU value	Highest EU value
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Households *at risk* of being over-indebted

Respondents feeling at risk of over-indebtedness in 2010	↗ 26%	25%	7%	52%
Respondents feeling at risk of over-indebtedness in 2009	↘ 22%	27%	9%	53%

II. EU SILC standard survey data²



III. EU SILC 2008 module: Over-indebtedness and financial exclusion³

	Czech Republic	EU average	Lowest EU value	Highest EU value
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Proportion of people in households with bank overdrafts, outstanding balances on credit cards or in arrears on other loans of over 100% of household disposable income

Overdrawn bank account (% of people in households overdrawn)	↘ 1.3%	2.2%	0.0%	7.7%
Credit or store card (% of people in households with outstanding balances)	↘ 0.1%	1.1%	0.0%	8.6%
Other loan/credit payments (% of people in households in arrears)	↘ 0.2%	0.3%	0.0%	1.1%

Proportion of people in households in arrears in servicing housing-related loans and bills and in paying other bills of over 100% of household disposable income

Housing bills (% of people in households in arrears)	↘ 0.1%	0.5%	0.0%	2.9%
Other payments (% of people in households in arrears)	↘ 0.0%	0.4%	0.0%	1.7%

Households living with outstanding debts and/or arrears of over 100% of household disposable income

Total (% of households with outstanding debts/arrears)	↘ 1.9%	4.6%	0.0%	11.8%
Income above 60% median (% of households with outstanding debts/arrears)	↘ 1.5%	4.2%	0.0%	11.3%
Income below 60% median (% of households with outstanding debts/arrears)	↘ 6.1%	7.0%	0.2%	13.7%
Materially deprived (% of households with outstanding debts/arrears)	↘ 4.1%	9.0%	0.1%	27.4%

Proportion of those in broad age groups with outstanding debts of over 100% of household disposable income

Households with all adults aged 25-39 (% of households with outstanding debts)	↘ 2.2%	6.3%	0.0%	17.2%
Households with all adults aged: 40-64 (% of households with outstanding debts)	↘ 2.4%	5.8%	0.0%	10.9%
Households with all adults aged: 65+ (% of households with outstanding debts)	↘ 0.1%	1.2%	0.0%	2.8%

Proportion of those in different types of household with outstanding debts of over 100% of household disposable income

Living alone (% of people in households with outstanding debts)	↘ 2.3%	4.3%	0.0%	8.2%
Single parent (% of people in households with outstanding debts)	↘ 3.9%	9.5%	0.0%	27.1%
Other (% of people in households with outstanding debts)	↘ 1.8%	4.8%	0.0%	12.1%

Proportion of those in households with outstanding debts of over 100% of household disposable income by marital status

Never married (% of people in households with outstanding debts)	↘ 2.2%	5.0%	0.0%	15.4%
Married (% of people in households with outstanding debts)	↘ 1.4%	4.1%	0.0%	9.7%
Separated/divorced (% of people in households with outstanding debts)	↘ 3.8%	7.5%	0.1%	13.9%
Widowed (% of people in households with outstanding debts)	↘ 0.5%	1.7%	0.0%	4.3%

Proportion of those in households with outstanding debts of over 100% of household disposable income by housing tenure

Owner occupied without mortgage (% of people in households with outst. debts)	↘ 1.4%	3.2%	0.0%	9.6%
Owner occupied with mortgage (% of people in households with outst. debts)	↘ 3.7%	6.3%	0.0%	16.1%
Market rent (% of people in households with outstanding debts)	↘ 4.5%	8.2%	0.0%	16.0%
Subsidised rent (% of people in households with outstanding debts)	↘ 1.7%	8.7%	0.0%	17.9%
Rent-free housing (% of people in households with outstanding debts)	↗ 2.8%	2.3%	0.0%	15.1%

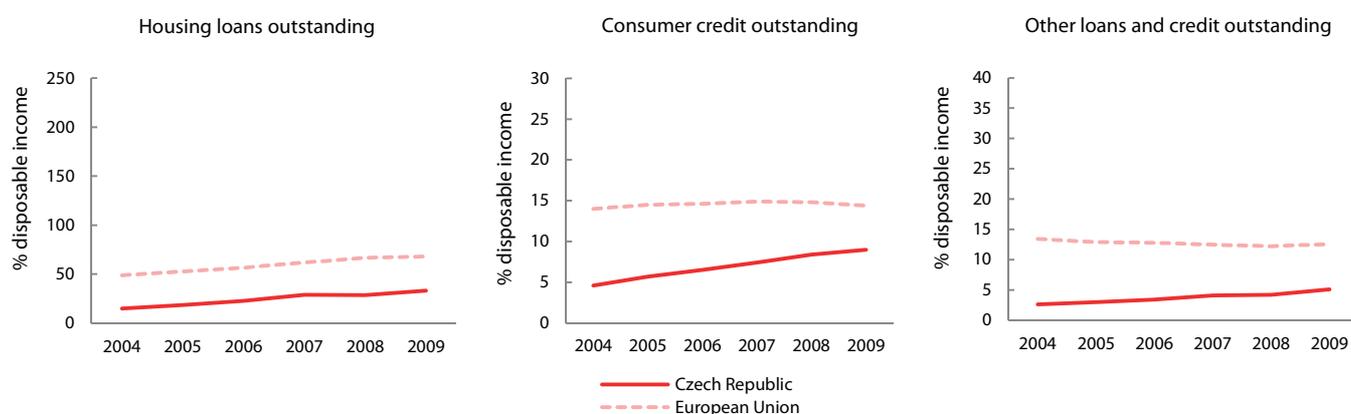
Proportion of those in households with outstanding debts of over 100% of disposable income by work intensity

Work intensity of 0 - 0.19 (% of people in households with outstanding debts)	↘ 2.5%	5.7%	0.0%	10.6%
Work intensity of 0.20 - 0.50 (% of people in households with outstanding debts)	↘ 2.1%	5.7%	0.0%	15.3%
Work intensity of 0.51 - 0.74 (% of people in households with outstanding debts)	↘ 2.9%	5.4%	0.0%	13.5%
Work intensity of 0.75 - 1.0 (% of people in households with outstanding debts)	↘ 1.8%	5.3%	0.0%	14.3%

Proportion of those in over-indebted households that experienced a major drop in income over the preceding year

Over-indebted (% of people in households that experienced drop in income)	↗ 35.5%	33.3%	0.0%	77.6%
Other (% of people in households that experienced drop in income)	↘ 17.3%	19.2%	5.9%	32.5%

IV. Loans and credit outstanding⁴



Notes:

(1) Eurobarometer 72.1 (2009) and Eurobarometer 74.1 (2010). Note: Those who answered 'very at risk' or 'fairly at risk' to the question 'Please tell me how much you feel at risk of being over-indebted'.

(2) Eurostat, SILC. Data as of December 2012.

(3) European Commission, Research Note 4/2010, Over-indebtedness new evidence from the EU-SILC special module.

(4) European Commission, Research Note 4/2010, Over-indebtedness new evidence from the EU-SILC special module. European Credit Research Institute (ECRI), Lending to households in Europe, 1995-2009 and Eurostat, National accounts.

6 DENMARK

Document The over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact - Country report Denmark

Prepared by Nicholas McSpedden Brown

Finalised on 20 December 2012

Final report

Over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact

6.1 DEFINITION OF OVER-INDEBTEDNESS

There is no generally accepted specific definition of household over-indebtedness in Denmark. This is related to difficulties arising from the multitude of factors that lead to over-indebtedness. As an example, one stakeholder interviewed pointed out that setting precise thresholds for when debt must be considered problematic is difficult because this depends on income, expectations of income acquisition, and future changes in external factors such as the interest rate, family lifestyle, amount of liquid assets and access to informal financial support.

It is not seen by most stakeholders interviewed as urgent to produce a better definition of household over-indebtedness. In Denmark it is more common to consider the non-payment of financial obligations in the wider context of social debate, along with the poor and the vulnerable; therefore it is seen as significantly more important to accurately define poverty, as this in many cases covers the question of over-indebtedness.¹⁶⁷

6.2 LEVEL OF OVER-INDEBTEDNESS

As there is no common definition of household over-indebtedness in Denmark, assessing changes in the level of over-indebtedness is difficult. However, on the basis of various indicators the level of over-indebtedness in Denmark has seen a slight increase in recent years. It nevertheless remains relatively low in comparison to other EU countries.

The debt servicing burden in Denmark was below the EU average for a number of indicators, such as the share of households in arrears relating to bank overdrafts or credit cards, or housing bill-related arrears (see Annex A). The total proportion of households with outstanding debts/arrears of over 100% of household disposable income was also low in 2008 (2.0%) as opposed to the EU average of 4.6%.¹⁶⁸

The EU-SILC data shows that the share of the Danish population that has reported arrears on mortgage or rent payments increased from 1.1% in 2008 to 2.7% in 2010, before dipping slightly to 2.5% in 2011. That share was nonetheless substantially below the EU average level of 4.0% (see Annex A). More recent data available from the Association of Danish Mortgage Banks for 2012 shows that the level of arrears on mortgage payments was the lowest since 2008 (see Annex B). In addition, the share of the population in arrears on utility bills increased from 1.8% in 2007 to 3.9% in 2011, which also remained well below the EU average (7.3% in 2007, 8.8% in 2011).

¹⁶⁷ As shown later in the report, in Denmark poorer households are considerably more likely to be over-indebted than the more wealthy ones.

¹⁶⁸ In the EU SILC module, outstanding debts/arrears are calculated as the sum of overdrawn bank accounts, outstanding credit card balances and arrears on other credits or loans and on housing and other bills.

The share of the Danish population in arrears on hire purchase instalments or other loan payments exceed the EU average in 2011. More specifically, in 2008 this share equalled 1.9%, followed by an increase to 3.6% of the population in 2011 (compared to the EU average of 2.4% in 2008 and 2.9% in 2011).

Finally, subjective data from the Eurobarometer surveys of 2009 and 2010 show that the sense of risk of over-indebtedness in Denmark was the *lowest* in the EU in 2009: 9% as opposed to the EU average of 27%. By 2010, this share increased slightly in Denmark (to 10%), while the EU average decreased (to 25%).

6.3 NATURE AND DRIVERS OF OVER-INDEBTEDNESS

6.3.1 Most common types of households that are over-indebted

According to the Danish central bank, the aforementioned large *gross* debt of Danish families stems from the frequent use of the financial system by those who have the means to do so, "since gross debt is generally offset by even more substantial assets."¹⁶⁹ The report identifies family income, age, house prices and the structure of the pension system to be the main explanatory factors in the balance between gross debt and assets. The report shows that in general families "predominantly use the financial system, they do not abuse it."¹⁷⁰

In particular, the report reveals that the high gross debt of Danish families, in comparison to other countries, is concentrated in families with the highest incomes, as well as those with the most financial assets, including pension wealth after tax. Also, among high-earning families in Denmark, the gross debt ratio is highest among those whose oldest member is in his or her thirties, but then decreases beyond this age.

In contrast, only slightly more than one third of families had *net* debt (i.e. assets excluding pension wealth *less* gross debt) in 2010, and among these the highest-earning families account for the largest net debt. Moreover, net debt is not common in the oldest age groups, whereas more than half of the families in the 25-34 age group had net debt, irrespective of their income. The report indicates that this should be attributed predominantly to education-related debt, among other factors.

The report concludes that "debt is generally concentrated in families who have the funds to meet the related obligations."¹⁷¹

It is noticeable, however, that the more wealthy households generally have debt service burdens (i.e. debt as a percentage of disposable income) below the levels of

¹⁶⁹ Danmarks Nationalbank, 2012, "The Wealth and Debt of Danish Families", Monetary Review, 2nd Quarter, Part 1, page 39.

¹⁷⁰ Ibid, page 39.

¹⁷¹ Ibid, page 43.

low-income households. This is confirmed in the EU-SILC module, where one indicator of the level of over-indebtedness within a given group is the proportion with outstanding debts and/or arrears of over 100% of household disposable income. According to this indicator, a much higher proportion of over-indebted households appears among materially deprived households¹⁷² than among households whose income is *above* 60% of the median income (17.7% as opposed to 1.6%). This figure is also substantially higher than the EU average of 9.0%. By this same measure of over-indebtedness, middle-aged households (defined as households with all adults aged between 25 and 39) are affected the most (2.7%) while senior households are hardly severely over-indebted (0.4%). The severity of over-indebtedness is related to work intensity: 5.0% of all households who were employed for less than 20% of the standard working time were over-indebted. Also, according to stakeholders interviewed as well as the EU-SILC data, over-indebtedness is higher among households whose members have children, are unmarried, middle-aged, living in rented accommodation, unemployed, and less educated. Indeed, data from the debt advice service interviewed show that in 2011, 82% of advisees were tenants, 77% were single, 35% have children under 18, and 48% were between 30 and 49 years old.¹⁷³

The Danish central bank study underlines that the composition of households taking on debt may not have changed much in recent years. According to the study, from 2002 to 2010 the percentage increase in gross debt was the largest in the oldest age groups. To a lesser but notable extent it also increased for families with the lowest incomes. However, when the increase in gross debt is measured in absolute terms (i.e. *Danish kroner* rather than a percentage of the previous level of debt), high-income families and families in the middle of the age distribution account for the largest increases, as high-income families have taken on significantly more debt in absolute terms.¹⁷⁴

Stakeholders indicated that over-indebted households are increasingly ones where the age group and the education level are higher than previously. The type of debt was more predominantly in the form of unpaid utility bills or mortgage instalments, as a consequence of buying a property in 2005-2007 before the crisis. An independent expert interviewed observed that repossession has increased in the last 5 years as over-indebted households are less capable of fulfilling their rent obligations. These developments are seen as related to the financial crisis and the ensuing across-the-board increase in unemployment.

¹⁷² Materially deprived is defined in the EU SILC module as not being able to afford at least 3 of 9 specified items.

¹⁷³ KFUM Sociale arbejde (YMCA Social Work), 2011, Midtvejsstatus På Fode Igen (Interim status report on project 'På Fode Igen'). Note that as KFUM may more predominantly advise 'weaker' or more exposed individuals, these figures may not be representative of people receiving debt advice in general.

¹⁷⁴ Danmarks Nationalbank, 2012, "The Wealth and Debt of Danish Families", Monetary Review, 2nd Quarter, Part 1, p. 42.

In conclusion, the picture of Danish indebtedness is one where debt is mainly concentrated on households that are relatively wealthy, asset-possessing (e.g. housing, pension savings), middle-aged and well-educated. On the other hand, over-indebtedness in terms of a lack of capacity to service debt is more predominantly a characteristic of those who are poorer, living in rented accommodation, of a young-to-middle age group, and less well-educated. Nonetheless, stakeholder assessments indicated that over-indebtedness has been increasingly affecting higher socio-economic classes over the last 5 years, mainly due to the financial crisis.

6.3.2 Causes of households' over-indebtedness

Macro-economic factors

According to stakeholders the unemployment level is the most important of the macro-economic factors that could be considered a cause of over-indebtedness or risk of over-indebtedness in Denmark. In 2008 unemployment at 3.4% was at its lowest level for decades,¹⁷⁵ and in the EU only the Netherlands exhibited a lower unemployment rate. By 2011 unemployment had more than doubled, to 7.6%, as a consequence of the financial crisis.

Cost of living

As Denmark is characterised by a high level of public expenditure (representing 57.9% of GDP in 2011),¹⁷⁶ a large welfare state (with total social expenditure representing an estimate of 30.5% of GDP in 2012)¹⁷⁷ and a universal social system (including health care), costs of living are less likely to be a significant cause of over-indebtedness in comparison to other Member States. Still, cost of living in Denmark was one of the highest in Europe in 2011, second only to Norway and Switzerland.¹⁷⁸ Indeed, stakeholders highlighted that utility costs have risen in the last 5 years, and housing costs remained relatively high despite the crisis.¹⁷⁹ Also, many younger Danes with tertiary education will have taken out government loans for general living expenses during their studies. This leaves them with a significant debt burden at the end of their studies, which is also reported to be a cause of over-indebtedness among young people.

¹⁷⁵ See Eurostat, 'Unemployment rate' (code: tsdec450).

¹⁷⁶ Eurostat, 'Total general government expenditure' (code: tec00023).

¹⁷⁷ OECD Social Expenditure (SOCX) statistics 2012.

¹⁷⁸ Source: Eurostat, 'Comparative price levels of final consumption by private households including indirect taxes.'

¹⁷⁹ The housing cost overburden rate, an indicator defined by Eurostat as the percentage of the population living in a household where the total housing costs (net of housing allowances) represent more than 40% of the total disposable household income (net of housing allowances), was 19.9% for Denmark in 2011, the second highest in the EU after Greece, after having been the highest in 2009 and 2010. Source: Eurostat.

Types of credit/loan taken out by households

A study undertaken by the Danish central bank¹⁸⁰ indicates that Danish households have a very high debt-to-income ratio. According to the study, "overall, the high gross debt is offset by large assets, e.g. via the widespread use of labour-market pensions."¹⁸¹ Another study by the central bank points out that labour-market pensions savings can be an incentive to increase debt, as they reduce the need to be debt-free before retirement.¹⁸²

Mortgages have been flagged by stakeholders as a significant cause of indebtedness, but the precise effect on over-indebtedness is difficult to assess. Before the crisis, a highly developed mortgage market existed. As was reported in the stakeholder interviews, a law brought into force in 2003 permitted the repayment of interest alone (rather than the principal as well) on mortgages over as much as 10 years. At the time, favourable market conditions encouraged the take-out of mortgages and accumulation of gross debt. According to another recent Danish central bank study,¹⁸³ "lower real interest rates and unemployment have also contributed to expanding household gross debt as a result of better opportunities to service and obtain higher debt." This in turn encouraged the purchase of real estate, and thus the rise of house prices. Houses then lost value significantly during the aftermath of the crisis, causing many households to become 'technically insolvent', i.e. the house price became lower than the value of the loan originally taken out. However, as the central bank shows, "households with high debt will typically have high wealth, since their homes are collateral for a large share of the debt."¹⁸⁴ This indicates that high mortgage-related debt alone is unlikely to be a source of over-indebtedness in Denmark. However, as the gross assets are illiquid (and therefore only paid out on retirement) households could still face liquidity problems in the case of a fall in income or a need to sell the property (e.g. due to divorce). As shown in Annex B, the number of home repossessions has indeed increased substantially since the crisis.

In contrast, one source that stakeholders broadly agreed was a cause of over-indebtedness is short-term, easy-to-obtain, high-interest rate consumer loans from unregulated lenders, such as SMS loans or internet loans. There has been a significant increase in such lending in recent years. Nonetheless, according to several stakeholders interviewed, there is now increased political focus in Denmark on restricting the availability of such loans in the near future. Such a move may alleviate

¹⁸⁰ Danmarks Nationalbank, 2012, "The Wealth and Debt of Danish Families", Monetary Review, 2nd Quarter, Part 1.

¹⁸¹ *Ibid*, page 39.

¹⁸² Danmarks Nationalbank, 2011, "Household Balance Sheets and Debt - and International Country Study", Monetary Review, 4th Quarter, Part 1, page 50. However, as labour market pensions are illiquid assets and can generally only be accessed following retirement, they may pose a risk to households faced with liabilities that depend on short-term, flexible interest rates.

¹⁸³ Danmarks Nationalbank, 2011, "Household Balance Sheets and Debt - and International Country Study", Monetary Review, 4th Quarter, Part 1, page 48.

¹⁸⁴ *Ibid*, page 55.

over-indebtedness in the long term, but in the short term it may aggravate over-indebtedness, as households will have more difficulty in taking out new loans to service existing loans.

Personal circumstances

Personal circumstances are the major cause to which over-indebtedness is attributed by stakeholders interviewed. This is most likely to come in the form of a drop in income caused by job loss, business failure, or other idiosyncratic shocks, such as illness, divorce/separation, or even a combination of these factors.

The proportion of households with outstanding debts of over 100% of disposable income that experienced a major drop in income over the preceding year was 37.7% approximately five years ago (according to the EU-SILC data), as opposed to 10.4% of the population in total.¹⁸⁵

6.3.3 Changes relevant for levels of over-indebtedness

Stakeholders indicated that the major economy-wide changes that have had a notable effect (positive or negative) on levels of over-indebtedness in Denmark over the last 5 years are related to unemployment, a fall in house prices, a dramatic drop in interest rates on mortgages, a restriction in the accessibility of credit, and an increase in interest-only loans and SMS/quick loans.

As mentioned above there has been a fairly significant increase in the unemployment level, which nonetheless may have had a less significant impact on over-indebtedness in Denmark than in other Member States thanks to a robust social safety net involving substantial unemployment benefits.

Interest rates on mortgages have dropped dramatically following the crisis: data from the Association of Danish Mortgage Banks shows that market rates on mortgage bonds hit a high of 5.87% at the end of 2008, before dropping to 0.87% in 2010, then to as low as 0.14% in 2012. Some stakeholders advanced that, as this drop gradually spilled into average loan pools with fixed interest rates, this has strongly curbed over-indebtedness arising from mortgages. Moreover, as interest rates were lowered in particular in a response to a drop in income in certain households having taken out mortgages, these households largely avoided home repossession.

However, as was also pointed out in the stakeholder interviews, the 'interest-only' loans introduced in 2003, which in most cases allowed the repayment of interest alone for 10 years, could cause an increase in over-indebtedness starting from 2013. Consumers who took out such loans will be required to pay down the debt principal in addition to the interest once the 10-year limit is exceeded.

¹⁸⁵ In the EU the average proportion of over-indebted households experiencing a major drop in income over the preceding year in was 33.3%, as opposed to 19.2% of the population in total.

It was also reported that the financial sector had tightened credit rules, thus making it more difficult to take out loans for both consumers and businesses, which could have a mitigating effect on over-indebtedness. This may, however, have the side-effect of forcing consumers to seek loans from unregulated lenders. As mentioned above, high-interest rate, short-term, 'quick' or SMS loans, usually from unregulated lenders, have seen a rise in recent years and have also affected levels of over-indebtedness.

6.3.4 Cultural attitude towards debt and actual level of households' (over-)indebtedness

More wealthy households have traditionally used financial markets quite commonly, as testified by levels of gross debt found to be positively correlated to income levels in Danish households in the Danish central bank study mentioned above. This is likely to have been facilitated by highly developed credit markets, particularly mortgage markets. However, it is not clear whether such an attitude is a cultural one linked to actual levels of over-indebtedness.

6.4 CONSEQUENCES OF OVER-INDEBTEDNESS

6.4.1 Consequences for affected households

Based on an average rating of consequences of over-indebtedness for households attributed by interviewed stakeholders, in Denmark the greatest consequence for affected households has been in the form of home repossession.¹⁸⁶ Available data shows that there has been a substantial increase in the number of home repossessions over the last few years, with a slight decrease in 2012 compared to the previous year (see Annex B).

Another potentially important consequence for affected households is financial exclusion: banks have the right to refuse the provision of a credit card to indebted consumers.

Homelessness is the least highly rated consequence for affected households of the potential consequences listed (among those stakeholders who assessed it), and other consequences relating to health and well-being were also perceived to be of lesser importance. The Danish social system was reported by several stakeholders to be well adapted to cushion the severity of these potential consequences.

6.4.2 Consequences of over-indebtedness for the financial services industry

According to the Danish central bank, following the financial crisis the financial sector's losses on households have been small despite rising gross debt and rising

¹⁸⁶ For those stakeholders who assessed this potential consequence.

unemployment.¹⁸⁷ In addition, it indicates that the low level of losses of the financial sector from lending to households is a consequence of, inter alia, very low interest rates, relatively low unemployment at the time, and substantial household gross wealth.¹⁸⁸ The financial sector has therefore not suffered major losses from general levels of over-indebtedness, as the over-indebted are unlikely to have taken out large loans.

6.4.3 Economic and social consequences of over-indebtedness for society

For a few stakeholders interviewed in particular, the major consequence of over-indebtedness for society in Denmark is the reduced productivity at work. However, as mentioned above, the social security system in Denmark is such that the consequences on society are not likely to be as significant as in other countries.

6.4.4 Debt collection practices

Stakeholders were divided as to potential changes in debt collection practices in the last 5 years. Some found that debt collection is now more systematic following the crisis and that the process of debt collection begins earlier. This may have reduced profits for debt collection agencies, as lenders are more willing to reduce costs and therefore collect debt themselves or look for cheaper offers from debt collection agencies, thus stimulating competition in the debt collection market. However other stakeholders interviewed did not report any changes, and no decisive evidence of significantly more aggressive debt collection practices was reported.

6.5 MEASURES IN FORCE TO ALLEVIATE THE IMPACT OF OVER-INDEBTEDNESS

6.5.1 Early identification of households at risk

Measures to identify households at risk of becoming over-indebted at an early stage exist in different forms and none is recognised as standard practice. Credit databases recording repayment problems are very common. One financial industry stakeholder noted however that a more general database of credits taken out by private individuals, providing information on e.g. the number of loans prospective borrowers have already taken out, as well as their outstanding debt would be more useful to preventing over-indebtedness. However current Danish data protection rules are such that measures to monitor consumers who have already taken out loans - beyond those that simply confirm the regularity of repayments - are not possible.

¹⁸⁷ Danmarks Nationalbank, 2012, "The Wealth and Debt of Danish Families", Monetary Review, 2nd Quarter, Part 1.

¹⁸⁸ Danmarks Nationalbank, 2011, "Household Balance Sheets and Debt - and International Country Study", Monetary Review, 4th Quarter, Part 1.

6.5.2 Advice offered to over-indebted households

Debt advice in Denmark is reported to be generally free of charge. Eurofound has previously reported that Denmark is not one of the countries with considerable debt advisory structures¹⁸⁹ and that the main providers of debt advice are consumer organisations.¹⁹⁰

According to a Danish debt advice provider, demand for debt advice has increased considerably in recent years. As an example, the debt advice provider advised 90 people in 2009, 141 in 2010, and 289 in 2011. In the first half of 2012, the total amount of people visiting the 5 debt advice services to which the Danish government provided a grant in 2009 was 2,000. In addition, waiting lists have increased: according to the debt advice service interviewed, advisees now need to wait 2-4 weeks for face-to-face advice, as opposed to 1-2 weeks a couple of years prior. All civil society organisations interviewed reported that more advice services have been set up and more volunteer advisors have been employed by the services.

The civil society organisations find face-to-face advice to be the most effective means. Drawing on data from the debt advice service interviewed, evidence shows that the service has generally targeted the right audience. It reports that: 72% of advisees discontinue debt advice because they consider they have received the advice they sought; 64% find that the advice provided has given them an overview of their personal finances; 34% achieved a repayment agreement either during or as a result of the advice provided; 32% experienced an increase in disposable income as a result of the advice; 63% state that advice has improved his/her family and/or general life situation.¹⁹¹

It is unclear whether funding of debt advice is sufficient. Increased funding from the government was proposed by one debt advice service.

6.5.3 Key measures in place to alleviate the impact of over-indebtedness

Informally brokered arrangements were reported to be fairly common by a majority of stakeholders interviewed, and sometimes free of charge. According to an independent expert interviewed: "It is rare for a debtor to enter into arrangements with several creditors out of court, but fairly common that a debtor and a single creditor make an arrangement whereby the debtor pays a certain amount for x months, and after that the rest of the debt is written off." However, awareness of the possibility of such arrangements is not widespread, suggesting that there could be a need for more financial education, as suggested by one stakeholder.

¹⁸⁹ See Eurofound, *Household debt advisory services in the European Union*, 2012, p. 9.

¹⁹⁰ Eurofound, *Managing household debts: Social service provision in the EU*, 2010, p. 10.

¹⁹¹ YMCA Social Work, 2011, *Midtvejsstatus På Fode Igen* (Interim status report on project 'På Fode Igen').

Formal procedures for debt settlement that do not take place in court were reported to be less common than informally brokered arrangements by most stakeholders and are unlikely to be free of charge.

In contrast, legal procedures that take place in court were considered widely available by interviewed stakeholders, but are mostly paid for by the consumer. This is provided for in regulation,¹⁹² where the bankruptcy court may, at the debtor's request, issue a ruling on debt relief if the defendant proves that the debtor is not able to and within the next few years has no prospect to meet their debt obligations, and it is assumed that debt relief will lead to a lasting improvement of the debtor's financial circumstances.

Finally, generally there is no specific financial support for over-indebted people. According to one stakeholder interviewed, it is more likely for the relevant municipality to provide funds for new housing rather than reimbursement of an over-indebted person's debt.

Most measures cited are found to be at least fairly effective, even if a number of stakeholders interviewed did not provide a definitive answer regarding the effectiveness.

6.5.4 Changes in response to over-indebtedness

The main change in responses to over-indebtedness during the past 5 years has been increased government funding of debt advice services. In addition, face-to-face debt advice is relatively new.

6.5.5 Types of households of over-indebted consumers not reached by current measures

According to interviewed stakeholders, a number of specific types of over-indebted households that are not reached by current measures. First, one debt advice service reports it has been difficult to reach young people and people living in remote areas. Their solution to this problem is to introduce a web-based tool that caters to young people in remote areas.

Second, it is very difficult for the unemployed to obtain debt rescheduling. In particular, under Danish law the percentage of one's income that must service outstanding debt must be fixed during the rescheduling process, for a repayment plan extending beyond 5 years. Subsequently, this percentage cannot be changed, regardless of the debtor's change in circumstances. As a consequence, a court may be reluctant to determine such a percentage if there is an indication that in the next five years the debtor's situation will be significantly better, e.g. due to reemployment.

¹⁹² Danish Bankruptcy Code, (Konkurslov), Part IV, 'Gældssanering', § 197.

6.5.6 Best practices

A banking association representative indicated that at first the over-indebted should seek a solution with the creditor before considering other means.

One debt advice provider suggested that "the volunteering aspect - help from one human being to another, that the centres are located in our social cafes where the target group is coming already, that it is free of charge, that the counselling is confidential and free of any creditor interest and finally that we have time available over months and years for each user of the service" were measures that could be considered best practices in debt advice.

6.6 OUTLOOK

Stakeholders generally did not expect that over-indebtedness will worsen in Denmark in the next 5 years, but this may depend heavily on external factors, such as the general economic situation in Europe.

As mentioned above, one aspect that may exacerbate over-indebtedness is the requirement to pay down debt from loans taken out in 2003 following legislation allowing 10-year 'interest-only' loans, i.e. loans for which only interest repayments were required for ten years.

Looking forward, specific regulatory measures to be enacted at national level suggested by stakeholders include:

- ▶ The establishment of a more general central credit database (as mentioned in Section 1.5.1; however a significant challenge would be ensuring the proper protection of personal data and privacy);
- ▶ The restriction of 'interest-only' loans or negative amortization loans;
- ▶ Restrictions on quick loans and SMS loans (which have received greater political focus recently);
- ▶ The restoration of a previously existing indexation of property value tax on current property valuation;¹⁹³
- ▶ Addressing the refinancing risk of adjustable-rate loans;

Stakeholders did not find that there was necessarily a need for any specific changes in the regulation of utilities or of the housing sector.

Non-regulatory measures suggested include continuous - and possibly increased - financial support of free debt advice and the initiation of a social debate concerning

¹⁹³ In 2001 a 'tax stop' was introduced that froze all taxes and duties at their January 2001 level, including this property value tax.

over-indebtedness, in order to raise social awareness and thus alleviate some of the shame or embarrassment associated with it.

6.7 REFERENCES

Danmarks Nationalbank, 'Household Balance Sheets and Debt - and International Country Study', *Monetary Review*, 4th Quarter, Part 1, Danmarks Nationalbank, Copenhagen, 2011.

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ANNEX A: STATISTICAL DATA FROM EU SOURCES

Final report

Over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact

Denmark

I. Eurobarometer¹

	Denmark	EU average	Lowest EU value	Highest EU value
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Households *at risk* of being over-indebted

Respondents feeling at risk of over-indebtedness in 2010	↘ 10%	25%	7%	52%
Respondents feeling at risk of over-indebtedness in 2009	↘ 9%	27%	9%	53%

II. EU SILC standard survey data²



III. EU SILC 2008 module: Over-indebtedness and financial exclusion³

	Denmark	EU average	Lowest EU value	Highest EU value
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Proportion of people in households with bank overdrafts, outstanding balances on credit cards or in arrears on other loans of over 100% of household disposable income

Overdrawn bank account (% of people in households overdrawn)	↘ 1.2%	2.2%	0.0%	7.7%
Credit or store card (% of people in households with outstanding balances)	↘ 0.0%	1.1%	0.0%	8.6%
Other loan/credit payments (% of people in households in arrears)	➡ 0.3%	0.3%	0.0%	1.1%

Proportion of people in households in arrears in servicing housing-related loans and bills and in paying other bills of over 100% of household disposable income

Housing bills (% of people in households in arrears)	↘ 0.4%	0.5%	0.0%	2.9%
Other payments (% of people in households in arrears)	:	0.4%	0.0%	1.7%

Households living with outstanding debts and/or arrears of over 100% of household disposable income

Total (% of households with outstanding debts/arrears)	↘ 2.0%	4.6%	0.0%	11.8%
Income above 60% median (% of households with outstanding debts/arrears)	↘ 1.6%	4.2%	0.0%	11.3%
Income below 60% median (% of households with outstanding debts/arrears)	↘ 5.4%	7.0%	0.2%	13.7%
Materially deprived (% of households with outstanding debts/arrears)	↗ 17.7%	9.0%	0.1%	27.4%

Proportion of those in broad age groups with outstanding debts of over 100% of household disposable income

Households with all adults aged 25-39 (% of households with outstanding debts)	↘ 2.7%	6.3%	0.0%	17.2%
Households with all adults aged: 40-64 (% of households with outstanding debts)	↘ 1.8%	5.8%	0.0%	10.9%
Households with all adults aged: 65+ (% of households with outstanding debts)	↘ 0.4%	1.2%	0.0%	2.8%

Proportion of those in different types of household with outstanding debts of over 100% of household disposable income

Living alone (% of people in households with outstanding debts)	↘ 3.1%	4.3%	0.0%	8.2%
Single parent (% of people in households with outstanding debts)	↘ 4.4%	9.5%	0.0%	27.1%
Other (% of people in households with outstanding debts)	↘ 1.4%	4.8%	0.0%	12.1%

Proportion of those in households with outstanding debts of over 100% of household disposable income by marital status

Never married (% of people in households with outstanding debts)	↘ 2.7%	5.0%	0.0%	15.4%
Married (% of people in households with outstanding debts)	↘ 1.1%	4.1%	0.0%	9.7%
Separated/divorced (% of people in households with outstanding debts)	↘ 2.5%	7.5%	0.1%	13.9%
Widowed (% of people in households with outstanding debts)	↘ 0.6%	1.7%	0.0%	4.3%

Proportion of those in households with outstanding debts of over 100% of household disposable income by housing tenure

Owner occupied without mortgage (% of people in households with outst. debts)	↘ 0.8%	3.2%	0.0%	9.6%
Owner occupied with mortgage (% of people in households with outst. debts)	↘ 1.2%	6.3%	0.0%	16.1%
Market rent (% of people in households with outstanding debts)	↘ 3.8%	8.2%	0.0%	16.0%
Subsidised rent (% of people in households with outstanding debts)	:	8.7%	0.0%	17.9%
Rent-free housing (% of people in households with outstanding debts)	:	2.3%	0.0%	15.1%

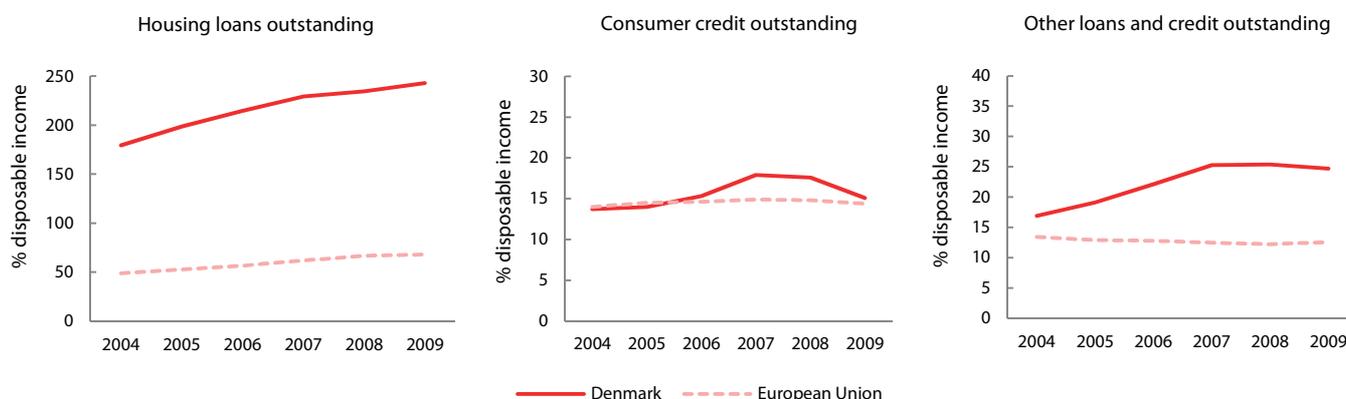
Proportion of those in households with outstanding debts of over 100% of disposable income by work intensity

Work intensity of 0 - 0.19 (% of people in households with outstanding debts)	↘ 5.0%	5.7%	0.0%	10.6%
Work intensity of 0.20 - 0.50 (% of people in households with outstanding debts)	↘ 3.2%	5.7%	0.0%	15.3%
Work intensity of 0.51 - 0.74 (% of people in households with outstanding debts)	↘ 2.6%	5.4%	0.0%	13.5%
Work intensity of 0.75 - 1.0 (% of people in households with outstanding debts)	↘ 1.4%	5.3%	0.0%	14.3%

Proportion of those in over-indebted households that experienced a major drop in income over the preceding year

Over-indebted (% of people in households that experienced drop in income)	↗ 37.7%	33.3%	0.0%	77.6%
Other (% of people in households that experienced drop in income)	↘ 10.4%	19.2%	5.9%	32.5%

IV. Loans and credit outstanding⁴



Notes:

(1) Eurobarometer 72.1 (2009) and Eurobarometer 74.1 (2010). Note: Those who answered 'very at risk' or 'fairly at risk' to the question 'Please tell me how much you feel at risk of being over-indebted'.

(2) Eurostat, SILC. Data as of December 2012.

(3) European Commission, Research Note 4/2010, Over-indebtedness new evidence from the EU-SILC special module.

(4) European Commission, Research Note 4/2010, Over-indebtedness new evidence from the EU-SILC special module. European Credit Research Institute (ECRI), Lending to households in Europe, 1995-2009 and Eurostat, National accounts.

ANNEX B: COMPLEMENTARY NATIONAL STATISTICAL DATA

Table 4. Arrears on mortgage repayments

Source: Civic Consulting based on the Association of Danish Mortgage Banks, <http://www.realkreditraadet.dk/Statistik/Arrears.aspx>.

	2008	2009	2010	2011	2012
Arrears on mortgage repayments	0.25	0.55	0.43	0.38	0.32

Note: The figures for each year represent the calculated average of the arrears rate for loans in each quarter (except 2012, which only includes the first three quarters). This rate shows how large a share of the total repayments has not been paid 3½ months after the due date at the latest. All private residential properties are concerned. The statistics are based on reports from mortgage banks.

Table 5. Home repossessions per quarter

Source: Civic Consulting based on the Association of Danish Mortgage Banks, http://www.realkreditraadet.dk/Statistik/Reposessed_homes.aspx.

	2008	2009	2010	2011	2012
Home repossessions	69	250	546	653	638

Note: The figures for each year represent the calculated average of the number of owner-occupied residential properties repossessed by the mortgage banks due to default in mortgage payments per quarter (except 2012, which only includes the first three quarters). All private residential properties are concerned. The statistics are based on reports from mortgage banks.

7 ESTONIA

<i>Document</i>	The over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact - Country report Estonia
<i>Prepared by</i>	Prof. Karsten Staehr and Merike Kukk, research scientist Tallinn University of Technology, Estonia
<i>Finalised on</i>	19 October 2012

Final report

Over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact

7.1 DEFINITION OF OVER-INDEBTEDNESS

Estonia does not have any generally recognised or official definition of households being over-indebted or at risk of becoming over-indebted. Different public and private institutions classify households as over-indebted or at risk of becoming over-indebted using their own criteria.

Commercial banks and other financial institutions use different criteria or definitions but they are generally not publicly available. Bank of Estonia monitors overdue bank loans. Debt advisors do not use pre-set definitions, but advise all households that perceive they have debt-servicing problems.¹⁹⁴

7.2 LEVEL OF OVER-INDEBTEDNESS

There are different phases of over-indebtedness, from the *risk* of over-indebtedness to arrears, enforcement proceedings and actual bankruptcy. Additionally - and in accordance with the definition of over-indebtedness applied in this study - over-indebtedness can stem from different types of payment obligations: mortgage loans, consumer loans and other debts, including those incurred from utility expenses.

One of the indicators of a household being at *risk* of over-indebtedness is the debt service burden, i.e. the debt servicing payments (including interest and the principal payment) as a share of the household's disposable income. A survey by the commercial bank SEB of some of their mortgage customers suggests that households consider a reasonable level of debt servicing payments to be less than 30% of their disposable income.¹⁹⁵ According to the annual survey of TNS Emor, debt servicing payments by Estonian households increased from 2006 to 2009, when 23% of indebted households had a debt service level higher than 30% of their disposable income (see Annex B, Table 1). In 2010 the share declined to 19%, but that is still higher than the 12% in 2007, before the crisis. A Eurobarometer survey (see Annex A) shows that the share of Estonian households who feel at risk of over-indebtedness increased from 30% in 2009 to 32% in 2010; these are higher values than the EU average.

The main indicator of over-indebtedness across households is the development of arrears. The EU-SILC data shows that the share of the Estonian population that

¹⁹⁴ Apart from the available literature, official statistics and the five stakeholder interviews which were conducted on the basis of the stakeholder questionnaire, this report is based on three additional interviews (with providers of debt advice outside of the capital (in Viljandi and Haapsalu) and a representative of a credit registration company) that were focused on specific topics and conducted by the authors.

¹⁹⁵ SEB Eesti, 'Kodulaenuklientide uuring 2012,' press conference presentation, http://www.seb.ee/sites/default/files/web/files/uudised/eluasemelaenude_pressiyritus_19062012.pdf, 2012.

reported being in arrears on mortgage or rent payments increased from 1.1% in 2008 to 2.7% in 2010. This share is substantially below the EU average level of 3.9%.

The share of the Estonian population in arrears on hire purchase instalments or other loan payments increased only slightly in 2007-2008 but increased substantially thereafter and reached 4.7% in 2010, which is somewhat above the EU average of 3.2%. The share of the population in arrears on utility bills increased significantly from 2007 to 2009 and exceeded the EU average in 2009. In 2010 11% of the Estonian population was in arrears on utility bills.

According to the credit register company Krediidinfo AS, the peak of payment arrears over 45 days was in 2009, while it stabilised in 2010.¹⁹⁶

The peak for non-performing housing loans (overdue by more than 60 days) was in the third quarter of 2010 when it reached 4.5%. It has since decreased, but was still 3% in June 2012, a level substantially above the pre-crisis level of 0.5% at the end of 2007. The peak for non-performing consumer loans (not including loans from the unregulated market) was 9.8% in February 2010, but decreased to 7.8% in June 2012. For comparison, at the end of 2007 it was 3.2% (see Annex B, Tables 2 and 3).

Statistics from the Estonian Ministry of Justice show that the number of enforcement proceedings peaked in 2009 when a total of 1,980 new proceedings were initiated. In 2011 there were 1,136 new proceedings initiated, which is 43% less than in 2009. Payment of order and debt claims reached their peak in 2008 with 68,218 new cases. The number of debt claims has been stable at around 39,000 cases in recent years, which is about 45% less than in 2008. The number of bankruptcies has continuously increased; in 2011 there were 400 new bankruptcy applications (see Annex B, Table 4).

The debt burden of Estonian households experiencing debt servicing problems is relatively modest in international comparison. Among the Estonian households that had outstanding (non-serviced) debts and/or arrears in 2008, the debt exceeded 100% of their disposable income in only 0.7% of the cases. This is far below the EU average of 4.6% (see Annex A).

To summarise, as some relevant indicators show, the problems of over-indebtedness worsened significantly in 2008–2010. The most common problems concern utility bills and consumer loans, while problems with mortgage and rent payments are less prevalent. In the last few years the number of severely indebted households in bankruptcy proceedings has increased. The interviews conducted in the summer of 2012 pointed to a worsening situation. An interviewed debt advisor noted that the number of debt counselling cases has increased and that the problems faced by households are more severe.

¹⁹⁶ See Krediidinfo AS, 'Pressiteade: Eestis on ligi 86 tuhat lõpetamata maksehäiretega isikut', press release, <http://www.krediidinfo.ee/index.php?m=74&ny=2011&news=330>, 2011.

7.3 NATURE AND DRIVERS OF OVER-INDEBTEDNESS

7.3.1 Most common types of households that are over-indebted

Households with relatively high incomes have accumulated the largest volume of debt in Estonia. However, these households have retained debt service burdens below the levels of low-income households.¹⁹⁷ According to the EU-SILC special module on over-indebtedness (see Annex A), more households are severely over-indebted among materially deprived households (3.8% of households with outstanding debts/arrears) and among households whose income is below 60% of the median income (2.2%). Middle-aged households are affected the most (1.6%), while senior households are hardly ever severely over-indebted (0.2%). The severity of the over-indebtedness is related to work intensity: 2.4% of the consumers with outstanding debt who were employed for less than 20% of the working time owned debts over 100% of their disposable income. The severity of over-indebtedness has been significantly lower than the EU average level.

According to several of the interviewed stakeholders, over-indebted households typically have very low incomes, typically due to unemployment, a lack of labour market competences and/or poor health. It is noticeable, however, that the problems of over-indebted households have grown more severe since the outbreak of the crisis. A debt advisor explained in the interview that in 2008-2009 around one third of cases involved clients who had accumulated arrears on SMS loans. In subsequent years, the debt advisor typically continued to advise these clients as they saw their bank accounts blocked and their debts processed by bailiffs.

7.3.2 Causes of households' over-indebtedness

Macroeconomic factors

Many households have experienced a substantial loss of income due to the deep recession, which started in 2008. Unemployment rose from 5.5% in 2008 to 16.9% in 2010 before starting to decrease gradually to reach 10.2% in the second quarter of 2012.¹⁹⁸ The volume of arrears increased only gradually as initially households used their financial buffers to overcome their problems; households deleveraged and increased their savings while consumption contracted sharply. The unemployment rate has decreased markedly since 2010 but remained at 10.2% of the labour force in the second quarter of 2012.

Nominal wages in Estonia declined after the outbreak of the global financial crisis. Average wages started falling (in comparison to the same quarter the year before) from the first quarter of 2009 and only returned to their pre-crisis level in the first

¹⁹⁷ Herzberg, V., *Assessing the Risk of Private Sector Debt Overhang in the Baltics Countries*, IMF Working Paper, No. 10/250, 2010.

¹⁹⁸ Viilman, N., and O. Soosaar, *Tööturu ülevaade 1/2012*, Bank of Estonia, 2012.

quarter of 2012.¹⁹⁹ Nominal wage declines were substantial in some sectors, in particular construction and financial services. Like nominal wages, real wages also fell in almost all sectors in the aftermath of the crisis. The average cumulative loss of purchasing power of an Estonian employee was 8.2% between 2009 and 2011.²⁰⁰

Cost of living

Households that face difficulties in paying housing costs do not have the option of reducing their rental costs. In the stakeholder interviews the lack of subsidised or low-cost rental accommodation was highlighted. One stakeholder called it "a big problem in Estonia".

Types of credit/loans taken out by households

A rapid increase in consumer loan and revolving loan offers in 2006–2007 was reported by the stakeholders. Commercial banks offered pre-determined consumer credit limits to customers via internet banks, mailing and telemarketing. Although commercial banks analysed the creditworthiness of their customers, they relaxed credit conditions in order to increase the customer base at a time of intensive competition and an inflow of foreign capital. Consequently, some households without the ability to repay were able to borrow, resulting in arrears. This explains the increasing volume of non-performing consumer loans.

Additionally, there was an intensive launch and marketing of SMS loans in 2006–2007 by numerous unregulated credit providers. One interviewee argued that credit providers promoted SMS loans very broadly and issued loans without any thorough credit analysis, hence targeting households with low or even no income. The interest rates of such loans have been several times higher than the ones of regulated credit providers. Additionally, the interest calculation was unfavourable to customers and consumers were unaware of the real cost of the SMS loans.²⁰¹ Consequently, several households were able to borrow without the ability to repay, which resulted in arrears.²⁰² According to a survey conducted by TNS Emor, approximately 3% of the total population had taken out an SMS loan in 2008–2009 (see Annex B, Table 5). There is no publicly available data about arrears of SMS loans among households.

¹⁹⁹ Statistics Estonia, Statistical database, variable identifier: WS010, <http://www.stat.ee> (accessed 3 Sept. 2012).

²⁰⁰ Levasseur, S., 'Labour market adjustments in Estonia during the 2008/2011 crisis', *Eastern Journal of European Studies*, Vol. 3, No. 1, 2012, pp. 123-143.

²⁰¹ The interest rate is calculated on the basis of the initial sum borrowed so it doesn't decrease during the repayment period.

²⁰² The financial industry stakeholder spelled out the two main problems stemming from an unregulated lending market. First, the law enables customers to turn to the courts in cases where the interest rate for the issued loan is triple the average interest rate for consumer credit offered by commercial banks, but this opportunity is rarely used as customers are not aware of it and the procedure is costly in any case. Second, although there are different requirements for institutions that provide consumer credit, there is no public institution responsible for controlling whether the requirements are followed on the unregulated lending market.

Mortgage debt increased considerably between 2004 and 2007, which in part can be explained by a desire to attain a better living environment after years of low investment in housing.²⁰³ Nevertheless, mortgage loans have not been the main source of over-indebtedness. An interviewed stakeholder from the financial industry stated:

During recession time the mortgage lenders tried to help debtors to overcome the hard times, but the lenders have only been able to be patient when customers have sought help quickly. Sometimes the customers play 'hide and seek' and take up loans from the unregulated market, using bank accounts in other credit institutions to hide the fact they have taken additional financial obligations. In many cases large financial obligations have come as a surprise to the bank that has granted the mortgage.

Personal circumstances

Several stakeholders underlined that one of the main causes for over-indebtedness is a significant decrease in real income. Data indeed suggest that falls in income and over-indebtedness are more closely related in Estonia than in some other parts of the EU. The EU-SILC special module revealed that in 2008 32.3% of over-indebted Estonian households experienced a large decline in income over the preceding year, a number that is comparable to the EU average. For comparison, only 9.3% of the households that are not over-indebted experienced a major income decline in Estonia, while the EU average is 19.2%.

Households in Estonia generally do not have experience from previous recessions on how to handle debt servicing problems, as household debt was modest until the economic boom in 2004–2007. An interviewed debt advisor pointed out that households tend to deny problems for a long time and this leads to an accumulation of problems. Moreover, discussions with debt advisors outside the capital, Tallinn, revealed that many over-indebted households lack money management skills. In some cases easy credit has been used for excessive consumption with the borrower having no intention of paying back the loan.

7.3.3 Changes relevant to levels of over-indebtedness

While the crisis meant large declines in incomes and rapid increases in unemployment during the years 2009–2010, the succeeding years have entailed a macroeconomic stabilisation. Nevertheless, macroeconomic issues remain important. Over time, many long-term unemployed have faced increasing problems servicing their obligations, including utility bills.

²⁰³ The availability of mortgage-backed loans was very limited until around 2002–2003, and households had therefore only limited possibilities to renovate the existing housing stock and to build new dwellings. Improved credit availability was one of the factors behind the subsequent housing boom; see Lamine, B. 'Estonia: analysis of a housing boom', *ECFIN Country Focus*, Vol. 4, No. 7, 2009.

The unemployment rate has remained high and long-term unemployment has become a problem. According to the unemployment insurance statistics approximately one third of unemployed individuals have been searching for a job for more than 24 months. The duration of unemployment insurance benefit is 180 or 270 days, and after this period the unemployment allowance payment is only 50–55 Euro per month.²⁰⁴ Some vulnerable households have also been negatively affected by the rising costs of food, heating and other forms of energy. In recent years Estonia has experienced one of the highest inflation rates in the EU.²⁰⁵

Mortgage-takers have benefited from lower interest rates; according to an interviewee from the Bank of Estonia 99% of mortgages have been issued with flexible interest rates tied to Euribor. It has been calculated by a commercial bank that their mortgage customers save on average around 360 Euro per year due to the lower interest rates.²⁰⁶ A debt advisor pointed out that:

... the interest rate has decreased, but it is a small share of the total debt payment of a household and it does not alleviate the problems of those who have become unemployed.

The ready availability of consumer loans and the promotion of SMS loans stopped in 2008 after debt defaults started to increase. The discussion with one of the stakeholders unveiled that the main focus of the SMS loan providers in 2009-2010 was on current debt clients to ensure the repayment of their loans. This current year SMS loan advertising has increased substantially as the economic situation of households has gradually improved and there are new potential customers in the market.

After the downturn of the economy in 2008 and the increase in income insecurity Estonian households have been reluctant to take on additional debts. Lower loan demand has been confirmed by research conducted by the Bank of Estonia.²⁰⁷

7.3.4 Cultural attitude towards debt and actual level of households' (over-) indebtedness

In general there is a common understanding among interviewees that many Estonians are reluctant to take on debt. Nevertheless, EU membership and years of rapid economic growth made people less cautious during the boom years. The increasing levels of indebtedness were caused by the desire of households to

²⁰⁴ Statistics of Unemployment Insurance Fund, 'Statistics', <http://www.tootukassa.ee/index.php?id=13066>, (accessed 3 Sept. 2012).

²⁰⁵ The consumer price index increased by 3.6% from July 2011 to July 2012; higher housing costs were responsible for half of the increase. See: Statistics Estonia, 'In July, the consumer price index was influenced the most by housing expenditures', press release, <http://www.stat.ee/57492>, 2012.

²⁰⁶ SEB Eesti, 'Low euribor significantly alleviates payment difficulties', press release, <http://www.seb.ee/en/news/2012-08-14/low-euribor-significantly-alleviates-payment-difficulties>, 2012.

²⁰⁷ Meriküll, J., *Households Borrowing During a Creditless Recovery*, Bank of Estonia Working Paper, No. 2/2012, 2012.

improve their living standards, which were substantially below West European levels.²⁰⁸ A relaxation of credit availability and expectations of income convergence to the EU average assisted these ambitions.²⁰⁹ During the recession, optimism was replaced by cautiousness and reluctance to take out additional debt.

7.4 CONSEQUENCES OF OVER-INDEBTEDNESS

7.4.1 Consequences for affected households

No studies investigating the consequences of over-indebtedness for the affected households in Estonia could be identified. Some stakeholders refer to two main consequences: first, unemployed people whose bank accounts have been blocked by bailiffs have lost interest in looking for a job because most of the additional income would be transferred to cover their debts; second, some households facing debt problems experience stress that can lead to additional problems in the family, alcohol addiction, etc.

One of the main consequences for mortgage-takers has been the repossession of the housing asset used as collateral. The share of non-performing mortgage loans was at its highest in 2010 when it reached 4.5% (see Annex B). As shown by previous research, real estate prices have fallen markedly; prices of flats have decreased by approximately 50% since the peak at the end of 2007.²¹⁰ Consequently, as also mentioned by the interviewee from the financial industry:

... residential real estate used as collateral was overvalued and the sale prices have been reduced heavily because of recessions and very poor quality/bad location. When this kind of collateral is sold today, the debtor in many cases still owes a considerably bigger sum to the bank.

7.4.2 Consequences of over-indebtedness for the financial services industry

Some interviewees identify additional costs related to overdue debts and provisions as the main consequence of over-indebtedness for commercial banks. As official statistics show, the costs have led to substantial losses in the banking sector in 2009 and at the beginning of 2010. A more serious threat to the financial stability of the financial sector has been defaults on corporate loans, as approximately 80% of write-offs have been related to corporate loans.²¹¹ Still, as documented in the Financial

²⁰⁸ Brixiova, Z., Vartia, L., and Worgotter, A., 'Capital Flows and the Boom-bust Cycle: The Case of Estonia', *Economic Systems*, Vol. 34, No 1, pp. 55-72, 2010.

²⁰⁹ Ibid.

²¹⁰ Aben, M., Kukk, M., and K. Staehr., 'Housing Equity Withdrawal and Consumption Dynamics in Estonia 2001–2011', *Research in Economics and Business: Central and Eastern Europe*, Vol. 4, No. 1, pp. 19–40, 2012.

²¹¹ Eesti Pank, *Financial Stability Review*, no. 1/2012, Bank of Estonia, 2010.

Stability Reviews of Bank of Estonia, the banks recovered fast and have been reporting profits since the second half of 2010.²¹²

Several SMS loan providers ceased trading after the increase in defaults. One interviewee reported that this actually benefitted the credit market as the quality of SMS loan providers improved. According to the same interviewee, in 2006-2007 several enterprises started to offer SMS loans without a long-term strategy, only because it seemed to be a profitable business.

7.4.3 Economic and social consequences of over-indebtedness

No research could be identified that would have estimated or assessed the costs of over-indebtedness for the society. Moreover, there has been no discussion in the media or with political circles regarding the consequences of over-indebtedness. One interviewee pointed out that one consequence of the increased over-indebtedness during the crisis was additional public costs to fund debt advisors and legal procedures. There are no quantitative estimates of such costs. Additional indirect costs pertain to the individual households who might face hardship, psychological pressures, social exclusion and possibly also exclusion from the labour market. As with the other broader consequences, no estimates of these social costs are available.

7.4.4 Debt collection practices

According to stakeholders both utility companies and unregulated loan providers forward their debt claims to debt collection companies. These may use means to collect debts that can be considered aggressive. For example, they sometimes may call the work place of the debtor to inform his or her superiors or colleagues about the debt-servicing problems. In some cases they turn to family members or relatives and/or they threaten to impose illegal sanctions. It is a common practice for SMS loan providers to use fast debt claim procedures and this is overall the most common way to process the debt claims (see Annex B). It is a faster and cheaper procedure for the claimant than others as it is implemented without court hearings. Notification about the claim and a debt repayment proposal are sent to the debtor by mail. If the debtor does not respond, the court decides on the debt enforcement measure without the involvement of the debtor.²¹³ The amounts that are claimed in court can substantially exceed the initial loan. In some debt claim cases, the clients are not aware of the debt claims as the notification about the claim does not reach them. The notification is sent to the address the person has registered as his or her residence, but in Estonia about 20% of the population does not reside at their registered address.²¹⁴

²¹²Financial Stability Reviews of Bank of Estonia are available at <http://www.eestipank.ee/en/publications/series/financial-stability-review>.

²¹³ More information on the fast debt claim procedure is available at <http://volanoustamine.minuraha.ee/files/v6lan6ustamine2.pdf>.

²¹⁴ Information from <http://www.postimees.ee/952890/riik-tahab-elukoha-ule-enam-kontrolli/>.

According to an interviewee from the financial industry, problems with the servicing of loans provided by commercial banks are typically dealt with in a more customer-friendly way; in most cases the problems are solved by direct negotiation between the customer and the bank.

7.5 MEASURES IN FORCE TO ALLEVIATE THE IMPACT OF OVER-INDEBTEDNESS

7.5.1 Early identification of households at risk

Credit providers analyse the credit-worthiness of customers before issuing loans. This typically involves checking the history of payment arrears in the main Estonian credit register (Krediidiinfo).²¹⁵ The credit register is operated by a private company that, among other activities, collects information about individuals who have been in arrears for over 45 days. All companies can send this information to the credit register and can, in turn, acquire information about the concurrent and past debt arrears of specified individuals. They receive data about: the duration of the arrear (starting date and, in the case of a former debt arrear, the end date); the amount of the arrear; and the industry sector of the company that has reported the arrear.

An interviewed debt advisor commented that SMS loan providers did not conduct credit-worthiness analysis in 2006–2007, although they have started to use the credit register for this purpose in recent years.

There is no mapping or monitoring by public institutions of the situation of indebted households and the probability that they will fall into arrears. Although SMS loans have exhibited a high probability that they will result in arrears, there is no monitoring of the amount of SMS loans issued by any institution.

7.5.2 Advice offered to over-indebted households

Availability and costs

As most over-indebted households in Estonia are low-income (see Section 7.3.1), we focus on services that are free of charge.

As was reported in the interviews conducted for this study, personalised debt advice is currently provided in Tallinn and some smaller cities in other regions (Viljandi, Haapsalu, Pärnu). It is not available in the countryside and in most other regions in Estonia. The state does not coordinate the debt advice network as it is the responsibility of municipalities.

²¹⁵ More information about the credit register is available at <http://www.krediidiinfo.ee>.

Other channels of advice are generally not available. Telephone advice is occasionally offered by debt advisors, typically working in a voluntary capacity. The interviewed debt advisor in Tallinn had sought to introduce personalised debt advice by telephone at the national level, but the project did not receive the anticipated public funding.

Demand for debt advice as assessed by stakeholders

The demand for debt counselling largely depends on advertising because - as was pointed out in the interviews - the service is relatively novel in Estonia. Nevertheless, information about the service is limited in most regions. The information about debt advice organisations and contact details can be found online but debt advisory services are not widely promoted. A debt advisor assessed that "many people are not aware of the possibility to receive debt advice for free which would help to alleviate their problems significantly".

Effectiveness as assessed by stakeholders

All interviewed debt advisors consider face-to-face personalised debt advice to be preferable when the cases are complicated and the debt advisor needs to see relevant documents, explain court procedures, help to write petitions, etc. A person typically needs several appointments with the debt advisor. One interviewee argued that consumers are not aware of the possibility of discharging debts (for instance, some claims expire) so advice at an early stage can be very effective.

Debt advisors suggested that the purpose of printed materials and web-based tools should be to increase awareness of the benefits of debt advice. Email and phone calls could be used for giving primary information and making initial contact, encouraging the household to then meet a debt advisor. As mentioned earlier, these channels are rarely available in Estonia.

Funding of debt advice

Several stakeholders pointed out that the funding of debt advice services is not sufficient in Estonia. A debt advisor asserted that "unfortunately the supply of a debt advice service does not depend on demand but on public funding". The central government does not provide funding and if a municipality identifies the need for free debt advice, it has to cover the costs and organise the service by itself. As pointed out in the stakeholder interviews, most small municipalities have difficulties in this regard. Outside the capital, the service is mostly offered within the framework of activities funded via the EU projects of the Unemployment Insurance Fund.

7.5.3 Key measures in place to alleviate the impact of over-indebtedness

Availability and costs

The first option offered to customers of commercial banks in arrears is the rescheduling of payment plans. In general customers are charged when changes are made to the loan contract.²¹⁶

As was confirmed in the stakeholder interviews, there are no formal procedures for out-of-court debt settlements and no well-developed provisions for the discharge of debt. A private debtor can use the bankruptcy procedure as detailed by the Bankruptcy Law.²¹⁷ This implies that all the assets of the debtor are managed by an appointed trustee and the debtor cannot leave his or her residence for more than 24 hours without notification. Additionally, he or she is prohibited from being an entrepreneur or working on the board of any company during the procedure and up to three years after the closure of the insolvency procedure.²¹⁸ The procedure is complicated for individuals and used very seldom (see Annex B, Table 4). It also entails court fees to be paid by the debtor.

In April 2011 the Debt Restructuring and Debt Protection Act entered into force.²¹⁹ The act stipulates that individuals can turn to the courts to apply for a rescheduling of their debt, an extension of due debt or a partial discharge of the debt. The debtor has to provide a sustainable debt restructuring plan, i.e. show that he or she is able to pay at least some of the debt due. The purpose of the law is to offer alternative options besides bankruptcy for indebted households with repayment problems. The debtor has to cover all the costs, including the court fees and the costs of the advisory service.

There is neither financial support for households to repay debts available in Estonia nor did stakeholders highlight any other key measures to alleviate the impact of over-indebtedness.

Effectiveness as assessed by stakeholders

One interviewed debt advisor stated that the preparation of the Debt Restructuring and Debt Protection Act was inadequate: "The process of passing the Debt Restructuring Act was political; debt advisors informed politicians at the very beginning that an act of this kind does not help." Statistics show that by June 2012

²¹⁶ More information on possible solutions of the payment problems is provided at <http://www.minuraha.ee/makseraskused>.

²¹⁷ The full text of the Bankruptcy Law (Pankrotiseadus) is available at <https://www.riigiteataja.ee/akt/13147742>.

²¹⁸ For more information see: <http://volanoustamine.minuraha.ee/>.

²¹⁹ The full text is available at <https://www.riigiteataja.ee/akt/106122010001&leiaKehtiv>.

only 61 applications for restructuring debt had been presented to the court and that 51 of them had been rejected.²²⁰

7.5.4 Changes in response to over-indebtedness

The measures introduced in recent years are described above, in Section 7.5.3. An additional pre-emptive measure should also be mentioned. In reaction to intensive SMS loan advertising in 2006–2007 and customers being unaware of the extraordinarily high costs of the loans, new requirements for consumer loan advertisements were introduced in November 2008.²²¹ These advertisements are now obliged to state the total costs of debt to the consumer. As of autumn 2012 stricter requirements regarding advertising of credits offers are planned in order to eliminate non-informative advertising that plays entirely on the emotions of potential borrowers.²²² The introduction of more stringent requirements regarding the evaluation of credit-worthiness has been announced as well.

7.5.5 Types of households of over-indebted consumers not reached by current measures

Many households do not receive debt counselling as debt advisors are available only in a few regions and generally advise only the unemployed as the service is funded by the Unemployment Insurance Fund (see Section 7.5.2). The Debt Restructuring Act does not offer any solutions to the households who cannot provide a sustainable debt restructuring plan because they do not have sufficient income to service their debt. Personal bankruptcy entails complicated procedures and requires covering high legal costs.

7.5.6 Best practices

One financial industry stakeholder suggested that the regulated credit provider's behaviour is best practice. No other suggestions of best practices were made in the stakeholder interviews, which may be explained by the very narrow range of measures in place to alleviate over-indebtedness.

7.6 OUTLOOK

As of October 2012 the outlook for over-indebted households exhibits substantial heterogeneity across different groups of households.

²²⁰ Information from Estonian Public Broadcasting ERR: <http://uudised.err.ee/index.php?06256739>.

²²¹ This follows from §29 in the Advertising Law: <https://www.riigiteataja.ee/akt/13260638>.

²²² Estonian Public Broadcasting ERR: <http://uudised.err.ee/index.php?06262169> (26 Sept. 2012).

The macroeconomic outlook is relatively stable (the summer 2012 economic forecast of the Ministry of Finance predicts GDP growth of 2.2% in 2012 and 3% in 2013).²²³ Moreover, in the aftermath of the financial and economic crisis households have generally taken a cautious attitude towards new loans and credit providers have undertaken more elaborate credit analyses. This suggests that relatively few "new" households will experience over-indebtedness problems in the coming years.

The speed at which the problems of households that are currently over-indebted can be solved depends not only on future macroeconomic and labour market trends but also on the duration and outcome of legal proceedings (bankruptcy or repayment of debt). The outlook of stable but modest rates of economic growth and the limited choice of remediating measures suggest that the existing stock of over-indebted households in Estonia may only decrease slowly in coming years.

The unwinding of the over-indebtedness of Estonian households may be hampered by the lack of a systematic approach to the problem. Households often deal with over-indebtedness problems on their own and spend a lot of time in economic and emotional anxiety.

The following highlights some areas of particular concern and some proposals on how to address the issues as voiced by the interviewed stakeholders:

1. Some interviewees mentioned that small municipalities are not able to provide the debt advice service that would be the first and most efficient support to households. It is suggested that the service should be coordinated at the national level. Currently state-level institutions are not involved in the problem.
2. One interviewee emphasised that there is no regulation for controlling the fast debt claim procedures in court which can result in debtors being liable for an amount significantly in excess of the initial debt. In many cases people do not have the opportunity to object to the extra charges because they do not receive the court notification of the fast debt claim.
3. It was underlined by one financial industry stakeholder that the unregulated lending market (service providers and loan volumes) should be mapped and their activities should be controlled. The experience of recent years suggests that households are not aware of all the costs and risks when borrowing in an unregulated market.

The lack of focus on over-indebtedness in the public debate and in policy-making in Estonia makes it unlikely that such initiatives will be undertaken in the short term. Over-indebtedness is likely to remain to be seen primarily as an individual's problem rather than a policy issue for some years to come.

²²³ Further details at <http://www.fin.ee/economic-forecasts>.

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ANNEX A: STATISTICAL DATA FROM EU SOURCES

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Estonia

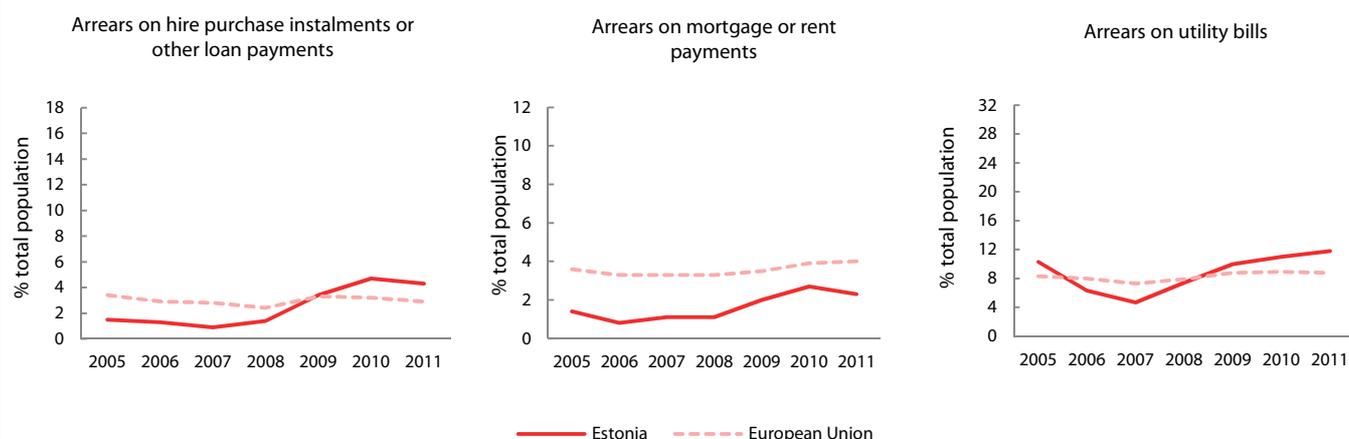
I. Eurobarometer¹

Estonia EU average Lowest EU value Highest EU value

Households *at risk* of being over-indebted

Respondents feeling at risk of over-indebtedness in 2010	↗ 32%	25%	7%	52%
Respondents feeling at risk of over-indebtedness in 2009	↗ 30%	27%	9%	53%

II. EU SILC standard survey data²



III. EU SILC 2008 module: Over-indebtedness and financial exclusion³

Estonia EU average Lowest EU value Highest EU value

Proportion of people in households with bank overdrafts, outstanding balances on credit cards or in arrears on other loans of over 100% of household disposable income

Overdrawn bank account (% of people in households overdrawn)	↘ 0.2%	2.2%	0.0%	7.7%
Credit or store card (% of people in households with outstanding balances)	↘ 0.1%	1.1%	0.0%	8.6%
Other loan/credit payments (% of people in households in arrears)	↘ 0.1%	0.3%	0.0%	1.1%

Proportion of people in households in arrears in servicing housing-related loans and bills and in paying other bills of over 100% of household disposable income

Housing bills (% of people in households in arrears)	↘ 0.2%	0.5%	0.0%	2.9%
Other payments (% of people in households in arrears)	:	0.4%	0.0%	1.7%

Households living with outstanding debts and/or arrears of over 100% of household disposable income

Total (% of households with outstanding debts/arrears)	↘ 0.7%	4.6%	0.0%	11.8%
Income above 60% median (% of households with outstanding debts/arrears)	↘ 0.3%	4.2%	0.0%	11.3%
Income below 60% median (% of households with outstanding debts/arrears)	↘ 2.2%	7.0%	0.2%	13.7%
Materially deprived (% of households with outstanding debts/arrears)	↘ 3.8%	9.0%	0.1%	27.4%

Proportion of those in broad age groups with outstanding debts of over 100% of household disposable income

Households with all adults aged 25-39 (% of households with outstanding debts)	↘ 1.0%	6.3%	0.0%	17.2%
Households with all adults aged: 40-64 (% of households with outstanding debts)	↘ 1.6%	5.8%	0.0%	10.9%
Households with all adults aged: 65+ (% of households with outstanding debts)	↘ 0.2%	1.2%	0.0%	2.8%

Proportion of those in different types of household with outstanding debts of over 100% of household disposable income

Living alone (% of people in households with outstanding debts)	↓ 1.2%	4.3%	0.0%	8.2%
Single parent (% of people in households with outstanding debts)	↓ 1.9%	9.5%	0.0%	27.1%
Other (% of people in households with outstanding debts)	↓ 0.5%	4.8%	0.0%	12.1%

Proportion of those in households with outstanding debts of over 100% of household disposable income by marital status

Never married (% of people in households with outstanding debts)	↓ 0.9%	5.0%	0.0%	15.4%
Married (% of people in households with outstanding debts)	↓ 0.4%	4.1%	0.0%	9.7%
Separated/divorced (% of people in households with outstanding debts)	↓ 1.3%	7.5%	0.1%	13.9%
Widowed (% of people in households with outstanding debts)	↓ 0.2%	1.7%	0.0%	4.3%

Proportion of those in households with outstanding debts of over 100% of household disposable income by housing tenure

Owner occupied without mortgage (% of people in households with outst. debts)	↓ 0.6%	3.2%	0.0%	9.6%
Owner occupied with mortgage (% of people in households with outst. debts)	↓ 1.2%	6.3%	0.0%	16.1%
Market rent (% of people in households with outstanding debts)	↓ 3.4%	8.2%	0.0%	16.0%
Subsidised rent (% of people in households with outstanding debts)	↓ 0.0%	8.7%	0.0%	17.9%
Rent-free housing (% of people in households with outstanding debts)	↓ 0.2%	2.3%	0.0%	15.1%

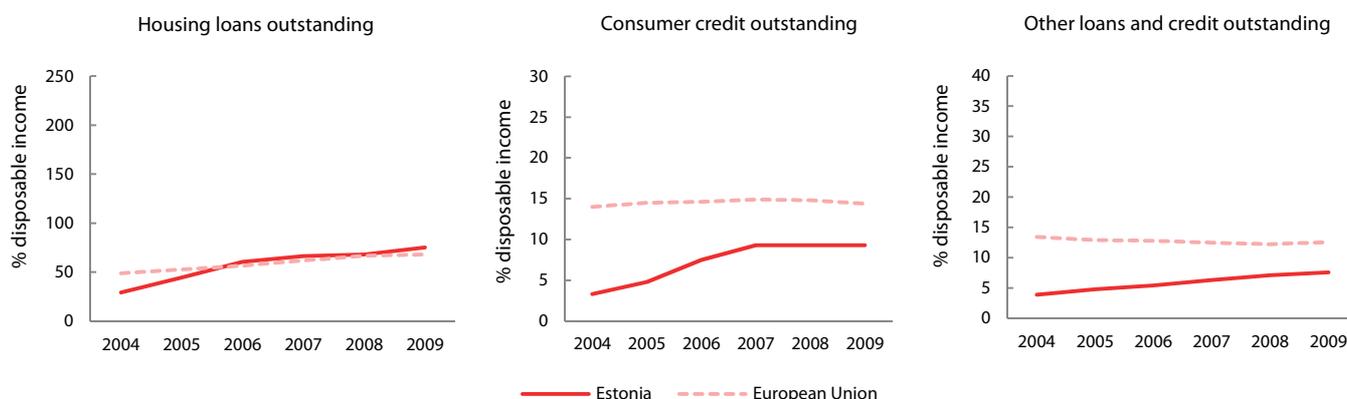
Proportion of those in households with outstanding debts of over 100% of disposable income by work intensity

Work intensity of 0 - 0.19 (% of people in households with outstanding debts)	↓ 2.4%	5.7%	0.0%	10.6%
Work intensity of 0.20 - 0.50 (% of people in households with outstanding debts)	↓ 0.8%	5.7%	0.0%	15.3%
Work intensity of 0.51 - 0.74 (% of people in households with outstanding debts)	↓ 0.2%	5.4%	0.0%	13.5%
Work intensity of 0.75 - 1.0 (% of people in households with outstanding debts)	↓ 0.6%	5.3%	0.0%	14.3%

Proportion of those in over-indebted households that experienced a major drop in income over the preceding year

Over-indebted (% of people in households that experienced drop in income)	↓ 32.3%	33.3%	0.0%	77.6%
Other (% of people in households that experienced drop in income)	↓ 9.3%	19.2%	5.9%	32.5%

IV. Loans and credit outstanding⁴



Notes:

(1) Eurobarometer 72.1 (2009) and Eurobarometer 74.1 (2010). Note: Those who answered 'very at risk' or 'fairly at risk' to the question 'Please tell me how much you feel at risk of being over-indebted'.

(2) Eurostat, SILC. Data as of December 2012.

(3) European Commission, Research Note 4/2010, Over-indebtedness new evidence from the EU-SILC special module.

(4) European Commission, Research Note 4/2010, Over-indebtedness new evidence from the EU-SILC special module. European Credit Research Institute (ECRI), Lending to households in Europe, 1995-2009 and Eurostat, National accounts.

ANNEX B: COMPLEMENTARY NATIONAL STATISTICAL DATA

Table 6. Distribution of debt service burden in Estonia (% of households who own leasing and debts from regulated providers)

Source: TNS Emor. Annual Survey on Financial Behaviour of Estonian Households (1000 respondents annually representing the Estonian population).

The share of debt service burden (including principal and interest payments) of disposable income	2006	2007	2008	2009	2010
Up to 10%	37%	36%	34%	27%	30%
10%–20%	27%	26%	24%	22%	24%
20%–30%	13%	15%	16%	17%	15%
30%–40%	6%	7%	8%	8%	9%
Over 40%	4%	5%	11%	15%	10%
No answer	13%	11%	7%	11%	12%

Table 7. Non-performing housing loans (overdue 60 days) in Estonia, end of period

Source: Bank of Estonia. Credit Institutions Statistics.

	2007	2008	2009	2010	2011	2012
March	0.3%	0.7%	2.9%	4.40%	4.0%	3.2%
June	0.2%	1.1%	3.7%	4.40%	3.9%	3.0%
September	0.4%	1.4%	4.1%	4.50%	3.7%	..
December	0.5%	1.8%	4.1%	3.9%	3.20%	..

Table 8. Non-performing consumer loans (overdue 60 days) in Estonia, end of period

Source: Bank of Estonia. Credit Institutions Statistics.

	2007	2008	2009	2010	2011	2012
March	2.4%	4.1%	7.3%	9.5%	9.0%	8.2%
June	2.5%	4.5%	8.4%	9.3%	9.0%	7.8%
September	3.0%	5.2%	8.9%	9.2%	8.7%	..
December	3.2%	5.8%	9.20%	8.9%	8.0%	..

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Table 9. Number of insolvency proceedings in Estonia

Source: Statistics from the Estonian Ministry of Justice.

	2007	2008	2009	2010	2011
Enforcement proceedings	258	482	1,980	1,235	1,136
Payment of order and debt claims	33,107	68,218	44,920	39,011	38,565
Bankruptcy petitions	98	156	198	328	400

Table 10. Coverage of SMS loans in Estonia

Source: TNS Emor. Annual Survey on Financial Behaviour of Estonian Households.

	2007	2008	2009	2010
Share of respondents who have taken an SMS loan	2%	3%	3%	1%

8 FINLAND

<i>Document</i>	The over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact - Country report Finland
<i>Prepared by</i>	Robert Graham
<i>Finalised on</i>	28 January 2013

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8.1 DEFINITION OF OVER-INDEBTEDNESS

In Finland, there is no general, formal definition of over-indebtedness. The Ministry of Trade and Industry is responsible for policies on over-indebtedness and the Ministry of Justice for the preparation of legislation related to credit issues.²²⁴ A number of government agencies also deal with these issues on a variety of levels and each organisation uses a different definition.

This was reflected in stakeholder responses. Only some interviewees used a specific definition in their work.²²⁵ When asked to specify their definition, this was the one specified in national law or regulation which refers to insolvency.²²⁶ One stakeholder defined over-indebtedness as a person's permanent inability to deal with their debts and another referred to "people or households who repeatedly cannot meet their financial commitments on time". An independent expert emphasised the subjective dimension, whereby the perspective of the consumer was important in defining the seriousness of their difficulties in meeting financial commitments. Interviewees also highlighted the coping behaviours such as taking out new loans to pay off old ones and reducing standard of living to a minimum as important dimensions in recognising over-indebtedness.

Comparing their own definition to that of this study, two interviewees felt that their definition was broader, for example by including people who had difficulty paying for food and shelter or the practice of paying old debts with new ones, while another two stated that their definition was focused on the individual level.

Stakeholders saw little need for a better definition for household over-indebtedness. However, an independent expert stated that a better definition would help prevent serious debt problems by raising awareness, because the social stigma associated with consumer debts was a barrier preventing consumers from seeking advice in good time.

²²⁴ Davydoff, D., Dessart, E., Naacke, G., Jentzsch, N., Figueira, F., Rothmund, M., Mueller, W., Kempson, E., Atkinson, A., and Finney, A. (eds.), *Towards a common operational European definition of over-indebtedness*, Directorate-General for Employment, Social Affairs and Equal Opportunities, European Commission, 2008, p.34.

²²⁵ For those who did not use a specific definition of over-indebtedness, the most common reason given was that existing definitions were not relevant for their purposes. For example, an interviewee from the financial industry said that they focused on defaults and debt impairments, and needed no general definition of over-indebtedness.

²²⁶ "Insolvency means other than temporary inability of the debtor to pay his debts as they become due. The following shall be taken into account when assessing the ability of the debtor to pay: 1) the funds from the liquidation of the assets of the debtor; 2) the income of the debtor and his earning potential, in view of his age, working capacity and other circumstances; 3) the necessary living expenses of the debtor; 4) the maintenance liability of the debtor; and 5) the other circumstances affecting the financial status of the debtor." Definition from Debt Adjustment Law cited in: Huls, N., Kiesilainen, J., Reifner, U., and Springeneer, H., *Consumer Overindebtedness and Consumer Law in the European Union: Final Report*, Directorate-General for Health and Consumer Protection, Commission of the European Communities, 2003, p. 19.

8.2 LEVEL OF OVER-INDEBTEDNESS

The majority of stakeholders interviewed for this study indicated that the numbers of households suffering from over-indebtedness had increased moderately over the previous five years in Finland, while none answered that it had decreased.²²⁷

Interviewees reported that they did not usually collect data relating to over-indebtedness themselves, but the general composition of household debt was summarised by Statistics Finland. For all types of credit, including housing loans, loan debts as a percentage of household disposable income increased from 78.2% in the first quarter of 2004 to 112.6% in the first quarter of 2011.²²⁸ Total household debt amounted to 105.5 billion Euro in 2011, of which 76.8 billion Euro were housing loans. The average debt per household-dwelling unit was 69,450 Euro for 2011, a significant increase from just over 40,000 Euro in 2002 (adjusted for inflation). From the previous year (2010), total debts went up by 2.0% in real terms and housing loans by 2.7%.²²⁹

Consumer credit outstanding as a percentage of household disposable income slightly increased in Finland from 2004 (9.3%) to 2009 (11.7%) but remained under the average level for the EU. The Guarantee Foundation (Takuu-Säätiö)²³⁰ reported that in 2010 17% of all households²³¹ in debt had loans more than three times their annual income; in 2002 this was only 8%. Evidence from EU-SILC data (see Annex A) indicates that the percentage of total population with arrears on mortgage or rent repayments remained fairly stable from 2005 (4.3%) to 2011 (4.8%), though this is higher than the EU average (4.0% in 2011). The percentage of the population with arrears on utility bills was at 7.8% in 2011 (1% below the EU average).

The proportion of those living in households with outstanding debts or arrears over 100% of disposable income was also low compared to the EU average (4.6%), with only 1% of the population classified as such in Finland.

²²⁷ However, one interviewee noted that the debt-servicing ability of households with housing loans remained good despite an increase in heavily indebted households (defined as those with high loan-to-value ratios) and that the amount of non-performing loans has remained small in real terms.

²²⁸ Official Statistics of Finland (OSF), 'Households' disposable income, loan debts and indebtedness ratio', *Financial accounts [e-publication], Appendix table 2*, Statistics Finland, Helsinki, 2013. URL: http://www.stat.fi/til/rtp/2012/03/rtp_2012_03_2013-01-18_tau_002_en.html.

²²⁹ Official Statistics of Finland, *Indebtedness [e-publication]*, Statistics Finland, Helsinki, 2011. URL: http://www.stat.fi/til/velk/2011/velk_2011_2012-06-27_tie_001_en.html.

²³⁰ The Guarantee Foundation is a national social organisation which assists private persons struggling with a financial crisis in solving their debt and payment problems. The objective is to improve management of personal finances and promote independent coping in the society. The operations are mostly financed by Finland's Slot Machine Association (RAY).

Takuu-Säätiö, *Slideshow about the Guarantee Foundation*, 2013.

URL: http://www.takuu-saatio.fi/@Bin/116775/Slideshow_Guarantee_Foundation_2011.pptx

²³¹ Ibid.

As regards subjective assessments by households of their financial situation, Eurobarometer data recorded a decrease in households who felt *at risk* of being over-indebted, to 11% in 2010 from 14% in 2009. This was also below the EU average of 25% for 2010.

In a survey by the Federation of Finnish Financial Services²³² with a large representative sample, only 7% of respondents stated that their income was exceeded by expenses. The rate of reported holding of savings and investments actually increased from 37% in 2003 to 59% in 2012. Furthermore, the share of respondents who reported holding a consumer credit loan was within the range of 30-34% of respondents from 2003-2012. The percentage of monthly net income used to service instalments and interest on loans fell from 25% in 2004 to 21% in 2012 for all types of loans, with the rate for housing loans increasing from 25% to 28% during the same period.

8.3 NATURE AND DRIVERS OF OVER-INDEBTEDNESS

8.3.1 Most common types of households that are over-indebted

Stakeholders gave varying answers as to what are the most common types of households that are over-indebted or have on-going problems meeting their financial commitments. The consensus reflected in the responses was that the households most at risk are those consisting of people between the ages of 25 and 39, one person households with children, those living in rented accommodation, containing one or two unemployed members, and having low levels of education.²³³ Households at risk of poverty (less than 60% of median disposable income) were also indicated as being one of the more common types of over-indebted households. These answers were consistent with the available data on the proportion of people in households with outstanding debts over 100% of disposable income (see Annex A), which display the higher relative amounts of households who are materially deprived, led by single parents, and live in rented housing.

One interviewee emphasised that different age groups may become over-indebted for different reasons:

Students have problems with quick loans, people around 30 want to have a family and take loans and credits to meet the needs of their new households. Middle-aged

²³² Federation of Finnish Financial Services, *Presentation on Saving, Borrowing, and Paying in Finland*, Finanssialan Keskusliitto (FK), Helsinki, 2012. URL: http://www.fkl.fi/en/material/publications/Publications/Saving_borrowing_and_paying_in_Finland_2012_slides.ppt

²³³ Two stakeholders highlighted in their comments that young people are particularly likely to be over-indebted. One of these interviewees added that sudden unemployment is a major reason for over-indebtedness, but education is not really a factor, whereas the other pointed out that current rising house prices are a mitigating factor for those with home loans.

people tend to lose their jobs because of the increased level of unemployment and consequently can have financial problems.

Half of those interviewed noticed a change in types of households affected by over-indebtedness during the previous five years. An independent expert stated that it has become more common for nuclear families (i.e. a pair of adults and their children) and those with mortgages to experience problems meeting financial commitments, along with young people having recently moved away from home. Young adults were seen as being increasingly represented by another interviewee, who highlighted the addiction to expensive life-styles and ease of access to credit for this group.

8.3.2 Causes of households' over-indebtedness

Macro-economic factors

Unemployment was mentioned mostly frequently as a cause of households' over-indebtedness by stakeholders, followed by the level of social welfare.

In fact the unemployment rate steadily decreased from 9.1% in 2002 to 6.4% in 2008. This rose slightly to 7.7% in 2012; this is below the EU27 average.²³⁴ The system of social welfare is comprehensive with a basic unemployment allowance of about 674 Euro per month²³⁵ and a general housing allowance of up to 80% of total rental cost for unemployed or low-income households. Looking forward, a respondent from a public authority said that their focus was on large housing loans which may cause future systemic risks. Another interviewee pointed out that house prices were quite high in historical terms, though not yet to the levels of the early 1990s.

Cost of living

According to Household Budget Survey²³⁶ (2010) figures Finland is the fourth most expensive country in the EU and the EEA in terms of cost of living. Housing costs were the costs of living most commonly cited in the stakeholder interviews as a cause of over-indebtedness, reflecting the high rents and rising house prices in Finland over the last several years.²³⁷ This was followed by other costs of living (such as food and transport) and utility bills.

²³⁴ Eurostat, 'Unemployment rate' (code: tsdec450).

²³⁵ Kela.fi, Basic Unemployment Allowance: Amount and taxation, Kela – The Social Insurance Institution of Finland, 2013. URL: <http://www.kela.fi/in/internet/english.nsf/NET/020702133505EH?OpenDocument>

²³⁶ European Job Mobility Portal (EURES), *Living and working conditions: Finland*, Directorate-General for Employment, Social Affairs, and Inclusion, European Commission, 2012.

²³⁷ See European Mortgage Federation, *op. cit.*

Types of credit/loan taken out by households

Regulated consumer credit with high interest rates and home loans and mortgages were commonly referred to in the stakeholder interviews as causes of over-indebtedness. One stakeholder hypothesised that the high level of home ownership encouraged some people to leverage these assets and take out more consumer credit. These debtors then tend to run into problems.

According to a paper on Finland's housing market,²³⁸ the 1989 peak of mortgage debt outstanding as a percentage of disposable household income was 90%. After the crash of the 1990s,²³⁹ this has been rising steadily again. Taking the residential mortgage debt as a ratio of GDP as an indicator, this figure has increased from 27.1% in 2004 to 42.7% in 2011.²⁴⁰ According to Statistics Finland, from 2002 to 2011, average housing loans grew in real terms by 74%, while all debts grew by 70%.²⁴¹ In terms of actual housing tenure, Finland was close to the EU27 average of 73.6% owner-occupier rate with 74.1% of the population owning their own home in 2009.²⁴² However, of these, the percentage with a mortgage or a loan at 43.7% of the population was considerably higher than the EU27 average of 27.1%. However, as mentioned previously, total arrears on rent and mortgages have remained stable over the last several years.

Stakeholders also pointed to 'other specific practices/easy to obtain products in the financial services industry' as causes of over-indebtedness. Most explained that they referred to loans applied for via SMS (on a mobile phone) or via the Internet. These loans are offered up to a maximum amount of a few hundred Euro, over a loan period of a few weeks. An interviewee working for public authorities mentioned that there are around 80 quick loan providers and that they "do not check their customers' creditworthiness". A 2008 study from the Finnish National Research Institute of Legal Policy²⁴³ on the topic found that the average cost on an example loan of 50 Euro for 14 days was 12 Euro, meaning that real yearly interest rates could be as high as several hundred per cent.

²³⁸ Vartia, L., 'Finland's Housing Market: Reducing Risks and Improving Policies'. *OECD Economics Department Working Paper*, No. 514, OECD Publishing, Paris, 2006.

²³⁹ The Finnish economic crisis of the early 1990s was primarily caused by a debt-financed boom in the latter half of the 1980s, initiated by financial market deregulation. See for an overview: Jaakko, K., *The Evolution of the Finnish model in the 1990s: From depression to high-tech boom*, VATT Discussion Paper 344, Government Institute for Economic Research, Helsinki, 2004.

²⁴⁰ European Mortgage Federation, *Hypostat 2011, 2012*, p.77.

²⁴¹ Official Statistics of Finland, *Indebtedness [e-publication]*. Statistics Finland, Helsinki, 2011. Access method: http://www.stat.fi/til/velk/2011/velk_2011_2012-06-27_tie_001_en.html.

²⁴² Eurostat, 'Housing statistics', *Statistics Explained*, 2013. URL: http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/Housing_statistics

²⁴³ Muttillainen, V. and Valkama, E., 'Payment Difficulties Associated with SMS Loans', *Research Communications 86*, National Research Institute of Legal Policy, Helsinki, 2008.

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The outcome of this is a rising number of defaults for these types of loans. According to the National Legal Research Institute of Legal Policy²⁴⁴ they were largely responsible for the increase in judgements on demands for payment of consumer credits in District Courts. These increased from about 20,000 in 2005 to 58,000 in 2007. The large increase came at a time when most other debt judgments (e.g. rental payments, utilities) were decreasing slightly in number.

Finally, a 2011 survey carried out by the Finnish Consumer Agency²⁴⁵ found that nearly 70% of responding financial and debt counsellors believed that extensive and highly visible marketing of loans is a major reason for indebtedness among their clients.

Personal circumstances

In terms of personal circumstances, stakeholders frequently perceived lack of money management skills as a cause of over-indebtedness. This was closely followed by a drop in income (due to various factors) and by poverty or low income in general.

8.3.3 Changes relevant for levels of over-indebtedness

The majority of stakeholders agreed that in the previous five years, there had been significant change in the macro-economic situation that had increased the level of over-indebtedness. The main driver here was almost universally seen by the stakeholders to be increased unemployment. Although the level of unemployment only increased modestly in 2009 and has since declined, unemployment was still perceived to have an impact, especially in certain sectors. As one interviewee said: "The economic crisis causes problems to some of our biggest national employers, for example to Nokia, paper factories, etc. This causes of course unemployment and problems for households."

Some stakeholders noted a fairly significant change in terms of low interest rates mitigating the level of over-indebtedness. Some commented that though the accessibility of long-term loans has decreased, access to consumer credit in general has become easier due to the low interest rates and competition between credit providers. Specifically, the amount of quick or 'SMS loans' was perceived by stakeholders to have increased significantly since 2005.

Half of all interviewees saw fairly significant change in terms of consumers increasingly accumulating debts from utilities, telecommunications services, and rent. As one interviewee put it:

²⁴⁴ Ibid.

²⁴⁵ Finnish Competition and Consumer Authority, 'Aggressive marketing of loans leads to higher debts', Press release 04/07/2011, KKV, Helsinki, 2011. Full report (in Finnish): <http://www.kuluttajavirasto.fi/File/600b90d9-06f1-44ee-92fd-064878a41ce3/Talous-%20ja%20velkaneuvojille%20tehdyn%20kyselyn%20tulokset.pdf>

Nowadays you have to have an intelligent mobile phone, everyone wants to have it, then you travel abroad and do not realise that prices are very expensive ... and it can be extremely expensive to rent in the Helsinki area, costs have gone up significantly.

There was broad consensus among stakeholders that there is a relationship in Finland between the cultural attitude towards debt and the actual level of household over-indebtedness. From their comments it appears that the attitude is changing overall but that there are important generational differences. As one independent expert explained:

In Finland, there is still a bit of a negative attitude towards indebtedness compared to many other countries. This is changing though, and younger generations have a more permissive attitude to being indebted than the older generations who still tend to be conservative in this respect.

This change in attitudes was seen by one stakeholder as being driven by the media. Another interviewee commented that the level of over-indebtedness "is related to marketing and living in a consumer society" and another that "it seems quite fashionable at the moment to show that you have money whether you have it or not." Finally, the cultural attitude towards mortgages was seen by one interviewee to have changed: instead of buying small flats first and gradually trading up, people want to buy a big house straight away, even if they cannot afford it, and consequently become over-indebted.

8.4 CONSEQUENCES OF OVER-INDEBTEDNESS

8.4.1 Consequences for affected households

The consequences of over-indebted most highly rated by stakeholders, in terms of their importance for affected households, were reduced standard of living, family breakdown or divorce, recourse to addictive behaviours and financial exclusion. In their comments, some stakeholders emphasised that home repossessions are rare, since insolvency law allows a person to keep their house. Reduced standard of living was mentioned as one of the most important consequences, while the impacts on mental health were seen as being related to a higher rate of depression and suicide in Finland, which is seventh highest in the EU²⁴⁶ overall. Homelessness decreased significantly in absolute terms between 1987 and 2002, while from 2003 to 2009 the level remained stable (ARA, 2010).²⁴⁷

²⁴⁶ Source: World Health Organisation, Suicide rates per 100,000 by country.
URL: http://www.who.int/mental_health/prevention/suicide_rates/en/

²⁴⁷ Luomanen, R., *Long term homelessness reduction programme 2008-2011. Background report of Ministry of the Environment*, Helsinki, 2010, p.42.

8.4.2 Consequences of over-indebtedness for the financial services industry

Finnish financial institutions have been seen as a "safe haven" for investment capital during the financial crisis and according to the Finnish Financial Supervisory Authority (FIN-FSA), the Finnish banking sector is well capitalised.²⁴⁸

Stakeholders considered the consequences of household over-indebtedness to be less important overall for the financial services industry. Of the various consequences discussed in the interviews, increased costs for financial service providers through stricter regulation of credit was the most highly rated, followed by higher costs of arrears and associated debt management. One interviewee noted that net impairment losses on household loans remained small, while demand remained unchanged over the last three years. This is consistent with a report from the Federation of Finnish Financial Services on Finnish Banking in 2011,²⁴⁹ where it was found that the majority (76%) of impairment losses resulted from loans granted to companies and housing corporations, while only a very small percentage of household loans resulted in losses for the banks.

8.4.3 Economic and social consequences of over-indebtedness for society

In terms of the economic and social impacts of over-indebtedness on society, the consequences rated most highly by stakeholders were reduced productivity at work, followed by the costs associated with assisting households to repay debts. One stakeholder noted that lending for house purchase and household over-indebtedness contribute to cyclical fluctuations, threatening the stability of the financial system as a whole; this could then undermine overall social stability. However, the stability of the unemployment rate and the low interest rates tied to EURIBOR were seen as mitigating factors.²⁵⁰

8.4.4 Debt collection practices

The Debt Collection Act from 1999 regulates the activities of debt collectors.²⁵¹ Proposals for better monitoring of debt collection, and to prevent collection charges from becoming excessive were made by a Working Group of the Finnish Consumer Agency in 2012.²⁵²

²⁴⁸ Federation of Finnish Financial Services, *Financial market Overview: 02/2012*, Finanssialan Keskusliitto (FK), Helsinki, 2012, p.415.

²⁴⁹ Federation of Finnish Financial Services, *Finnish banking in 2011*, Finanssialan Keskusliitto (FK), Helsinki, 2012, p.10.

²⁵⁰ The 6 month EURIBOR for Finland went from 4.7% on 2 Jan 2008 to 0.51% (6-month) 10 Sep 2012. Source: Bank of Finland. <http://www.suomenpankki.fi/en/tilastot/korot/Pages/default.aspx>

²⁵¹ Ministry of Employment and the Economy, *Regulated trades: debt collection agencies*, Helsinki, 2010. [Referred 15.12.2012] <http://www.tem.fi/index.phtml?l=en&s=2369>

²⁵² Finnish Competition and Consumer Authority, *'New ways to monitor the Finnish Debt Collection Act proposed'*, Current Issues in Consumer Law 2/2012, Helsinki, 2012. [Referred: 28.01.2013] <http://www.kuluttajavirasto.fi/Page/34eb3afa-518b-450d-ab79-b13b2e0256b8.aspx?groupId=10d5c38a-277b-492b-a9f0-3c339d94c778&announcementId=d12dab53-8598-45fe-90a1-22fc5767a95d#>

Stakeholders perceived few changes in the past five years in the direction of more aggressive debt collection practices, instead emphasising relative stability. One interviewee pointed out that:

In Finland we have the so called paper of good collection practices which contains e.g. the settlements of collection in different part of collection proceedings. This is currently defined as best practice but there are attempts to integrate it into the legal framework and we hope that it quickly comes into force (hopefully next year or in two years).

However, competition between debt collectors and aggressive practices like calling debtors by phone or sending text messages were seen as problematic practices in the meantime.

8.5 MEASURES IN FORCE TO ALLEVIATE THE IMPACT OF OVER-INDEBTEDNESS

8.5.1 Early identification of households at risk

Only a minority of stakeholders reported early warning measures to be common. Interviewees mentioned the lack of a national credit rating register, and varying quality of procedures to evaluate repayment ability in financial institutions. The largest credit referencing agency in Finland (*Suomen Asiakastieto Oy*)²⁵³ records only "negative" debt ratings such as defaults, but does not record "positive" scores such as when a person repays their debt on time and in full.

8.5.2 Advice offered to over-indebted households

Availability and costs

The majority of stakeholders considered face-to-face debt advice to be widely available. It was noted that this was a communal service and free access is guaranteed in legislation.²⁵⁴ It was therefore considered easy to access, but subject to long waiting times for an appointment - an average of 42 days was mentioned by one report.²⁵⁵ There was a consensus among stakeholders that advice by telephone is

²⁵³ The company states on its website that they provide "the most extensive and comprehensive consumer credit data file in Finland ... with the entire credit data history of consumers, also consumer credit defaults and e.g. own credit stoppages." This data is provided to clients of the service who wish to assess the repayment capability of the consumer being granted credit, in accordance with the Credit Information Act. See: <https://www.asiakastieto.fi/en/>

²⁵⁴ According to the Finnish Consumer Agency, "An Act on budget advice was introduced in 2000, with the purpose of providing information and advice to private citizens on the management of their household economy and their debts (The Financial and Debt Counselling Act 4.8.2000/713)." Quoted in Helesuo, S., 'Tackling debt problems in Finland', *Money matters: Debt advice services, no.7*, European consumer debt network, 2007.

²⁵⁵ *Ibid.*

partly or widely available, but availability was seen as limited due to staffing issues. The Guarantee Foundation is the major provider with its "Debt Line" service,²⁵⁶ along with the Lutheran Church.²⁵⁷ Few stakeholders perceived advice by email or online chat to be widely available. This role was seen by one stakeholder as being provided by private websites and Internet forums where expert knowledge was not represented. Only some stakeholders considered printed information to be widely available. Providing printed information consistently was seen as a problem, since printing costs were significant for organizations that have few spare financial resources.

Demand for debt advice as assessed by stakeholders

The majority of stakeholders indicated that demand for face-to-face services was very or fairly high, along with demand for telephone based services. Demand for printed material was seen as highest, followed by debt advice by email or online chat, while demand for web-based tools was less important. Overall demand for debt advice had increased in the last five years according to the majority of stakeholders. Some suggested that the growth in consumer credit and new products such as SMS loans was the main reason.

A concrete sign of a growth in demand was seen by one civil society interviewee, who reported that waiting times for face to face appointments were becoming longer than before, though this was perceived to be stabilizing recently. Another interviewee stated that new types of service such as web-based tools and telephone centres have been rolled out over the last five years, so debt advice was being offered in ways which were not possible before.

Effectiveness as assessed by stakeholders

Stakeholders judged the different delivery channels as having varying levels of effectiveness. Generally, the effectiveness of face to face contact over printed or Internet based methods was emphasized.

One respondent on the other hand, believed that telephone advice was more effective than face-to-face advice because the person could reach the advice faster, while printed information was of little use, since consumers usually wanted to speak to someone in person. Another stakeholder stated that face-to-face meetings and advice by telephone were effective in reducing panic and helping people to start to deal with their problems, even when the information given was very basic.

²⁵⁶ "The Debt Line is for persons having trouble with debt and payments or their family members. You can phone free of charge from anywhere in Finland. The telephone discussions survey the overall situation, offer advice and instruct in further actions. All discussions are strictly confidential." See: <http://www.takuu-saatio.fi/en/telephone-counselling/>

²⁵⁷ The Evangelical Lutheran Church of Finland provides general counselling for a number of issues including economic guidance and material help. See: <http://evl.fi/EVLen.nsf/Documents/E7E06A1732C53C17C22572B4001DBC5E?OpenDocument&lang=EN>

However, the effectiveness of face-to-face meetings being reduced by long delays was cited as a problem, since an over-indebted consumer could face mounting problems over a period of several months waiting for an appointment.

Regarding debt counselling in general, one study²⁵⁸ analysed surveys of clients of the debt advice service and found that most clients considered that debt counselling had a positive effect on their economic position and their debt problems; satisfaction was highest amongst those with debt problems arising out of consumer credit.

Funding of debt advice

The majority of the funding for debt advice and counselling is from the national budget,²⁵⁹ while the municipalities pay the rest of the costs. However, municipal contributions are voluntary and vary widely, leading to situations whereby some municipalities have restricted access to services. Services from the Guarantee Foundation are funded primarily from Finland's Slot Machine Association (RAY).²⁶⁰

There was consensus among stakeholders that funding for debt advice was insufficient. Stakeholders repeatedly emphasised the need for more central government funding given that municipal authorities typically did not have enough money to adequately fund services.

8.5.3 Key measures in place to alleviate the impact of over-indebtedness

The basis for consumer insolvency legislation is the Debt Adjustment Act of 1993,²⁶¹ which was a response to the economic crisis of the early 1990s in Finland. Under this Act the debtor must first seek a voluntary arrangement with creditors before moving to formal resolution or adjustment mechanisms.

Failing this, debtors can apply for a restructuring loan with the Guarantee Foundation²⁶² for a maximum of 34,000 Euro in order to consolidate and pay back all debts. However, this process is conditional on the debts being private household debts only. In addition, the debtor must possess the ability to pay all their creditors back, and that there is no other reasonable possibility to arrange the debts.²⁶³

²⁵⁸ Valkama, 2004. Debt Counselling in the Early 21st Century. National Research Institute of Legal Policy, Publication No. 208, p102.

²⁵⁹ Helesuo, S., 'Tackling debt problems in Finland', *Money matters: Debt advice services, no.7*, European consumer debt network, 2007.

²⁶⁰ The Finnish Slot Machine Association (RAY) enjoys the right of sole provider of gaming services in Finland. RAY's entire proceeds are used for supporting Finnish health and social welfare organisations (nearly 900). RAY's funding operations are controlled at national level by the Ministry of Social Affairs and Health. Together with the Ministry, RAY signs annual agreements on the result objectives of funding operations. The sum distributed for such purposes in 2011 was 411 million Euro. See: <https://www.ray.fi/en/beneficiaries/>

²⁶¹ See (in Finnish): <http://www.finlex.fi/fi/laki/ajantasa/1993/19930057>

²⁶² Takuu-Säätiö, *Slideshow about the Guarantee Foundation*, 2013. http://www.takuu-saatio.fi/@Bin/116775/Slideshow_Guarantee_Foundation_2011.pptx

²⁶³ See 'Preconditions for receiving a guarantee' at <http://www.takuu-saatio.fi/en/guarantee-operations/restructuring-loan/preconditions-for-receiving-guar/>.

If the debtor qualifies, they can apply for a debt adjustment procedure through the courts. Here a payment plan is issued by the court and the debtors pay their debts according to their ability to pay during a fixed period of time (usually five years) and the remaining debts are then written off. The debtor retains income necessary for living expenses,²⁶⁴ while any additional income is garnished and distributed amongst the creditors according to the payment plan. All other assets (normally excluding their own home) are sold to pay off the debts.

According to research from the National Research Institute of Legal Policy²⁶⁵ the yearly applications for debt adjustment declined from a peak of 14,000 in the mid-1990s to about 3000 applications per year in 2008/2009.²⁶⁶ Compared to the adult population as a whole, those who seek debt adjustment are more likely to be middle-aged, living on their own, with a lower level of education, and unemployed or single parents. Couples, well-educated persons, young people, the elderly, and those in employment are less likely to seek debt adjustment.

Unsuccessful business activity was found to be the most common reason for applying for debt adjustment, along with income shocks due to unemployment or illness. The authors also note that in the years from 1993-2005, there has been a decrease in the volume of debts, but an increase in the number of debts. This was accompanied by an increasing emphasis on ordinary debts without security, and consumer credit in general.

Availability and costs

The majority of stakeholders perceived informal, formal, and legal debt settlement procedures as being available. As outlined previously, entry to formal court procedures is legislated by the 1993 Debt Adjustment Act (and subsequent revisions), which requires the debtor to have first attempted a negotiated settlement with creditors. Regarding financial support for households to repay debts or arrears, such as from a public fund, the Lutheran Church of Finland was seen as being nearly the only actor in this area, apart from informal sources such as family and friends. However, since 2003 municipalities can arrange social credit granting to their residents; this makes credit with reasonable conditions available to those who would otherwise not be eligible. One survey from 2008 revealed that 22% of the Finnish

²⁶⁴ Necessary living expenses are slightly higher than the minimum social welfare contributions. For details of the whole process, see Niemi, J., *Debt Adjustment Law in Finland: A Short Description*, 2010. <http://www.helsinki.fi/oikeustiede/omasivu/niemi/news/Debt%20Adjustment%20Law%20in%20Finland%20Niemi%202010.pdf>

²⁶⁵ Muttillainen, V., 'Debt adjustments in courts: debtors and payment plans 2005', *Research Communications no. 75*, National Research Institute of Legal Policy, 2007.

²⁶⁶ Niemi., 2010, *Op. cit.*

population lived in a municipality where social credit was being granted and this was expected to expand in the future.²⁶⁷

Effectiveness as assessed by stakeholders

The most effective measure according to stakeholders is that of legal procedures that take place in court, such as consumer insolvency proceedings. Stakeholders stated that informally brokered arrangements are effective, as well as formal procedures that do not take place in court, such as mediated agreements. However, one interviewee stated that it took too long to get in the process and was expensive to debtors. Muttillainen (2007) reports that during the years 1993-2005 about 86,000 debtors applied for a formal debt adjustment; the courts confirmed the payment plans of about 78% of these. Of those who receive a payment plan, close to 60% are able to pay off their debts over the period of the payment plan (typically five years), by selling assets or from their income.

8.5.4 Changes in response to over-indebtedness

A few stakeholders noted that measures to deal with over-indebtedness have changed during the last five years. Their comments suggest that changes have been minor, with extensions to the timetable of payments in legal restructuring of debts, and longer time periods to arrange debt repayments. More attention to debt counselling was also described during recent years.

8.5.5 Types of households of over-indebted consumers not reached by current measures

Respondents agreed that there are specific types of households not reached by current measures. Specifically, people with alcohol problems, young people, the unemployed, those with irregular earnings, and those under the poverty line were mentioned. One independent expert claimed that approximately 700,000 people with low incomes²⁶⁸ are essentially excluded from society and are also much less likely to seek out debt advice. Also, according to a local authority stakeholder, many people are reluctant to reach out to debt advice centres until it is too late to take effective action.

8.5.6 Best practices

One stakeholder considered that the procedure for legal restructuring of debts represented good practice. On the other hand, another stakeholder while referring to the debt restructuring procedure said that the "arrangements that are available are

²⁶⁷ Consumer Agency, 2009. Measures Aimed At Improving The Position of the Consumer Debtor since the 1990s in Finland. Publication Series 2/2009.

²⁶⁸ Defined as 60% of median national disposable income (Eurostat).
http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/Glossary:At-risk-of-poverty_threshold

very exclusive in the sense that they require certain criteria to be met, and not all people are aware of them. The whole system needs reforms."

8.6 OUTLOOK

The majority of stakeholders expected the number of over-indebted households to increase in the next five years. Most stakeholders attributed this to adverse future macroeconomic factors, such as rises in unemployment or interest rates, and unpredictable effects of the global economic crisis. Two stakeholders mentioned a cultural climate where people are increasingly likely to attempt to maintain standards of living by using credit. One mentioned that the number of people with low credit-worthiness has gone up significantly and will increasingly have financial problems in the future.

There was also consensus that there were specific new challenges to be addressed by policymakers, of which overconsumption, financial education of young people, dealing with informal loans, and managing the macroeconomic situation were mentioned.

The majority of stakeholders made the case for additional regulation of credit and practices of lenders, at both national and EU levels. On the national level, stricter regulation on payday and SMS loans was seen as a priority, along with regulation on credit statistics to make it harder for lenders to offer credit to those who already have many creditors..

Regarding regulation of specific sectors, few stakeholders believed that additional changes were needed in relation to utilities. Regarding regulation of the housing sector, two stakeholders thought that more regulation at the housing level was needed, primarily in reforming the mortgage interest deduction from taxes.

Other measures suggested by stakeholders were the introduction of a social fund model from public funds to help over-indebted people, as well as financial education and cultural measures to encourage more responsible use of credit.

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ANNEX A: STATISTICAL DATA FROM EU SOURCES

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Finland

I. Eurobarometer¹

Finland EU average Lowest EU value Highest EU value

Households *at risk* of being over-indebted

Respondents feeling at risk of over-indebtedness in 2010	↘ 11%	25%	7%	52%
Respondents feeling at risk of over-indebtedness in 2009	↘ 14%	27%	9%	53%

II. EU SILC standard survey data²



III. EU SILC 2008 module: Over-indebtedness and financial exclusion³

Finland EU average Lowest EU value Highest EU value

Proportion of people in households with bank overdrafts, outstanding balances on credit cards or in arrears on other loans of over 100% of household disposable income

Overdrawn bank account (% of people in households overdrawn)	:	2.2%	0.0%	7.7%
Credit or store card (% of people in households with outstanding balances)	↘ 0.0%	1.1%	0.0%	8.6%
Other loan/credit payments (% of people in households in arrears)	⇒ 0.3%	0.3%	0.0%	1.1%

Proportion of people in households in arrears in servicing housing-related loans and bills and in paying other bills of over 100% of household disposable income

Housing bills (% of people in households in arrears)	↘ 0.2%	0.5%	0.0%	2.9%
Other payments (% of people in households in arrears)	⇒ 0.4%	0.4%	0.0%	1.7%

Households living with outstanding debts and/or arrears of over 100% of household disposable income

Total (% of households with outstanding debts/arrears)	↘ 1.0%	4.6%	0.0%	11.8%
Income above 60% median (% of households with outstanding debts/arrears)	↘ 0.6%	4.2%	0.0%	11.3%
Income below 60% median (% of households with outstanding debts/arrears)	↘ 3.3%	7.0%	0.2%	13.7%
Materially deprived (% of households with outstanding debts/arrears)	↘ 6.4%	9.0%	0.1%	27.4%

Proportion of those in broad age groups with outstanding debts of over 100% of household disposable income

Households with all adults aged 25-39 (% of households with outstanding debts)	↘ 1.1%	6.3%	0.0%	17.2%
Households with all adults aged: 40-64 (% of households with outstanding debts)	↘ 1.4%	5.8%	0.0%	10.9%
Households with all adults aged: 65+ (% of households with outstanding debts)	↘ 0.1%	1.2%	0.0%	2.8%

Proportion of those in different types of household with outstanding debts of over 100% of household disposable income

Living alone (% of people in households with outstanding debts)	↓ 2.1%	4.3%	0.0%	8.2%
Single parent (% of people in households with outstanding debts)	↓ 2.5%	9.5%	0.0%	27.1%
Other (% of people in households with outstanding debts)	↓ 0.6%	4.8%	0.0%	12.1%

Proportion of those in households with outstanding debts of over 100% of household disposable income by marital status

Never married (% of people in households with outstanding debts)	↓ 1.7%	5.0%	0.0%	15.4%
Married (% of people in households with outstanding debts)	↓ 0.5%	4.1%	0.0%	9.7%
Separated/divorced (% of people in households with outstanding debts)	↓ 1.9%	7.5%	0.1%	13.9%
Widowed (% of people in households with outstanding debts)	↓ 0.4%	1.7%	0.0%	4.3%

Proportion of those in households with outstanding debts of over 100% of household disposable income by housing tenure

Owner occupied without mortgage (% of people in households with outst. debts)	↓ 0.2%	3.2%	0.0%	9.6%
Owner occupied with mortgage (% of people in households with outst. debts)	↓ 0.6%	6.3%	0.0%	16.1%
Market rent (% of people in households with outstanding debts)	↓ 2.4%	8.2%	0.0%	16.0%
Subsidised rent (% of people in households with outstanding debts)	↓ 2.7%	8.7%	0.0%	17.9%
Rent-free housing (% of people in households with outstanding debts)	↓ 0.5%	2.3%	0.0%	15.1%

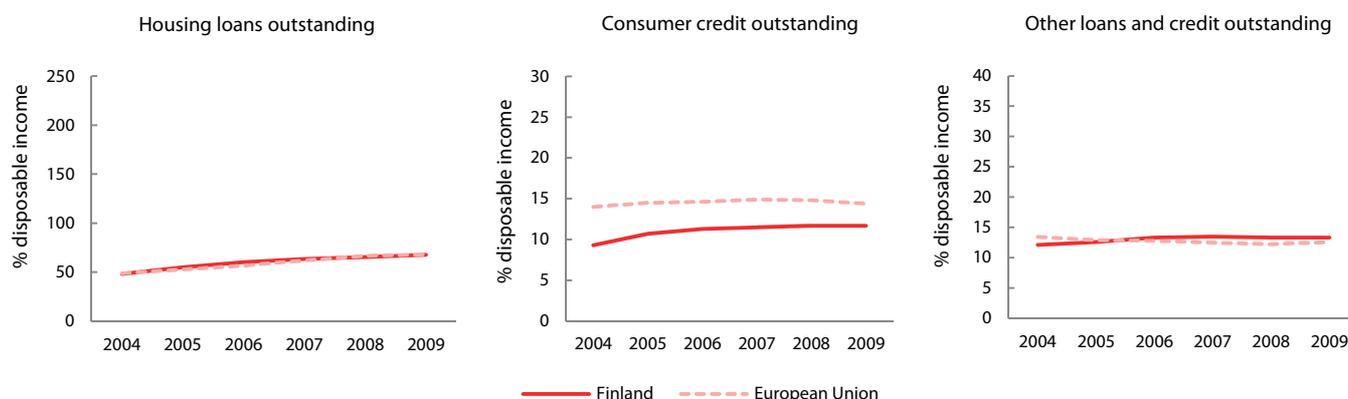
Proportion of those in households with outstanding debts of over 100% of disposable income by work intensity

Work intensity of 0 - 0.19 (% of people in households with outstanding debts)	↓ 2.7%	5.7%	0.0%	10.6%
Work intensity of 0.20 - 0.50 (% of people in households with outstanding debts)	↓ 1.2%	5.7%	0.0%	15.3%
Work intensity of 0.51 - 0.74 (% of people in households with outstanding debts)	↓ 0.8%	5.4%	0.0%	13.5%
Work intensity of 0.75 - 1.0 (% of people in households with outstanding debts)	↓ 0.8%	5.3%	0.0%	14.3%

Proportion of those in over-indebted households that experienced a major drop in income over the preceding year

Over-indebted (% of people in households that experienced drop in income)	↓ 32.3%	33.3%	0.0%	77.6%
Other (% of people in households that experienced drop in income)	↓ 13.1%	19.2%	5.9%	32.5%

IV. Loans and credit outstanding⁴



Notes:

(1) Eurobarometer 72.1 (2009) and Eurobarometer 74.1 (2010). Note: Those who answered 'very at risk' or 'fairly at risk' to the question 'Please tell me how much you feel at risk of being over-indebted'.

(2) Eurostat, SILC. Data as of December 2012.

(3) European Commission, Research Note 4/2010, Over-indebtedness new evidence from the EU-SILC special module.

(4) European Commission, Research Note 4/2010, Over-indebtedness new evidence from the EU-SILC special module. European Credit Research Institute (ECRI), Lending to households in Europe, 1995-2009 and Eurostat, National accounts.

9 FRANCE

<i>Document</i>	The over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact - Country report France
<i>Prepared by</i>	Georges Gloukoviezoff and Robert Graham
<i>Finalised on</i>	7 January 2013

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9.1 DEFINITION OF OVER-INDEBTEDNESS

A large majority of stakeholders interviewed for this study used a specific definition for households or individuals being over-indebted. This was mainly the one defined in France for the debt settlement procedure as set out in legislation. The article L330.1²⁶⁹ of the French Consumer Code (*Code de la consommation*) states that:

Over-indebtedness of a natural person is characterised by the manifest inability of the debtor in good faith to repay the whole of his/her non-professional debts due now and in the future.

The purpose of this definition is to identify who is eligible for the debt settlement procedure managed by the Banque de France. Therefore when the debate refers to over-indebted households it is usually about people who have successfully applied to the procedure.

This legal definition is narrower than the one used for this study and faces difficulties in capturing the variety of types of over-indebtedness. This weakness led to the recent emergence of the concept of "*mal-endettement*" which could be translated as "badly indebted", and which was mentioned by a few civil society interviewees. This term was popularised by the government Ombudsman (*Médiateur de la République*) in 2008 and refers to a financial situation characterised by difficulty in repaying debts, that have been brought about by poor use of credit.²⁷⁰ This difficulty is considered to be temporary, but a change in personal circumstances such as unemployment, divorce or sickness can suffice to tip such a household into over-indebtedness in the legal sense.²⁷¹

According to one interviewee a further definition (often referred to as 'passive' over-indebtedness in the literature)²⁷² refers to people who face difficulties repaying their debt due to increasing burdens of living costs or reductions in income, and where exogenous factors rather than poor financial management are to blame.

Regarding a definition of households *at risk* of being over-indebted, only a few stakeholders stated they used one. Where one was used, this was either the aforementioned '*mal-endettement*' definition, or based on different criteria. For example, a stakeholder from the financial services industry referred to risk scores generated when clients did not meet monthly repayments on times. An independent

²⁶⁹ "La situation de surendettement des personnes physiques est caractérisée par l'impossibilité manifeste pour le débiteur de bonne foi de faire face à l'ensemble de ses dettes non professionnelles exigibles et à échoir." Article L330-1, Code de la consommation. At: <http://www.legifrance.gouv.fr/affichCodeArticle.do?idArticle=LEGIARTI000023276446&cidTexte=LEGITEXT000006069565>

²⁷⁰ Médiateur Actualités, 'Malendettement: une urgence sociale', *Le Journal du Médiateur de la République*, No.41, 2008.

²⁷¹ See also Athling, *Le mal-endettement: mythe ou réalité?* Actes de la 9eme edition des dejeuners-debats d'Athling, 2012.

²⁷² Anderson, R., Dubois, H., Koark, A., Lechner, G., Ramsay, I., Roethe, T., and Micklitz, H-W., *Consumer Bankruptcy in Europe: Different Paths for Debtors and Creditors*, EUI Working Papers, Department of Law, European University Institute, 2011, p.12.

expert stated that their definition of households at risk of over-indebtedness considered the "budget left over after all other commitments (accommodation and energy, phone, insurances, taxes, credit, food, clothes)" and that:

Our [estimation] is based on different criteria: our private database with observation of way of life; the French regulation of minimum resources; and the French regulation about over-indebtedness. A difference between a household at risk of being over-indebted and a household that is actually over-indebted could be that those at risk are having difficulty meeting their commitments (e.g. budget after meeting commitments is too low), but they are still in a position to actually meet them. An over-indebted person cannot actually meet commitments."

Overall, stakeholders were not convinced of the need for better definitions. One independent expert commented that the current legal definition of over-indebtedness was quite precise, and was a practical, widely used measure that indicated objective levels of over-indebtedness. However, a few respondents from the financial industry stated that it would be useful to have a standardised European definition, in order to better compare statistics between Member States, or to identify those at risk earlier, so as to develop better prevention policies.

9.2 LEVEL OF OVER-INDEBTEDNESS

Consistent with other Member States, households in France have been taking on more debt. The household debt to disposable income ratio in France climbed steadily over the past decade, from 54% in 2000 to 83% in 2011. This is somewhat below the Euro area average of 99%, and similar to the German level of 86%. Meanwhile, the level of non-performing loans to total gross loans increased from 2.7% in 2007 to 4.2% in 2010; a significant rise, but proportionately well below the EU average.²⁷³

When it comes to the measures of over-indebtedness employed by this study, such as the EU-SILC statistics, statistics show only moderate changes. The percentage of the total population with arrears on key commitments barely increased from 2007 to 2011, and at the end of this period stood at 9.9%, lower than the EU average (of 11.4%).²⁷⁴ Breaking down arrears into constituent types, the percentage of the total population with arrears on mortgage or rent repayments even decreased slightly over the period.

Subjective assessments of households of their financial position showed that respondents in France were less likely to feel at risk of being over-indebted than other Member States. EU-SILC data also attempts to assess financial vulnerability, and this showed an increasing trend since the onset of the financial crisis. When asked

²⁷³ Eurostat, 'Household debt to disposable income ratio' (code: tec00104) and IMF data.

²⁷⁴ Eurostat, 'Arrears on key commitments' (code: ilc_mdcs05).

whether their household was able to make ends meet only with difficulty, 20% of households responded that this was the case in 2011, compared to 16% in 2007.²⁷⁵ However, these levels were always at least five percentage points below the EU average for the same period. These results were consistent with European Social Survey (ESS) data,²⁷⁶ which also showed that from 2002 to 2010, more households over time felt that surviving on their present income was very difficult, but this level was still amongst the lowest of all countries surveyed.

Based on the narrow definition of over-indebtedness given by the French law, the level of over-indebtedness has steadily increased over the last five years as was widely underlined by stakeholders. Between 2007 and 2012, the number of applications to the Banque de France debt settlement procedure increased from 179,784 in 2007 to 228,383 in 2012, an increase of 27%.²⁷⁷ Currently, around 746 000 households are considered as currently benefiting (or about to benefit) from the Banque de France procedure and represents 2.8% of all households. The average amount of debt owed per case is also relatively high at 36,801 Euro in 2011, itself an increase on 34,456 Euro in 2010.

This number of over-indebted is slightly higher than that provided by the EU-SILC special module in 2008 which defined those with high levels of arrears at 2.3% of the population.²⁷⁸ It should be emphasised that the previous figure relates to households who have successfully applied to the Banque de France procedure but ignores people who are over-indebted according to the study definition but have not yet applied, or who had their application refused.

The Banque de France also compiles the National Database on Household Credit Repayment Incidents (FICP) where people who are at least three months in arrears on all types of credit (including unauthorised overdrafts) are listed. Over-indebted people having applied to the Banque de France procedure are also included. At the end of 2011, 2.6 million people were listed.²⁷⁹ Despite changes in the way data are stored (some categories have seen the length of time of registration reduced in 2010), between end of 2007 and end of 2011, the number of people registered increased by 10.3%. Another study from 2010 by the independent research centre CRÉDOC

²⁷⁵ Eurostat, 'Percentage of population with inability to make ends meet' (code: ilc_md09).

²⁷⁶ European Social Survey, rounds 1-5 (code : hincfel).

²⁷⁷ See: http://www.banque-france.fr/fileadmin/user_upload/banque_de_france/La_Banque_de_France/barometre-surendettement-2012T1.pdf

²⁷⁸ Fondeville, N., Ozdemir, E. and Ward, T., *Over-indebtedness: New evidence from the EU-SILC special module*, European Commission, Directorate-General for Employment, Social Affairs and Equal Opportunities, Research Note 4/2010, 2010.

²⁷⁹ At: <http://www.banque-france.fr/la-banque-de-france/missions/protection-du-consommateur/fichiers-dincident-bancaire/fichier-national-des-incidents-de-remboursement-des-credits-aux-particuliers-ficp.html>

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indicated that 6% of households can be considered as at risk of over-indebtedness as they often or sometimes were unable to repay their loans.²⁸⁰

Despite the moderate level of arrears as shown through statistical data, a large majority of stakeholders interviewed share the assessment that over-indebtedness had increased significantly over the last five years, and none of the interviewees stated that it had decreased or remained the same. Stakeholders cited various statistics to support this judgment, the majority of which were the number of debt settlement procedures performed by the Banque de France, in support of this judgment.

However, increasing over-indebtedness may not necessarily be to blame for these increases. Multiple stakeholders highlighted how recent modifications to the law raised awareness of the procedure among consumers, and made it more accessible. Specifically, the 2010 reforms implementing the provisions of the Consumer Credit Directive known as the 'Lagarde Act' simplified the personal recovery procedure, aiming to speed up the procedure, make it more effective, and increase consistency.²⁸¹

9.3 NATURE AND DRIVERS OF OVER-INDEBTEDNESS

9.3.1 Most common types of households that are over-indebted

The stakeholders responses were mainly framed by the statistics provided by the Banque de France regarding profile of people having applied to its procedure.²⁸² The most recent data (for 2011) shows that the population of over-indebted households is characterised by the predominance of people living alone - single, separated, divorced or widowed - (64%) and with no dependents (52%). These two categories have been growing since 2001. Over-indebted people live mainly in rented accommodation (79%).²⁸³

The majority of over-indebted people are aged between 35 and 54 however people over 55 years old who represented only 13% of the population in 2001 now represent 24% (people over 65 increased from 4% to 8%).

The situation with regard to unemployment confirms the importance of professional difficulties faced by over-indebted people, where 26% of those over-indebted are

²⁸⁰ Credoc, *Les Conditions d'accès aux services bancaires des ménages vivant sous le seuil de pauvreté*, Rapport réalisé par le CRÉDOC pour le Comité consultatif du secteur financier, 2010.

²⁸¹ Banque De France, 'Dealing with household over-indebtedness', Factsheet no. 134, Direction de la Communication, 2012.

²⁸² Banque de France, *Le surendettement des ménages, enquête typologique 2011*, January 2013.

²⁸³ Compared to only 37% in the general population, according to Eurostat data (code: ilc_lvho02).

unemployed, 12% are without an occupation and 11% are without work because of disability, long-term illness, or maternity leave.

Regarding income levels, 79% of over-indebted households have monthly income less than 2000 Euro, while 49% had an income at or below the minimum wage.²⁸⁴ As a result, about 81% of applications were characterised by a weak or non-existent repayment capacity.

Given their reliance on Banque de France statistics, it is not surprising that stakeholders chose similar categories when asked what were the most common types of households experiencing difficulties meeting their financial commitments. The majority of stakeholders chose households between the ages of 40 and 64, one person households with children, those living in rented accommodation, households with an unemployed member, and households at risk of poverty (less than 60% of median disposable income) as the most common types. In terms of changes in types of households becoming over-indebted in the previous five years, several stakeholders cited an increase in older people and households at risk of poverty.

9.3.2 Causes of households' over-indebtedness

Macro-economic factors

The French economy has remained relatively stable throughout the financial crisis and the economic recession that followed it. Although France suffered decreases in real GDP per capita in 2008 and 2009, these were less severe than in many other Member States, and growth resumed in 2010 and 2011. Unemployment, which was at an historically low 7.8% in 2007, only increased modestly to 9.6% in 2011, remaining very close to the EU average.

According to stakeholders the macroeconomic factors that were amongst the most important causes of over-indebtedness were the level of employment and the level of income (wages and social benefits). Regarding the level of employment, stakeholders underlined that job loss involves a drop in income which makes it difficult to sustain repayments and minimum living standards simultaneously. More generally, one independent expert cited:

massive unemployment and the long term transformation of the welfare state: the level of social redistribution of resources is insufficient to support households who are in precarious situations. [There has been] a transformation of the labour market [...] that implies precariousness, uncertainty, and a lower level of income.

An independent expert also disagreed with a narrow focus on the individual or household level, saying rather that:

²⁸⁴ According to Eurostat data (code: tps00155) the minimum wage for France was 1,365 Euro per month in 2011.

What you call "personal circumstances" are anything but personal. Poverty, level of income etc. are all social matters, not personal ones. The fact that people get low and irregular wages and subsidies explain massive over-indebtedness in a society with quite easy open access to consumer credit.

While most stakeholders did cite unemployment and macro-economic conditions in general as important, one stakeholder raised a critical voice:

It's difficult to say the wage level is too low, for example, because what would be the correct wage level? The problem is that people spend more money than they have. There are people with high incomes who are over-indebted and people with low incomes that are not over-indebted.

However, the majority of the 20 household interviewees conducted for this study held similar views to the majority of the stakeholders. Twelve households were affected by unemployment at the time of the interview, while a further two households had been affected in the past. In addition to unemployment, a couple of interviewees referred to underemployment as an issue. Wage level and social welfare level were also mentioned fairly frequently. For example, in relation to social welfare level, a few households indicated that they did not receive unemployment benefit, despite not having a job, while one interviewee complained about the irregularity of her social welfare payments.

Cost of living

Median household incomes have risen by about 22% since the onset of the financial crisis in France, notably more than in the EU as a whole, which only rose 7%.²⁸⁵ Meanwhile, the cost of living as measured by the Harmonised Index of Consumer Prices rose by nearly 8%, slightly below EU average values. As in other Member States, however, some items in the index rose more than others. The electricity, gas, and other fuels index rose by 28% during the same period, for example, outstripping any rise in median incomes.²⁸⁶ A recent report from the Conseil National de Lutte Contre l'Exclusion also points out the fact that costs of living are rising quicker than resources of middle and low income household putting them at risk of over-indebtedness.²⁸⁷

This is consistent with the observation of the Banque de France regarding the evolution of the nature of the debt of over-indebted households, which found that for those applicants found to be over-indebted for the debt settlement procedure, arrears on energy bills are present in almost half of all cases, and this had increased by nearly 10% from 2010. (Though they only represented 1.7% of the total value of debts

²⁸⁵ Eurostat, 'Median equivalised net income' (code: ilc_di04).

²⁸⁶ Eurostat, 'Harmonised Index of Consumer Prices' (code: prc_hicp_aind).

²⁸⁷ CNLE, 2012, Pour une mise en oeuvre du droit à des moyens convenables d'existence, Paris.

At: http://www.cnle.gouv.fr/IMG/pdf/Rapport_CNLE_Reste_pour_vivre_imprimable_aout_2012.pdf

overall).²⁸⁸ This was also the case for housing debts, where they were identified in 45% of cases.

Considering stakeholder responses, interviewees considered that utility and housing costs were amongst the most important causes of households' over-indebtedness in terms of cost of living. Furthermore, the majority of stakeholders confirmed that they had seen consumers increasingly accumulating debts from utilities, telecommunication services, and rent during the previous five years. One stakeholder from civil society stated that:

For four or five years we have been seeing an increase of telecommunication debt. This is another topic, mainly because of mobile phones, which are more expensive than regular ones. Many consumers near the borders have problems with French phones because they automatically switch to Belgian networks. Communication in France is overall quite cheap, it is when you are calling abroad that it gets expensive. Rents are quite expensive, especially in Paris or other cities. For example, if you want to rent 30 square meter flat, you have to spend 700 Euro in Paris, and the social allocation is more or less 400 Euro, so you cannot live with only social subventions and this is a big problem. A lot of employees of state are over-indebted because they can just pay their rent and then cannot pay the rest of living expenses and commitments.

Households interviewed most frequently mentioned housing and childcare or child related costs as a cause of difficulties. For example, one interviewee explained that her landlord had decided to double her rent, from 530 Euros to 1020 Euros. In terms of childcare costs, one interviewee stressed the difficulties of providing her child with the type of education she would wish for him (music lessons, private schooling, etc.).

Types of credit/loan taken out by households

According to stakeholders, the types of credit and loan taken out by households that were amongst the most important causes of over-indebtedness were mainly regulated consumer credit with high or average interest rates. In comments, stakeholders repeatedly emphasised that this referred to the phenomenon of revolving credit. Revolving credit is a type of open-end credit that allows the consumer to have a fixed amount of credit available at all times; a typical example is a credit card, issued by a bank or large store ('loyalty cards'). Though a flexible means of credit, the requirement for a minimum repayment to be made every month (of which a large proportion is simply high rate interest) means that they can be very expensive in the long run.

In France, recent reforms (in the 'Loi Lagarde') have stipulated that any revolving credit below 3,000 Euro must be repaid over a maximum period of three years (five

²⁸⁸ Supra.

years for loans above 3,000 Euro). In addition, each term of revolving credit must include repayment of capital whose amount is fixed by law, and the borrower is given written notification in their monthly statement of the estimated time remaining for repayment of the loan, and lenders must verify the creditworthiness of the consumer every three years.²⁸⁹ However, problems with compliance with this law have been questioned by some recent research.²⁹⁰ Therefore, according to one stakeholder from civil society, it was unsurprising that:

The main topic and the type we see most frequently is revolving credit - the type sold in supermarkets or in technological shops. This is credit that is sold without any assessment of solvency of households and with very high interest rate (between 15 and 20%) whereas more classical credit would have interest rate between 8 and 10% but is sold only in banks. The problem is that if a French person goes to a supermarket to buy a TV, the shop will only propose revolving credit and not a classical one. A second problem is that there is no verification of solvency, so if the household has difficulty to pay back the first revolving credit they can go to the next supermarket and get another credit to pay back the old one.

According to stakeholders, this was not a new development. But there were changes in the regulatory and supply sides:

As indicated above, we have seen a diffusion of revolving credit for all uses: paying bills, food purchases, etc. Previously consumer credit in supermarkets was only accessible in the same supermarket, now this is changing because this will be used for all supermarkets. The problem has existed for more or less 20 years, but now it is changing because now you can use credit for buying everything.

Although the effects of the 'Loi Lagarde' are hard to judge given its recent introduction, a few stakeholders stated that access to this type of credit has become more difficult since the financial crisis. This seems to be reflected in Banque de France figures, where revolving credit comprised the main component of applicants' consumer debt arrears (at 78%), but the proportion of these type of debts to all debt had decreased from 40.1% in 2010 to 34.6% in 2011.

Home mortgages were not seen as especially problematic by stakeholders, because of stricter requirements for creditworthiness. There is some evidence that mortgages as such are not a significant cause of over-indebtedness. According to the Banque de France, only 7.1% of over-indebted people in France have a mortgage and their proportion is decreasing since 2001. However, after having gone down from 1.5% in 2001 to 0.9% in 2007, the rate of doubtful mortgages has increased to 1.3% in 2011.²⁹¹

²⁸⁹ See Dolceta (online consumer education): <http://www.dolceta.eu/france/Mod2/-/Quel-credit-choisir-.html>

²⁹⁰ UFC-Que Choisir, Campagne crédit consommation: les établissements discrédités, 2012.

²⁹¹ ACP, 2012, "Enquête annuelle sur le financement de l'habitat en 2011", Analyse et Synthèse, n°8, Paris, Banque de France.

The role played by consumer credit is backed-up by reports from household interviewees who all had different types of consumer credit but emphasise the cost, the ease of access as well as the complexity of revolving credit. For example, one interviewee explained that his bank contacted him with the offer of credit and persuaded him to go for the maximum amount. Generally, the interviewees seemed to think that an income or credit check had been done, but some of these did not think it was particularly strict (e.g. the lender asked about the level of income but did not demand proof). Some interviewees admitted lying to their lender in order to get the loan: "I was telling them I was working, but of course I was not telling them that I had plenty of other loans!"

Several household interviewees did not consider themselves to be irresponsible for taking out the loan, for example because their income had been higher at the time they had taken it out. Some others were more ambivalent. For example, one interviewee pointed out that taking out a loan with a 20% interest rate could not be considered responsible. However, some interviewees stressed that they had not had a choice, because they had needed the money. One interviewee explained that, "There was no more money coming in, we had to eat...". Some interviewees blamed the lender for giving them the money and not making a proper check of their ability to repay.

Personal circumstances

Stakeholders judged insufficient income to be amongst the most important causes of over-indebtedness. The reason behind this insufficiency could be an income drop due to unemployment, business failure, or due to reasons such as illness or divorce. Sustained poverty was also ranked amongst the most important causes, so that exogenous income shocks and structural low income were differentiated. Several stakeholders highlighted the multidimensional and complex nature of over-indebtedness:

People who file for debt settlement are rather people who are in a difficult socio-economic situation and have often been confronted with an accident of life (separation, divorce, prolonged illness). The occurrence of this event is the reason that they are no longer able to meet their commitments. The debate focuses on the question of whether the accident or the fact that these people have subscribed to many consumer credits is the primary cause. It is often a mixed situation: people have socio-economic problems and simultaneously subscribe to several small consumer loans so it is not very easy to discern what is primary and what is secondary. For example, is the person divorced because of his financial situation, or has experienced financial difficulties after a divorce?

Many of the interviewed households had been affected by a drop in income, for example as the result of unemployment or business failure, but also due to other factors such as illness or the death of a family member. These drops in income could

have different effects. One household interviewee described how he started using a credit card after becoming unemployed in order to cover the gap between his previous income and his social benefits. A couple of households specified that their pre-existing level of debt had become problematic when their income was reduced.

A related issue that affected several households - consistent with stakeholder responses - was that of poverty. For example, one interviewee explained that her income simply wasn't enough to cover her basic living expenses: "These 600 Euros [social benefits] for three people... it is not enough". Out of the 18 cases where it was possible to make an assessment, two thirds of households were determined to be at risk of poverty.

The uncertainty that over-indebted people face and the weakness of their budget make any unplanned change in their situation dangerous. This was underlined by one interviewee. She explained that her problems were largely caused by bad luck, but were also the result of bad decisions: "It may be a wrong decision at the wrong time. To take a loan while the future is uncertain, it is not the best idea." However, other interviewees suggested that their lenders had been more to blame than themselves, because they had given them too much access to credit.

9.3.3 Changes relevant for levels of over-indebtedness

The majority of stakeholders identified significant changes in the macro-economic situation following the financial crisis, increasing the level of over-indebtedness. Several stakeholders highlighted specific aspects. Among these were the increase in unemployment and cuts in welfare benefits, economic stagnation and a decrease in purchasing power, increased banking fees and reduced accessibility of credit.

Regarding provision of credit, stakeholders consider that it did not play a significant role except representatives from consumer organisation and NGOs who point out the role of revolving credit, as detailed above. According to stakeholders, unregulated lenders hardly exist in France and informal lending suffers from a lack of any real data.

Stakeholders agreed that the transposition of the European consumer credit directive²⁹² have reduced aggressive advertisements as well as raising consumer awareness about the risks of consumer credit. However, a recent evaluation of the impacts of this law states that if some positive impacts can be identified it is too early to say if they are the results of the law and if the global impact is positive regarding preventing and dealing with over-indebtedness.²⁹³

²⁹² Charlton, S., *National Report on the transposition of the Consumer Credit Directive in France*, European Legal Studies Institute, Universität Osnabrück, 2012.

²⁹³ See: <http://www.senat.fr/notice-rapport/2011/r11-602-notice.html>

Regarding the interviewees, fourteen households were in arrears with their rent or utilities at the time of the interview.²⁹⁴ A few household interviewees felt that they were paying more than they should for their rent or utilities, but they did not consider themselves to have behaved irresponsibly. For example, one interviewee explained that her rent became too high after the death of her husband, but that she could not find another place to live. Likewise, another interviewee pointed out that her apartment was poorly insulated, which increased her heating costs, but that it was difficult for her to find a new apartment with her low income. In one case, the interviewee's arrears were the result of her daughter changing the mobile phone contract after a phone call from the provider (which she was not entitled to do).

9.3.4 Cultural attitude towards debt and actual level of households' (over-) indebtedness

Nearly half of stakeholders interviewed stated that there was a relationship in France between the cultural attitude to debt and the actual level of household over-indebtedness. Of those who commented, the majority emphasised that France had a relatively low level of household over-indebtedness compared to neighbouring Member States, and attributed this to a historical reluctance to take on debt.

However, one independent expert stated that more emphasis should be put on sociological, rather than cultural factors:

Indebtedness is not only a matter of culture, but also a matter of level of the welfare state. There is no need to get indebted to go to college in France for instance. In France, over-indebtedness is not related to French culture, but rather to poverty.

Another stakeholder saw a generational change occurring. According to the interviewee, internet banking had exacerbated debt and purchasing practices especially among young people. Adding to this was the increase in life expectancy, adding to the expenses; the role of education was also stressed as defining the culture around debt and saving.

9.4 CONSEQUENCES OF OVER-INDEBTEDNESS

9.4.1 Consequences for affected households

Stakeholders identified some major consequences for over-indebted households which are consistent with the rare research looking at the consequences of over-indebtedness.²⁹⁵

²⁹⁴ Another two households had other forms of arrears, such as tax arrears or a fine from a public transport company.

²⁹⁵ Georges Gloukoviezzoff, *L'exclusion bancaire. Le lien social à l'épreuve de la rentabilité*, Paris, Presses Universitaires de France, 2010.

The highest ranked (going by average scores) consequence identified was that of financial exclusion. First, people who are over-indebted and qualify for the debt settlement procedure provided by the Banque de France are automatically listed into a public register (FICP) which prevents access to credit for several years. Regarding other banking products, one financial industry stakeholder noted that banks can decide to remove means of payment (e.g. debit card, cheque book) from their over-indebted customers. Some others also closed customers bank accounts as soon as they learnt that the customer was going through the debt settlement procedure. This practice has been prohibited by the 'Loi Lagarde' (see before) and banks are now obliged to leave the account open and allow a minimum of banking services. Nevertheless, out of the 20 households interviewed, two had seen their account closed and five had seen their means of payment removed.

The next most highly ranked consequences were those deteriorating well-being, family breakdown or divorce, and deteriorating mental health. Though not elaborated by stakeholders in comments, deteriorating mental health was the main consequence quoted by the households interviewed. Several households were particularly affected by the impact that their difficulties had on their social life, for example because they could not afford to accept invitations to restaurants.

Many household interviewees described themselves as suffering from depression or stress, in some cases to the extent that it seriously impacted their ability to work, or caused significant tension between themselves and their partners. In several cases, the interviewees reported that they felt humiliated and devalued by their situation. One interviewee explained, "I felt downgraded, like people who lost their job. It is like a divorce, a failure". In particular, interviewees mentioned being humiliated by the experiencing of receiving charity or asking for help. These impacts on mental health can also have consequences on health in general - one civil society stakeholder claimed that 20% of over-indebted people seeking advice were referred to the stakeholders organisation by their GP.

All these consequences are very similar to those experienced by people facing poverty. However, a key difference lies in the fact that over-indebtedness also affects people with a level of income above the poverty line. For these over-indebted households, the necessity to downgrade their lifestyle can be particularly painful.

9.4.2 Consequences of over-indebtedness for the financial services industry

According to stakeholders, the most highly ranked consequences for the financial services industry are, as might be expected, the costs of arrears and agreed repayment/debt management plans (costs which do not include the Banque de France procedure as it is free for creditors) and costs of defaulted credit. However, there is no public data allowing to assess the level of these costs.

The next most highly ranked consequence was costs related to stricter regulation of credit. This statement is supported by a recent evaluation of the "Loi Lagarde" of July 2010 (implementation of the European credit directive) which shows that lenders' business model has been adversely impacted by the law.²⁹⁶

This was emphasised by comments from financial industry stakeholders. One noted that the new law resulted in high costs for credit institutions, in terms of IT, staff training, and granting credit. However, another noted that defaults are observed on less than 3% of credits, and even though the debt settlement procedure generates costs for the financial industry, it also facilitates some level of repayment and enables households to become solvent members of society again.

9.4.3 Economic and social consequences of over-indebtedness for society

Stakeholders ranked two main costs of over-indebtedness for society the highest: costs associated with assisting households to repay debts/arrears and legal costs associated with over-indebtedness.

The focus on these two costs is probably related to the fact that the Banque de France's procedure to deal with over-indebtedness is at no cost for debtors and creditors. Therefore, it is the Banque de France and the French state who are responsible for funding the procedure. In that respect, the report of the Cour des comptes in 2010²⁹⁷ highlights the fact these costs are high and barely known. They would be of 196 million Euro in 2008 and 215 million Euro in 2009 for the Banque de France while the level of these costs is totally unknown for the state but could exceed several hundred million Euro. One stakeholder noted that in France, money was spent for 'treating' over-indebtedness through the court procedure, but there was less money spent on preventing it in the first place.

Other stakeholders specifically mentioned high health costs for over-indebted persons, lower productivity at work, and generally higher social welfare costs.

9.4.4 Debt collection practices

Stakeholders had witnessed increasingly aggressive debt collection practices during the previous five years. Rather, the contrary was the case - according to several, recent changes in the law had improved the situation somewhat. However, according to a civil society stakeholder, it seems that some creditors are quicker to react in case of arrears, especially energy suppliers which are prompt to switch off the supply if arrears are not repaid. Another stakeholder mentioned that some firms and banks had outsourced debt collection services, and in some cases could use aggressive practices (e.g. calls to the workplace, home visits, etc.).

²⁹⁶ See: <http://www.senat.fr/notice-rapport/2011/r11-602-notice.html>

²⁹⁷ Cour des comptes, *La lutte contre le surendettement des particuliers : une politique publique incomplète et insuffisamment pilotée*, Rapport public annuel 2010 – février 2010.

A heterogeneity of debt collection practices was experienced by household interviewees. A few of them were able to report positive experiences with their lenders. For example, a couple of households came to agreements with their landlords, so that they would accept late payments. In one case, the household was offered the possibility of suspending their credit card payments for a period. However, the interviewees more frequently indicated that they had not been able to come to terms with their lenders. In addition, several interviewees found it unpleasant to be contacted by their creditors, and a few considered their behaviour to be aggressive. One interviewee explained, "They harassed me. It was not bearable anymore. It never stopped ringing. When I went to bed, I removed the battery of the phone so it did not ring at eight in the morning."

9.5 MEASURES IN FORCE TO ALLEVIATE THE IMPACT OF OVER-INDEBTEDNESS

9.5.1 Early identification of households at risk

Stakeholders either did not know or thought that measures to identify households at risk of becoming over-indebted at an early stage are hardly common. Financial industry stakeholders explained that they implemented scoring systems which allow them to identify such customers but it seems to be limited to the time of the lending decision.

Only the Banque de La Poste and the credit card provider Cetelem have implemented pilot programs to enable early identification.²⁹⁸ However, these pilots are too recent to have produced strong results and reliable evaluation. The Banque de La Poste's pilot is based on the collaboration of La Poste and the NGO CRESUS (which specialises in supporting over-indebted people) and the UNCCAS, a league of social workers providing many kinds of support,²⁹⁹ while the Cetelem example is an internal project.

9.5.2 Advice offered to over-indebted households

Availability, funding and costs

There is no organised provision of financial advice to over-indebted households at national level which could explain why the vast majority of stakeholders were unable to reply to these questions. The main source of advice for over-indebted households are social workers working for local authorities. However, their training regarding over-indebtedness is low and they often lack the capacity to provide appropriate face-to-face advice. Other programmes are privately funded (mainly donations) as

²⁹⁸ Rapport de Monsieur François Soulage, Président du groupe de travail "Inclusion bancaire et lutte contre le surendettement", Conférence nationale : Lutte contre la pauvreté et pour l'inclusion sociale, 10-11 December, 2012

²⁹⁹ See: <http://www.laposte.fr/legroupe/Nos-activites/L-Enseigne-La-Poste>

there is no public financial support. There is therefore no systematic evaluation of the effectiveness of debt advice.

Some non-governmental organisations (e.g. Crésus,³⁰⁰ Archimed³⁰¹) are dedicated to assisting households in financial difficulties however they are not in position to meet the demand. Some financial services providers have also set up dedicated programmes to provide debt advice. The most well-known example in France is the "Bridge point" (*Point Passerelle*) set up by the cooperative banking group Crédit Agricole. This system enables vulnerable people to talk about their money problems and are advised how to find a solution by talking to trained counsellors. Since its inception, 52 *Points Passerelle*, in 28 regional banks are in operation, covering three quarters of French territory.³⁰² While insufficient to meet demand, these services are usually free of charge.

This situation is well illustrated by the experience of household interviewees. Three quarters of them had received personalised, face-to-face debt advice. Mostly they received this from social workers, but a few interviewees indicated that they had received help from non-governmental organisations specialising in debt advice.³⁰³ A few households had only sought advice from their relatives or their banker, while one interviewee indicated that she had not sought any advice at all. Two households received help from relatives who had experienced over-indebtedness themselves. In both cases they were recommended to apply to the debt settlement procedure administered by the Banque de France.

Demand for debt advice

Most stakeholders did not have a clear opinion on the demand for debt advice services, but of those who answered, it was judged to be fairly or very high. Regarding the evolution of the need for debt advice in the last five years, only a minority had an opinion, but those who had an opinion thought that it had increased. The array of different organisations and lack of coordination was highlighted by more than one stakeholder, and one civil society stakeholder noted a paradox whereby:

The majority of indebted people wants advice to improve their situation, and the realisation of their situation is improving slowly. For these people, there is still a lack of information about how and where to get advice. Nevertheless, a significant part of people presenting a risk of becoming over-indebted refuse to be helped or to take advice.

³⁰⁰ See: http://www.cresus-iledefrance.org/index_fichiers/Page381.htm

³⁰¹ See: <http://www.archimed-conseil-credit.fr/>

³⁰² See: http://www.creditagricole.info/fnca/ca1_843240/points-passerelle-les-chemins-de-la-reussite

³⁰³ In France, there is a type of social worker, a "conseiller en économie sociale et familiale" that specialises in providing financial advice to disadvantaged families. For example, they may provide budgeting advice.

In general, household interviewees supported the analysis that more and better debt advice is needed. Some of them felt that personalised debt advice was helpful for over-indebted households and one in particular praised the emotional support that she received from her social workers: "It was wonderful to go there: a little coffee, you are relaxed, everybody comes to see you... It is people who are dedicated, nice, it is unbelievable. If they would not have been there, I would not have coped".

However, other interviewees expressed criticism of the advice they received. For example, one interviewee felt that social workers should be more personal and understanding. She felt that social work "is production-line work" and that "nobody listens to you". Another interviewee explained that the social workers had helped her, but that she found the experience to be painful and humiliating. One interviewee suggested that social workers should be more numerous, so that they could help people more quickly.

9.5.3 Key measures in place to alleviate the impact of over-indebtedness

Availability and costs

Informally brokered arrangements between the debtor and creditors such as a repayment plan, a debt management plan or debt write-off that may be brokered by a debt counsellor

Stakeholders either don't know or state that informally brokered arrangements are not available at all. Only individual attempts by debtors to reach an arrangement with creditors are foreseen. However, some relevant pilot programs are in place within cooperative banks at regional level as well within the CRESUS organisation which is working with some credit card providers.

Some households made use of measures such as informal arrangements with their creditors. Specifically, three households reached an agreement with their landlords regarding the late payment of their rent.

Formal procedures for debt settlement that do not take place in court

This is the heart of the French model to tackle over-indebtedness. The procedure was established in 1990, following the adoption of the Act 89-1010 on "the prevention and resolution of difficulties arising from the over-indebtedness of individuals and families", commonly referred to as the Neiertz Act, after the Secretary of State who initiated it.

The Banque de France procedure is based on debt settlement that does not take place in court. It is widely available as over-indebted households can apply to a regional "commission of over-indebtedness" (with often several offices in the same

region) administered under the auspices of the Banque de France. It is free of charge for the debtor.

The initial stage of the procedure is based on an attempt to help the debtor and creditors arrive at an out of court settlement, based on an agreed repayment schedule and possibly a moratorium. As it stands, in the event of a failure to agree on an out-of-court settlement, the commission can, at the debtors request, draw up measures to settle or postpone the debt or a moratorium that are imposed on both the debtor and the creditors.³⁰⁴

Three quarters of interviewed households had made use of formal measures to alleviate their financial difficulties. These households had all used the official procedure of the Banque de France, but were all at different stages of the process. Some had only recently submitted their applications, while others had already received debt moratoriums or repayment plans.

Legal procedures that take place in court (e.g. consumer insolvency proceedings)

The second stage of the legal procedure that takes place in court is accessible only after having successfully applied to the Banque de France's procedure, and where no formal out of court procedure is possible (e.g. because the debtor has no means of repayment). Therefore, it is as widely available as formal procedures for debt settlements that do not take place in court and is also free for the debtor. It is called the "personal recovery procedure" (*procédure de rétablissement personnel*) where in the event of the debtors situation appearing "irremediably compromised", the commission recommends the personal recovery procedure to the magistrate, which involves the total cancellation of the debts concerned, following the sale of any distrainable assets.

Financial support for households to repay debts/arrears (e.g. by public fund)

Stakeholders were unaware of the existence of financial support available for households to repay debt arrears. However, according to a few stakeholders, there exists some public funds helping people to repay arrears regarding rents and energy. An example is the FSL (*Fonds de solidarité logement*) which distributes financial aid to prevent persons in financial difficulty becoming homeless.³⁰⁵ Such funds are widely accessible through social workers however there are various eligibility criteria.

Regarding other type of debts (mobile phone, credit, etc.) there is usually no public fund. A stakeholder from civil society emphasised that they provided financial support to help people to deal with their financial commitments. However, they also

³⁰⁴ Banque De France, 'Dealing with household over-indebtedness', Factsheet no. 134, Direction de la Communication, 2012.

³⁰⁵ See: <http://vosdroits.service-public.fr/F1334.xhtml>

underlined the limits of such help as it is only short term, of a limited amount and does not help by itself to resolve the causes of the difficulties.

Other measures

Stakeholders were not aware of other measures. However, when financial difficulties are the result of an unplanned change in the situation of the borrower but there is an expectation that the situation will improve, a legal possibility of "debt resting" (*Délais de grâce*) exists (Article L313-12 of the Consumer Code).³⁰⁶ The judge can suspend the repayment or reschedule a debt over 2 years, depending on the borrower's situation. This solution is different from those available for over-indebtedness debtors but offers a temporary solution for people facing temporary difficulties with their credit. Such a solution is widely accessible and at a limited cost however it is not widely known.

Effectiveness as assessed by stakeholders

The stakeholders assessment of the effectiveness of the key measures in place in France mainly focuses on the Banque de France procedure and the majority judged this to be very or fairly effective. However one civil society stakeholder highlighted a lack of household tracking and support by public authorities in order to prevent relapses.

The Cour des comptes report³⁰⁷ about this procedure also provides a positive assessment of the procedure which is seen as an effective and balanced way to deal with over-indebtedness as it mixes non-judicial and judicial approaches as well as offering the possibility of repayment plan, moratorium or bankruptcy (with or without liquidation of the assets). However, its effectiveness has been questioned as 17% are second time applicants due to a failure of the solutions provided in the first instance.

According to the report, the difficulty seems to be because the approach is too administrative. The "Commissions" do not have enough time or resources to meet the debtor and to carry out an in-depth assessment in order to define a really suitable and personalised repayment plan. Another weakness is the lack of support for the debtor once the solution is agreed. Despite the fact that the law stipulates that a social workers should support the debtor during the repayment plan, no funding has been made available to provide this service.

³⁰⁶ See:

http://www.legifrance.gouv.fr/affichCode.do;jsessionid=9D74FEF5F75577F32D1851E360B7784E.tpdjo09v_2?idSectionTA=LEGISC TA000006161909&cidTexte=LEGITEXT000006069565&dateTexte=20120823

³⁰⁷ Cour des comptes, *La lutte contre le surendettement des particuliers : une politique publique incomplète et insuffisamment pilotée*, Rapport public annuel 2010 – février 2010.

9.5.4 Changes in response to over-indebtedness

A large majority of stakeholders agreed that there changes in responses to over-indebtedness during the past five years.

As mentioned previously, the main changes in responses to over-indebtedness have been implemented by the 'Loi Lagarde' from July 2010.³⁰⁸ In addition to implementing the provisions of the Consumer Credit Directive, it involves several modification to the Banque de France procedure in order to better protect the debtor and to improve the efficiency of the procedure:

- ▶ The law limited to three months the length of time for the commission to assess an application.
- ▶ In order to make the procedure quicker, it has been decided that the commission will be in charge of implementation of a complete write-off of debts when there is no liquidation of the assets while it was before the role of the judge. The judge only has to validate the decision.
- ▶ Once an application has been accepted, all debt recovery actions by creditors are forbidden until the commission has made a decision about the solution to be implemented.
- ▶ Retail banks cannot close the current account of a customer who has applied to the Banque de France.
- ▶ The way the minimum budget which has to be protected when repayment plans are defined has been harmonised across the regional commissions.

9.5.5 Types of households of over-indebted consumers not reached by current measures

There was no clear consensus as to types of households not reached by current measures. However, a number of stakeholders focused on socio-demographic aspects. For example, one civil society stakeholder highlighted households with very low education, and considered that more information should be present in places linked to the "life accidents" that can lead to over-indebtedness, such as courts, hospitals, and employment agencies. An independent expert also highlighted small business owners, craftsman, and freelance workers as vulnerable groups. This is linked to the fact that over-indebted households who have professional debt are not eligible to the Banque de France procedure. One stakeholder also claimed that some households are not fully aware of the procedure and fear its consequences for them so they give up the idea of applying.

³⁰⁸ See: <http://www.legifrance.gouv.fr/affichTexte.do?cidTexte=JORFTEXT000022419094>

9.5.6 Best practices

The majority of stakeholders were able to highlight some specific measure to alleviate over-indebtedness that they considered to be best practice. These included:

- ▶ Changes in preventing over-indebtedness through reforms set out in the 'Loi Lagarde'.
- ▶ Actions by consumer educations such as CRESUS - general financial education about debt and credit practices.
- ▶ A pilot telephone-based debt advice service provided by the CRESUS and the city of Grenoble. The CCAS (*Centre Communal d'Action Sociale*) of Grenoble is providing the debt advice through phone but also meets people for face-to-face interview and helps them find a professional to talk to.
- ▶ The 'Point Passerelle' program of Credit Agricole as it exists in the North East Region (other regions have also implemented their own Points Passerelle but not necessarily with the same characteristics).

Many of these best practices are also listed in a report carried out for the government in order to improve policies implemented in that field.³⁰⁹

9.6 OUTLOOK

Overall, most stakeholders who expressed an opinion on the matter expected the number of over-indebted households to increase in the next five years. The reasons for this pessimism are numerous but are in the main macro-economic or structural factors; stakeholders cited the financial crisis, rising unemployment, stagnation of salaries, rising costs of housing, the emergence of 'workfare', and even the rise in one parent families. Despite reforms, one civil society stakeholder remained pessimistic due to the lack of compliance with the law in some sectors:

The economic situation in France will probably continue to be difficult in the next years. More, our recent study on distribution of consumer's credit in supermarket shows that - despite of a recent law to improve practices on credit distribution - most of points of sale are still distributing consumer credit without verifying solvency or giving information to the consumer on how the credit works, what is his real price, etc.

A few stakeholders emphasised the difficulty of making solid predictions, but one independent expert thought that:

³⁰⁹ Rapport de Monsieur François Soulage, Président du groupe de travail "Inclusion bancaire et lutte contre le surendettement", Conférence nationale : Lutte contre la pauvreté et pour l'inclusion sociale, 10-11 December, 2012

The profile of over-indebted people [will] change: less people with an excess of credit; more people with debts concerning utility and housing commitments. It depends on the economic context. The new law will make a difference, [as it will be] harder for people to take out large credits.

The majority of all stakeholders stated that there were specific new challenges to be addressed by policy makers. The challenges and proposals identified were quite varied, but revolved around a few central themes. Multiple stakeholders mentioned the importance of improving or developing housing policy, and of increasing the level of financial education. An independent expert elaborated on this theme and recommended developing more strategies of prevention, such as communicating more widely to the public, making people aware of the limit of credit, and to develop independent financial advice services. They also recommended helping very poor people with budget management advice, before debt problems became critical, and to widen welfare measures such as guaranteed housing, minimum utilities and food.

The importance of the welfare state in preventing over-indebtedness was highlighted by a stakeholder from civil society who mentioned the need for a cultural change in this area:

In France, there is a huge temptation to try to impose credit in all the purchases: for example, in health, in food, etc. We consider that credit should only be used to buy household goods (cars, refrigerators, washing machine, dishwasher...). Credit mustn't replace national solidarity!

Regarding legislative and procedural challenges, one financial industry stakeholder said that the debt settlement procedure should be made easier and more accessible for some over-indebted households, and that specific measures to avoid evictions of tenants should be enacted, while an independent expert mentioned the development of a national positive credit register to ensure more effective repayment checks.³¹⁰ Moreover, one financial industry stakeholder thought that over-indebtedness is a specific and local issue which should be treated at the national level, and that European action should be limited to data collection and information exchange between Member States. But another financial industry stakeholder thought that real action was needed at European level:

The real challenge is in European economic development, reducing unemployment, improving purchasing power, and controlling expenses related to housing. But in the micro-economic framework financial education is necessary. And it must be ensured that any extension of credit is subject to a credit check by an institution that is properly regulated, equivalently across Europe.

³¹⁰ Some of these recommendations have recently been taken into account by a report for the government following several working meetings with stakeholders and an analysis of the effects of the 'Loi Lagarde' for the Senate. See also: *Crédit à la consommation et surendettement : une réforme ambitieuse à compléter*, Rapport d'information de Mmes Muguette DINI et Anne-Marie ESCOFFIER, fait au nom de la commission pour le contrôle de l'application des lois, 2012. At: <http://www.senat.fr/rap/r11-602/r11-6021.pdf>

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ANNEX A: STATISTICAL DATA FROM EU SOURCES

Final report

Over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact

France

I. Eurobarometer¹

	France	EU average	Lowest EU value	Highest EU value
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Households *at risk* of being over-indebted

Respondents feeling at risk of over-indebtedness in 2010	↗ 27%	25%	7%	52%
Respondents feeling at risk of over-indebtedness in 2009	↗ 29%	27%	9%	53%

II. EU SILC standard survey data²



III. EU SILC 2008 module: Over-indebtedness and financial exclusion³

	France	EU average	Lowest EU value	Highest EU value
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Proportion of people in households with bank overdrafts, outstanding balances on credit cards or in arrears on other loans of over 100% of household disposable income

Overdrawn bank account (% of people in households overdrawn)	↘ 0.6%	2.2%	0.0%	7.7%
Credit or store card (% of people in households with outstanding balances)	↘ 0.4%	1.1%	0.0%	8.6%
Other loan/credit payments (% of people in households in arrears)	↗ 0.3%	0.3%	0.0%	1.1%

Proportion of people in households in arrears in servicing housing-related loans and bills and in paying other bills of over 100% of household disposable income

Housing bills (% of people in households in arrears)	↗ 0.6%	0.5%	0.0%	2.9%
Other payments (% of people in households in arrears)	↘ 0.2%	0.4%	0.0%	1.7%

Households living with outstanding debts and/or arrears of over 100% of household disposable income

Total (% of households with outstanding debts/arrears)	↘ 2.3%	4.6%	0.0%	11.8%
Income above 60% median (% of households with outstanding debts/arrears)	↘ 1.7%	4.2%	0.0%	11.3%
Income below 60% median (% of households with outstanding debts/arrears)	↘ 6.6%	7.0%	0.2%	13.7%
Materially deprived (% of households with outstanding debts/arrears)	n.a.	9.0%	0.1%	27.4%

Proportion of those in broad age groups with outstanding debts of over 100% of household disposable income

Households with all adults aged 25-39 (% of households with outstanding debts)	:	6.3%	0.0%	17.2%
Households with all adults aged: 40-64 (% of households with outstanding debts)	:	5.8%	0.0%	10.9%
Households with all adults aged: 65+ (% of households with outstanding debts)	:	1.2%	0.0%	2.8%

Proportion of those in different types of household with outstanding debts of over 100% of household disposable income

Living alone (% of people in households with outstanding debts)	:	4.3%	0.0%	8.2%
Single parent (% of people in households with outstanding debts)	:	9.5%	0.0%	27.1%
Other (% of people in households with outstanding debts)	:	4.8%	0.0%	12.1%

Proportion of those in households with outstanding debts of over 100% of household disposable income by marital status

Never married (% of people in households with outstanding debts)	:	5.0%	0.0%	15.4%
Married (% of people in households with outstanding debts)	:	4.1%	0.0%	9.7%
Separated/divorced (% of people in households with outstanding debts)	:	7.5%	0.1%	13.9%
Widowed (% of people in households with outstanding debts)	:	1.7%	0.0%	4.3%

Proportion of those in households with outstanding debts of over 100% of household disposable income by housing tenure

Owner occupied without mortgage (% of people in households with outst. debts)	:	3.2%	0.0%	9.6%
Owner occupied with mortgage (% of people in households with outst. debts)	:	6.3%	0.0%	16.1%
Market rent (% of people in households with outstanding debts)	:	8.2%	0.0%	16.0%
Subsidised rent (% of people in households with outstanding debts)	:	8.7%	0.0%	17.9%
Rent-free housing (% of people in households with outstanding debts)	:	2.3%	0.0%	15.1%

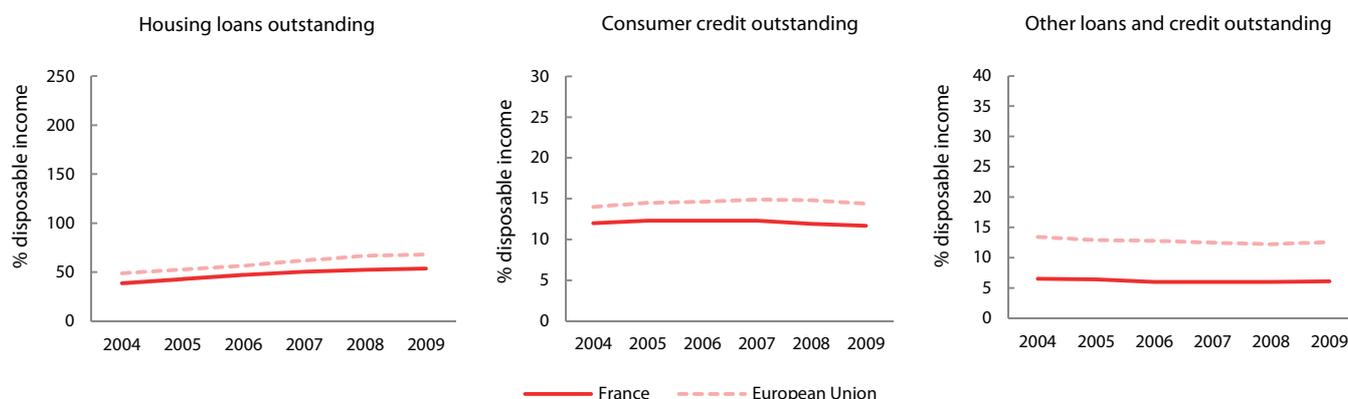
Proportion of those in households with outstanding debts of over 100% of disposable income by work intensity

Work intensity of 0 - 0.19 (% of people in households with outstanding debts)	:	5.7%	0.0%	10.6%
Work intensity of 0.20 - 0.50 (% of people in households with outstanding debts)	:	5.7%	0.0%	15.3%
Work intensity of 0.51 - 0.74 (% of people in households with outstanding debts)	:	5.4%	0.0%	13.5%
Work intensity of 0.75 - 1.0 (% of people in households with outstanding debts)	:	5.3%	0.0%	14.3%

Proportion of those in over-indebted households that experienced a major drop in income over the preceding year

Over-indebted (% of people in households that experienced drop in income)	:	33.3%	0.0%	77.6%
Other (% of people in households that experienced drop in income)	:	19.2%	5.9%	32.5%

IV. Loans and credit outstanding⁴



Notes:

(1) Eurobarometer 72.1 (2009) and Eurobarometer 74.1 (2010). Note: Those who answered 'very at risk' or 'fairly at risk' to the question 'Please tell me how much you feel at risk of being over-indebted'.

(2) Eurostat, SILC. Data as of December 2012.

(3) European Commission, Research Note 4/2010, Over-indebtedness new evidence from the EU-SILC special module.

(4) European Commission, Research Note 4/2010, Over-indebtedness new evidence from the EU-SILC special module. European Credit Research Institute (ECRI), Lending to households in Europe, 1995-2009 and Eurostat, National accounts.

10 GERMANY

<i>Document</i>	The over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact – Country report Germany
<i>Prepared by</i>	Dimitris Georganakos and Robert Graham
<i>Finalised on</i>	22 February 2013

Final report

Over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact

10.1 DEFINITION OF OVER-INDEBTEDNESS

The definition of over-indebtedness in Germany depends to a certain extent on the organisation using it. As in Europe generally, there exist administrative-juridical, objective-quantitative, and subjective/qualitative definitions. According to the law on insolvency (*Insolvenzordnung* or InsO), inability to pay is defined as when the debtor is not in the position to fulfil their payment obligations. This is usually presumed if the debtor has suspended their payments.³¹¹ Over-indebtedness is then strictly defined as when the income and property of the debtor no longer cover their payment obligations.³¹²

As regards academic and civil society definitions, these are usually orientated towards an assessment of household income i.e. that after paying for minimum subsistence costs the remaining monthly income does not cover repayments in full.³¹³ In Germany, the applied subsistence level is defined as the social assistance level.³¹⁴ Meanwhile, debt advice providers tend to focus more on the subjective experience and negative effects on households, such as in the definition quoted in a position paper from the workgroup for the German association of debt advice providers (*Arbeitsgemeinschaft Schuldnerberatung der Verbände*).³¹⁵

However, as summarised by the *Institut für Finanzdienstleistungen* (IFF),³¹⁶ most of the practically used definitions describe over-indebtedness as a (relative) lack of liquidity and inability to meet payment obligations. It can also be considered to be a special case of poverty (since the households suffer from the inability to pay for basic living requirements), but can also extend to higher income households, that also have higher payment obligations.

³¹¹ "Der Schuldner ist zahlungsunfähig, wenn er nicht in der Lage ist, die fälligen Zahlungspflichten zu erfüllen. Zahlungsunfähigkeit ist in der Regel anzunehmen, wenn der Schuldner seine Zahlungen eingestellt hat.". Source: § 17 Insolvenzordnung vom 5. Oktober 1994 (BGBl. I S. 2866).

³¹² "Überschuldung liegt vor, wenn das Vermögen des Schuldners die bestehenden Verbindlichkeiten nicht mehr deckt, es sei denn, die Fortführung des Unternehmens ist nach den Umständen überwiegend wahrscheinlich.". Source: § 19 Insolvenzordnung vom 5. Oktober 1994 (BGBl. I S. 2866).

³¹³ For a fuller discussion, see Korczak, D., *Definitonen der Verschuldung und Überschuldung im Europäischen Raum*, Bundesministeriums für Familie, Senioren, Frauen und Jugend, Berlin, 2003.

³¹⁴ Zimmermann, G., *Wer ist überschuldet and was sind die Ursachen für Überschuldung?*, Schufa (ed.) Schuldenkompass 2007, Wiesbaden, 2007, pp. 91-116.

³¹⁵ „Überschuldung ist Ausdruck wirtschaftlicher Armut und psycho-sozialer Notlage. Überschuldete Haushalte können mit ihrem Laufenden Einkommen (nach Auflösung ihrer Reserven) den Zahlungsverpflichtungen nicht mehr vollständig nachkommen, selbst wenn sie ihre Lebenshaltung einschränken. Sie sind wirtschaftlich und sozial destabilisiert, auch in dem Sinne, dass sie sich wirtschaftlich einschränken müssen und eigene Kontrolle (Verbrauchersouveränität) über ihr wirtschaftliches Handeln einbüßen“. Stellungnahme der AG SBV, BAG-SB Informationen. 16 Jhg, Heft 4, 2001, p68.

³¹⁶ Institut für Finanzdienstleistungen (IFF), *Überschuldungsreport 2012*, Hamburg, 2012, p.12. See: <http://www.iff-hamburg.de/index.php?id=3024>

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Over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact

In the literature, more specific types of household over-indebtedness are also listed.³¹⁷ These include subjective, relative, absolute, public and hidden over-indebtedness. Their definitions depend on the relative stage of the overall process of over-indebtedness. This process proceeds from being at risk of over-indebtedness, to implementing coping strategies, relative over-indebtedness, absolute over-indebtedness, subjective indicators of distress, use of debt advice services, use of a consumer insolvency procedure, followed by a period of rehabilitation. For example, relative over-indebtedness occurs when income does not cover financial commitments in the medium term, while 'absolute' over-indebtedness occurs afterwards, when the situation turns critical. Indications include payment arrears, warning letters, negative entries in the SCHUFA credit register,³¹⁸ eviction proceedings, and so on.

Turning to the stakeholders interviewed for this study, the vast majority stated that they used in their work a specific definition for over-indebted households. Stakeholders provided different definitions for over-indebtedness that they used, such as a simple estimation of whether the income remaining minus debt repayment is lower than someone receiving social assistance, or the case where someone is not able to pay an invoice for more than 90 days. An independent definition was mentioned by one stakeholder, where the definition used by SCHUFA was established by a survey on over-indebtedness in 2007.³¹⁹

However, stakeholders also used definitions that had been in practical use for a long time or were used generally. For example, one local authority stakeholder said that:

Households are considered over-indebted when their income is not high enough to cover their financial commitments and living costs. The definition is taken from a book entitled 'Schuldnerberatung'³²⁰ and has been used in Germany for over 20 years.

With reference to comparisons between their own definitions of over-indebtedness and the one adopted by this study, interviewees pointed first to the scope of the definition, i.e. that they used a broader or narrower definition. First, an independent

³¹⁷ IFF, op cit.

³¹⁸ The Schufa Holding AG (SCHUFA) is a privately organised credit register that is by far the most widely used in Germany. SCHUFA provides credit-relevant information (credit-worthiness scores) to approximately 7000 clients, including banks, savings banks, as well as trading companies and other branches of industry. The SCHUFA database currently contains 514 million records on 66.2 million people. This corresponds according to SCHUFA estimation to roughly 95% of the financially active German population. Alongside the basic information on names, date of birth and addresses, SCHUFA also collects information on current accounts, credit cards, mobile phone contracts, leasing contracts, loans and mail order purchases on account. Additional information, regarding the income of an individual or the purpose of certain loans, is not collected given the strict provisions of the German data protection law. The main competitors in this field are Creditreform, Bürger Wirtschaftsinformationen as well as Arvato Infoscore.

See: <http://www.schufa.de/en/en/unternehmen/unternehmenstartseite.jsp>

³¹⁹ Schulden-Kompass 2007, Empirische Indikatoren der privaten Ver- und Überschuldung in Deutschland", p. 133 f., published by SCHUFA Holding AG (http://www.schufa-kredit-kompass.de/media/teamwebservices/downloads/sk07_gesamt.pdf)

³²⁰ Groth, U., *Schuldnerberatung. Praktischer Leitfaden für die Sozialarbeit*, Frankfurt a. M. / New York 1984, S. 16.

expert argued that the definition used in the study does not specify a time period over which repayment difficulties are reported, and the term 'on-going' is unspecific and lacks a clear meaning. A credit referencing agency stakeholder noted that their definition included not only statistical, legal, or insolvency proceedings data, but also information that was only available to them, which showed the likelihood of debts being repaid.

However, a civil society stakeholder highlighted the need for the definition not only to be backward looking (i.e. measuring past repayment difficulties), but to take into account the possibility of future repayment difficulties. They also noted that the Federal Statistical Office defined those users of debt advice agencies as over-indebted, assuming that those using the service were de facto over-indebted. The 'Debtor atlas' (*Schuldneratlas*) from the Creditreform organisation attempted to use a number of factors to provide a general picture of over-indebtedness.³²¹

With reference to households that are *at risk of over-indebtedness*, the majority of the stakeholders stated that they did not use a specific definition. However, different measures were cited. For example, a stakeholder from a credit reference agency stated that only households that exceed certain limits (i.e., in missing scheduled payments) are of interest. On the other hand, an independent expert argued that there are various poverty measures that can be used to identify the most financially vulnerable segments of the population, such as measuring the relation of household income after repayments to subsistence level and the (absolute or relative) difference between the two.

Finally, most of stakeholders did not state there to be a need for a better definition of over-indebtedness. This was related in the comments to the problem that different definitions could be required depending on the aim of the research, but also the difficulty of measuring the mix of subjective and objective criteria.

10.2 LEVEL OF OVER-INDEBTEDNESS

There are a number of data sources available for Germany that measure various aspects of over-indebtedness. These include the standardised EU-SILC arrears data, but also other sources, such as those calculated by credit bureaus, the number of private insolvency proceedings, users of debt advice agencies, percentage of defaulted loans as a percentage of all loans (collected by SCHUFA), the average amounts of private liabilities, and socio-economic surveys on income and wealth distribution (collected by the Federal Statistical Office or the Ministry of Labour and Social Affairs). Subjective evaluations by households are also available from

³²¹ Creditreform, *SchuldnerAtlas 2012: Jährliche Analyse zur *berschuldung von Privatpersonen in Deutschland*, Creditreform Wirtschaftsforschung, 2012.

European-level datasets, such as the EU-SILC indicators, Eurobarometer surveys, the European Social Survey (ESS), and others.

According to the survey data from the EU-SILC, Germany ranks consistently below the European average on the incidence of all three types of arrears under consideration (i.e., on consumer loans, mortgages/rent, and utility bills), with only 5.2% of households reporting arrears compared to the EU average of 11.4% in 2011. This is the case for all years covered by the survey and the trend has been consistently downward since 2006, though the percentage rose slightly from 2010 to 2011. In fact, from the start of the financial crisis (2007) to the latest year for which data is available (2011), the proportion of households suffering from arrears has decreased by 10%, compared to an increase of 15.2% in the EU as a whole.³²²

Breaking these figures down into specific types of arrears, the overall trend is consistent with arrears on utility bills.³²³ Again, utility arrears in Germany (3.9%) are less than half the EU average (of 8.8%) in 2011, and this proportion has been very stable for the 2007-2011 time period. During this period, utility arrears in the EU overall increased by over a fifth (20.5%). However, this figure conceals some important trends: namely, the rising rate of electricity arrears. For example, the debt advice agency of Berlin reported a rise in the share of their clients with electricity arrears from 14.7% in 2007 to 24.3% in 2012.³²⁴ An even larger proportionate rise was seen from the debt advice agencies in Rheinland-Pfalz,³²⁵ where energy supply as a cause of debt problems rose by one fifth from 2010 to 2011.

Comparing the prevalence of arrears in mortgages/rents is trickier given that these are relevant for certain population subgroups (i.e., mortgagors/renters) that differ significantly across European countries.³²⁶ However, in general, arrears on rent or mortgages are consistent with the general measures. The proportion of those reporting arrears on rent or home loans increased slightly (from 2.2% in 2007 to 2.4% in 2011), while the overall amount remains slightly less than half the EU average (4.0% in 2011).

Similarly, arrears in consumer credit should be seen in relation to the prevalence of consumer credit and use of credit cards by the general population (for example credit

³²² Eurostat, 'Arrears (mortgage or rent, utility bills or hire purchase)' (code: ilc_md05).

³²³ Eurostat, 'Arrears (utility bills)' (code: ilc_md07).

³²⁴ <http://www.schuldnerberatung-berlin.de/index.php?id=105>

³²⁵ Rheinland-Pfalz Schuldnerberatung Statistik, 2012.

³²⁶ For a recent cross-country comparison of wealth holdings and debts of households 50 plus across various European countries see Christelis, Georgarakos, and Haliassos (2013). According to the figures they present, households living in different countries form very heterogeneous portfolios and there is not an obvious correspondence between certain assets (like home) and the means used to finance its purchase (e.g., mortgages). For example, Germany has the lowest home ownership rate (51%) among eleven continental European countries, England, and the US. Nevertheless, this does not imply a low prevalence of households with a mortgage in the population (actually, a non-trivial fraction of older German households that are homeowners appear in the data with an outstanding mortgage).

arrears may appear low in a given country because only few households make use of such credit, nevertheless the relative incidence of arrears conditional on having consumer credit may be high). However, using EU-SILC data,³²⁷ the trend in Germany is downward, from 1.9% of total households in 2008, to 1.2% of total households in 2011. This is again about half the level of the EU average, which increased slightly from 2.8% in 2007 to 2.9% in 2011.

Subjective measurements of households partially contradict these more objective indicators. According to Eurobarometer data,³²⁸ the fraction of respondents in Germany who report feeling at risk of over-indebtedness in 2010 is 12%. Notably, this figure is significantly lower than the EU average (25%) and towards the lowest recorded among European countries in the survey. This was supported by European Social Survey data (see Synthesis Report), which showed a consistent decrease in financial strain from 2006 to 2010.

A similar measure but using EU-SILC data found that households who stated they were able to make ends meet only with difficulty³²⁹ actually rose from 6.1% of total households in 2007, to 9.4% in 2011, though this level was only around a third of the level of the EU average (which was 25.6% in 2011). Similarly, households were asked to assess their ability to face an unexpected financial expense in the EU-SILC data.³³⁰ Though this showed a small decrease from 2007 (where it was 36.5% of households interviewed) to 2011 (34.5%), this was still quite near the EU average (of 37.5%).

Substantive research and data sources are available on the national level. For example, the Creditreform credit rating agency used data based on negative evaluations of Creditreform data subjects. Using these criteria,³³¹ the proportion of the total adult population was assessed to have declined from a high of 10.9% in 2007, to 9.1% in 2009. However, since then, the percentages have again been rising, to 9.7% in 2012. This equates to 3.26 million households.

However, other indicators show a high level of stability. The failure ratio of loans according to SCHUFA remained stable at 2.5% in 2011, the same figure as for 2008.³³² Also, the historical loss ratio according to statistics from the Ministry of Finance³³³ was also stable at 0.2%, unchanged from 2004. Finally, the number of consumer insolvency procedures in 2011 also showed a slight drop, from 103,085 in 2007 to

³²⁷ Eurostat, 'Arrears on hire purchase instalments or other loan payments' (code: ilc_md08).

³²⁸ Eurobarometer 321 and 355 (Poverty and Social Exclusion, February 2010 and December 2010, respectively).

³²⁹ Eurostat, 'Percentage of households with inability to make ends meet' (code: ilc_md09).

³³⁰ Eurostat, 'Inability to face unexpected financial expenses' (code: ilc_md04).

³³¹ Creditreform, *SchuldnerAtlas Deutschland*, 2012, p.4.

³³² Schufa, *Kredit-Kompass 2012: Empirische Indikatoren der privaten Kreditaufnahme in Deutschland*, SCHUFA Holding AG, 2012.

³³³ BaFin, cited in IFF (2012).

101,075 in 2011.³³⁴ This development was confirmed by similar figures from the Bürgel financial information agency,³³⁵ and the highest rates of private insolvencies per capita were observed in the states of Niedersachsen and Schwesig-Holstein, with the lowest rates in Bavaria and Baden-Württemberg.

When asked how to assess how the numbers of households that are over-indebted or have on-going difficulties meeting their financial commitments have changed over the last five years, no clear consensus was seen by stakeholders interviewed for this study. A number of stakeholders emphasised that the numbers of households suffering from over-indebtedness has fluctuated in the last 10 years, from a rise between 2005-2008, and a decrease thereafter. However, a few stakeholders specifically raised concerns about the quality and sources of data. One independent expert explained that:

Since the Federal Government does not support quantitative research on over-indebtedness for some years now, there have been few independent investigations on this subject since 2002. This leaves us reliant upon the data available from suppliers, for example the number of enforcement attempts as registered at the credit bureaus like SCHUFA or Creditreform. As a result the danger occurs that the perception of over-indebtedness is narrowed to the supplier-relevant aspects. In addition, the observance of scientific standards is not guaranteed because providers do not normally disclose the calculation methods used. Looking at the data it should be taken into account that 'hard negative signs' are stored at the credit bureaus for only a proportion of over indebted households. Therefore it is not certain whether the data is valid to represent over indebtedness.

Finally, the time lag between households becoming over-indebted and going to debt advice agencies was mentioned, with a typical figure being around 3 years. Therefore any reductions in over-indebtedness due to the recent falls in unemployment and economic upturn (assuming these to be causal factors: see section below) may take several years to filter through to the actual figures.

10.3 NATURE AND DRIVERS OF OVER-INDEBTEDNESS

10.3.1 Most common types of households that are over-indebted

Stakeholders were asked to report likely over-indebtedness across key socio-economic characteristics (i.e. age, household composition, homeownership status, employment status, education, and disposable income). Their assessment is complemented here by national level analyses of over-indebtedness (for example through the IFF *Überschuldungsreport* and debt advice agencies). The EU SILC also

³³⁴ Insolvenzstatistik des Statistischen Bundesamts, 2012 (cited in IFF *Überschuldungsreport*, 2012, p.25).

³³⁵ Bürgel, *Schuldenbarometer*, 2012.

provides information on the prevalence of households in financial distress (defined as those with outstanding debts in excess of their disposable income) across different socio-economic groups.

With reference to age, most of the stakeholders thought that over-indebtedness is more common for the age group of 25 to 39, followed by those aged 40 to 64. This might be the case because older households are more likely to have paid off debts that they assumed at an earlier stage of the lifecycle, or because older cohorts tend to borrow less than the younger ones, or because households aged between 30-40 require more products to provide for a growing family. According to EU-SILC data, almost 11% of those surveyed in the age groups 25-39 and 40-54 have to service debts in excess to their disposable income. This fraction drops sharply to less than 3% for the age group of those aged more than 65 years old.³³⁶ The IFF *Überschuldungsreport* notes that the average age of those seeking debt advice remains around 40 years of age, and that 90% of those over-indebted are between 22 and 64 years old.

Households living in rented accommodation were more likely according to stakeholders to suffer from over-indebtedness than other household tenure types. As regards different household composition, financial distress was reported by stakeholders to be more common among single parents and among those living alone. This is supported by data from the *Überschuldungsreport*, which calculates that the proportion of single parent households who are over-indebted is two and half times higher than their proportion in the general population. Children typically act as a strain on current resources and are also likely to imply future committed expenditures, thus increasing the financial demands on a household. Keese (2009),³³⁷ using household survey data from the German Socio-Economic Panel (SOEP), finds evidence that children increase the likelihood of over-indebtedness.

Furthermore, households with at least one unemployed person are more likely to be over-indebted, compared to their counterparts that earn monthly income (either as employees or as retired). The importance of this factor is discussed further in section 1.3.2, below.

Stakeholders interviewed also report a proportionally higher risk of over-indebtedness at lower levels of education. This is likely to be the case because education associates with higher labour income and thus contributes to wealth accumulation.³³⁸ In addition, the better educated are more likely to find a better job and in a shorter period if they are unemployed. Furthermore, education can

³³⁶ A similar pattern is observed in the European average.

³³⁷ Keese, M., *Triggers and Determinants of Severe Household Indebtedness in Germany*, Ruhr Economic Papers #150, Ruhr Graduate School in Economics, Universität Duisberg/Essen, 2009.

³³⁸ For the implied differences in labour earnings and employment across different education levels, see for example: http://www.bls.gov/emp/ep_chart_001.htm

approximate (future) income prospects. However, one stakeholder cautioned that amongst their clients were those with a university education, though they were much more seldom seen than skilled workers or those with a high-school education.

The vast majority of the stakeholders recognised disposable income as a key factor that relates to over-indebtedness. In particular, households that earn less than 60% of the median disposable income are subject to a much higher risk of over-indebtedness. For example, information from debt advice agencies in Rheinland-Pfalz³³⁹ showed that in 2011, 38% of clients earned no more than 1,000 Euro per month, and only 13% earned over 2,000 Euro per month.

As regards *changes* in the types of households that are at risk of over-indebtedness during the last five years, stakeholders who provided an assessment were evenly split between those who observed hardly any or no change at all and those who said that there had been fairly significant changes. Stakeholders in the latter group point to the increase of the unemployed or to the increase of workers with low wages (that do not allow them to maintain a certain standard of living), as key recent changes that have contributed to over-indebtedness.

However, some moderate increases in the oldest and youngest age groups were mentioned by stakeholders. This was evidenced by some recent studies. For example, the percentage of those over-indebted³⁴⁰ over 65 years of age increased from 2.6% in 2005 to 4.5% in 2011. Though still a small group, one stakeholder blamed the impact of historical trends:

A reason why older people are increasingly affected by over-indebtedness is that the last twenty years has seen less good economic development than in the previous period, which means that many people haven't worked their whole life, which means that their pensions are smaller. In the last ten years people above the age of 55 would have difficulties in finding a job.

Also, a couple of stakeholders stated that the number of people from traditional, middle-class milieus had increased, as they experienced a drop in income. A final issue is that of migrants to Germany, who show higher levels of over-indebtedness. According to the Federal Statistical Office,³⁴¹ the proportion of over-indebted people who did not possess German citizenship rose from 9.7% in 2006 to 15.7% in 2011. This is high in comparison with their overall percentage of the population, which in 2010 was 8.7%.

Overall, the factors described were consistent with interviews with indebted households conducted for this study. These interviews were conducted with 20

³³⁹ IFF Überschuldungsreport, 2012, p.43.

³⁴⁰ Ibid.

³⁴¹ IFF Überschuldungsreport, p.45.

households in Germany³⁴² who were either at risk of over-indebtedness, currently over-indebted, or had been previously over-indebted. Here, measures were made of household size, current employment status, monthly net income, levels of debt, assessed causes and consequences of being over-indebted, and measures sought to address the issue. So, for example, six households interviewed included an unemployed member, and only five households interviewed earned over €2,000 per month.

10.3.2 Most important causes of households' over-indebtedness

Macro-economic factors

At this point it should first be noted that macroeconomic conditions in Germany that may be relevant for household over-indebtedness have remained relatively stable or even improved during the recent financial turmoil. In particular, unemployment rates in Germany decreased during recent years (from 8.7% in 2007 to 5.9% in 2011), while median income of households increased by 7.1% during the same period, slightly above the EU average. In addition, aggregate data shows a slight decline in the amount of total loans given to households during the decade of 2000s as going by the household debt to income ratio, which declined from 94% in 2007 to 86% in 2011.³⁴³

Most research recognizes persistent unemployment as a key macroeconomic factor that is likely to contribute to household over-indebtedness.³⁴⁴ Empirical studies that utilize household survey data have identified unemployment as a key factor for over-indebtedness across countries. May and Tudela (2005)³⁴⁵ and Magri and Pico (2011)³⁴⁶ show that the unemployed are significantly more likely to experience difficulties in servicing their mortgage debt. In addition, Georganakos, Lojschova and Ward-Warmedinger (2010)³⁴⁷ find that the unemployed are more likely to report higher levels of financial distress across most of the European countries they examine.

³⁴² Out of 120 in total. See synthesis report for a review of overall findings and methodology.

³⁴³ Eurostat indicators, 'Unemployment rate', 'median equivalised net income', and 'gross debt to income ratio of households', (codes: tsdec450, ilc_di04, and tec00104).

³⁴⁴ In academic research, studies on household indebtedness typically take into account individual employment status, but also regional unemployment rates, given that households that live in high unemployment regions face worse job prospects (see for example, Duygan and Grant, 2009 who use European data from the ECHP). In addition, data from the ECHP has been used to associate household over-indebtedness with some institutional indicators that vary across countries, like information sharing arrangements, judicial efficiency, and individual bankruptcy regulations (Jappelli, Pagano and Di Maggio, 2008).

³⁴⁵ May, O. and Tudela, M., 'When is mortgage indebtedness a financial burden to British households? A dynamic probit approach', Bank of England, 2005.

³⁴⁶ Magri, S. and Pico, R., 'The rise of risk-based pricing of mortgage interest rates in Italy', Banca D'Italia, 2011.

³⁴⁷ Georganakos, D., Lojschova, A. and Ward-Warmedinger, M., 'Mortgage Indebtedness and Household Financial Distress', European Central Bank, 2010.

In Germany, research supporting this hypothesis includes a recent econometric study by Keese (2009)³⁴⁸ which found a strong positive and independent effect of being unemployed on the likelihood of becoming over-indebted, using random and fixed-effects panel regressions based on SOEP (German Socio-Economic Panel) data. Unemployment is connected with a loss of income in general, which is the inevitable result of unemployment for any longer than a brief period; data from debt advice agencies, for example in Rheinland-Pfalz,³⁴⁹ confirms unemployment as one of the leading causes of over-indebtedness for their clients.

Reviewing stakeholder responses, the macro-economic factors identified as the most important causes of households' over-indebtedness were unemployment level, followed by social welfare level, and wage level. Movements in exchange or interest rates were not seen as important.³⁵⁰ As mentioned previously, the factors are connected. As one financial industry stakeholder explained, "Unemployment is more important than poverty. People have to adjust their consumption to their new, lower income. If they can't do this they take on debts to fill the gap." However, one civil society stakeholder highlighted the problem of many people working in very precarious, low paid jobs, where their level of income was only a little higher than what they would get from the social welfare system. The level of social welfare for those in long term unemployment (the so-called Hartz IV social assistance) was also considered low, leaving households vulnerable to unexpected financial expenses. The process of claiming benefits was also seen as problematic by one independent expert:

The welfare system in Germany is not too bad compared to some countries, but the way it is administered is a problem, it's different from the legal reality. Normally social welfare is enough to survive, but people don't necessarily get what they should get. The effort of going in and fighting for everything and proving everything is too much for some people, so they don't claim the benefits they should receive.

The key role of unemployment for over-indebtedness is also recognized by most of the interviewed households. While only six of the 20 households interviewed were unemployed at the time of the interview,³⁵¹ half of interviewees referred to unemployment as a cause of previous or current over-indebtedness. Lower wages was in some cases a consequence - some of the households had experienced unemployment in the past and this in turn had forced them to accept low paid or less stable jobs.

³⁴⁸ Keese, M., *Triggers and Determinants of Severe Household Indebtedness in Germany*, Ruhr Economic Papers #150, Ruhr Graduate School in Economics, Universität Duisberg/Essen, 2009.

³⁴⁹ Schuldnerfachberatungszentrum Rheinland-Pfalz, Schuldnerberatung im Rahmen des Verbraucherinsolvenzverfahrens in Rheinland-Pfalz, Statistik 2011, Ministerium für Arbeit, Soziales, Gesundheit und Demografie Rheinland-Pfalz, 2012.

³⁵⁰ In fact, lower interest rates were seen as a recent mitigating factor in regards over-indebtedness.

³⁵¹ Or during the period of financial difficulties, in the case of the previously over-indebted households.

Cost of living

From the stakeholders point of view, utility bills represented the most important committed expenditure that is likely to cause over-indebtedness. In addition, several stakeholders recognized the importance of housing costs and other costs of living (such as food and transportation expenditures). In contrast, health related costs and education expenditures are considered less important for over-indebtedness.

Nearly half of all stakeholders interviewed also stated that there had been significant changes in the previous five years as regards consumers increasingly accumulating debts from utilities, telecommunications services, and rent. One independent expert emphasised that telecommunication had become more important for integration in society but also more expensive on certain levels. Combined with stagnating wages and a privatised rent market, this stakeholder saw changes ahead for the politics around the social welfare system and local government policy. A consumer organisation stakeholder also claimed that housing and energy prices were constantly rising and were the cause of multiple financial problems.

That said, arrears on utility bills have been shown (as explained previously) to be stable for several years, and below the EU level. Costs of living as measured by the HICP have also increased by a little over 10% since 2005 as measured by the HICP, though this is below the EU average.³⁵² At the same time, median income increased by 16% during the same period, with real adjusted gross disposable income of households per capita showing a very similar trend.³⁵³

As mentioned previously, statistics from debt advice agencies (e.g., from Rheinland-Pfalz) show a clear increase in the total amount of debt owed to energy and telecommunications services since 2007. From 2007 to 2009, the share of total debts represented by energy costs rose by 36% for debt advice clients surveyed, and this share increased a further 19% between 2010 and 2011.³⁵⁴ Mobile or telephone debts also increased during this period and retained the second-highest share of total debts.³⁵⁵

From the interviewed households' point of view, the general costs of living and childcare or child related costs are amongst the most important costs that are likely to cause over-indebtedness. For example, in terms of childcare or child related costs, one interviewee stressed the difficulties of bringing up her daughter alone after separating from her partner. In a few cases, the interviewees also mentioned utility

³⁵² Electricity prices for consumers increased by about 8% from 2005 to 2007 (Eurostat, 'Electricity prices for household consumers', code: ten00115), while natural gas prices increased by 38% during the same period (Eurostat, 'Gas prices for household consumers', code: ten00113).

³⁵³ Eurostat, 'Real adjusted gross disposable income of households per capita' (code: tec00113).

³⁵⁴ http://www.s fz.uni-mainz.de/Dateien/Statistik_2011.pdf

³⁵⁵ http://msagd.rlp.de/fileadmin/masgff/soziales/Statistik_2009.pdf

costs and healthcare costs. For example, an interviewee reported that he had got into difficulties as a result of a dentist bill that he could not afford to pay.

Types of credit/loan taken out by households

A further element explored in this study is to what extent both the level of indebtedness of households overall, and specific types of credit or loan taken out by households, are important causes of household over-indebtedness.

Various academic studies examine the level of household over-indebtedness by using objective measures of the debt burden in relation to assets and financial resources. Two such frequently used measures are the debt-to-income servicing ratio (defined as the fraction of monthly debt instalments that a household has to pay over monthly household income) and the loan-to-value ratio (defined as the value of outstanding mortgage over the current value of the house). The higher these two ratios are the more likely it is for households to experience problems in servicing their debts.³⁵⁶

The types of credit most frequently mentioned that contribute to households' over-indebtedness according to stakeholders interviewed was that of regulated consumer credit with high interest rates, followed by regulated credit or loans with average interest rates, and then home loans/mortgages.³⁵⁷ However, predatory or usurious loans, informal credit, and products from unregulated lenders were not ranked as important. Stakeholders emphasised that there was not really a market for unregulated lenders, and that there were no SMS or doorstep loans readily available. In fact, one financial industry stakeholder noted that due to tightened financial regulation, there was a marked tendency towards a 'flight to quality' within the financial sector, where lenders sought to avoid potentially risky clients. Increased product transparency through the internet was also seen as a positive influence.

A further factor according to multiple stakeholders were various kinds of regulated credit that carried high costs when payments were missed, or had high interest rates to begin with. For example, overdrafts or credit cards with interest rates as high as 10 or 12% were mentioned by a civil society stakeholder, who noted that these rates

³⁵⁶ See for example, May and Tudela (2005) who use British survey data and find that households with a high loan to value ratio have greater difficulties in meeting scheduled mortgage payments. In addition, Del Rio and Young (2005) show that the higher the unsecured debt to income ratio and the mortgage income gearing, the greater the problems in servicing debts. In addition, many financial practitioners look whether the debt-to-income servicing ratio exceeds 30%. This is a 'benchmark' cut off point in order to classify a household as a risky borrower in the sense that it is likely to face severe difficulties in servicing its debt in the future (e.g., see DeVaney and Lytton, 1995).

³⁵⁷ Mortgages typically represent the most important household liability. According to the ECB calculations, loans for house purchase account for almost 60% of the loans to households in the Euro area, followed by other household lending (roughly 25%) and consumer credit (almost 15%). See: http://www.ecb.europa.eu/pub/pdf/other/art1_mb201101en_pp57-72en.pdf, p.61. According to Georgarakos, Haliassos and Pasini (2012), who examine household survey data from a representative sample of Dutch households over the period 2001-2008, more than 40% of households have an outstanding collateralized loan (mostly mortgages for the main residence) with a median outstanding amount among those with such a loan of 98,000 euro. On the other hand, 22% have an outstanding consumer loan (with almost 4,000 euro conditional median outstanding amount), while only 4% state that they have taken an informal loan from friends or relatives (with roughly 3,300 euro conditional median outstanding amount).

were controversial, given the very low interest rates available to banks because of ECB policy. A further problem was that those using these products were doing in so in an inappropriate way, for example by using overdrafts to finance debt over a long period.

One independent expert also mentioned aggressive marketing of certain financial products, such as insurance:

There are insurance advisers that go around and get people to sign contracts, e.g. for life insurance or accident insurance. At a point, people can't pay it anymore and get into debt. There are also changes in health insurance, 'Zusatzbeiträge'. People also have to pay more for a dentist. And there are people who have to get private health insurance, which is sometimes not transparent. People think they are covered, but then find out they are not and come out of it with debt.

Related to this, loans linked to payment protection insurance cross-sold with consumer instalment credit were seen as a large problem by one independent expert. Though technically not required in order to take out the loan, consumers were often convinced by agents to take it out, and the premiums were seen as very high in comparison to normal forms of insurance. They explained that:

Rules on usury are not effective for these types of loans. There are no fixed limits on interest rates, like in some other countries, but court decisions from the 1980s say that double the average interest rate is considered to be usurious. And if this is the case then the provider is not allowed to charge any interest at all. As long as the products are not complicated it is not so hard to find out if it's double the average. But with connected products it's not so easy, as there's no information about the real price. It is a bit like a hidden interest rate.

Regarding mortgages, opinions were mixed. A financial industry stakeholder stated simply that "there is no big issue with mortgages in Germany", while a stakeholder working for a public authority emphasised that there had been no large property bubble as elsewhere, and that property was never financed with 100% LTV loans. However, research using socio-economic panel data from Germany³⁵⁸ has shown that servicing a home loan or mortgage was the greatest factor in predicting household over-indebtedness, ahead even of unemployment, number of children, and exogenous shocks.

In the consumer interviews with affected households, causes of their over-indebtedness were given. Usually, there was no one cause, but a number of contributing factors. That a number of factors came together to push a household over the edge into over-indebtedness was also emphasised by several stakeholders. In most of the cases, interviewed households refer to bank loans, credit cards and/or overdrafts that have been taken from regulated lenders as causes of their financial

³⁵⁸ Keese (2009), *supra*.

difficulties. On the other hand, only two interviewees also reported problems as the result of taking out home loans/mortgages.

Personal circumstances

The *Überschuldungsreport* lists the five most common causes of over-indebtedness that may be located at the level of personal circumstances and that are reported to debt advice agencies in Germany. These are (in order) unemployment, divorce or separation, over-consumption, illness, and business failure.³⁵⁹

Among the personal circumstances that are likely to cause over-indebtedness highlighted by the stakeholders is income (either because the income earned by the household is too low, because the household experiences a negative income shock due to unemployment or because unexpected health and other family problems). The relevance of income has been also identified by academic studies that examine associations between certain household characteristics and over-indebtedness³⁶⁰ as well as the emphasis on these factors in debt advice practice in Germany.³⁶¹ The stakeholders also point to a lack of households' money management skills and capability in dealing with financial products.³⁶²

This is consistent with research by Keese (2009),³⁶³ who provides a list of drivers of severe household (over-)indebtedness that are not related to unemployment, low income, or cost of living, but are rather 'endogenous' or personal behaviours maladapted to certain regulatory regimes. These include:

- ▶ Moral hazard (where consumers seek insolvency procedures as an easy way out of their debt problems when the rules are biased in favour of debtors);
- ▶ Market failure (information asymmetry between creditors and debtors);
- ▶ Procrastination;
- ▶ Hyperbolic discounting (preferring rewards sooner rather than later);
- ▶ Irrational behaviour;
- ▶ Excessive preference for present consumption;

³⁵⁹ IFF, *Überschuldungsreport*, 2012.

³⁶⁰ See for example Duygan and Grant, 2009)

³⁶¹ See: Mantseris, N., *Ursachen der Überschuldung*, Forum-schuldnerberatung.de, 2010.

³⁶² There is growing academic research on households' financial literacy, namely their ability to understand basic economic concepts and to deal with complicated and risky financial products (see Van Rooij, Lusardi, and Alessie, 2011). Recent research points also to the importance of debt literacy, showing that households that do not understand concepts such as interest compounding or minimum repayment requirements are more likely to experience problems in servicing their debts (see Lusardi and Tufano, 2009 and Disney and Gathergood, 2012). In addition, there is research suggesting that households can be affected on their borrowing decisions not only by their own circumstances but also by comparisons they make to the living standards of their peers. Such social influences can be so strong that can induce over-indebtedness, especially among households that consider themselves poorer than their acquaintances (Georgarakos, Haliassos, Pasini, 2012).

³⁶³ *Supra*, p.8.

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▶ Lack of financial or debt literacy.

However, interviewed households provided different reasons for their over-indebtedness. Around three quarters of interviewees indicated that their financial difficulties had been caused by a drop in income, as the result of unemployment, business failure, illness or separation. For example, one interviewee indicated that her husband had been made unemployed twice over the last seven years, each time forcing him to accept a lower paid job. Another interviewee left his job in order to set up a business, which did not bring in enough revenue to meet his living expenses. In some cases, interviewees described low income as a cause of their over-indebtedness, although only two of the households who gave clear information about their total income were assessed to be at risk of poverty.

Changes relevant for levels of over-indebtedness

As mentioned previously, nearly half of all stakeholders interviewed stated that there had been significant changes in the previous five years as regards consumers increasingly accumulating debts from utilities, telecommunications services, and rent. However, when asked about changes in other areas (the macro-economic environment, use of loans with high interest rates from regulated lenders, use of loans from unregulated lenders, use of predatory or usurious types of credit, removal of specific lending practices, use of informal loans, regulatory environment, and cultural practices), most stakeholders saw little or no change during the previous five years.

In addition, although the majority of the stakeholders did not find that there was any notable change in household access to credit, a few stakeholders highlighted more restrictive lending practices. According to one independent expert, "Less money in total is lent to individuals. They still lend money, but not at such high levels as before."

With reference to the demand side, most of the stakeholders reported that consumers were not taking up more loans with higher interest rates, either from regulated or unregulated lenders. According to a financial industry stakeholder, loans from unregulated lenders played only a small role.

Likewise, most stakeholders did not think that there was not any increase in informal borrowing (i.e. through family and friends), but two stakeholders dissented. An independent expert claimed that middle class individuals, increasingly affected by financial difficulties, had more possibilities to solve short term problems by borrowing from family members, while a civil society stakeholder highlighted the rise in reduced working hours (*Kurzarbeit*), where unemployment was avoided, but the

loss in income forced previously solvent individuals to seek temporary loans from friends or family.³⁶⁴

10.3.3 Cultural attitude towards debt and actual level of households' (over-) indebtedness

The majority of stakeholders stated that there was a relationship in Germany between the cultural attitude towards debt, and the actual level of household over-indebtedness. Furthermore, the majority of stakeholders stated that there had not been any change in cultural attitudes that has increased over-indebtedness during the previous five years. However, a number of open comments pointed to a more nuanced conclusion.

Firstly, a number of comments pointed to the cultural attitude in Germany, in comparison to other attitudes, to be more cautious about taking out loans. This was qualified by referring to generational changes, where young people were more willing to take out more debt. As one financial industry stakeholder said:

Older people put more value on being debt-free. They have learned to work and save, and tend to buy new things with the money they have saved. But this attitude has changed with younger people, who are much more relaxed. They also don't have that much information about financial products and don't have many savings.

According to another financial industry stakeholder, market analysis by a credit referencing agency confirmed this by showing that the younger age segment has a higher propensity to finance consumption through debt. The cause of this generational change was according to a number of stakeholders not purely cultural. Rather, technological and economic change was involved. While an independent expert highlighted the need of young people to take on more risk because of fewer employment possibilities, a financial industry stakeholder highlighted the role played by technological and financial innovation.³⁶⁵

Other technologies were also relevant. According to another stakeholder, extensive use of internet banking is making people less aware of what they are doing with their money - especially when people have more than one bank, they have a weaker overview of their finances, since nothing is on paper.

Finally, although a more cautious attitude towards debt was seen as limiting over-indebtedness in general, an independent expert warned that the social taboo on debts (and over-indebtedness) hindered people to seek out advice in a timely

³⁶⁴ "Das bezieht sich wieder auf die Kurzarbeit. Viele von den Ratsuchenden die in Kurzarbeit sind, haben versucht, über Familienmitglieder oder Freunde Überbrückungsgelder zu erhalten."

³⁶⁵ "Es gibt sowohl mehr Finanzprodukte als auch mehr Einkaufsmöglichkeiten (Internet, Versandhandel, Bestellungen per SMS, Herunterladen von Downloads/Spielen usw.). Das führt zu einer Veränderung in der Mentalität in Hinblick auf Überschuldung."

manner when they faced serious debt problems. According to this stakeholder, this lead to the effect that the "debt career" from the first sign of problems to the final debt release through the insolvency process took on average about 13 years for the individual affected.

10.4 CONSEQUENCES OF OVER-INDEBTEDNESS

10.4.1 Consequences for affected households

Financial exclusion (i.e. lack of access to credit or even inability to open a bank account) was recognized by most of the stakeholders as among the most important consequences of over-indebtedness.³⁶⁶ Though limiting further access to credit for the over-indebted prevents a further debt spiral, the linkages between their credit rating and everyday aspects of life had serious consequences. According to a civil society stakeholder,

Over-indebted households' people have problems getting a bank account, which they of course need in order to receive their wages. They may also need credit to buy things, for example products over the Internet, or credit for a car in order to get to work. When a person has a poor credit rating, then it can also be difficult to find a place to live or to get a telephone connection.

An independent expert also emphasised financial exclusion as a consequence, and cited their own data, showing that 20% of people seeking professional debt advice do not have their own current bank account.

The next most highly rated consequences according to stakeholders were deterioration of living standards and overall well-being. These effects were wide-ranging. Exclusion from cultural activities and ability to participate in social life were highlighted, as well as negative impacts on physical and mental health. This is in line with the findings of a recent study³⁶⁷ which showed that individuals with problems in servicing their mortgage debt tend to have much worse psychological health. But research based on German socio-economic panel data³⁶⁸ also found that level of debt (and over-indebtedness indicators) to be strongly correlated with health satisfaction, mental health, and obesity. This relationship held for physical and mental health even when controlling for unobserved heterogeneity and reversed causality using a fixed-panel regression model. The multifaceted consequences of over-indebtedness on private households were also examined by a study commissioned for the Federal

³⁶⁶ Stakeholders were asked to rank a list of consequences for households, the financial services industry, and society on a scale of 0 (not at all important) to 10 (very important).

³⁶⁷ See Gathergood, 2012.

³⁶⁸ Keese, M., and Schmitz, H., *Broke Ill, and Obese: The effect of Household Debt on Health*, Ruhr Economic Papers N. 234, Ruhr Graduate School in Economics, Universität Duisberg-Essen, 2010.

Ministry for Families, the Elderly, Women and Youth, and broadly confirm these findings.³⁶⁹

At this point, it is useful to see how the 20 interviewed households in Germany assessed the consequences of their over-indebtedness. The results are in line with the consequences reviewed above. Interviewees referred to a reduced standard of living and deteriorating well-being/mental health as the most common consequences. Several interviewees indicated that they were cutting down on activities like eating out or going on holiday, or even basic items, such as food or a washing machine.

In terms of deteriorating well-being or mental health, several interviewees reported suffering from stress, anxiety and depression, in a few cases to the extent that they were receiving medical treatment or had become suicidal. Other health problems, such as sleeping disorders, stomach aches and obesity were also mentioned. Many interviewees referred to consequences such as social exclusion or family breakdown. One interviewee explained that her child was bullied at school because of the family's financial situation.

Eight interviewees reported that they had at least temporarily been excluded from a bank account. In addition, four households felt themselves to be excluded from credit, while three interviewees indicated that they had experienced difficulties with renting an apartment as a result of their negative SCHUFA entries.

10.4.2 Consequences of over-indebtedness for the financial services industry

The most highly rated consequence by stakeholders on the financial services industry was that of costs of defaulted credits for creditors, while the least highly rated was lower demand for credit because of higher risk premiums. According to a financial industry stakeholder, the costs of default was the most immediate consequence but also an important impact on the profit and loss statement and capital structure of lenders. They added that:

Reputational risk is an important aspect, not the least given the political sensitivity of consumer lending. There are strong consumer protection rules in Germany and banks, certainly [our] Bank, are conscious of the importance of responsible lending.

It should be noted that in the financial industry there is a standard distinction between collateralized loans (i.e. loans that use as a collateral the asset which they were used to finance, typically the home for taking a mortgage) and non-collateralized or consumer loans for which there is not any collateral. In the latter type of loans, a default will imply greater costs for the lender. Nevertheless, there are also

³⁶⁹ Münster, E., und Letzel, S., 'Überschuldung, Gesundheit und soziale Netzwerke, Expertise erstellt im Auftrag des Bundesministeriums für Familie, Senioren, Frauen und Jugend.' In: *Bundesministerium für Familie, Senioren, Frauen und Jugend: Materialien zur Familienpolitik* Nr. 22/2008: Lebenslagen von Familien und Kindern - Überschuldung privater Haushalte. 2008, S. 55-137

potential risks for the banks from defaults on collateralized loans, especially during periods that the values of collateral assets depreciate due to adverse macroeconomic conditions.³⁷⁰

Overall, the stakeholders did not rate consequences for the financial industry very highly compared to consequences for households and the wider society. This may be because, as one civil society stakeholder said, lenders already take the risk of failure into account when they give credit. And particularly with home loans, debtors have normally already paid a large portion of the debt, so the creditors have already made some profit through the interest charged.

10.4.3 Economic and social consequences of over-indebtedness for society

Going by average scores, among the listed potential consequences of over-indebtedness for society, the stakeholders pointed to a loss in confidence in the financial services industry as the most highly rated consequence for society, followed by increased use of health care services due to poor mental or physical health, and reduced productivity at work. The importance of these effects has been analysed by the previously mentioned Ministry study.³⁷¹

Least important as going by average ratings was homelessness and this was probably to do with the high level of social assistance and tenant rights in Germany. As a financial industry stakeholder put it, "when you receive social assistance, you also receive money for rent. Therefore even though you are over-indebted, you can stay in your home. As a result, there are no great problems with housing."

However, the category of 'other effects on the wider society' was rated higher than all of these. Indications of these other effects were "criminal and semi-criminal acts to cope with the debts", "social disadvantages and a feeling of shame", "lowered purchasing power", and a feeling of unfairness as a consequence of the financial crisis: "Banks are rescued with billions of Euro, while the 'regular' citizen is left 'high and dry'".³⁷²

³⁷⁰ As a point of comparison, the financial sector in the US has been accused of a lack of discipline in applying sound banking standards prior to the recent financial studies. As a result, sizeable household groups borrowed at levels that expose them to subsequent difficulties in debt servicing and a nontrivial risk of default during the Great Recession. For example, Mian and Sufi (2009) show that a shift in credit supply is a key factor in the expansion of subprime mortgages in the U.S. Demyanyk and Van Hemert (2012) find that the quality of such loans deteriorated for six consecutive years prior to the crisis.

³⁷¹ Münster, E., und Letzel, S., 'Überschuldung, Gesundheit und soziale Netzwerke, Expertise erstellt im Auftrag des Bundesministeriums für Familie, Senioren, Frauen und Jugend.' In: *Bundesministerium für Familie, Senioren, Frauen und Jugend: Materialien zur Familienpolitik Nr. 22/2008: Lebenslagen von Familien und Kindern - Überschuldung privater Haushalte*. 2008, S. 55-137

³⁷² "Fehlende Kaufkraft, Arbeitsplatzverlust durch Überschuldung (Sozialleistung anstelle von Steuern und Beiträgen), "gefühlte Ungerechtigkeit" (Banken werden mit Milliarden gerettet, der "normale" Bürger wird "hängen gelassen")"

10.4.4 Debt collection practices

A vast majority of interviewees reported that they had not noted increasingly aggressive debt collection practices during the previous five years. One financial industry stakeholder commented that although there were some changes seen with smaller debt collection agencies, the large majority are not aggressive. A financial industry stakeholder commented that:

The debt collection practices have become more moderate and the debt collection bureau has a strong communication role. Over the last five years there has been hard competition in a lot of areas and companies pay attention to customer retention. It is really expensive to get new clients.

Of the few stakeholders who did note that debt collection had become more aggressive, collection without legal basis and threatening phone calls were cited as specific practices.

10.5 MEASURES IN FORCE TO ALLEVIATE THE IMPACT OF OVER-INDEBTEDNESS

10.5.1 Early identification of households at risk

The majority of industry stakeholders stated that measures that aim to identify at an early stage households at risk of over-indebtedness are very or fairly common. In their answers they repeatedly emphasised the key role of SCHUFA, which is the central credit bureau in Germany. SCHUFA calculates (client-customized) credit scores about individuals, which are used to evaluate the likelihood of default for a specific contract. Individuals are typically required to provide this credit score in order to apply for a new loan, hire purchase agreement, or before they rent an apartment.³⁷³ If the SCHUFA credit score is too low because of previous repayment problems, consumers will find it difficult to acquire regulated credit products, and so limit their ability to become over-indebted. That said, one civil society stakeholder considered the system to be more a form of protection for the lender than for the consumer.

Other measures included those applied when potentially over-indebted people came into contact with various services. For example, one stakeholder from the financial services industry cited consumer advice agencies and social welfare offices, where it was sometimes attempted to identify and help over-indebted households at an early stage. Especially when applying for social assistance, households were required to transparently disclose all income and expenditure in order to qualify for benefits, thus bringing to light cases of households at an early level of over-indebtedness. Other

³⁷³ More details about SCHUFA can be found here: <http://www.schufa.de/en/en/unternehmen/unternehmenstartseite.jsp>

specific measures beyond better risk management, more data collection by lenders, and preventative measures such as financial education, were not highlighted.

10.5.2 Advice offered to over-indebted households

Availability and costs

Debt counselling/advice provision in Germany today is a collaboration between consumer organisations (often belonging to church umbrella organisations such as the *Caritasverband* or *Diakonische Werk*), and municipalities, with the staff involved divided between social workers and lawyers. While debt counselling as such has been developing since the 1980s, the introduction of consumer insolvency proceedings in 1999 has meant that insolvency counselling was added as a further field of activity, specified in §305 of the Insolvency law (InsO).³⁷⁴ Debt advice organisations and individuals have developed cross-body networks for sharing information and supporting political lobbying. In 1986, the *Bundesarbeitsgemeinschaft Schuldnerberatung* (BAG-SB), was set up, and a working group on debt advice, the *Arbeitsgemeinschaft Schuldnerberatung der Verbände* (AG SBV),³⁷⁵ coordinates debt advice on a national level. Debt advice agencies are legally defined and coordinate their activities in cooperation with municipalities.³⁷⁶ Generally, since debt advice agencies are operated by charity or welfare organisations, debt advice is free. However, some private agencies may charge fees.

To gain additional information on debt advice in Germany, stakeholders interviewed were asked for their opinion on the availability, costs to over-indebted households, demand for, awareness of, and effectiveness of different types of personalised debt advice. These debt advice methods were those of face-to-face, by telephone, by email or online chat, web-based, or via printed materials.

Most of the stakeholders agree that face-to-face advice is widely or partly available in Germany for over-indebted households. The next most available service type was by telephone, and via printed materials. In contrast, the stakeholders did not indicate such wide availability of advice through email or other web-based services.

One independent expert highlighted that the quality of debt advice varied geographically, depending on levels of funding, while another stakeholder mentioned the effects of funding restrictions:

People are complaining that it takes time to get appointments, that there are too few people in debt advice. This happens everywhere.

³⁷⁴ See: http://www.gesetze-im-internet.de/inso/__305.html.

³⁷⁵ See: <http://www.agsbv.de/index.php/wer-sind-wir/aufgaben>

³⁷⁶ See SGB XII: http://www.bag-sb.de/uploads/tx_inhalt/Positionspapier_AGSBV_zu_SGB_2_u_12.pdf

In line with the views expressed by the stakeholders about availability of advice for over-indebted households in Germany, the vast majority of interviewees declared that had received personalized, face-to-face debt advice. It should be noted however, that in several of these cases, the interviewees only received this advice at a fairly late stage (e.g. when they decided to apply for personal insolvency). In some cases, the interviewees explained that they would have sought help earlier, but they were not aware of the existence of debt counselling, they were afraid of being criticised or they felt that they could deal with their problems alone. Only two interviewees had not yet sought any advice, and one of these was planning to do so in the future.

Demand for debt advice as assessed by stakeholders

Most of the stakeholders claimed that demand for debt advice from over-indebted households was very high. On the other hand, demand by over-indebted households for advice via phone or electronic means was markedly lower. Additionally, half of the stakeholders felt that demand for debt advice had remained stable in the last five years, with another half believing that it fairly or very much increased.

Regarding the grounds for and impact of this increase in demand, stakeholders gave varying answers. An independent expert stated that the increase was due to "more people with financial problems, debt advice better known, and more cooperation of Jobcenters with advice agencies", while another financial industry stakeholder said that:

Despite the reduction in over-indebtedness, demand has increased, because the consumer insolvency procedure is so complicated. In fact, the people need the advice process - without it they cannot proceed with the insolvency procedure.

The demand was judged so high by one civil society stakeholder, that in their opinion, only 12-15% of people seeking debt advice would get the help they needed. This manifested itself in long waiting periods (of up to four months), work intensification for existing debt advice providers, and possible impacts on quality. Even more worryingly, one interviewee working for a public authority stated that due to the combination of high demand and insufficient funding, the number of illegal debt advice services had recently increased.

Effectiveness as assessed by stakeholders

Most stakeholders judged face to face debt advice as very or fairly effective, while less than half judged telephone advice to be effective. Many stakeholders felt they could not assess the effectiveness of electronic or web based tools or simply thought that their effectiveness is low. One financial industry stakeholder stated that face-to-face advice was the best type of advice that could be given, but printed information, though widely available, was not effective. The role of debt advice centres in

providing people not only with help to go through the insolvency procedure, but also in providing financial education was seen by one stakeholder as important:

The only measure that is really helpful is face-to-face advice but at the end of the day it is really complicated to give people the skill to manage their lives in the future. Often we talk about people who are over-indebted, not those losing their job but without an overview of their spending. So it is more a problem of behaviour and that is why it is very important to have a face-to-face discussion with them.

However, debt advice in general was seen by one independent expert as not reaching some households. Despite the effectiveness of debt advice centres, the problem was that:

They don't reach everybody and in particular they don't reach people at the very bottom. [...] Some people don't go to get debt advice because their problems are so huge and they don't see a future for themselves, so they think 'why not be over-indebted?'

The conclusions of stakeholders are broadly in line with academic research on the effectiveness of debt advice. For example, a study commissioned for the Federal Ministry of the Family, Elderly, Women, and Youth³⁷⁷ in 2004 found that the profile of clients after a year of debt of advice showed a marked increase in those in secure employment, rising incomes, and general improvement in standard of living. Other studies showed similar results, with debt advice also found to save money for public authorities in one Berlin-based cost-benefit analysis.³⁷⁸

Funding of debt advice

The majority of the stakeholders stated that the funding of debt advice services in Germany is rather not sufficient or not sufficient at all. However, there were some dissenting opinions. While one financial industry stakeholder stated that "it could be better, but is not bad", a stakeholder working for a public authority was more emphatic: "Despite empty public coffers, the state and communal authorities fund the debt and insolvency advice centres adequately". Other stakeholders held opposing views; one independent expert stated that since the proportion of people receiving the help they needed was low, actual funding should be tripled. Confusions around funding were blamed by a stakeholder working for a public authority for a recent decrease in the number of available advice centres:

In Germany, we have 16 federal states and 32 various systems of debt advice funding. There is typically a local funding subject, usually the community, then the federal state and then another kind of funding, typically the Sparkasse. Especially

³⁷⁷ Hamburger, F., Kuhlemann, A., and Walbrühl, U., *Wirksamkeit von Schuldnerberatung*, Expertise in Auftrag des Bundesministeriums für Familie, Senioren, Frauen und Jugend, 2004.

³⁷⁸ E.g. Meinhold, M., *Einspareffekte für das Land Berlin aus der Tätigkeit der Schuldner- und Insolvenzberatungsstellen*, Berlin, 2003.

community and federal state try to declare someone else responsible for funding. Consequently, debt advice is usually funded by community, insolvency advice by the state and there is often an argument between the two about what exactly is debt advice and what is insolvency advice. As a result of these arguments, advice centres do not have enough funding.

Other stakeholders emphasised a need for the federal government to have more involvement with funding, alongside the industry and banking sectors. An expansion of services to reach schools, and greater cooperation between social workers and lawyers were also mentioned by stakeholders as measures benefiting from more funding.

10.5.3 Key measures in place to alleviate the impact of over-indebtedness

Informally brokered arrangements between the debtor and creditors such as a repayment plan, a debt management plan or debt write-off that may be brokered by a debt counsellor

The majority of the stakeholders agree that such programs are at least partly available in Germany. Regarding their cost to over-indebted households the majority of interviewees stated that they are partly free and partly financed by households. This reflects the fact that under the consumer insolvency procedure, consumers must attempt with the aid of a debt advisor to come to an informally brokered arrangement (*außergerichtliche Einigungsversuch*).³⁷⁹

The effectiveness of these arrangements is debatable however, as according to one of the civil society stakeholders, only between 10-20% of these negotiations are successful. This is mainly because one debtor may have several different creditors, and only one needs to refuse to negotiate in order for the procedure to be judged as failed. However, when agreed, an independent expert argued that such informal arrangements can be beneficial for households, as they avoid engagement in costly legal procedures, while the creditor gets at least a part of their loan back.

Five of the 20 households that were interviewed report that they had reached an informally brokered arrangement with their creditors. For example, one interviewee had already managed to negotiate a reduction of his debt from 8,000 to 4,000 Euro, and was expecting to achieve a further reduction. However, a few other interviewees reported that they had attempted to negotiate informal arrangements, but that this had failed.

³⁷⁹ Heuer et al., 'Der außergerichtliche Einigungsversuch im Verbraucherinsolvenzverfahren', *Der Hallesche Graureiher*, Martin-Luther-Universität Halle-Wittenberg, Institut für Soziologie, 2005, p.6.

Legal procedures that take place in court (e.g. consumer insolvency proceedings)

Legal procedures such as consumer insolvency proceedings are recognized as the most widely available procedure by the majority of stakeholders. In terms of effectiveness, one independent expert referred to the existing insolvency process as very effective, the risk of moral hazard from free riding to get rid of debt being judged acceptable.

That the consumer insolvency procedure was effective was also the conclusion of a study by the debt advice agency in Berlin, which surveyed about 600 former clients who had undergone the court insolvency procedure from 2002 to 2005. Here, a number of positive effects were noted. These included the restoration of their own current account, and freedom from constant demands for repayments for creditors. Health improvements were also noted - according to the report, 70% of respondents spoke of an improved quality of living, while 55% of respondents confirmed that their health had improved.³⁸⁰

As has been explained previously, the consumer insolvency procedure (*Insolvenzordnung*, or InsO) was introduced in 1999 and since 2001 there has been a possibility of cost deferral for those not in a position to pay court fees (§4a, InsO).³⁸¹ One stakeholder claimed that this was the key change for making the process more effective.

In terms of household interviews conducted for this study, more than half of the households interviewed in Germany had made use of legal procedures (i.e. consumer insolvency proceedings) in order to alleviate their financial difficulties. Of these, some had already been discharged, while others were still in the process of repaying their debts. Another four interviewees were planning to apply for consumer insolvency in the future, but had not yet done so.

Financial support for households to repay debts/arrears (e.g. by public fund) and other measures

Unlike the availability of the aforementioned arrangements most of the interviewees state that financial support is rare or not available at all in Germany. Social assistance from the state is available only for certain fixed costs such as rent. Nevertheless, there are individual cases of charities, such as the Marianne von Weizsäcker Stiftung,³⁸² which supports via once-off payments and other support the agreement of an informally brokered debt repayment plan as mentioned above. However, the target

³⁸⁰ Jahn, W., and Richter, C., *Das Verbraucher-insolvenzverfahren: Eine Zwischenbilanz aus Schuldnersicht*, Landesarbeitsgemeinschaft Schuldner-und Insolvenzberatung Berlin e.V., 2006.

³⁸¹ See: http://www.gesetze-im-internet.de/inso/_4a.html. According to research from the debt and insolvency advice centres of Berlin, about 80% of those going through the insolvency procedure had their costs deferred (see next footnote for reference).

³⁸² See: http://www.weizsaecker-stiftung.de/cms/upload/pdf/Schritt_fr_Schritt.pdf

group is limited to those suffering from addiction problems and is not a general charity for debtors.

10.5.4 Changes in response to over-indebtedness

Most of the stakeholders interviewed did not state that there was any change in measures aiming to alleviate the impact of over-indebtedness during the last five year. However, one civil society stakeholder pointed to debates on-going since 2004 on the reform of the consumer insolvency procedure. These reforms have been described by consumer advocacy organisations as worsening conditions for poorer debtors, strengthening creditor claims to the detriment of debtors seeking a new start, and weakening the likelihood of achieving brokered debt agreements.³⁸³

10.5.5 Types of households of over-indebted consumers not reached by current measures

Answers to this question are very noisy, with stakeholders' views equally split between 'yes', 'no', and 'do not know'. One group identified by a civil society stakeholder was that of those still employed; in some municipalities only those receiving social assistance were allowed free access debt advice, because of a judgement from the Federal Social Court (*Bundessozialgericht*). Employees are instead forced to use fee-paying services from lawyers when undergoing the consumer insolvency procedure. According to a stakeholder working for a public authority, though procedures were open for everybody, not everybody availed of them:

There are people, most with multiple problems, that do not look for help. There is also the problem, that some over-indebted people do not look for help, perhaps because of shame, because they think the problems have not become big enough yet, or maybe because they attempt to get help from family or friends to resolve the situation. This group is an unknown quantity, because we have no contact with these people.

Finally, one stakeholder mentioned that households with an immigrant background could not always be reached by current measures, commonly because of language problems.

10.5.6 Best practices

Only a minority of stakeholders agreed that there were specific measures in place to alleviate over-indebtedness that they would consider best practices. Of those who provided suggestions, multiple stakeholders cited the personal debt counselling centres, which in the best case created transparency on both sides and combined a

³⁸³ See press release from Infodienst Schuldnerberatung, 'Reform der Verbraucherinsolvenz 2012': http://www.infodienst-schuldnerberatung.de/fileadmin/user_upload/Rubriken/Insolvenzrecht/2012/ReformInsoStellnahmeSchrankenmueller.pdf

moderate debt repayment plan that encouraged financial discipline on the part of the debtor.

From the households' point of view, many of them see debt counselling as the best type of support. Most of these had sought out personalized debt advice themselves and had found the experience very helpful. For example, interviewees praised the information and guidance they received from debt counselling, as well as the emotional support it gave them. One interviewee described seeking out debt counselling as "one of the few things that I have done right in my life".

10.6 OUTLOOK

Despite the relative stable unemployment rates and the macroeconomic conditions in Germany during the recent financial crisis, the majority of stakeholders who expressed an opinion thought that over-indebtedness will somewhat increase or remain stable in the next five years. However, none of the stakeholders expected that there would be any dramatic changes in over-indebtedness, in terms of large increases or decreases.

The majority of comments supporting these opinions referred to the present and future macro-economic situation. A civil society stakeholder noted that the current state of over-indebtedness was at an historically high level; should macro-economic situations continue to be stable, then at most a moderate increase was expected. This expectation was also found in other comments - a slow decline or a stable level was expected. However, the development of the Euro-crisis was highlighted as a wild card, while a civil society stakeholder forecasted that the net income of citizens would sink in future because of higher taxes, increases in cost of living, and higher social insurance contributions.

In addition, there were disagreements on whether there are any new challenges that need to be addressed by policy makers, with no majority prevailing. Moreover, those interviewees who believed that new challenges should be addressed expressed heterogeneous views on the nature of those challenges (e.g. aging and demographic transition; energy and age poverty; debt advice; financial education). Two unique factors stood out: in the first case, a financial industry stakeholder emphasised the importance of mobile payments and software downloads, where the lack of tangibility regarding online payments made it easier to get into debt. In the second case, an independent expert raised concerns about the ease at which young people under the age of 18 were able to accumulate a large amount of debt; a clarification of how and under what conditions teenagers are able to conclude contracts was suggested. Two stakeholders also mentioned a shortening of the period of the insolvency procedure (currently 6 years) to 3-4 years.

A slight majority of stakeholders expressed the view that changes were needed in regulation of credit and lenders' commercial practices. This was overwhelmingly suggested at the EU, rather than national, level. These were generally aimed at restrictions on the marketing or sale to consumers of potentially dangerous financial products, such as speculative investments, payment protection insurances, and high interest rates on overdraft accounts, i.e. responsible lending. However, a stakeholder from a local authority emphasised full access for all to a bank account:

There has been a long debate about accessibility of bank account for everyone in Germany, but nothing is really happening. There is a need for regulation in this respect and regulation from the European Commission that would have to be implemented in each country would certainly help here.

As regards additional changes in regulation of utility companies or of housing providers most of the interviewees state they did not know, followed by those who think that such changes are not necessary. However, two stakeholders argued that utility companies should guarantee a minimum level of availability for the most disadvantaged households, either by offering them for free, or regulating their payment through unemployment benefit. In regards the housing sector, a stakeholder working for a public authority argued for the revival of the public housing sector for low income families, and better protection against home repossessions.

Regarding non-regulatory measures, there was more consensus and suggestions revolved around more financial education from an early age and better funding for debt advice agencies. Finally, the need for more independent research was stressed.

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Final report

Over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact

ANNEX A: STATISTICAL DATA FROM EU SOURCES

Final report

Over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact

Germany

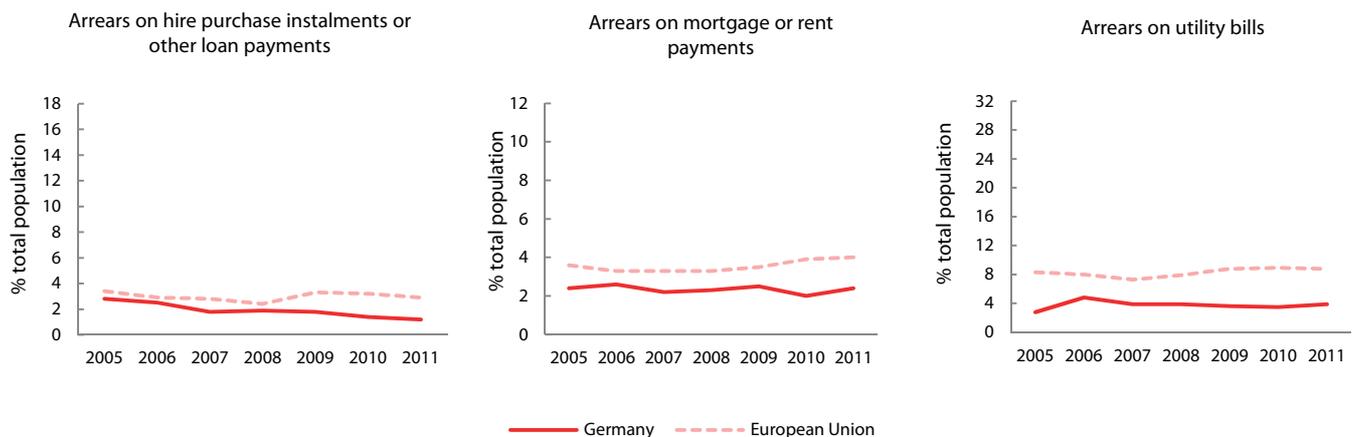
I. Eurobarometer¹

	Germany	EU average	Lowest EU value	Highest EU value
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Households *at risk* of being over-indebted

Respondents feeling at risk of over-indebtedness in 2010	↘ 12%	25%	7%	52%
Respondents feeling at risk of over-indebtedness in 2009	↘ 12%	27%	9%	53%

II. EU SILC standard survey data²



III. EU SILC 2008 module: Over-indebtedness and financial exclusion³

	Germany	EU average	Lowest EU value	Highest EU value
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Proportion of people in households with bank overdrafts, outstanding balances on credit cards or in arrears on other loans of over 100% of household disposable income

Overdrawn bank account (% of people in households overdrawn)	↗ 7.7%	2.2%	0.0%	7.7%
Credit or store card (% of people in households with outstanding balances)	↘ 1.0%	1.1%	0.0%	8.6%
Other loan/credit payments (% of people in households in arrears)	↘ 0.2%	0.3%	0.0%	1.1%

Proportion of people in households in arrears in servicing housing-related loans and bills and in paying other bills of over 100% of household disposable income

Housing bills (% of people in households in arrears)	↘ 0.2%	0.5%	0.0%	2.9%
Other payments (% of people in households in arrears)	↗ 1.7%	0.4%	0.0%	1.7%

Households living with outstanding debts and/or arrears of over 100% of household disposable income

Total (% of households with outstanding debts/arrears)	↗ 10.2%	4.6%	0.0%	11.8%
Income above 60% median (% of households with outstanding debts/arrears)	↗ 10.4%	4.2%	0.0%	11.3%
Income below 60% median (% of households with outstanding debts/arrears)	↗ 9.3%	7.0%	0.2%	13.7%
Materially deprived (% of households with outstanding debts/arrears)	↗ 22.2%	9.0%	0.1%	27.4%

Proportion of those in broad age groups with outstanding debts of over 100% of household disposable income

Households with all adults aged 25-39 (% of households with outstanding debts)	↗ 11.7%	6.3%	0.0%	17.2%
Households with all adults aged: 40-64 (% of households with outstanding debts)	↗ 10.9%	5.8%	0.0%	10.9%
Households with all adults aged: 65+ (% of households with outstanding debts)	↗ 2.8%	1.2%	0.0%	2.8%

Proportion of those in different types of household with outstanding debts of over 100% of household disposable income

Living alone (% of people in households with outstanding debts)	↗ 6.8%	4.3%	0.0%	8.2%
Single parent (% of people in households with outstanding debts)	↗ 13.6%	9.5%	0.0%	27.1%
Other (% of people in households with outstanding debts)	↗ 10.8%	4.8%	0.0%	12.1%

Proportion of those in households with outstanding debts of over 100% of household disposable income by marital status

Never married (% of people in households with outstanding debts)	↗ 8.1%	5.0%	0.0%	15.4%
Married (% of people in households with outstanding debts)	↗ 9.7%	4.1%	0.0%	9.7%
Separated/divorced (% of people in households with outstanding debts)	↗ 11.2%	7.5%	0.1%	13.9%
Widowed (% of people in households with outstanding debts)	↗ 4.0%	1.7%	0.0%	4.3%

Proportion of those in households with outstanding debts of over 100% of household disposable income by housing tenure

Owner occupied without mortgage (% of people in households with outst. debts)	↗ 9.6%	3.2%	0.0%	9.6%
Owner occupied with mortgage (% of people in households with outst. debts)	↘ 0.0%	6.3%	0.0%	16.1%
Market rent (% of people in households with outstanding debts)	↗ 10.9%	8.2%	0.0%	16.0%
Subsidised rent (% of people in households with outstanding debts)	↗ 13.5%	8.7%	0.0%	17.9%
Rent-free housing (% of people in households with outstanding debts)	↗ 6.8%	2.3%	0.0%	15.1%

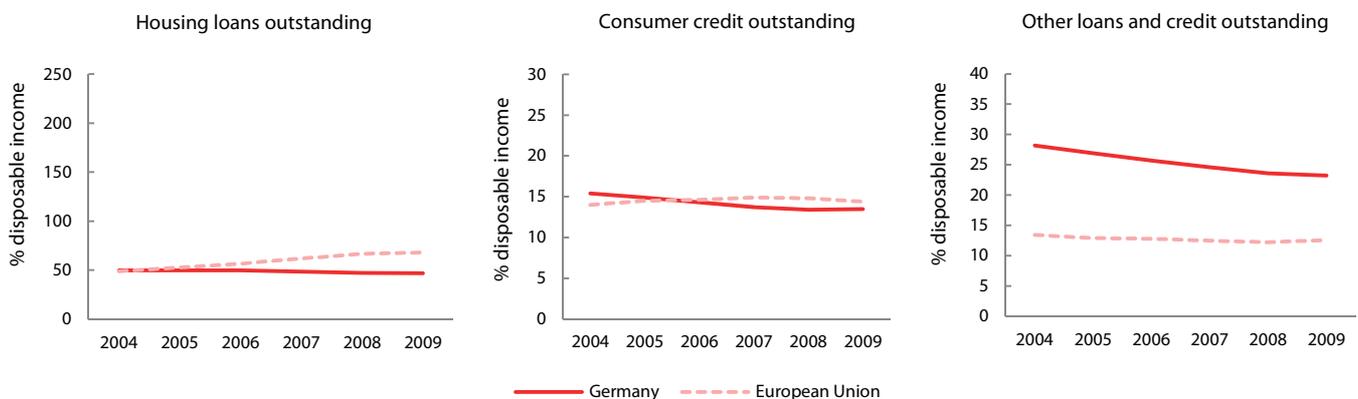
Proportion of those in households with outstanding debts of over 100% of disposable income by work intensity

Work intensity of 0 - 0.19 (% of people in households with outstanding debts)	↗ 8.9%	5.7%	0.0%	10.6%
Work intensity of 0.20 - 0.50 (% of people in households with outstanding debts)	↘ 2.3%	5.7%	0.0%	15.3%
Work intensity of 0.51 - 0.74 (% of people in households with outstanding debts)	↗ 13.5%	5.4%	0.0%	13.5%
Work intensity of 0.75 - 1.0 (% of people in households with outstanding debts)	↗ 12.0%	5.3%	0.0%	14.3%

Proportion of those in over-indebted households that experienced a major drop in income over the preceding year

Over-indebted (% of people in households that experienced drop in income)	↘ 25.5%	33.3%	0.0%	77.6%
Other (% of people in households that experienced drop in income)	↘ 12.6%	19.2%	5.9%	32.5%

IV. Loans and credit outstanding⁴



Notes:

- (1) Eurobarometer 72.1 (2009) and Eurobarometer 74.1 (2010). Note: Those who answered 'very at risk' or 'fairly at risk' to the question 'Please tell me how much you feel at risk of being over-indebted'.
- (2) Eurostat, SILC. Data as of December 2012.
- (3) European Commission, Research Note 4/2010, Over-indebtedness new evidence from the EU-SILC special module.
- (4) European Commission, Research Note 4/2010, Over-indebtedness new evidence from the EU-SILC special module. European Credit Research Institute (ECRI), Lending to households in Europe, 1995-2009 and Eurostat, National accounts.

11 GREECE

Document The over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact - Country report Greece

Prepared by Melina Mouzouraki

Finalised on 4 January 2013

Final report

Over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact

11.1 DEFINITION OF OVER-INDEBTEDNESS

In Greece there is no commonly used definition of over-indebtedness, as was reflected in the interviewees conducted with stakeholders. The term over-indebtedness is, nevertheless, broadly used and reference is commonly made to over-indebted persons as well as to over-indebted households.³⁸⁴

The interviewees who reported the use of a specific definition mostly referred to the one provided in the legal system,³⁸⁵ namely that contained in the law providing for a legal scheme of debt adjustment and debt relief adopted in 2010 (Law 3869/2010 on "Debt adjustment of over-indebted individuals").³⁸⁶ This law does not specify a definition of over-indebtedness as such, but it stipulates (in article 1) that the protection is granted to "individuals (natural persons), who are excluded from resorting to commercial bankruptcy law, who - without intention - are in permanent inability to serve their debts".

The scope of Law 3869/2010 essentially coincides with the definition of over-indebtedness used in this study. Both the law and the study definition refer to difficulty with meeting one's commitments; the difficulty must be ongoing; and there is no distinction made regarding the type of debt (e.g. whether the borrowing is secured or unsecured). On the other hand, there are two important differences. The Greek law requires that the debtor unintentionally get into the situation where they are unable to pay, and secondly, it does not refer to households, but only to individuals.

There is no definition in the legal system regarding individuals or households at risk of being over-indebted, and almost all interviewees who expressed an opinion on this matter responded negatively as to the need to introduce such a definition. Only one interviewee (from civil society) reported the use of a definition of households or persons at risk of over-indebtedness, referring to "people who can still cope with their financial obligations but it is obvious that they will not be able to in the future".

³⁸⁴ Reference to "over-indebted persons" or "over-indebted households" is made in various public documents, reports, surveys, articles in mass media, for example: Albanos, A., 'Study on the Support of Over-indebted Households in the European Regions'; Economic Chamber of Greece, 'The crisis of the Greek Economy and how to tackle it', pp. 4; Balourdos, D., 'The consequences of the crisis to poverty and to financial exclusion, Initial calculations and policies of adaptation', *Social Research Review*, 2011, pp. 134-135; Balourdos, D. and Spiropoulou, N., 'The Poverty Portrait in Greece under the crisis', 2012.

³⁸⁵ One interviewee from a civil society organisation reported the use of a somewhat different definition. This organisation considers households to be over-indebted if they "cannot meet their financial obligations (instalments of any kind) and cannot meet their daily needs".

³⁸⁶ Law 3869/2010 (Official Journal A 130/03.08.2010), as modified by law 3986/2011 (OJ A 152/1.7.2011), by Law 3996/2011 (OJ A 170/5.8.2011), by law 4019/2011 (OJ A 216/30.9.2011) and by the recent Legislative Act of 18.12.2012 (OJ A 246/18.12.2012).

11.2 LEVEL OF OVER-INDEBTEDNESS

The number of households that are over-indebted/have ongoing difficulties meeting their financial commitments has increased significantly in Greece over the last five years. This was reported by the stakeholders and is clear from the relevant statistical data.

First of all, the total level of indebtedness, in terms of the ratio of debt to GDP, increased from 10% in 2001 to 45% in 2007 and to 61% in 2011.³⁸⁷

Furthermore, there was an increase in the percentage of the total population with arrears. This rose from 26.4% in 2007 to 31.9% in 2011, which was almost three times the EU average of 11.4%.³⁸⁸

The percentage of the total population with arrears specifically on mortgage or rent payments also increased in this period, from 7.4% to 11% (above the EU average of 4% in 2011).³⁸⁹

Additionally, there was a notable increase in non-performing loans (NPL) in the portfolios of the Greek commercial banks.³⁹⁰ The NPL ratio rose to 7,7% in 2009, from 5,0% in 2008.

In 2009, 23% of the population felt at risk of over-indebtedness (against an EU average of 27%), whereas this share rose to 31% in 2010 (with an EU average at 25%).³⁹¹

The number of persons who sought free help with respect to out-of-court debt arrangement plans rose from 1,446 in 2010, when the law on over-indebtedness was launched, to 11,720 in 2011; i.e. within only one year (as was reported in the stakeholder interviews).³⁹²

With regard to the legal procedures of over-indebtedness that take place in court, 26,869 legal procedures were initiated within less than two years: from 1 January 2011 until 6 September 2012. This number alone is an important demonstration of

³⁸⁷ Bank of Greece, *Summary of Annual Report 2011*, Chart 17.

³⁸⁸ Eurostat, 'Arrears (mortgage or rent, utility bills or hire purchase)' (code: ilc_md05).

³⁸⁹ Eurostat, 'Arrears on mortgage or rent payments' (code: ilc_md06).

³⁹⁰ Bank of Greece, *Financial Stability Report 2010*, p. 66.

³⁹¹ Special Eurobarometer, *Poverty and Social Exclusion Report, 2010*, p. 42.

³⁹² The law on debt arrangement for over-indebted individuals (Law 3869/2010) provides for an obligatory pre-judicial phase, i.e. an attempt to reach an out-of-court debt payment plan with the creditors. Debtors may be assisted by several institutions, including consumer organizations, as well as the Hellenic Consumer Ombudsman (HCO).

how sharply the number of over-indebted people in Greece have increased in the last years.³⁹³

11.3 NATURE AND DRIVERS OF OVER-INDEBTEDNESS

11.3.1 Most common types of households that are over-indebted

As reported by the stakeholders interviewed in Greece, over-indebtedness spans across all types of households.³⁹⁴ Most interviewees felt that the situation is more critical for one- or two-person households with children, consisting of people between the ages of 24 and 64, because of higher living expenses. As one expert pointed out, older people are less exposed to debt, because they tend to have a less positive attitude towards credit and are more inclined to save.

Generally speaking, the most notable change in recent years regarding the types of households that are over-indebted is the growing number of middle class households affected. This was referred to by stakeholders and would mainly concern households with a higher education level and which live in owner-occupied housing (with mortgages).³⁹⁵ They are experiencing difficulties in meeting their financial obligations because of unemployment or salary cuts in conjunction with unexpected life events.

11.3.2 Causes of households' over-indebtedness

Until the end of the 1980s the Greek banking system was highly regulated. The early 1990s saw the gradual lifting of regulative restrictions on the credit market. After the entry of Greece into the Eurozone in 2001 and the complete deregulation of consumer credit in 2003, household borrowing grew quickly, with growth averaging about 28% annually in the period from 2002 to 2007.³⁹⁶ This increase reflected both the intensifying competition among banks in retail banking and the low initial level of household indebtedness.³⁹⁷ Interest rates for consumer credit were very high, i.e. higher than the average interest rates of the respective category of credit in the Eurozone.³⁹⁸ The most common type of household debt was related to credit cards,

³⁹³ The statistical data, published in September 2012, are kept in the registry of the Athens' Peace of Court.

³⁹⁴ People under the age of 25 are less affected because the credit expansion almost froze after 2009.

³⁹⁵ The level of homeownership in Greece is around 74%. This high rate is typical for Southern Countries and is among the highest in Europe (See: Hess, A. and Holzhaus, A., 'The structure of European mortgage markets', 2008, p. 5.

³⁹⁶ Mitrakos, T. and Simigiannis, G., 'The determinants of Greek household indebtedness and financial stress', Bank of Greece, Economic Bulletin May 2009, page 7.

³⁹⁷ Greece's household debt-to-GDP ratio in 2001 was only 10% when the EU ratio was 55% (Bank of Greece Annual Report 2011, chart 17).

³⁹⁸ Bank of Greece, Annual Reports of 2005 and following years. E.g. 'Annual Report of Monetary Policy 2005-2006', table III.5 page 61. See also Chart 15 'Average interest rate spread between new loans and new deposits in Greece and the euro area Jan.2003-Feb.2012', 'Summary of the Annual Report of the Bank of Greece', 2011, p.53.

with the highest interest rate among all types of credit, ranging between 17% and 21%. The second most common category of loans was housing-related loans.³⁹⁹

Throughout this period, after the year 2000, the average Greek household was exposed to a heavy advertising and promotion of a variety of credit means without being offered a possibility to access financial advice or having sufficient knowledge of financial products. As has been previously pointed out, neither the credit institutions nor the state put in place any mechanisms at this time to ensure the responsible use of credit and prevent over-indebtedness,⁴⁰⁰ although, as generally known, continuous accumulation of debt is expected to undermine a household's ability to regularly service its loan obligations.

The severe fiscal crisis and the sudden recession that followed⁴⁰¹ have led to a drastic turnaround in the living standards of Greek households and thus the inability to keep up with payments - including among those who had made a rational use of credit based upon their income and expenditure.

The current mass inability to meet financial obligations has designated over-indebtedness as a systemic social problem.⁴⁰²

One should also note that family ties - which are very strong in Greece - helped for many years to keep the level of over-indebtedness relatively low, as the family would help the debtor to keep up with the loan payments. On the other hand, strong family ties have helped to diffuse over-indebtedness, as many family members are engaged in credit as guarantors.

Causes of over-indebtedness that were noted in the stakeholder interviews are presented in the following paragraphs.

Macro-economic factors

All interviewed stakeholders shared the view that unemployment and wage level are causes of over-indebtedness. Social welfare level was also indicated by most stakeholders as a cause.

³⁹⁹ According to Mitrakos, T. and Simigiannis, G ('The determinants of Greek household indebtedness and financial stress', Bank of Greece, Economic Bulletin May 2009, p. 32), 40.1% of all indebted households reported a housing-related debt in 2007.

⁴⁰⁰ Spirakos, D., Paper for the Conference on Over-indebted households organized by the Ministry of Economy, Competitiveness and Shipping in Athens on 15.3.2010.

⁴⁰¹ A severe fiscal crisis broke out in Greece in late 2009 and intensified in the first months of 2010. In May 2010 Greece resorted to the support mechanism established by the European Commission, the International Monetary Fund and the European Central Bank. The adjustment programs enforced by the governments have resulted in an economic recession, significant salary cuts, businesses closing down and an explosive rate of unemployment.

⁴⁰² Amitsis, G. and Manrin, G., 'Action Plan to create a network of consultancy services for over-indebtedness in Greece', Final Report to the Ministry of Labour and Social Insurance, Athens, May 2012, page 63.

These factors have deteriorated due to the financial crisis and deep recession. The unemployment rate has been constantly growing, reaching an average of 17,7% in 2011,⁴⁰³ and 21.8% by January 2012. Long-term unemployment rate has also been growing.⁴⁰⁴ It is also worth noting that in the period 2009-2011 the number of unemployed heads of households doubled.⁴⁰⁵

As mentioned, the wage level was also identified by the stakeholders as a cause of financial difficulties. Since 2009 Greek GDP growth has been negative. Wage cuts have been very significant in both the public and private sectors. Many public sector employees, who had scheduled their borrowing upon a reliable steady income, have become unable to service their loans.⁴⁰⁶

Social welfare has also been seriously cut due to the government's austerity measures, which also further restricts the ability of households to meet their financial commitments.⁴⁰⁷

Moreover, as banks were also faced with a liquidity restraint because of the financial crisis, they were not in a position to provide the market with re-financing credit products.

Cost of living

Most stakeholders identified utility costs as a cause of over-indebtedness, but other cost of living, such as housing and childcare related costs, education and healthcare costs, as well as the cost of food, were also pointed out by some interviewees as being causes of over-indebtedness.⁴⁰⁸ It is worth noting that the wage cuts of the last years did not lead to price cuts, and in those cases where price cuts have taken place, the benefit for the consumer was lost due to heavy taxation, for example an increase of VAT in goods and services in 2010.

⁴⁰³ Bank of Greece, 'Summary of the Annual Report 2011', EL STAT (National Statistical Service) Labour Force Surveys, Chart 7 'Total Unemployment Rate (1999-2011)', p. 50 and p. 12.

⁴⁰⁴ Mitrakos, T. and Zografakis, S, 'The low income risk in households with unemployed members during the current crisis', Bank of Greece, May 2011.

⁴⁰⁵ As above in www.epikaira.gr. In numbers: 1,075,081 persons were unemployed in the second trimester of 2012 (up from 780,375 in 2011, 573,812 in 2010, 444,619 in 2009, 388,549 in 2008 and 423,369 in 2007) (See: National Statistical Service, 'Press Release from June 7 2012', www.statistics.gr).

⁴⁰⁶ According to the Federation of Public Employees around 400,000 public employees have got a mortgage and are unable to keep their monthly payments due to the cut of 50%-70% of their wage (www.enet.gr, 16.9.2012).

⁴⁰⁷ One interviewee cited the example of unemployment benefit which was been cut from 461 to 359 Euro and is granted only for a period of one year (this change is provided in law 4046/14.2.2012).

⁴⁰⁸ Some interviewees reported the increased cost of dealing with health problems, as a result of the collapse of the Social Security funds. One civil society stakeholder pointed out the fact that Greek households pay privately for the education of the children as well for health treatment, because of the poor quality of the public education and health systems.

Types of credit/loan taken out by households

Mortgages, which were indicated by all but one stakeholder as a cause of over-indebtedness, used to be commonly given out at a 100% loan-to-value (LTV) ratio, or even more, through a second mortgage contract, complementary to the basic mortgage, for repair of the property. It was only after 2010 that the banks tightened their terms and conditions on housing loans and reduced the LTV. Most stakeholders also indicated loans from regulated lenders with average interest rates and other regulated consumer credit with high interest rates as causes of over-indebtedness.⁴⁰⁹ Several pointed out that consumer credit interest rates were extremely high in Greece over the past decade.

Personal circumstances

Personal circumstances were also identified by stakeholders as a cause of over-indebtedness. In line with the previously noted importance of the macro-economic factors, all interviewees pointed to a drop in income caused by unemployment or business failure as a cause of over-indebtedness. This was followed by poverty and a decreasing or stagnant income while the costs of living steadily increase. Other personal circumstances such as divorce and illness can also be considered relevant, although there are no official statistical data available in Greece as of yet.⁴¹⁰

11.3.3 Changes relevant for levels of over-indebtedness

As already noted, there have been significant changes in the macro-economic situation which have - as interviewees pointed out - increased the level of over-indebtedness.

In addition, the level of over-indebtedness has been aggravated by the practices in the lending market. The liquidity squeeze experienced by the Greek banks and the notable increase in NPLs led to an increased reluctance of banks to extend new credit.⁴¹¹ Many households and businesses have been affected by this and, having difficulty staying afloat, have turned to non-regulated, usurious lenders. One interviewee working for a public authority reported:

In 2011 and 2012 we observed a great number of consumers trying to solve disputes with unregulated creditors, who gave them loans at extremely high

⁴⁰⁹ One financial industry stakeholder noted: "Sometimes people overuse credit cards to cover sudden expenses. These have a high interest rate, so when people get money from credit cards to pay other loans, they get deeper into the hole and they end up with an unbearable type of burden."

⁴¹⁰ According to research conducted on behalf of the Consumers' Association E.K.P.I.Z.O. among those who sought this association's assistance, 1 in 5 declared an income up to 4,000 Euro, i.e. less than the poverty ceiling of 7,178 Euro/person. Moreover, the interviewees in the mentioned research thought that the main causes for their over-indebtedness were high interest rates (61.6%), debt recycling (55.7%), wage cuts (45.1%), job loss (35.3%) and/or an illness/accident/death (27.5%). It is worth noting that the interviewees' borrowing, as they reported, was largely related to their everyday needs. (www.ekpizo.gr)

⁴¹¹ Foundation for Economic and Industrial Research, 'The Greek Economy 4/11', 2011, p. 47.

interest rates. These creditors are basically common loan-sharks, acting on the margins of the law and exploiting the dramatic financial situation of people who desperately need money to cover emergencies (e.g. urgent and expensive medical services), but have exhausted all possible means of regulated credit.

Although there are no official statistical data on usury in Greece, reference can be made to police files on usury in the major cities of Greece (Athens and Thessaloniki), as well as in other provincial cities.⁴¹² The Financial and Economic Crime Unit also reports an increase in complaints concerning usury, as well as an increase in organized groups of loan sharks acting in Attica and Volos.⁴¹³ In addition, numerous pawnshops have emerged in recent years, many of them illegal, buying mostly gold but also any other items.

The Hellenic Consumer Ombudsman noted in the latest annual report that several organisations which call themselves "Debt management bureaus" have been asking people in need of money to use their credit cards to buy certain goods. The "bureaus" keep the goods, and pay the consumers 50% of the total charge on the credit card.⁴¹⁴

Another development that has led to difficulties for Greek households is related to the fact that some households took out mortgages in foreign currency, particularly in Swiss Francs. At the time when these loans were being promoted in Greece (2007, 2008 and 2009), the exchange rate was around 1.6, whereas it currently is at 1.20, resulting in a considerable increase in the monthly instalments.⁴¹⁵

There has also been an increase in the inability of Greek households to pay their utility bills. This is mainly the case for electricity bills, which have risen considerably in the last two years.⁴¹⁶ Heating is also a major problem for households, due to the significant increase in the price of petrol and gas.⁴¹⁷

⁴¹² See Attikipress.gr/7895thessaloniki-syllipsi.

⁴¹³ http://kathimerini.gr/4dcgi/_/_articles_economy_2_24/01/2012_469921-49 members of four major groups of loan sharks acting in Thessaloniki, to which many suicides of victims are attributed, were arrested in 2012.

⁴¹⁴ The Greek Ombudsman, 'Annual Report 2011', Athens, 2012, pp. 67-68).

⁴¹⁵ According to the European Central Bank, the average exchange rate of the Euro against the Swiss Franc in the period 2 January 2007 to 9 January 2009 was 1.61, reaching a high point of 1.68 on 12 October 2007. By 21st December 2012 it had sunk to 1.2.

See: <http://www.ecb.int/stats/exchange/eurofxref/html/eurofxref-graph-chf.en.html>

⁴¹⁶ According to data given by D.E.H., the major electricity company in Greece, the debt of households which was at 483 million Euro in July 2011 reached the sum of 629 million Euro in April 2012 (<http://www.ethnos.gr/article.asp?catid=227708&subid=16.9.2012>).

⁴¹⁷ The price of petrol doubled during the last years because of a rise of a special tax, as provided in Law 3054/2002 (OJ a 230) as modified by Law 3851/2010 (for more details please see at the site of the Ministry of Energy, Environment and Climatic Change at www.ypeka.gr).

11.3.4 Cultural attitude towards debt and actual level of households' (over-) indebtedness

The cultural attitude towards debt has changed in the last decade, as borrowing came to be considered more acceptable and people started using credit to improve their living standards. One interviewee commented: "The modern Greek person saw happiness and prosperity as achievable through excessive consumerism and felt at ease with borrowing in order to attain a comfortable living standard comparable to that of Western societies." After the financial crisis, a notable change in the opposite direction can be noted, with people adopting a more conservative attitude to indebtedness.

11.4 CONSEQUENCES OF OVER-INDEBTEDNESS

11.4.1 Consequences for affected households

The consequences of over-indebtedness rated most highly by stakeholders are reduced standard of living, the deterioration of well-being and the deterioration of mental health.⁴¹⁸ For example, one public authority stakeholder referred to increased suicide rates as a result of the economic crisis. In the last two years, the number of suicides in Greece caused by debt has increased by 40%.⁴¹⁹

The consequences of the financial crisis on health are distributed in a different way depending on social class: low income households are twice as at risk of an early death, as the result of issues related to income, education, health care, housing and nutrition, factors that act in a cumulative way. Rising unemployment is associated with an increase in mental disorders, addiction problems, suicide and the mortality rate from ischemic heart disease. The poorer segments of the population are more vulnerable to these effects.⁴²⁰

Homelessness was also identified by stakeholders as a consequence of over-indebtedness. Until 2010 statistics on homelessness were very favourable for Greece. However, the number of homeless people has dramatically increased during the last two years as a result of the financial crisis.⁴²¹ The estimated increase is of 25% and is

⁴¹⁸ Some interviewees pointed out that an objective ranking of consequences by importance is not feasible because of a lack of solid data.

⁴¹⁹ According to the "The Lancet" during the period 2007-2009 suicides in Greece have increased by 17%, which puts Greece first in the list of European countries by percentage of rise of suicides. In the help line (1018), put in place since 2007, financial problems was the first cause told to the psychologists in charge. Currently the most common feature of the people addressing themselves to this helpline is difficulty to cope with one's debts (www.iefimerida.gr/news/28432/9.12.2011).

⁴²⁰ Kyriopoulous, G. and Tsiantou, B., 'Financial crisis and its impact on health and medical care', Health Economics, Archives of Hellenic medicine 2010.

⁴²¹ Giannetou, K, 'The Social Problem of Homelessness', ISTAME, Report of Public Policy, in which it is stated that NGOs estimate that the homeless people in Greece are around 20.000. In the Survey done by NGO "Klimaka 55" about the psycho-social profile and the

attributed to the so-called "neo-homeless", mainly the unemployed and people with major financial difficulties.⁴²²

Home repossession is another consequence directly related to over-indebtedness. Nevertheless, the initiation of foreclosure proceedings against debtors has been suspended since 2010. Such suspension, currently valid until 31 December 2012 (and prolongation of which are currently being negotiated between Greek and troika representatives), concerns debts of a maximum amount of 200.000 Euro towards credit institutions only, as well as all debts irrespective of sum and creditor if the property at stake is the debtor's only and main residence.⁴²³ Had this suspension not been in place, home repossession, as a legal right of the creditor in case of due debts, would have increased dramatically.⁴²⁴

Financial exclusion, which is also identified by stakeholders as a consequence for over-indebted households, has only recently started to become apparent. It has been reported that consumers that have initiated the personal insolvency procedures are immediately cut off any financial product (e.g. a debit card) and are declared insolvent in the Bank Information System called TIRESIAS.⁴²⁵ In 2008, the percentage of people living in households without any bank account reached 70,1% in Greece, against an EU27 average of 12%.⁴²⁶

Utility disconnections is another consequence of the financial difficulties of Greek households. According to recent data from the major electricity company, 30.000 disconnections are taking place per month⁴²⁷

11.4.2 Consequences of over-indebtedness for the financial services industry

The consequences of over-indebtedness for the financial service industry referred to by stakeholders include the cost of defaulted credits for creditors, the loss of potential customers for financial services providers through more restrictive lending practices,

living standard of homeless in Athens, Thessaloniki and Larissa (2005-2006, 200 people) 50,3% lost their home because of financial difficulties and low income).

⁴²² Alamanou, A., Stamatogiannopoulou, E., Theodorikakou, O., Katsadoros, K, 'The Configuration of Homelessness in Greece during the financial crisis', Klimaka NGO, Paper for the European Research Conference at Pisa, 16th September 2011 (www.klimaka.org.gr/newsite/download).

⁴²³ Suspension of foreclosure proceedings is provided in Law 3869/2010 art.19 par.1, as amended by Law 3896/2011, as amended by Legislative Act published in OJ 262/16.12.2011 and Legislative Act of 18.12.2012 (OJ A246/18.12.2012).

⁴²⁴ According to the press, more than 50.000 houses are at risk of foreclosure, out of which 20.000 are the main residence of the debtor., Katerina Giannetou, see above.

⁴²⁵ Tiresias S.A. is a Credit Bureau created by Credit Institutions in Greece. It keeps several credit profile data, like the Default Financial Obligation System (DFO) which contains data concerning the credit behaviour of individuals and companies (<http://www.teiresias.gr>).

⁴²⁶ Balourdos, D., 'The impact of the crisis on poverty and financial exclusion: initial calculations and adjustive policies', The Greek Review of Social Research, 134-135, A-b, p.165-192 (http://www.grsr.gr/preview.php?c_id=464).

⁴²⁷ This information was given to the Hellenic Parliament on November 15, 2012 by the Managing Director of the DEH Electricity Company, Ar. Zervos.

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the costs of arrears and agreed repayment/debt management plan for creditors, the increased costs for financial services providers through stricter regulation of credit as well the lower demand for credits because of higher risk premiums.

11.4.3 Economic and social consequences of over-indebtedness for society

Over-indebtedness has important economic and social consequences for society overall, as was observed by the stakeholders. The consequences rated most highly by stakeholders were loss of consumer confidence in the financial services industry, reduced productivity at work and the increased use of health care services due to poor mental or physical health. Economically, stakeholders also commented that society has to bear the costs for the provision of debt advice services, of legal costs associated with over-indebtedness, and the costs of other measures to alleviate the impact of over-indebtedness. These costs can indeed be very important. Nevertheless, there has so far been no policy put in place in Greece to tackle or alleviate the impacts of over-indebtedness, with the exception of the adoption of Law 3869/2010, because the resources provided are extremely restricted.

One stakeholder from a public authority pointed out that there has been an increase in crime, which can partially be attributed to long-term unemployment and lack of any income in certain parts of the population, as well a general turmoil and political instability strongly related to the economic recession.

11.4.4 Debt collection practices

Stakeholders mostly agreed that there has been a very significant change during the past five years regarding the use of aggressive debt collection practices. This is the inevitable result of debt accumulation and unserviced borrowing.

The collection of debt as such is not regulated in Greek law. What is regulated is the business activity of debt management on behalf of the credit institutions.⁴²⁸ In the framework of debt management, these businesses inform debtors about their debts and mediate on behalf of the banks for debt arrangements.⁴²⁹ The law sets out in detail the legal framework in which such business may operate, for example at what stage, how often and in what ways such companies are allowed to contact the debtor. However, the law is violated in many ways.⁴³⁰ For example, contact is made at inappropriate hours, or several times a day, or before a debt is even due,

⁴²⁸ Law 3759/2009 (OJ A 68), as revised by Law 4038/2012 (OJ A 14/2.2.2012). One of the changes of the amending Law of 2012 consists in the obligation of business to record the communications with the debtors and keep records for one year after such communication.

⁴²⁹ Some information in English can be found at the site of the Hellenic Association of Debt Management Companies (www.eseda.gr)

⁴³⁰ The state agency which is responsible for monitoring of this business is the General Secretariat for Consumer Affairs. Consumer complaints regarding this business is registered and handled by the GSCA. 1465 complaints have been filed during the last 3 years according to the interviewee from the GSCA. Recently fines were imposed to six companies regarding violations of the Law 3758/2009. Information can be found at the Press Release of 10.10.2012 (www.efpolis.gr)

communication is addressed not only to the debtor but also to relatives or at the debtor's workplace, or it is insulting and/or threatening, i.e. falsely claiming that in case of non-payment the debtor would go to jail, although one cannot be imprisoned for private debts in Greece.

This activity is, nevertheless, pursued not only by the debt management companies which are registered and monitored by the state and have to respect the procedure provided in law, but also from law firms which do not fall into the field of application of the law regulating the activity.

11.5 MEASURES IN PLACE TO ALLEVIATE THE IMPACT OF OVER-INDEBTEDNESS

11.5.1 Early identification of households at risk

There are no state policies in place regarding the early identification of households at risk.

Moreover, during the big credit expansion of the years following 2001, Greek credit institutions showed little or no interest in this. The rule, as drafted by the Bank of Greece in October 2006,⁴³¹ that the ratio of monthly payments of debt to the monthly income of a debtor should not exceed 30%, was not respected by the banks. However, as many interviewees stated, credit institutions today have adopted stricter rules for extending credit with regard to the assessment of the income of the debtor. Additionally, creditors are currently taking the initiative to - directly or indirectly- contact their clients immediately in case of any delay of a monthly payment in order to take hold of the situation of the debtor at a stage as early as possible. Creditors are also much more responsive to debtors' requests for adjustments in case of income restriction.

11.5.2 Advice offered to over-indebted households

Availability and costs

Personalised debt advice - face-to-face

Free debt advice in Greece is restricted to entities that participate in the Assistance Network for the Over-indebted put in place by the General Secretariat for Consumer Affairs in 2010 in order to support the obligatory phase of the out-of-court debt settlement as provided by Law 3869/2010. The entities participating in the Network are paid by the state and provide their assistance for free. These entities are the following: a major number of Bars of Lawyers throughout the country, consumers'

⁴³¹ www.bankofgreece.gr.

associations all over Greece,⁴³² the Hellenic Consumer Ombudsman⁴³³ and the Hellenic Ombudsman for Banking and Investment Services (H.O.B.I.S).⁴³⁴

According to the records of the Hellenic Consumer Ombudsman which is responsible for collecting data from all participating entities to this project, around 7,000 dossiers (out-of-court payment plans) have been concluded with the assistance of the entities participating in the network.

In addition, a large number of financial consultants and lawyers have appeared on the market during the last two years, offering their services in debt advice and debt settlement, as well as in the legal procedure of Law 3869/2010.

Personalised debt advice - by telephone

Some consumers' associations offer a helpline for debt advice⁴³⁵. The General Secretariat also offers help by telephone, but this is not sufficient considering the high level of demand and the need for a free, well-organised telephone debt advice service.

Personalised debt advice - by email / online chat

Personalised debt advice by e-mail is only partially available. Generally speaking, consumers in Greece, who are often not very familiar with technology, prefer to get personally in touch with the organisation or the person who would provide debt advice to them.

Web-based tools targeted at over-indebted households

The General Secretariat for Consumer Affairs offers two web-based tools free-of-charge, on its website targeted at over-indebted households (www.efpolis.gr). These tools help consumers draft a payment plan in the framework of the procedure provided in law, i.e. the obligatory out-of-court debt settlement plan, which is the obligatory first phase provided in Law 3869/2010.

Printed information targeted at over-indebted households

Such information is available in private companies acting in the market of debt settlements.

⁴³² The list can be found at the site of the General Secretariat for Consumer Affairs (www.efpolis.gr)

⁴³³ The Hellenic Consumer Ombudsman was established by Law 3297/2004 (Official Journal 259/2004)

⁴³⁴ Information on H.O.B.I.S. can be found at its site www.hobis.gr

⁴³⁵ For example, E.K.Pl.ZO Consumers' Association, www.ekpizo.gr

Demand for debt advice as assessed by stakeholders***Effectiveness as assessed by stakeholders***

Stakeholders indicated that they do not have data to assess the demand for debt advice or the effectiveness of such advice.

Funding of debt advice

Funding of debt advice in Greece is restricted to the afore-mentioned "Assistance Network for the Over-indebted".⁴³⁶ Such funding is provided for by the NSRF 2007-2013.⁴³⁷

11.5.3 Key measures in place to alleviate the impact of over-indebtedness***Availability and costs***

Informally brokered arrangements between the debtor and creditors such as a repayment plan, a debt management plan or debt write-off that may be brokered by a debt counsellor

Informally brokered arrangements between the debtor and creditors are currently widely available from legal or financial counsellors working on behalf and at the expense of the over-indebted consumers. In many cases, such arrangements are pursued by banks or debt management companies directly with the debtor. Nevertheless, according to an interviewee from a major consumers' association, the arrangements that are proposed by the banks are a "100% failure, as they are not realistic. They propose high rates, new mortgages...". In extreme cases of serious illness or unsecured debt of unemployed individuals, solutions proposed by creditors include partial debt write-offs or a debt management plan that begins with an interest free period of one or two years.

Formal procedures for debt settlement that do not take place in court

As explained above, Law 3869/2010 requires that the debtor negotiates with their creditors before filing a petition in court. Negotiations are a precondition to entry into the formal debt adjustment system. A 100% consensus of all creditors is needed in order to adopt an out-of-court debt settlement.

The rationale for this provision was to promote negotiations, as there seem to be clear advantages for both creditors and debtor, in particular a reduction in the length

⁴³⁶ The Assistance Network for the Over-indebted was set up by Ministerial Decision 1.3120/oik.3.630/9.3.2011 "System for the Management, Monitoring, Assessing and Control for the "Enforcement Support of Law 3869/2010 in the field of assistance in pursuing an out-of-court debt settlement".

⁴³⁷ The National Strategic Reference Framework 2007-2013 refers to the programming of the European Union funds for Greece for the period 2007-2013 (www.espa.gr/en).

of the process and a low cost procedure for the debtor. The creditors would be informed of the overall financial situation of the debtor and their difficulties in repaying the debts. Aware that the debtor also had the possibility of applying for the legal proceedings for debt adjustment, the creditors would have the opportunity to agree on an extra-judicial payment plan.⁴³⁸

Nevertheless, this consensual procedure has in practice so far proved to be a failure, since less than 1% of the out-of-court proposed payment plans have been accepted by the creditors.⁴³⁹

Legal procedures that take place in court (e.g. consumer insolvency proceedings)

Consumer insolvency proceedings are regulated in Law 3869/2010. This law is the regulatory intervention of the state to tackle over-indebtedness and serves to protect the over-indebted person and reintegrate them into society.⁴⁴⁰ As far as the procedure is concerned, the legislator adopted a complex model, following the procedure of collective satisfaction of creditors as provided in the Greek Bankruptcy Code, with some exceptions.⁴⁴¹

Financial support for households to repay debts/arrears (e.g. by public fund)

There is no provision in Greece for the financial support for households to repay debts/arrears. Other means of support are provided by the Greek Orthodox Church.

Effectiveness as assessed by stakeholders

The legal proceedings foreseen in Law 3869/2010 were assessed as very effective or fairly effective by stakeholders. Many court decisions have been issued that are favourable to over-indebted persons, "as they foresee debt write-offs and comfortable payment schemes for the rest of the remaining debt", as one public authority stakeholder explained. Furthermore, the stakeholder commented that "Court decisions are tailor-made and are reached after taking into consideration the particular social and economic circumstances of each individual (age, employment situation, health condition, marital status, income levels etc)".

Two main problems regarding the enforcement of the legal proceedings are identified by stakeholders: the duration of the proceedings, since the hearing is currently set after 2-5 years, depending on the competent court, and the fact that the courts tend to leave people who are declared insolvent with a very restricted monthly income.

⁴³⁸ Explanatory Report of Law 3869/2010, p. 4, www.hellenicparliament.gr

⁴³⁹ Statistics of the dossier by EKPIZO.

⁴⁴⁰ Kritikos, A., 'Debt adjustment of over-indebted individuals Law 3869/2010', Athens, 2010, p.17.

⁴⁴¹ Venieris, I. and Katsas, T., 'Enforcement of Law 3869/2010 for Over-indebted Individuals', Nomiki Vivliothiki, p.. 23.

Regarding the obligatory first phase of the out-of-court debt arrangement, stakeholders agree that it has not worked in practice and debtors always have to proceed to the court.

11.5.4 Changes in response to over-indebtedness

The adoption of a law for debt adjustment and debt relief is an important change in terms of responses to over-indebtedness. In addition, the stay of enforcement proceedings since 2010 is also of major importance. Generally, there is more public discussion taking place about over-indebtedness as well as an interest in the provision of debt advice, although this has not yet been crystallized in concrete policy measures.

11.5.5 Types of households of over-indebted consumers not reached by current measures

The current legal framework does not concern individuals who have a permanent inability to keep with the payments of their commitments if these have been taken on within the preceding year. Moreover, traders are excluded, as they can have recourse to the bankruptcy code procedure, where, however, the debtor's dwelling is not protected.

Guarantors are in a difficult situation. In case the principal debtor cannot pay and decides to use the insolvency proceedings, then creditors can address themselves to guarantors for satisfaction. Guarantors are entitled to make use of Law 3869/2010 as well as and independently of the principal debtors, but there are cases where such guarantors, although their financial situation is poor, do not meet the personal insolvency criteria and find themselves in a deadlock.

11.5.6 Best practices

There are specific provisions in the Greek legal system that may be considered to represent best practices, such as:

1. Experience from other countries has shown that debtors are discouraged from having recourse to the over-indebtedness procedure because of the fact that their dwelling is liquidated. This is the reason why in many cases debtors opt for a re-scheduling of the debts, which is a temporary relief and essentially perpetuates the debts, often under worse terms than the initial credit agreement. While traditional bankruptcy laws provide for the liquidation of all assets (i.e. including the home of the debtor) in order to pay the debts, the Greek law allows the debtor to ask the court for the exemption of liquidation of this home of residence, as explained above. This provision gives a broader protection to the debtor and to his dependents to maintain their standard of living. It essentially helps social cohesion, as well as keeping prices

for real estate at a reasonable level and giving an incentive to debtors to keep up payments towards creditors.

2. The stay of proceedings until 31 December 2013 regarding any immobile property for debts up to 200,000 euros towards credit institutions as well as debts irrespective of amount and creditor if the debtor's dwelling is at stake.

3. No confiscation or foreclosure is allowed on the debtor's only dwelling regarding debts to credit institutions which do not exceed the sum of 20,000 Euro and are related to consumer loans or credit cards, if the debtor is unable to pay and if he has not consented to a mortgage on his dwelling.⁴⁴² The prolongation of this provision, which was valid only until 31 December 2013, is currently being negotiated by Greek and troika representatives.

11.6 OUTLOOK

Stakeholders expected that over-indebtedness in Greece would increase in the next five years, due to the escalating crisis and the recession into which the country has sunk. Despite austerity measures, the Greek economy is continuing to decline. Salary cuts, social benefit cuts and the high unemployment rate are leading to the deterioration of households' finances and an increase in the number of households that will not be able to meet their financial commitments in the coming years.

For these reasons, there is a need for policy measures that would mitigate the problem of over-indebtedness and its consequences.

For example, it would be necessary to introduce a better means of monitoring the financial market, although some stakeholders disputed whether the necessary political will exists for this. In particular, responsible credit, as a basic principle for all creditors to respect, was referred to by stakeholders.

In terms of procedures for debt settlement, Law 3869/2010 should be monitored by the state, adapted to current circumstances and amended where necessary. For example, some interviewees made the point that implementing changes to improve the out-of-court debt settlement procedure would save the costs and time inherent to court proceedings. It has been argued that such a procedure should be organized in a way that all parties involved would actively participate: creditors, debtors, as well as the state acting as a third party guaranteeing objectivity and efficiency.⁴⁴³ Another

⁴⁴² Art 5 of Law 3714/2008 (OJ A 231/7.11.2008). Source: Spirakos, D., 'Tackling over-indebtedness during the financial crisis', paper submitted in the European Consumer Debt Network Conference in Athens, 22 November 2012.

⁴⁴³ Spirakos, D., 'Tackling over-indebtedness during the financial crisis', paper submitted in the European Consumer Debt Network Conference in Athens, 22 November 2012.

issue that needs to be addressed is the length of personal insolvency proceedings, where the time gap between the filing of the petition and the hearing has now risen to five years, due to an unexpectedly high number of petitions on over-indebtedness in relation to the shortages in the judicial system. However, a stakeholder from the financial services industry pointed out the moral hazard in making debt resettlement, in particular consumer insolvency, too accessible and would like to see that it is only offered to those who really deserve it.

In addition, one stakeholder stressed the need for the introduction of financial education programmes, which would help consumers improve their money management skills.

Finally, there is a need for a nationwide network, which would provide high quality debt and money advice for free.⁴⁴⁴ This network would help put in place a policy to identify individuals and households at risk of being over-indebted and to provide support so as to prevent it.

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⁴⁴⁴ The General Secretariat for Consumer Affairs has commissioned a study on the development of an advice and support network for consumers on issues of over-indebtedness. The study, done by the "Institute of Social Innovation, is concluded but no further action is taken yet to establish the network.

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Final report

Over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact

ANNEX A: STATISTICAL DATA FROM EU SOURCES

Final report

Over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact

Greece

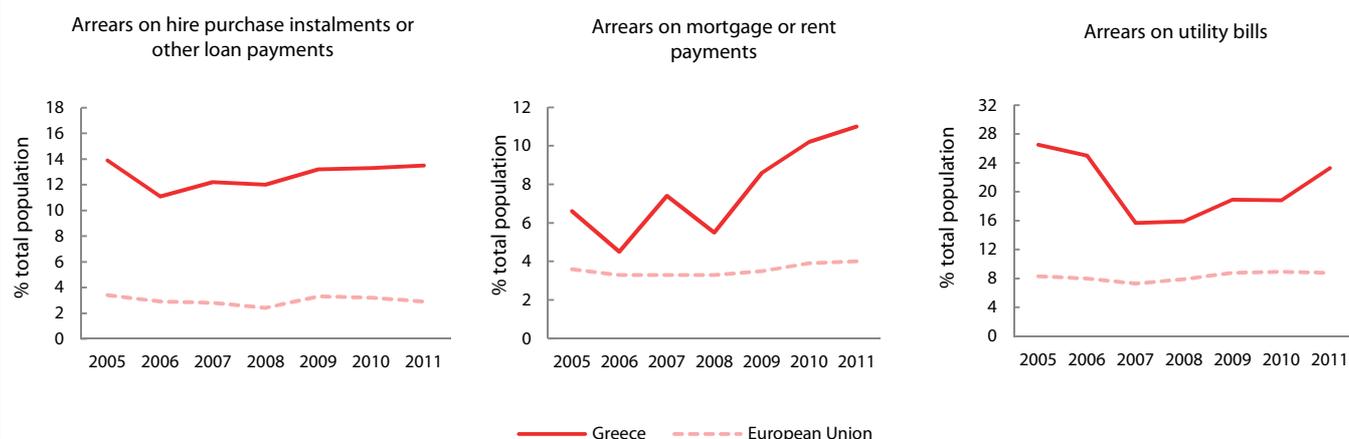
I. Eurobarometer¹

	Greece	EU average	Lowest EU value	Highest EU value
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Households *at risk* of being over-indebted

Respondents feeling at risk of over-indebtedness in 2010	↗ 31%	25%	7%	52%
Respondents feeling at risk of over-indebtedness in 2009	↘ 23%	27%	9%	53%

II. EU SILC standard survey data²



III. EU SILC 2008 module: Over-indebtedness and financial exclusion³

	Greece	EU average	Lowest EU value	Highest EU value
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Proportion of people in households with bank overdrafts, outstanding balances on credit cards or in arrears on other loans of over 100% of household disposable income

Overdrawn bank account (% of people in households overdrawn)	↘ 0.7%	2.2%	0.0%	7.7%
Credit or store card (% of people in households with outstanding balances)	↗ 2.5%	1.1%	0.0%	8.6%
Other loan/credit payments (% of people in households in arrears)	↗ 1.1%	0.3%	0.0%	1.1%

Proportion of people in households in arrears in servicing housing-related loans and bills and in paying other bills of over 100% of household disposable income

Housing bills (% of people in households in arrears)	↗ 0.9%	0.5%	0.0%	2.9%
Other payments (% of people in households in arrears)	↗ 0.5%	0.4%	0.0%	1.7%

Households living with outstanding debts and/or arrears of over 100% of household disposable income

Total (% of households with outstanding debts/arrears)	↗ 5.3%	4.6%	0.0%	11.8%
Income above 60% median (% of households with outstanding debts/arrears)	↘ 3.4%	4.2%	0.0%	11.3%
Income below 60% median (% of households with outstanding debts/arrears)	↗ 12.8%	7.0%	0.2%	13.7%
Materially deprived (% of households with outstanding debts/arrears)	↗ 11.0%	9.0%	0.1%	27.4%

Proportion of those in broad age groups with outstanding debts of over 100% of household disposable income

Households with all adults aged 25-39 (% of households with outstanding debts)	↘ 5.0%	6.3%	0.0%	17.2%
Households with all adults aged: 40-64 (% of households with outstanding debts)	↘ 5.6%	5.8%	0.0%	10.9%
Households with all adults aged: 65+ (% of households with outstanding debts)	↗ 2.0%	1.2%	0.0%	2.8%

Proportion of those in different types of household with outstanding debts of over 100% of household disposable income

Living alone (% of people in households with outstanding debts)	↗ 5.5%	4.3%	0.0%	8.2%
Single parent (% of people in households with outstanding debts)	↗ 17.3%	9.5%	0.0%	27.1%
Other (% of people in households with outstanding debts)	↗ 5.2%	4.8%	0.0%	12.1%

Proportion of those in households with outstanding debts of over 100% of household disposable income by marital status

Never married (% of people in households with outstanding debts)	↘ 4.9%	5.0%	0.0%	15.4%
Married (% of people in households with outstanding debts)	↗ 4.9%	4.1%	0.0%	9.7%
Separated/divorced (% of people in households with outstanding debts)	↗ 12.4%	7.5%	0.1%	13.9%
Widowed (% of people in households with outstanding debts)	↗ 3.7%	1.7%	0.0%	4.3%

Proportion of those in households with outstanding debts of over 100% of household disposable income by housing tenure

Owner occupied without mortgage (% of people in households with outst. debts)	↗ 4.1%	3.2%	0.0%	9.6%
Owner occupied with mortgage (% of people in households with outst. debts)	↘ 6.1%	6.3%	0.0%	16.1%
Market rent (% of people in households with outstanding debts)	↗ 9.6%	8.2%	0.0%	16.0%
Subsidised rent (% of people in households with outstanding debts)	↘ 0.0%	8.7%	0.0%	17.9%
Rent-free housing (% of people in households with outstanding debts)	↗ 4.5%	2.3%	0.0%	15.1%

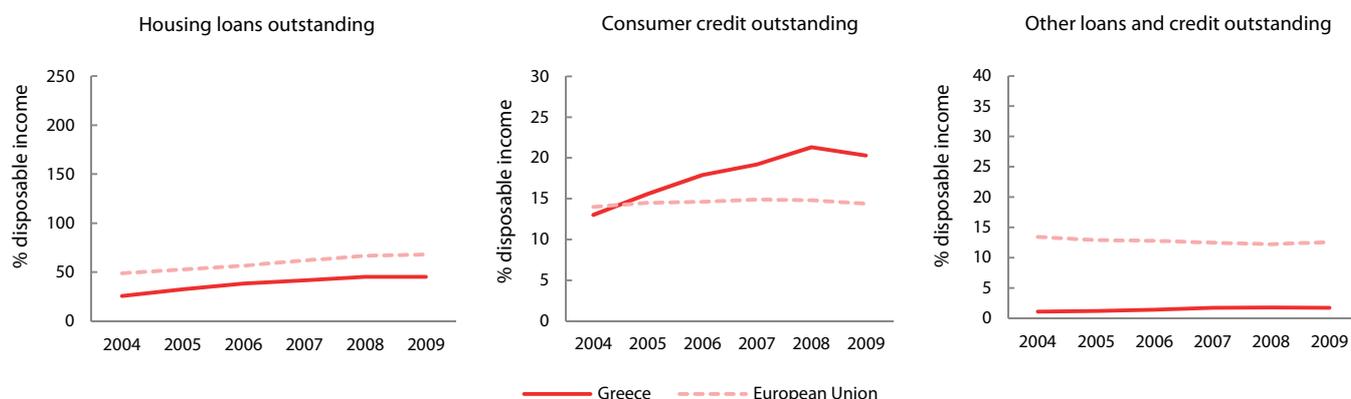
Proportion of those in households with outstanding debts of over 100% of disposable income by work intensity

Work intensity of 0 - 0.19 (% of people in households with outstanding debts)	↗ 8.3%	5.7%	0.0%	10.6%
Work intensity of 0.20 - 0.50 (% of people in households with outstanding debts)	↗ 5.8%	5.7%	0.0%	15.3%
Work intensity of 0.51 - 0.74 (% of people in households with outstanding debts)	↗ 6.7%	5.4%	0.0%	13.5%
Work intensity of 0.75 - 1.0 (% of people in households with outstanding debts)	↘ 4.5%	5.3%	0.0%	14.3%

Proportion of those in over-indebted households that experienced a major drop in income over the preceding year

Over-indebted (% of people in households that experienced drop in income)	↗ 41.7%	33.3%	0.0%	77.6%
Other (% of people in households that experienced drop in income)	↘ 17.3%	19.2%	5.9%	32.5%

IV. Loans and credit outstanding⁴



Notes:

(1) Eurobarometer 72.1 (2009) and Eurobarometer 74.1 (2010). Note: Those who answered 'very at risk' or 'fairly at risk' to the question 'Please tell me how much you feel at risk of being over-indebted'.

(2) Eurostat, SILC. Data as of December 2012.

(3) European Commission, Research Note 4/2010, Over-indebtedness new evidence from the EU-SILC special module.

(4) European Commission, Research Note 4/2010, Over-indebtedness new evidence from the EU-SILC special module. European Credit Research Institute (ECRI), Lending to households in Europe, 1995-2009 and Eurostat, National accounts.

12 HUNGARY

<i>Document</i>	The over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact - Country report Hungary
<i>Prepared by</i>	Anikó Bernát
<i>Finalised on</i>	10 December 2012

Final report

Over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact

12.1 DEFINITION OF OVER-INDEBTEDNESS

According to stakeholders, there is no common definition of over-indebtedness in Hungary, and a variety of definitions were used by the stakeholders that took part in an interview.

One of the definitions used was based on the Act on Social Administration and Benefits,⁴⁴⁵ which specifies eligibility criteria for participation in publicly funded over-indebtedness programmes. According to these criteria, a household can participate in an over-indebtedness programme and get funding to repay its debts if the debt is the result of rent or utility arrears, is at least six months old and to the value of more than 50,000 HUF, or if at least one utility service has been cut off, and as long as the household's income is not above the minimum level required for housing needs (as defined by the local authority).

A public authority stakeholder that took part in an interview argued that this definition should be modified, as the minimum length and value of the arrears is too high for many indebted households.

Another stakeholder indicated that a household could be seen as over-indebted if it used more than 30% to 35% of its disposable income for housing costs (including mortgage, rent and utilities). However, the stakeholder commented that this definition could also be seen as a definition for households at risk of over-indebtedness.

A similar definition was used by a public authority, i.e. that households could be seen as over-indebted if their debt service exceeded 30% of their net income. This stakeholder also considered households to be over-indebted in cases where they had applied for loan restructuring.

Stakeholders did not specify that they used a specific definition for households at risk of over-indebtedness.⁴⁴⁶

12.2 LEVEL OF OVER-INDEBTEDNESS

All stakeholders agreed that there had been a significant increase in the number of over-indebted households in the last five years.

⁴⁴⁵ Act III of 1993 on Social Governance and Social Benefits, 55§ (Az 1993. évi III. törvény a szociális igazgatásról és szociális szolgáltatásokról, 55. §)

⁴⁴⁶ One public authority stakeholder commented that one could potentially base such a definition on the ratio of loan to value or payment to income (e.g. a household with a LTV of 75% or a PTI of 40% might be seen as at-risk).

This assessment is supported by data from Eurostat, which shows that the percentage of the population with arrears increased from 19.1% in 2007 to 24.7% in 2011.⁴⁴⁷ This was more than twice the EU average of 11.4% (in 2011).

The same period also saw an increase in the share of loans that were more than 90 days in arrears in relation to total household loans, from 2.9% to 14.8%.⁴⁴⁸

If we look at the period 2005 to 2011, the percentage of the population with arrears on their rent or mortgage payments has more than doubled, from 2.8% to 6.5%.⁴⁴⁹ This was above the EU average of 4%.

In terms of the volume of mortgages in the banking system which are more than 90 days overdue, an even more significant increase is visible. The total volume of these loans increased from 356 million Euro in the fourth quarter of 2008 to 1,964 million Euro in the fourth quarter of 2010.⁴⁵⁰

According to the Eurobarometer nearly half of the Hungarian respondents (49%) felt at risk of over-indebtedness in 2010. This is a slight decrease from 2009 (53%), but still double the EU-average (see Annex A).

12.3 NATURE AND DRIVERS OF OVER-INDEBTEDNESS

12.3.1 Most common types of households that are over-indebted

According to stakeholders, households with an income of 60% or less than the median (i.e. households at risk of poverty) are more commonly affected by over-indebtedness. This is confirmed by data from Eurostat, which shows that 5.9% of households at risk of poverty in Hungary have outstanding debt or arrears amounting to at least 100% of disposable income, compared to only 2% of households not at risk of poverty (see Annex A).

Stakeholders also indicated that households with one or two unemployed persons were more likely to become over-indebted. This is likewise supported by Eurostat data, according to which households with a work intensity of 0.75 - 1.0 are less than half as likely to be over-indebted as households with a work intensity of 0.20 - 0.50.

However, stakeholders indicated that there had been a change in the types of household affected by over-indebtedness in the last five years. Due to the economic crisis and changes in exchange rates, households with higher education and income levels were increasingly affected by financial difficulties, in particular those with

⁴⁴⁷ Eurostat, 'Arrears (mortgage or rent, utility bills or hire purchase)' (code: ilc_mdcs05).

⁴⁴⁸ Hungarian Central Bank, 'Loan overdue more than 90 days to total household loans', 2012.

⁴⁴⁹ Eurostat, 'Arrears on mortgage or rent payments' (code: ilc_mdcs06).

⁴⁵⁰ European Mortgage Federation, 'Study on Non-Performing Loans in the EU', 2011, p. 24.

mortgages in foreign currencies. Prior to this, over-indebtedness was primarily related to poverty and it was rare for households with mortgages to become over-indebted.

In general, households with children, households affected by illness and households consisting of separated or divorced people were also considered to be particularly vulnerable.

12.3.2 Causes of households' over-indebtedness

Macro-economic factors

Stakeholders most frequently referred to the unemployment level and movements in exchange rates as macro-economic factors that cause over-indebtedness. The unemployment level in Hungary in 2011 was 10.9%, i.e. more than three percentage points higher than in 2007 (7.4%) and above the EU average of 9.7%.⁴⁵¹ Movements in exchange rates were seen as particularly important due to the high prevalence of foreign currency mortgage loans (in the first quarter of 2009, foreign currency loans made up 70% of all loans in Hungary).⁴⁵² As one stakeholder explained: "In Hungary the FX [foreign currency] mortgage loans are responsible for a significant part of households' payment problems as the local currency has depreciated a lot since 2008". For example, the value of the Euro rose from 229 Hungarian Forints on 22 July 2008 to 320 on 4 January 2012.⁴⁵³ Finally, around half of stakeholders referred to wage level and interest rates as causes of over-indebtedness.

Cost of living

In terms of the cost of living, stakeholders most frequently referred to utility costs as a cause of over-indebtedness. One civil society stakeholder commented that there had been too much focus on mortgages and that utility arrears were more important in terms of the number of people affected. Indeed, 23% of the population had utility arrears in 2011, about three or four times the amount of people with mortgage or rent arrears.⁴⁵⁴ Utility costs are driven up by the infrastructural specificities of housing in Hungary, namely poor quality heating systems and insulation.⁴⁵⁵

Besides utility bills, housing costs and other costs of living (such as food or transportation) also play a role in causing households' financial difficulties. According to a survey from 2003, housing costs made up 30% of household expenditure for 20%

⁴⁵¹ Eurostat, 'Unemployment as a percentage of the labour force' (code: tsdec450).

⁴⁵² Hungarian Central Bank, 'FX loans to total loans'.

⁴⁵³ European Central Bank, 'Euro exchange rates HUF'. See: <http://www.ecb.int/stats/exchange/eurofxref/html/eurofxref-graph-huf.en.html>

⁴⁵⁴ Eurostat, 'Arrears on utility bills' (code: ilc_mdcs07).

⁴⁵⁵ Bernát, A. and Kőszeghy, L., 'Managing household debts: Hungarian country report', Eurofound TARKI Social Research Institute, Budapest, 2011, p. 7.

of households in Hungary.⁴⁵⁶ One interviewee highlighted that in many households incomes are half of what would be needed to cover the cost of living. Another stakeholder added that in general the disparity between the wage level and the consumer prices is at the heart of the problem in Hungary.

Types of credit/loans taken out by households

Regarding the types of credit taken out by households, almost all stakeholders mentioned home loans and mortgages as a cause of over-indebtedness, and they also feature prominently in the domestic public debate. As explained above, many mortgages in Hungary were taken out in foreign currency, which became problematic for households when the value of the Hungarian Forint depreciated. The assessment given by the stakeholders as to the importance of foreign currency loans is supported by the results of the consumer interviews that took place in Hungary. More than half of the 20 households that took part in an interview had taken out a foreign currency loan and been negatively affected by the changing exchange rates.

Stakeholders also referred to regulated consumer credit with high interest rates and predatory or usurious types of credit. One stakeholder commented that the usury loans were more widespread in poorer parts of the country, mainly in villages where there are no banks. Some of the most vulnerable people in society are affected, predominantly the Roma minority. It is also evident from policy papers that there are still large numbers of people, particularly Roma, who have no access to banking and other mainstream financial services. These people are the target group of informal lenders.⁴⁵⁷

Personal circumstances

A drop in income caused by unemployment or business failure was the personal circumstance most frequently referred to by stakeholders. Data from the EU-SILC 2008 special module gives a similar picture, in that it shows that 47.5% of over-indebted households had experienced a major drop in income in the preceding year, compared to only 27.4% of other households. Stakeholders also frequently referred to poverty, lack of money management skills and incapacity to deal with financial products. For example, one stakeholder commented that many people had not been able to cope with the culture of consumption that developed with the change in economic system. Another stakeholder added that many households had taken out the maximum credit amount that the household budget could support and that once there is a problem they do not have any savings or fall-back options.

⁴⁵⁶ Ibid., p. 5.

⁴⁵⁷ See e.g. Financial Inclusion for the Roma: Banking As a Key to Social Progress. Open Society Roma Initiatives Policy Brief <http://www.romadecade.org/files/downloads/Employment%20Resources/RomaFinancialInclusion.FinalLayout.3.19.20.pdf>

The results of the consumer interviews generally support the above assessment. Several of the interviewees reported that they had suffered from a drop in income due to unemployment, illness or some other factor (such as a salary cut or business failure). Some households indicated that they had problems with money management. For example, one interviewee explained, "It may be a nice and easy thing to say that low income is the cause, but the real situation is different and much more simple. I never had the ability of long time planning regarding my finances. Or if I plan I can't keep myself to that".

12.3.3 Changes relevant for levels of over-indebtedness

Almost all stakeholders observed an increase in the accumulation of debts from utilities, telecommunication services and rents in the last five years. They linked this to an increase both in the price of utilities and of rented accommodation. For example, one stakeholder criticised the state for its inadequate housing policy, in particular for the increase in rental prices for municipally owned housing. Indeed, the housing cost overburden rate for households in rented accommodation was 43.8% in 2011, significantly above the EU average of 26.1%. In 2010, the figure was even higher: 49.9%.⁴⁵⁸ A recent survey carried out by the TARKI Social Research Institute in 2012 shows that people in Hungary are far more likely to have problems with utility bills than with consumer credit.⁴⁵⁹

Another change that has taken place in the last five years regards the accessibility of credit. The stakeholders who took part in interviews tended to agree that this has been reduced, as banks have adopted more restrictive lending practices and the government has introduced stricter regulation. Several pieces of legislation have been introduced by the government since 2009 to ease the burden on over-indebted households and impose limits on the availability of credit, for example with the use of maximum loan-to-value limits. In particular, the accessibility of foreign currency loans has been severely restricted, to extent that one stakeholder commented that "foreign currency loans are almost not available any more".

In addition to a reduction in the accessibility of credit as the result of legislation, stakeholders referred to a more cautious attitude on behalf of lenders. For example, one stakeholder commented:

It has become harder to get this type of credit [i.e. overdrafts and credit cards]. Banks are offering them much less. The "credit thrown after you" type of thing does not exist anymore.

⁴⁵⁸ Eurostat, 'Housing cost overburden rate by tenure status' (code: tessi164).

⁴⁵⁹ TARKI, 'A magyarok negyede továbbra is küzd a havi számlákkal', 2012. See: http://www.tarki.hu/hu/news/2012/kitekint/20120620_szamla.html (available only in Hungarian)

At the same time as credit from regulated lenders has been reduced, stakeholders indicated that there had been an increase in the number of households taking out credit from unregulated and predatory/usurious lenders. For example, one stakeholder commented, "Usury is expanding (...) as the social welfare system is being destroyed while the availability of legal credit for a segment of society is at least rather problematic". However, two stakeholders indicated that there had been increased government action against usurious lenders, which was having a positive effect.

In general, there has been a significant change in the regulatory environment in the last few years, not only to reduce to accessibility of credit, but also to help households that are already over-indebted. In 2009 a moratorium was introduced on court-ordered evictions and a Crisis Fund was set up by the government to provide financial support to households experiencing severe hardship.⁴⁶⁰ In 2011 the government introduced a "Home Protection Action Plan", in co-operation with the Hungarian Banking Association. This foresaw the lifting of the moratorium on foreclosures, but imposed a quota system that limited the number of foreclosures that could take place. Its other main aspects were as follows: (1) exchange rate fixing (the difference between the fixed and the actual rate is collected and will be financed by the lenders in HUF, carrying an interest rate linked to the benchmark Hungarian interbank rate); (2) the setting up of a National Asset Management Agency to provide help to households facing foreclosures; (3) enabling mortgage lending in Euros, but only according to strict regulation.⁴⁶¹

In the second half of 2011 an early repayment scheme for housing loans in foreign currency was introduced. This scheme allowed debtors to repay the entire outstanding amount by the end of 2011 at a fixed exchange rate. The difference between the actual and the fixed exchange rate had to be paid by the banks, which represented a substantial loss for the banking industry.⁴⁶² This measure can be seen as partially effective, but only for better off households who were in a position to repay the loan in one sum. Therefore, from mid-2012 the government introduced a new measure aimed at vulnerable households. This also applied a fixed exchange rate, but the difference between the fixed and the actual rate was to be paid by the bank, the state and the household in equal measure at the end of a five year period.

⁴⁶⁰ Bernát, A. and Kőszeghy, L., 'Managing household debts: Hungarian country report', Eurofound TARKI Social Research Institute, Budapest, 2011.,p. 13

⁴⁶¹ For example, the income of the borrower would have to be more than 15 times as high as the minimum wage and denominated in Euros. See: Bernát, A. and Kőszeghy, L., 'Managing household debts: Hungarian country report', Eurofound TARKI Social Research Institute, Budapest, 2011.,p. 14.

⁴⁶² Reuters, 'Hungarian banks see 20 pct of FX borrowers opting for early repayment', 2012. <http://uk.reuters.com/article/2012/01/03/hungary-banks-idUKL6E8C316K20120103>

12.3.4 Cultural attitude towards debt and actual level of households' (over-)indebtedness

Most of the stakeholders indicated that there was a relationship between the cultural attitude towards debt and the actual level of households' indebtedness. They predominantly referred to the heritage of the socialist regime and its economic culture, and explained that it took time to learn how a capitalist economy works (e.g. what credit means and how credit cards work etc.). For example, one stakeholder commented: "Knowledge of the functioning of credit was really low and not only with very poor households but with middle class households too".

Stakeholders also agreed that cultural attitudes towards debt had changed in the last five years, i.e. households had become much more cautious when it comes to taking out credit. Among the other developments of the past few years, the more rigorous practices of utility companies targeting their non-paying clients and the decreasing value and time of eligibility of unemployment and other social benefits were mentioned as factors which may influence the culture and the habits of paying utility bills.

12.4 CONSEQUENCES OF OVER-INDEBTEDNESS

12.4.1 Consequences for affected households

The consequences of over-indebtedness that were rated most highly by stakeholders that took part in an interview were reduced standard of living, utility disconnection and deteriorating mental health and well-being. These were followed by home repossession and family breakdown or divorce. Further consequences mentioned by the stakeholders include the removal of children from the household by authorities⁴⁶³ and the more general phenomenon of social exclusion. The lack of personal insolvency in Hungary was emphasised as a relevant factor that aggravates the consequences of being over-indebted.

The picture given by stakeholders corresponds well with the consequences described by over-indebted households that took part in an interview for the study. These most frequently referred to a reduction in their standard of living, explaining, for example, that they could not afford to pay for healthcare or provide for their children as they would like to. They also highlighted utility disconnection and the effects of over-indebtedness on their well-being and mental health. For example, one interviewee commented: "You can survive the financial part of it...But it's a hard task to think about it continuously. These thoughts accompany you every day, all the time."

⁴⁶³ The interviewee explained: "For example, they move to a small shed in the garden of the grandmother where there is no water or electricity and it is wet, and the child protection authorities want to move the children away because the circumstances are inadequate."

Around half of the interviewed households from Hungary had experienced utility disconnection at some point.

12.4.2 Consequences of over-indebtedness for the financial services industry

The consequence of over-indebtedness for the financial services industry rated most highly by stakeholders was the costs of defaulted credit for creditors, followed by the costs of arrears and agreed payment or debt management plans for the creditors; the lower demand for credit due to the higher risk premiums and the increased costs for financial services providers through stricter regulation of credit. The most highly rated other consequence, according to stakeholders, is the early repayment scheme introduced by the Hungarian Government in 2011 related to the situation of borrowers with loans in Swiss Francs, which caused a huge loss for the banking system.

12.4.3 Economic and social consequences of over-indebtedness for society

The most highly rated consequences, in terms of the economic and social effects of over-indebtedness on society, were reduced productivity at work and loss of consumer confidence in the financial service industry. Another effect of over-indebtedness on the macro level is the negative effect it has on consumption levels, which holds back economic growth.⁴⁶⁴

12.4.4 Debt collection practices

The majority of stakeholders had observed an increase in the use of aggressive debt collection practices in the last five years. For example, one stakeholder explained that lenders were imposing stricter deadlines and showing less understanding for the debtor. Another stakeholder indicated that there was a lack of regulation of the debt collection sector and pointed to the prevalence of abusive practices, such as threats of violence against the debtor. On the other hand, due to the moratoriums and limits on selling the houses of over-indebted households, which are the result of political and social pressure on the government, many fewer houses have been sold in auctions in the last few years.

12.5 MEASURES IN FORCE TO ALLEVIATE THE IMPACT OF OVER-INDEBTEDNESS

12.5.1 Early identification of households at risk

Almost all stakeholders reported that measures to identify households at risk of becoming over-indebted at an early stage are hardly common or not common at all.

⁴⁶⁴ Szigel, G. and Faykiss, P., 'The effect of indebtedness on the financial and income position of Hungarian households', Hungarian Central Bank (MNB), 2012.

One financial industry stakeholder mentioned the "positive list of good debtors" of the Credit Bureau which might be useful for this purpose in the future.

12.5.2 Advice offered to over-indebted households

In Hungary, a classical financial advice service hardly exists, at least not in terms of independent financial advisors paid by the clients. Borrowers with problems can turn to their banks in case of mortgage debts, or to the local government's debt advisory and management unit, but only on larger settlements and only with social housing rent or utility arrears. The latter is the dominant type of debt advisory and management services in Hungary. Legislation on systematic debt advisory services was passed in 2001, but operated on a voluntary basis. Therefore only a few local governments provided such services. The system was thus amended in 2005 and again in 2006, when the provision of debt advisory services became compulsory for towns with a population of over 40,000 and when new forms of housing-cost management (such as public utility pre-payment arrangements⁴⁶⁵) were also introduced.⁴⁶⁶

Availability and costs

Personalised debt advice

The debt management services operated by the local governments mostly on a compulsory basis are the most widespread form of debt advice and management service. However there are other stakeholders providing such services, primarily the utility service providers, but also some NGOs, such as the Network Foundation: Foundation for Budapest Fee Payers and Defaulting Payers and the Héra Foundation (both representatives of the energy sector and utility providers), or the Tutor Foundation, Habitat for Humanity Hungary, Home Attendant Programme by Association for Youth in the city of Pécs or the Hitel-S programme of the Hungarian Maltese Charity Service.⁴⁶⁷ These are personalised face-to-face advice services in most cases, therefore for households at risk of over-indebtedness this type of advice is the most available one. However such face-to-face debt advice services are available only for households with utility or rent arrears and primarily for those living on larger settlements, as the banks and utility service providers usually do not have branch offices in small settlements and the local government is not obliged to provide debt advisory and management services there.

⁴⁶⁵ A prepayment meter is a device which allows households to pay for their gas and electricity upfront. They work in a similar manner to pre-paid cell phones, as the consumer has to top it up with credit to access gas or electricity.

⁴⁶⁶ Bernát, A. and Kőszeghy, L., 'Managing household debts: Hungarian country report', Eurofound TARKI Social Research Institute, Budapest, 2011

⁴⁶⁷ Ibid.

Regarding the further types of advice offered for over-indebted households the possibilities are scarce and stakeholders therefore had little to say about them. Among these personalised debt advice by telephone is still the most widespread type; most of the interviewees who had any knowledge on it assessed it as available, but to a lesser extent than the face-to-face advice services (but also free of charge).

Debt advice via email or online chat is rarely available but generally free of charge, according to stakeholders. Web-based tools are available on the same very low level as chat or email services for over-indebted households. But if they available they are generally free of charge. On the other hand, many of the over-indebted households do not have access to the internet, as the result of demographic characteristics (older, with a lower level of education), a lack of IT skills and affordability reasons.

Printed information targeted at over-indebted households is also less available; according to half of the stakeholders it is not available at all. If this type of information is available, it is generally also free of charge.

Demand for debt advice as assessed by stakeholders

Although debt advice services are available for a large share of the population, stakeholders assessed that the degree to which these services are known to consumers is very low. On the other hand, the level of demand by affected households was assessed to be high. The demand for advice services has increased very much over the past five years according to the stakeholders. This is in line with the findings from previous research.⁴⁶⁸

Effectiveness as assessed by stakeholders

Most of the stakeholders who provided an assessment said that face-to-face advice is fairly effective in alleviating the impact of over-indebtedness.⁴⁶⁹ Besides this it is very hard to assess the effectiveness of a concrete measure due to the lack of monitoring in this area. Indirectly it could be said that as the main type of debt advisory services (face-to-face) is not available for a substantial share of the target group (as they are living on small settlements and they are poor), its effectiveness must be assessed as low from their perspective.

Funding of debt advice

The stakeholders agree that the funding of debt advice services is rather insufficient or not sufficient at all. Ninety per cent of the costs for the municipalities of larger settlements which must provide debt advisory and management services are covered

⁴⁶⁸ Bernát, A. and Kőszeghy, L., 'Managing household debts: Hungarian country report', Eurofound TARKI Social Research Institute, Budapest, 2011

⁴⁶⁹ A similar finding was reported in Ibid.

by the central government budget,⁴⁷⁰ but the funding of other stakeholders, especially NGOs working on this field, is scarce, unsure and largely insufficient.

12.5.3 Key measures in place to alleviate the impact of over-indebtedness

Availability and costs

Informally brokered arrangements between the debtor and creditors, such as a repayment plan, a debt management plan or debt write-off that may be brokered by a debt counsellor, are widely or partly available, according to all stakeholders who provided an answer. However, one stakeholder pointed out that some debtors drop out of the arrangements as they are unable even to pay the amended instalments. Another interviewee highlighted that banks usually offer loan restructuring for a fee; clients usually have to pay higher interest rates and they also have to take over the administrative costs. According to a civil society stakeholder, the price of these arrangements can be up to 20,000 Hungarian Forint, especially if a lawyer is needed.

Regarding legal procedures that take place in court, stakeholders emphasised that there is no law on consumer insolvency. Enforcement procedures regarding the reselling of houses with mortgage arrears were stopped by the moratorium introduced by the government. In sum, based on the answers of the stakeholders, legal procedures that take place in the court are rare. However, one civil society stakeholder commented that 70% of its clients wanted to go to court.

One important measure in place to alleviate the effects of over-indebtedness is the exchange rate fixation programme for FX mortgage borrowers. This is an agreement between the bank and the debtor about a reduced payment based on the fixed exchange rate and the programme provides a payment service relief for five years. This programme can be regarded as effective, but it is still in a very early stage. There is a similar scheme for defaulted borrowers, which can be regarded as insufficient.⁴⁷¹

For the most hard-hit segment of defaulted mortgage borrowers a so-called National Asset Management Company has been established, which, in theory, will take over the loan and the real estate of the borrowers, and rent them back their former real estate at a favourable price, but the launch of the operation of this programme has been delayed and its future is unsure.⁴⁷²

By the end of 2011, a special pay-back programme helped those who have mortgage loans but who had enough resources to pay back the mortgage loan in one

⁴⁷⁰ See Act III of 1993 on Social Governance and Social Benefits, 55§ (Az 1993. évi III. törvény a szociális igazgatásról és szociális szolgálatokról, 55. §) and Bernát, A. and Kószeghy, L., 'Managing household debts: Hungarian country report', Eurofound TARKI Social Research Institute, Budapest, 2011

⁴⁷¹ For further details, see: Hungarian Central Bank, 'Report on Financial Stability: April 2012', 2012.

⁴⁷² Bernát, A. and Kószeghy, L., 'Managing household debts: Hungarian country report', Eurofound TARKI Social Research Institute, Budapest, 2011, p. 14.

instalment on a fixed and lower exchange rate than the actual rate was. The banks received significantly less than they should have done and it was a huge loss for the banks, as explained above. This programme was promoted as a measure to help mortgage loan borrowers to avoid being indebted but in fact this measure was available only for those households who were able to pay back a huge amount of money within a short period of time, so the effectiveness of this programme from the aspect of over-indebted mortgage credit user households is doubtful.

Effectiveness as assessed by stakeholders

Informally brokered arrangements between the debtor and creditors, such as a repayment plan, a debt management plan or debt write-off, was assessed as fairly effective by the majority of stakeholders, while in the rest of the key measures investigated the majority of the stakeholders did not express any opinion. According to those who were able to assess them, formal procedures and financial support were judged as effective measures.

12.5.4 Changes in response to over-indebtedness

The majority of the stakeholders reported that responses to over-indebtedness in terms of measures to alleviate its impact had changed during the previous five years. As explained above, the Hungarian Government has introduced several measures to tackle the impact that the financial crises had on the households with foreign currency mortgages. These measures range from the moratorium on court ordered evictions to early repayment and temporary exchange rate fixing programmes.

Some of the stakeholders stated that these responses are too recent for them to be able to provide an opinion on their effectiveness. However, there are some indications that they are having an effect. For example, the share of FX denominated loans to total loans dropped from 71% in the first quarter of 2009 to 64% in the fourth quarter of 2011.⁴⁷³ Nonetheless, one stakeholder commented that some measures only provide a temporary relief to the financial situation of the affected households, which are likely to fall back into the same situation due to an insufficient income.

12.5.5 Types of households of over-indebted consumers not reached by current measures

The majority of the stakeholders observed specific types of over-indebted households that are not reached by current measures. For example, they referred to the victims of usury or illegal loans, which are usually among the poorest households, as not protected by these measures. In general households in poorer rural regions, especially on smaller settlements, low income and unemployed households without savings were considered to be the most vulnerable.

⁴⁷³ Hungarian National Bank, 'FX loans to total loans'.

12.5.6 Best practices

Most stakeholders indicated that there are some measures in place that could be considered best practice. For example, one representative of local government described their own programme as representing best practice, as this is a compulsory and publicly financed service that reaches a lot of people who would not have been reached otherwise. Another stakeholder recommended a programme based on a Dutch example and operated in a large city in South-Western Hungary between 2005 and 2011, namely the Home Attendant Programme in Pécs operated by the Association for Youth (this programme does not exist anymore). The key elements of the project were financial support combined with intensive social work in collaboration with the local authority and with some specific agreements with the utility companies. Another suggestion was for increased cooperation between utility companies and banks.

12.6 OUTLOOK

The Hungarian economy contracted by 1.7% in 2012 and is expected to stagnate in 2013. A slight improvement in unemployment is expected, but this is projected to remain above 10%.⁴⁷⁴ In line with these economic forecasts, the stakeholders tended to predict that the number of over-indebted households in Hungary would increase in the next five years.

The majority of interviewees indicated that there were specific new challenges that need to be addressed by policy makers. Some general remarks were made regarding the unemployment rate, the rise of political extremism and the exclusion of the Roma population from social transfers. More specific suggestions were that pre-paid electricity should be available for more households, or that there is a need for consumer consolidation and consumer insolvency to help those who are currently unemployed due to the crisis. One stakeholder highlighted that utility bill debts and rent arrears should be more of a focus for policy makers, and that, in general, households with low income should receive more attention. Another suggestion related to the need to improve the renting market for apartments.

On the whole, stakeholders indicated that changes regarding the regulation of credit, utilities and housing should be made at the national level.

Finally, the majority of stakeholders believed that there was a need for other, non-regulatory measures. More financial education for consumers was recommended, in order to improve the financial literacy of Hungarian households, for example through popular channels such as TV series. Generally, stakeholders referred to the need to develop the budgeting skills of households. Mention was made of personal

⁴⁷⁴ European Commission, European Economic Forecast: Winter 2013, 2013, p. 64.

mentoring. One stakeholder suggested system of support for over-indebted households based on the French model, within which the banks would closely cooperate with social workers. Another stakeholder made a related point, saying that more consultation with the actors in the field was a must.

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ANNEX A: STATISTICAL DATA FROM EU SOURCES

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Hungary

I. Eurobarometer¹

Hungary EU average Lowest EU value Highest EU value

Households *at risk* of being over-indebted

Respondents feeling at risk of over-indebtedness in 2010	↗ 49%	25%	7%	52%
Respondents feeling at risk of over-indebtedness in 2009	↗ 53%	27%	9%	53%

II. EU SILC standard survey data²



III. EU SILC 2008 module: Over-indebtedness and financial exclusion³

Hungary EU average Lowest EU value Highest EU value

Proportion of people in households with bank overdrafts, outstanding balances on credit cards or in arrears on other loans of over 100% of household disposable income

Overdrawn bank account (% of people in households overdrawn)	↘ 1.2%	2.2%	0.0%	7.7%
Credit or store card (% of people in households with outstanding balances)	↘ 0.3%	1.1%	0.0%	8.6%
Other loan/credit payments (% of people in households in arrears)	↘ 0.2%	0.3%	0.0%	1.1%

Proportion of people in households in arrears in servicing housing-related loans and bills and in paying other bills of over 100% of household disposable income

Housing bills (% of people in households in arrears)	↗ 0.7%	0.5%	0.0%	2.9%
Other payments (% of people in households in arrears)	↘ 0.3%	0.4%	0.0%	1.7%

Households living with outstanding debts and/or arrears of over 100% of household disposable income

Total (% of households with outstanding debts/arrears)	↘ 2.5%	4.6%	0.0%	11.8%
Income above 60% median (% of households with outstanding debts/arrears)	↘ 2.0%	4.2%	0.0%	11.3%
Income below 60% median (% of households with outstanding debts/arrears)	↘ 5.9%	7.0%	0.2%	13.7%
Materially deprived (% of households with outstanding debts/arrears)	↘ 5.2%	9.0%	0.1%	27.4%

Proportion of those in broad age groups with outstanding debts of over 100% of household disposable income

Households with all adults aged 25-39 (% of households with outstanding debts)	↘ 2.8%	6.3%	0.0%	17.2%
Households with all adults aged: 40-64 (% of households with outstanding debts)	↘ 2.7%	5.8%	0.0%	10.9%
Households with all adults aged: 65+ (% of households with outstanding debts)	↘ 0.3%	1.2%	0.0%	2.8%

Proportion of those in different types of household with outstanding debts of over 100% of household disposable income

Living alone (% of people in households with outstanding debts)	↓ 1.8%	4.3%	0.0%	8.2%
Single parent (% of people in households with outstanding debts)	↓ 4.8%	9.5%	0.0%	27.1%
Other (% of people in households with outstanding debts)	↓ 2.4%	4.8%	0.0%	12.1%

Proportion of those in households with outstanding debts of over 100% of household disposable income by marital status

Never married (% of people in households with outstanding debts)	↓ 1.8%	5.0%	0.0%	15.4%
Married (% of people in households with outstanding debts)	↓ 1.9%	4.1%	0.0%	9.7%
Separated/divorced (% of people in households with outstanding debts)	↓ 2.6%	7.5%	0.1%	13.9%
Widowed (% of people in households with outstanding debts)	↔ 2.0%	1.7%	0.0%	4.3%

Proportion of those in households with outstanding debts of over 100% of household disposable income by housing tenure

Owner occupied without mortgage (% of people in households with outst. debts)	↓ 1.8%	3.2%	0.0%	9.6%
Owner occupied with mortgage (% of people in households with outst. debts)	↓ 4.6%	6.3%	0.0%	16.1%
Market rent (% of people in households with outstanding debts)	↓ 3.4%	8.2%	0.0%	16.0%
Subsidised rent (% of people in households with outstanding debts)	↓ 6.6%	8.7%	0.0%	17.9%
Rent-free housing (% of people in households with outstanding debts)	↓ 1.9%	2.3%	0.0%	15.1%

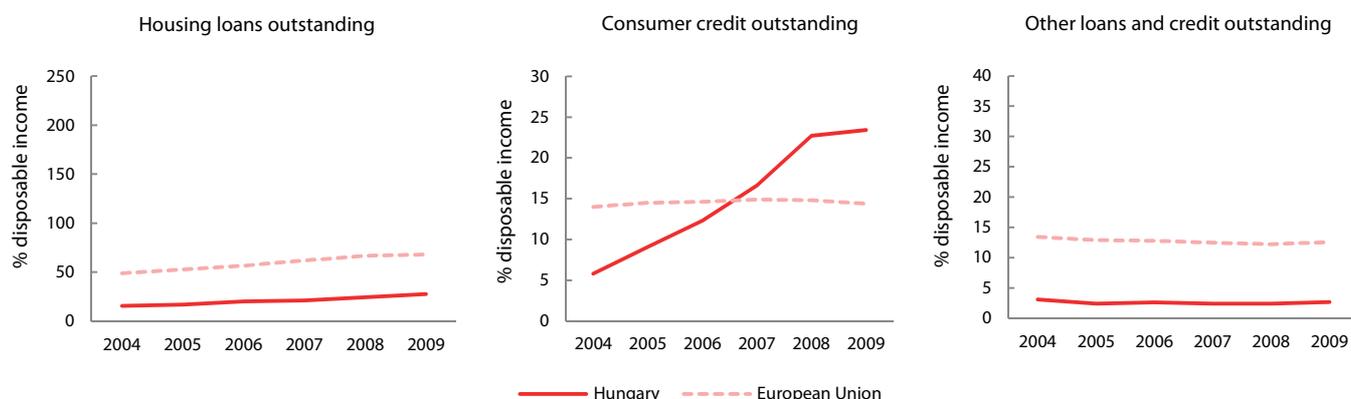
Proportion of those in households with outstanding debts of over 100% of disposable income by work intensity

Work intensity of 0 - 0.19 (% of people in households with outstanding debts)	↓ 3.4%	5.7%	0.0%	10.6%
Work intensity of 0.20 - 0.50 (% of people in households with outstanding debts)	↓ 3.9%	5.7%	0.0%	15.3%
Work intensity of 0.51 - 0.74 (% of people in households with outstanding debts)	↓ 2.2%	5.4%	0.0%	13.5%
Work intensity of 0.75 - 1.0 (% of people in households with outstanding debts)	↓ 1.5%	5.3%	0.0%	14.3%

Proportion of those in over-indebted households that experienced a major drop in income over the preceding year

Over-indebted (% of people in households that experienced drop in income)	↗ 47.5%	33.3%	0.0%	77.6%
Other (% of people in households that experienced drop in income)	↗ 27.4%	19.2%	5.9%	32.5%

IV. Loans and credit outstanding⁴



Notes:

- (1) Eurobarometer 72.1 (2009) and Eurobarometer 74.1 (2010). Note: Those who answered 'very at risk' or 'fairly at risk' to the question 'Please tell me how much you feel at risk of being over-indebted'.
- (2) Eurostat, SILC. Data as of December 2012.
- (3) European Commission, Research Note 4/2010, Over-indebtedness new evidence from the EU-SILC special module.
- (4) European Commission, Research Note 4/2010, Over-indebtedness new evidence from the EU-SILC special module. European Credit Research Institute (ECRI), Lending to households in Europe, 1995-2009 and Eurostat, National accounts.

13 IRELAND

<i>Document</i>	The over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact - Country report Ireland
<i>Prepared by</i>	Dr Stuart Stamp, Independent Social Researcher and Research Associate, Department of Applied Social Studies, NUI Maynooth
<i>Finalised on</i>	7 September 2012

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13.1 DEFINITION OF OVER-INDEBTEDNESS

There are no national definitions of 'over-indebtedness' or 'at risk of over-indebtedness' in Ireland. Data from the stakeholder interviews suggests that in the absence of an agreed definition, a case by case approach is generally being applied to determine both who is or is not over-indebted or at risk of being so. An example here, cited by a financial industry stakeholder, is the use of "cash-flow insolvency" as a proxy for over-indebtedness in that context. The 'case by case' ethos also informs the policy response to personal debt problems in Ireland, and underpins both the statutory Code of Conduct on Mortgage Arrears⁴⁷⁵ (as well as the associated Mortgage Arrears Resolution Process or 'MARP') and the proposed Personal Insolvency Bill going through the Irish parliament at the time of writing.⁴⁷⁶ In a research/policy context, organisations such as the Economic and Social Research Institute,⁴⁷⁷ Combat Poverty Agency, Money Advice and Budgeting Services (MABS) and TASC have drawn on the following definition of 'over-indebtedness' proposed by Stamp (2009):⁴⁷⁸

People are over-indebted if their net resources (income and realisable assets) render them persistently unable to meet essential living expenses and debt repayments as they fall due.

In terms of an operationalized definition, the Economic and Social Research Institute (ESRI) has developed a composite measure for over-indebtedness; this measure is based on persistent arrears, a heavy payment burden and an inability to access money to pay for unexpected expenses.⁴⁷⁹ The Central Statistics Office on the other hand, in its Surveys on Income and Living Conditions (SILC), uses a series of discrete indicators to estimate levels of over-indebtedness.⁴⁸⁰ These are: (i) experience of arrears within the previous 12 months; (ii) going into debt to meet ordinary living expenses within the previous 12 months; (iii) an inability to afford an unexpected living expense of around €1,100 without borrowing; (iv) the degree of difficulty in

⁴⁷⁵ Central Bank of Ireland, *Code of Conduct on Mortgage Arrears*, Dublin: Central Bank of Ireland, 2010.

<http://www.centralbank.ie/regulation/processes/consumer-protection-code/documents/code%20of%20conduct%20on%20mortgage%20arrears%20%201%20january%202011.pdf>

⁴⁷⁶ Government of Ireland, *Personal Insolvency Bill*, Dublin: Government of Ireland, 2012.

<http://www.inis.gov.ie/en/JELR/Pages/PR12000198>

⁴⁷⁷ See for example Russell, H. and Maitre, B., *Financial Exclusion and Over-indebtedness in Irish Households*, Dublin: Economic and Social Research Institute, 2011, p14.

http://www.socialinclusion.ie/publications/documents/2011_03_07_FinancialExclusionPublication.pdf

⁴⁷⁸ Stamp, S., *A Policy Framework for Addressing Over-indebtedness*. Dublin: Combat Poverty Agency, 2009, p7.

http://www.cpa.ie/publications/APolicyFrameworkForAddressingOverIndebtedness_2009.pdf

⁴⁷⁹ Russell, H. and Maitre, B., *Financial Exclusion and Over-indebtedness in Irish Households*, Dublin: Economic and Social Research Institute, 2011, p.15.

⁴⁸⁰ Central Statistics Office, *Survey on Income and Living Conditions 2010*, Cork: Central Statistics Office, 2012.

http://www.cso.ie/en/media/csoie/releasespublications/documents/silc/2010/silc_2010.pdf

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making ends meet, and (v) the burden of housing costs. Finally, the Central Bank of Ireland categorises mortgage over-indebtedness as a situation where a borrower is in arrears of more than 90 days.⁴⁸¹

A consensus emerged among stakeholder interviewees that agreed definitions of 'over-indebtedness' and 'at risk of over-indebtedness', acceptable to all parties to the problem, would be useful and three different contexts were suggested where such a definition would be particularly helpful. First, in a policy/research context, a more robust definition would facilitate longitudinal study of the problem and policy response within countries, and data/policy comparisons between countries. Second, in a regulatory/planning context, a set definition of over-indebtedness (acceptable to government, banking authorities and financial institutions), might help avert future crises, such as the one we are currently experiencing, by enabling key parties to identify the onset of the problem at an early stage and respond accordingly. Finally, in a service delivery context, an agreed definition could enable service providers both to better target their interventions and possibly dovetail their services more effectively.

13.2 LEVEL OF OVER-INDEBTEDNESS

Income to debt ratios suggest that the level of overall household debt in Ireland increased substantially over the duration of the boom.⁴⁸² Most stakeholders interviewed in Ireland reported that they do not collect data relating to over-indebtedness themselves. At a national level, data on levels and characteristics of over-indebtedness are not readily accessible; information on problems relating to unsecured debt for example is particularly difficult to obtain.⁴⁸³ An independent expert put forward a possible reason for this:

Across the board Ireland is quite poor in terms of data collection and statistics over time (for resource rather than technical reasons). Part of the reason is that there is a critical mass required in terms of data collection capabilities, and this is a small country, but there are still grounds for criticism. Freedom of information laws can also be quite restrictive so we are quite reliant on what official institutions release themselves.

⁴⁸¹ Central Bank of Ireland *Residential Mortgage Arrears and Repossessions Statistics: Q2 2012*, Dublin: Central Bank of Ireland, 2012.
<http://www.centralbank.ie/press-area/press-releases/Pages/ResidentialMortgageArrearsandRepossessionsStatisticsQ12012.aspx>

⁴⁸² Oireachtas Research and Library Service, *Debt Part 2: Personal Debt and Consequences*. Dublin: Oireachtas Research and Library Service, 2010.
http://www.oireachtas.ie/parliament/media/housesoftheoireachtas/libraryresearch/spotlights/Personal_Debt_and_Consequences.pdf

⁴⁸³ Stamp, S., *A Policy Framework for Addressing Over-indebtedness*. Dublin: Combat Poverty Agency, 2009, pp. 7-14.

Data that are available, however, indicate that both the extent of over-indebtedness and its characteristics have changed significantly in recent years. SILC data⁴⁸⁴ suggests that before the financial crisis struck in 2008, around 10% of households were in arrears with at least one bill or loan; this figure had risen to over 22% by 2010.⁴⁸⁵ The Eurobarometer surveys of 2009 and 2010 suggest that the percentage of households feeling at risk of over-indebtedness has also been rising in Ireland, from 28% in 2009 to 30% in 2010; both figures are slightly above the EU average.

A similar trend is indicated by Central Bank data in respect of mortgage arrears.⁴⁸⁶ An examination by the (then) Financial Regulator,⁴⁸⁷ published in December 2008,⁴⁸⁸ found that 1.4% of residential mortgage accounts were over 3 months in arrears as at June 2008. This figure had increased to 3.3% by September 2009⁴⁸⁹ and by June 2012 the corresponding figure had risen substantially to 10.9%.⁴⁹⁰ There are particular problems with arrears in the “buy to let” market. Repossessions, however, have remained low, as a result of a combination of policy interventions (e.g. the MARP) and pragmatic considerations based on high levels of negative equity, a depressed housing market, a legal judgement,⁴⁹¹ and (in the view of one stakeholder), historical resonances of property repossession in Ireland. There are indications in the most recent data published by the Central Bank that the number of mortgages less than three months in arrears is declining slightly.⁴⁹² However, it should be noted that the number of people choosing to voluntarily surrender their properties is increasing and

⁴⁸⁴ An annual Survey of (Irish) Income and Living Conditions (SILC) has been conducted by the Central Statistics Office (CSO) each year since 2003.

⁴⁸⁵ Central Statistics Office, *Survey on Income and Living Conditions 2010*, Cork: Central Statistics Office, 2012, p. 31.

⁴⁸⁶ Reports issued by the Central Bank of Ireland (CBI) on the extent of mortgage arrears and repossessions, have been published each quarter since December 2009.

⁴⁸⁷ The Central Bank Reform Act, 2010, created a new single unitary body, the Central Bank of Ireland, responsible for both central banking and financial regulation. The new structure replaced the previous related entities, the Central Bank and the Financial Services Authority of Ireland and the Financial Regulator. The Act commenced on 1 October 2010. See: <http://www.centralbank.ie/about-us/Pages/default.aspx>

⁴⁸⁸ Financial Regulator, *Findings of Arrears and Repossessions Handling Procedures Examination*, Dublin: Financial Regulator, 2008. <http://www.centralbank.ie/regulation/processes/consumer-protection-code/compliance-monitoring/documents/examination%20of%20arrears%20and%20repossessions%20handling%20procedures%2016%20december%202008.pdf>

⁴⁸⁹ Central Bank of Ireland, *Residential Mortgage Arrears and Repossessions Statistics: Quarter ended September 2009*, Dublin: Central Bank of Ireland, 2009.

<http://www.financialregulator.ie/press-area/press-releases/pages/newdataonresidentialmortgagearrearsandrepossessionpublished.aspx>

⁴⁹⁰ Central Bank of Ireland, *Residential Mortgage Arrears and Repossessions Statistics: Q2 2012*, Dublin: Central Bank of Ireland, 2012.

⁴⁹¹ There is a legal impediment to mortgage lenders repossessing certain properties where these relate to registered land:

See http://www.williamfry.ie/publication-article/repossession_of_property_in_loan_default.aspx.

The government has recently announced it is to address this issue:

See <http://www.independent.ie/business/irish/government-vows-to-close-loop-hole-preventing-banks-repossessing-homes-3324077.html>

⁴⁹² Central Bank of Ireland, *Residential Mortgage Arrears and Repossessions Statistics: Q2 2012*, Dublin: Central Bank of Ireland, 2012.

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leading to an increase in the amount of properties in the possession of the banks. According to the Central Bank:⁴⁹³

A total of 170 properties were taken into possession by lenders during the quarter [January-March 2012], of which 65 were repossessed on foot of a Court Order, while the remaining 105 were voluntarily surrendered or abandoned. The total number of properties taken into possession in the first quarter of 2012 represents an increase of 27.8% compared with the final quarter of 2011.

The numbers using Money Advice and Budgeting Services have also increased substantially in recent years.⁴⁹⁴ In the second quarter of 2008, 4,702 new clients used MABS services and there were 2,313 calls to the Helpline; by way of contrast, in the second quarter of 2012, a total of 6,802 new clients used MABS services and there were 6,197 calls to the MABS Helpline⁴⁹⁵ – an increase of 45% and 168% respectively.⁴⁹⁶

Regarding levels of different types of debt, as the EU SILC standard survey data confirms, the incidence of arrears on hire purchase or other loan repayments, mortgage or rent payments and utility bills all rose substantially in the period 2005 to 2010. However, it is the extent of mortgage arrears (as indicated by quarterly Central Bank data referred to above), which is causing most concern among policymakers in Ireland, and has led to the establishment of two separate working groups to make recommendations to address the problem.⁴⁹⁷ As mentioned above, levels of utility debt have also been increasing, particularly among lower income groups with whom such debt has been consistently associated.⁴⁹⁸ Data on utility arrears is somewhat hard to come by, but media reports suggest that around 310,000 utility customers entered into special instalment arrangements to pay electricity bills in 2011, and that

⁴⁹³ Central Bank of Ireland, *Residential Mortgage Arrears and Repossessions Statistics: Q1 2012*, Dublin: Central Bank of Ireland, 2012.

⁴⁹⁴ Statistics on the profiles of service users have been published every quarter by state-funded Money Advice and Budgeting Services (MBS) since the beginning of 2008.

⁴⁹⁵ See: <http://www.mabs.ie/news-press/mabs-statistics/>

⁴⁹⁶ Note that the MABS Helpline only went live in September 2007, which may be a factor here. The corresponding figure for callers to the Helpline in the second quarter of 2009 was 6,016.

⁴⁹⁷ The first group established by government published the “Cooney” Report in November 2010 (Department of Finance, *Final Report of the Expert Group on Mortgage Arrears and Personal Debt*. Dublin: Department of Finance, 2012.) <http://www.finance.gov.ie/viewdoc.asp?DocID=6583>

The second group drew up the “Keane” Report, which was published in September 2011. (Department of Finance, *Final Report of the Inter-Departmental Mortgage Arrears Working Group, 30 September 2011*. Dublin: Department of Finance, 2011.)

<http://www.finance.gov.ie/documents/publications/reports/2011/mortgagearr2.pdf>

⁴⁹⁸ See Central Statistics Office, *Survey on Income and Living Conditions 2010*, Cork: Central Statistics Office, 2012, p.69; Russell, H. and Maitre, B., *Financial Exclusion and Over-indebtedness in Irish Households*, Dublin: Economic and Social Research Institute, 2011, p.89

See also; Stamp, S., *An Exploratory Analysis of Financial Difficulties among Those Living Below the Poverty Line in Ireland*, Dublin: Combat Poverty Agency, 2009, p.64.

http://www.cpa.ie/publications/workingpapers/2009-02_WP_FinancialDifficultiesAmongThoseLivingBelowThePovertyLine.pdf

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of these, some 130,000 were in arrears on these bills.⁴⁹⁹ The most recent data identifiable show that prosecutions for unpaid television licences increased from 15,700 in 2009 to 20,000 in 2010.⁵⁰⁰ Arrears on credit union loans are also considerable, estimated to be in the region of 1 Billion Euro as at the end of 2011.⁵⁰¹

13.3 NATURE AND DRIVERS OF OVER-INDEBTEDNESS

13.3.1 Most common types of households that are over-indebted

A consensus emerged among interviewed stakeholders that although over-indebtedness is prevalent throughout society, some household types are more likely to experience difficulties than others. To summarise, these are households consisting of people between the ages of 25 and 39; households with children (whether one or two parent); households in owner-occupied housing with a mortgage who bought during the boom; households containing at least one unemployed person; households where people left school at primary or secondary level (and did not continue on to third level/college); finally, households at risk of poverty. The (limited) evidence currently available bears out these experiences. For example, MABS statistical data for 2012 illustrate that its service users are most commonly aged 26-40, female, couples with children or lone parents, mortgage holders and those with a primary income consisting of social welfare.⁵⁰²

Analysis of data gathered before the economic crash suggests that the profile of over-indebted households has changed significantly in one respect, namely housing tenure. For example, in a study of SILC survey data for 2008,⁵⁰³ the ESRI found that households most likely to report over-indebtedness were those renting their homes (i.e. tenants). This study also confirms that those most at risk are those in the lowest income quintiles, and those headed by an unemployed person, a sick/disabled person, a person with low qualification levels or a lone parent; a strong relationship was identified between over-indebtedness, poverty and the experience of deprivation, in line with a previous study, again based on data largely gathered prior

⁴⁹⁹ 'ESB uses UK debt collectors as 130,000 in arrears on bills', *Irish Independent*, 23rd February 2012.

<http://www.independent.ie/business/personal-finance/latest-news/esb-uses-uk-debt-collectors-as-130000-in-arrears-on-bills-3029085.html>

⁵⁰⁰ 'TV License Offences Jump by a Third in One Year', *Irish Independent*, 7th May 2011.

<http://www.independent.ie/irish-news/tv-licence-offences-jump-a-third-in-one-year-26730200.html>

⁵⁰¹ 'Credit unions run to court as arrears hit €1bn mark', *Irish Independent*, 14th February 2012.

<http://www.independent.ie/irish-news/credit-unions-run-to-court-as-arrears-hit-1bn-mark-26821561.html>

⁵⁰² See:

http://www.mabs.ie/fileadmin/user_upload/documents/About_MABS/MABS_Statistics/Mabs2_National_Stats_Report_2012_Q2_2.pdf

⁵⁰³ Russell, H. and Maitre, B., *Financial Exclusion and Over-indebtedness in Irish Households*, Dublin: Economic and Social Research Institute, 2011.

to the economic crash in 2008.⁵⁰⁴ It is likely that tenants (and particularly local authority or 'social' tenants) are still at greater risk of over-indebtedness than other tenure types, together with people buying their homes through the local authority;⁵⁰⁵ however, the emergence of a new cohort of over-indebted "mainstream" mortgage-holders, who had reasonable incomes and considerable, though mostly manageable, credit commitments during the boom is the most notable change over the past 4 or 5 years. As one respondent from public authorities explained:

The households most affected by the crisis were those whose members were in the 'family formation years', who had bought several financial products entailing regular repayments, which they were able to sustain before the crisis, but much less so afterwards.

A number of explanations for this change were put forward by the stakeholders and the picture that emerges is as follows. A construction-led property (and economic) boom, fuelled by cheap, readily accessible credit, in turn facilitated by soft-touch regulation, sucked in to home purchase a number of householders, primarily in the 25-40 age group, many with children. Rapidly increasing house prices provided enhanced equity for people to borrow cheaply (for home improvements, debt consolidation and further property purchase) on the strength of the rising value of their home; there was a widespread (and misplaced) belief that property prices would continue to rise. As a result, a house-price bubble emerged and subsequently burst as a consequence of what in retrospect was an unsustainable boom. Those who had borrowed heavily (to purchase or develop over-priced properties) on the strength of good incomes during the boom were left particularly exposed by the crash.

Many, particularly those dependent on the construction sector, lost their jobs or saw their businesses fail as unemployment soared to 15%⁵⁰⁶; those who have remained at work have experienced pay cuts, increased levies/taxation, and in some cases, reduced hours with less pay. Falling incomes, compounded by the subsequent draining of savings and a reduction in social welfare payments, have contributed to an inability to manage current debt levels. The lack of accessible debt settlement or personal insolvency provisions has served to prolong people's problems as there is effectively no systemic way out of over-indebtedness at the time of writing.⁵⁰⁷ Falling property prices (currently estimated to be over 50% below peak on average)⁵⁰⁸ mean

⁵⁰⁴ Stamp, S., *An Exploratory Analysis of Financial Difficulties among Those Living Below the Poverty Line in Ireland*. Dublin: Combat Poverty Agency, 2009, p.64.

http://www.cpa.ie/publications/workingpapers/2009-02_WP_FinancialDifficultiesAmongThoseLivingBelowThePovertyLine.pdf

⁵⁰⁵ See: <http://www.irishexaminer.com/ireland/kfojojsnmhid/rss2/>

⁵⁰⁶ In July 2012 the unemployment rate in Ireland was 14.8%. Source: Central Statistics Office (2012). Live Register July 2012. Cork: Central Statistics Office.

http://www.cso.ie/en/media/csoie/releasespublications/documents/labourmarket/2012/lreg_jul2012.pdf

⁵⁰⁷ Personal insolvency legislation is, however, due to be introduced by the end of 2012 (as discussed later in this report).

⁵⁰⁸ '20% of Irish mortgages to default, predicts Fitch', *Irish Times*, 2nd August 2012.

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that negative equity is a reality for many who bought at the height of the boom (2005-2007); this in turn has reduced household liquidity. One civil society stakeholder pointed out that over-indebtedness remains a problem among the tenanted sector, although this group is often overlooked as a result of the policy focus on mortgages.

13.3.2 Causes of households' over-indebtedness

Macro-economic factors

As described above, interviewees referenced unemployment and reduced wage levels as the two most important 'macro-economic' causes of over-indebtedness in Ireland. According to the Central Statistics Office, the standardised unemployment rate in Ireland as of July 2012 was 14.8%, a (Live Register seasonally adjusted) total of 437,300 persons; the number of people on the Register for more than a year was at an all-time high of 200,086 people (43.5% of the total on the Register).⁵⁰⁹ By way of comparison, the unemployment rate in Ireland in 2006 was 4.3% (the third lowest unemployment rate in the EU 27 at the time); the long-term unemployment rate in Ireland in 2005 was 1.4%.⁵¹⁰ According to a report on the most recent Census (2011):⁵¹¹

Households with a loan or mortgage which were headed by a person who was unemployed or looking for their first job numbered 14,757 in 2006. By 2011 this figure had increased significantly to 50,792, representing 8.7% of all mortgaged households. Of the 50,792 mortgaged homes where the head of household had no employment in 2011, 25,921 (51%) did not have anyone within the household who was at work.

Business failure is another factor. One interviewee referred to the impact of the economic recession on "failed small and medium enterprises leading to an inability to service unsustainable personal debt levels".

A number of stakeholders also highlighted social welfare levels as a factor. Social welfare cutbacks (along with tax rises) have been largely driven by an 'austerity'

<http://www.irishtimes.com/newspaper/finance/2012/0802/1224321295760.html>

⁵⁰⁹ Central Statistics Office, *Live Register July 2012*, Cork: Central Statistics Office, 2012.

http://www.cso.ie/en/media/csoie/releasespublications/documents/labourmarket/2012/lreg_jul2012.pdf

⁵¹⁰ Central Statistics Office, *Measuring Ireland's Progress*, Cork: Central Statistics Office, 2006.

<http://www.cso.ie/en/newsandevents/pressreleases/2007pressreleases/measuringirelandsprogress2006/>

⁵¹¹ Central Statistics Office, *Profile 4: The Roof Over Our Heads*, Cork: Central Statistics Office, 2012. See:

http://www.cso.ie/en/media/csoie/census/documents/census2011profile4/Profile4_The_Roof_over_our_Heads_entire_doc.pdf, p14.

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policy adopted to comply with the terms of the EU/IMF bailout package for Ireland.⁵¹² There have been significant cuts in welfare rates since the crash in 2008.⁵¹³ There have also been tightened eligibility criteria for various entitlements, notably to mortgage interest supplement, a payment to assist certain social welfare claimants to meet the costs of their mortgage repayments; concerns have been expressed that such changes may lead to increased over-indebtedness.⁵¹⁴

Cost of living

A number of specific costs of living were referenced by interviewees as contributing to financial difficulties. All respondents mentioned utility costs and a majority referenced housing costs (high mortgage payments and increasing interest rates), child-related/childcare costs (which are un-subsidised in Ireland),⁵¹⁵ and healthcare costs which have resulted in a large number of people cancelling their private healthcare plans.⁵¹⁶ As an interviewee who works with a government agency commented: "Cost of living has been going up overall, especially gas, electricity, new water charges have been announced..."⁵¹⁷

Education costs (e.g. increased university fees), predatory credit loans, increased taxation and reductions in public services were also mentioned by respondents as cost of living factors relevant to over-indebtedness.

Types of credit/loan taken out by households

All respondents considered credit extended by way of home loans/mortgages to be an important cause of over-indebtedness (it should be noted that levels of Irish home-ownership are high: at almost 70% according to the most recently available

⁵¹² EU/IMF Programme of Financial Support for Ireland, Memorandum of Understanding Between the European Commission and Ireland, 16th December 2010.

<http://www.finance.gov.ie/documents/publications/reports/2011/euimfrevised.pdf>

⁵¹³ To give but one example, a couple with one child would have received €166.00 per month in universal child benefit in 2008; by 2012, this had been cut to €140.00 per month (a reduction of 15%).

⁵¹⁴ Free Legal Advice Centres and the Northside Community Law Centre, *Submission on the Social Welfare and Pensions Bill 2012*, Dublin: Free Legal Advice Centres, 2012.

http://www.flac.ie/download/pdf/flac_nclc_submission_on_social_welfare_pensions_bill_2012_final.pdf

⁵¹⁵ 'Parents 'need support' with childcare costs', *Irish Examiner*, 7th August 2012.

<http://www.irishexaminer.com/breakingnews/ireland/parents-need-support-with-childcare-costs-562054.html>

⁵¹⁶ An estimated 65,000 people cancelled their private health insurance in 2011. See 'Health insurance hikes - should you stick or switch?', *Irish Times*, 28th February 2012.

<http://www.irishtimes.com/newspaper/finance/2012/0228/1224312477348.html>

⁵¹⁷ This view is corroborated by recent data issued by the Central Statistics Office, reported in the *Irish Times* ('Gas and electricity cost 10% more than year ago', *Irish Times*, 10th August 2012). Overall, consumer prices, as measured by the Consumer Price Index, increased by 1.6% from July 2011 to July 2012.

<http://www.irishtimes.com/newspaper/ireland/2012/0810/1224321894838.html>

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Census data;⁵¹⁸ this is due to a combination of historic and cultural factors, combined with the impact of a range of public policy measures to both support and facilitate owner occupation). Academic analysis bears out this view:

Between 2000 and 2007, mortgage credit outstanding in Ireland rose by over 300%, from 31.1 to 75.3% of GDP.... this dramatic growth in mortgage lending was concentrated in the 2002 to 2005 period.... this development was driven both by a rise in the number of mortgages granted and in the size of loans. The number of mortgages granted per annum rose from 57,300 in 2000 to a peak of 111,300 in 2006. However concurrently, residential mortgage debt per capita rose even faster, from €8,620 to €29,290.⁵¹⁹

The vast majority of interviewees also considered unsecured lending from mainstream lenders with average interest rates to be a major cause of household over-indebtedness. Again, there is evidence in the literature to support this view; consumer credit and credit debt both grew significantly during the boom.⁵²⁰ Poor or non-existent regulation undoubtedly contributed to what one stakeholder referred to as "a substantial amount of reckless lending". Financial exclusion, however, and the widespread use of moneylenders in this context, remained an issue in Ireland during the boom, and the available evidence suggests that this has increased following the downturn (see Section 1.4.1 below).

Personal circumstances

A number of changes in personal circumstances were highlighted by stakeholders as causing or contributing to on-going difficulties. All interviewees made reference to a drop in income, predominantly (but not exclusively) as a consequence of unemployment or business failure; so whilst macro-economic change may be seen as the key underlying cause, the resulting income shock is the trigger that signals the onset of debt problems; there is evidence in the literature to support this analysis.⁵²¹ The combination of reduced and often resulting low income, increased living costs

⁵¹⁸ Central Statistics Office, *Profile 4: The Roof Over Our Heads*, Cork: Central Statistics Office, 2012. See:

http://www.cso.ie/en/media/csoie/census/documents/census2011profile4/Profile4_The_Roof_over_our_Heads_entire_doc.pdf p12. However, the Census also reveals that the overall home ownership rate has dropped sharply, from 74.7% in 2006 to 69.7% in 2011.

⁵¹⁹ Norris, M. and Brooke, S., *Lifting the Load: Help for people with mortgage arrears*, Dublin: Waterford MABS, Citizens Information Board and MABSndI, 2011, p41.

http://www.citizensinformationboard.ie/downloads/lifting_the_load_sep11.pdf

⁵²⁰ See for example: Kelly, J., and Reilly, A., 'Credit Card Debt in Ireland: Recent Trends', *Central Bank of Ireland Quarterly Bulletin*, No. 1 (February 2005), p.85-100.

<http://www1.centralbank.ie/data/QtBullFiles/2005%2001%20Signed%20Article%20-%20Credit%20Card%20Debt%20in%20ireland.pdf>

⁵²¹ Stamp, S., *The Impact of Debt Advice as a Response to Financial Difficulties in Ireland*. *Social Policy and Society*, Volume 11, Issue 01, January 2012, p98.

<http://journals.cambridge.org/action/displayAbstract?fromPage=online&aid=8448270>

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and high credit liabilities, in some cases accompanied by ill-health or relationship breakdown, is a potent mix; for many, accustomed to managing on adequate resources, this situation is entirely unprecedented, hence they did/do not know what to do or where to turn.

13.3.3 Changes relevant for levels of over-indebtedness

All respondents noted “significant changes” in the macro-economic situation that have served to increase the level of over-indebtedness in Ireland. These have already been noted above, namely increases in unemployment, (small) business failure, taxation and charges,⁵²² and reductions in net incomes, welfare payments, house prices, consumer lending and public services. Income inequality, increased in Ireland between 2009 and 2010.⁵²³ The impact of ‘austerity measures’ was frequently mentioned. As an independent expert commented:

It is difficult to capture everything. There has been an equivalent of 24.6 billion (15% GDP) of cumulative discretionary tax increases and public spending cuts (fiscal austerity).

As regards measures to mitigate levels of over-indebtedness, the fact that mortgage interest rates have remained relatively low was cited as a mitigating factor by some respondents; those with tracker mortgages, linked to ECB base rates, have seen their interest rates remain particularly low.⁵²⁴ However, as the same interviewee as cited above explained “the impact is overwhelmed by the scale of the crash”.

All interviewed stakeholders considered that changes in lending practices, coupled with regulatory restrictions, are having a significant impact on over-indebtedness. Since 2008, lending institutions and in particular banks, have been much more cautious in their lending policy and fewer loans are now being granted. One interviewee referred to banks’ attempts to “de-leverage”, in line with Troika policy.⁵²⁵ Another interviewee commented on reduced loan to value (LTV) and loan to income (LTI) ratios now being applied in the context of mortgage lending, which is in turn

⁵²² For example, the Government recently introduced a ‘Household Charge’, an annual charge introduced by the Local Government (Household Charge) Act 2011, which is payable by owners of residential property.

<https://www.householdcharge.ie/default.aspx>

⁵²³ Central Statistics Office, *Survey on Income and Living Conditions Preliminary Results 2011*, Cork: Central Statistics Office, 2011.

http://www.cso.ie/en/media/csoie/releasespublications/documents/silc/2010/prelimsilc_2010.pdf

⁵²⁴ ‘Central Bank figures show that Irish mortgage interest rates are lower than the euro zone average’, *RTE News/Business*, 8th June 2012.

<http://www.rte.ie/news/2012/0608/irish-mortgage-interest-rates-lower-than-euro-zone.html>

⁵²⁵ The EU/IMF Programme of Financial Support for Ireland: 16th December 2010, states (p. 10): “A fundamental downsizing and reorganisation of the banking sector—complemented by the availability of capital to underpin solvency—is required to restore confidence. Addressing market perceptions of weak bank capitalisation, overhauling the banks’ funding structure, and immediately beginning a process of downsizing the banking system will be required.”

See: <http://www.finance.gov.ie/documents/publications/reports/2011/euimfrevised.pdf>

impacting on the Irish housing market. This is in contrast to the practice of offering 100% (or above 100%) mortgages during the peak of the boom, often coupled with high LTI ratios. Small businesses are also having difficulty accessing credit, an issue which has led to the establishment by government of a Credit Review Office.⁵²⁶

Specific practices or products in the financial services industry have now either been removed or are no longer in existence. One interviewee commented: "Regulation has increased but the damage has been done." Low interest 'tracker mortgages' for example (which track the ECB rate), were discontinued in 2009, although many borrowers still have them and are protected under the MARP.⁵²⁷ At the other end of the lending scale, sub-prime mortgages are no longer offered by former providers, although, as noted by one respondent, "they are still collecting outstanding loans". The revised Consumer Credit Directive and updated Consumer Protection Code⁵²⁸ together impose (ostensibly) more rigorous standards on credit providers, although no information is available as yet on their impact. As regards utility providers, whilst the introduction of pre-payment meters by energy companies may be helping address the extent of utility arrears, again, an evaluation of their impact would be useful.

Anecdotally, there would appear to be indications of an increase in illegal moneylending as a consequence of the prolonged credit crunch but due to its nature, there is no available data on this; several respondents made reference to a need for research in this area. As regards legal or licensed moneylending, a recent survey carried out for the Irish League of Credit Unions (ILCU) suggests there to be an increase in the numbers borrowing from such moneylenders.⁵²⁹

Due to its nature, there are no data on the number of consumers receiving help from family members in terms of meeting repayments or settling debts. However, several respondents were aware of parental/family support being given in this regard. As noted elsewhere in this report, utility arrears are a major, and growing, issue in Ireland, arising from an inability to meet all commitments from reduced resources.

The major change in the regulatory environment relevant to over-indebtedness has been the issuing of a statutory Code of Conduct on Mortgage Arrears (CCMA) by the Central Bank in January 2011. The Mortgage Arrears Resolution Process (MARP), referenced above, is the key component of this Code, and is designed to create a 'forbearance' framework within which realistic engagement between lenders and

⁵²⁶ See: <http://www.creditreview.ie/>

⁵²⁷ Central Bank of Ireland, *Code of Conduct on Mortgage Arrears*, Dublin: Central Bank of Ireland, 2010, p11.

⁵²⁸ Central Bank of Ireland, *Consumer Protection Code 2012*, Dublin: Central Bank of Ireland, 2012.

<http://www.centralbank.ie/regulation/processes/consumer-protection-code/documents/consumer%20protection%20code%202012.pdf>

⁵²⁹ Irish League of Credit Unions, *What's left tracker- July 2012*, Dublin: Irish League of Credit Unions, 2012.

<http://www.creditunion.ie/communications/news/2012/title,6904,en.php>

distressed borrowers can take place. It is difficult to evaluate the success or otherwise of the impact of the Code in the absence of data to this effect. However, recent Central Bank reports on mortgage arrears (see Section 1.2) include data on the number of re-structured mortgages; presumably, many of these are on foot of the MARP and give an indication of its possible impact. As one interviewee explained, there is "much more interplay at the personal level between creditor and debtor. We now have a more consultative and conciliatory process."

As of March 2012, 79,712 principal dwelling mortgage accounts (around 10% of all mortgage accounts) had been re-structured of which 38,658 were not in arrears and were performing as per the restructured arrangement. However, the remaining restructured accounts (41,054) were in arrears of varying lengths. According to the Central Bank, "arrangements whereby at least the interest only portion of the mortgage is being met account for just over half of all restructure types (52.3%)".⁵³⁰ Forbearance mechanisms such as this may help borrowers whose financial circumstances improve within a reasonable period. However, such measures can arguably exacerbate and prolong problems for those who are not so fortunate, and/or whose mortgages are realistically unsustainable; they may, in effect, be 'throwing good money after bad'.

At the time of writing, a Personal Insolvency Bill is going through the parliamentary process. This Bill includes three proposed out of court procedures, helpfully summarised by the Free Legal Advice Centres as follows:⁵³¹

(i) A Debt Relief Notice (DRN) for write-off of qualifying debt up to €20,000, subject to a three year supervision period (to be administered through MABS);

(ii) A Debt Settlement Arrangement (DSA) for agreed settlement of unsecured debt over 5 years;

(iii) A Personal Insolvency Arrangement (PIA) for agreed settlement of secured debt up to €3 million (this cap can be waived with the consent of all secured creditors) and unsecured debt, over 6 years;

A new Insolvency Service will certify or determine applications for the Debt Relief Notice, and will certify applications for the Debt Settlement Arrangement or Personal Insolvency Arrangement, and these will be ratified by the Circuit or High Courts. Lastly, Personal Insolvency Practitioners will make proposals on behalf of debtors in the Debt Settlement Arrangement and Personal Insolvency Arrangement and must act impartially.

⁵³⁰ Central Bank of Ireland, Residential Mortgage Arrears and Repossessions Statistics: Q1 2012. Dublin: Central Bank of Ireland, 2012.

⁵³¹ Free Legal Advice Centres, 'Relief at insolvency law reform - wary on bank veto & debtor supports'. *Press release*, 29th June 2012. FLAC has some concerns over the likely effectiveness of the proposed legislation as evident from the press release. <http://www.flac.ie/news/2012/06/29/relief-at-insolvency-law-reform-wary-on-bank-veto-debtor-supports/>

Although the Bill has been broadly welcomed, there are some concerns about specific provisions;⁵³² these are discussed in brief below (see Section 1.6).

Many stakeholders referred to a changed attitude to borrowing/credit among consumers since the downturn and that there is now a widespread reluctance to borrow at all, or at least an inclination to borrow more sensibly. It is possible (although too early to say) that the importance assigned to home ownership in Ireland may decline to some degree as a result of the mortgage crisis and people's experiences as a result.

13.3.4 Cultural attitude towards debt and actual level of households' (over-) indebtedness

There is little evidence on the issue of cultural attitude towards debt in Ireland, and there was no consensus in this regard among interviewees. Accumulation of personal debt during the boom was encouraged, facilitated and for many became the norm; thus it is probably accurate to say that there was a cultural shift in attitudes towards indebtedness during this period as many sections of Irish society (and particularly those in the younger age ranges) embraced a consumer culture.

Increased indebtedness during the boom did not, however, equate to increased levels of over-indebtedness at that time; levels with respect to the latter remained low as people had the resources to repay their debts and were clearly motivated enough to do so. In Ireland, most people take their debts seriously and inability to pay causes considerable anxiety. As one interviewee commented: "People feel an obligation to paying their debts."

The moral obligation to repay debts is reflected in an antiquated and Victorian legal system, and in warnings issued by institutional actors (such as the Financial Regulator and the IMF) who refer to the dangers of moral hazard⁵³³ and the need to maintain the discipline of debt repayment.⁵³⁴

All the evidence, much of it anecdotal, suggests that there is a moral imperative to repay debts embedded within Irish society, that the majority of people in trouble are 'can't pay' as opposed to 'won't pay', and that over-indebted people feel shame and guilt when they are unable to meet their debt obligations. There is a sense that the stigma attaching to over-indebtedness may, however, be reducing as the problem becomes more widespread and publicly discussed, especially in the media. Despite

⁵³² Free Legal Advice Centres, 'Relief at insolvency law reform - wary on bank veto & debtor supports'. *Press Release*, 29th June 2012.
<http://www.flac.ie/news/2012/06/29/relief-at-insolvency-law-reform-wary-on-bank-veto-debtor-supports>

⁵³³ 'Mortgage arrears; evictions are not the answer', *Irish Examiner*, 28th May 2012.
<http://www.irishexaminer.com/opinion/editorial/mortgage-arrears--evictions-are-not-the-answer-120901.html>

⁵³⁴ 'IMF calls for personal debt law', *Irish Examiner*, 15th June 2012.
<http://www.irishexaminer.com/archives/2012/0615/business/imf-calls-for-personal-debt-law-197465.html>

widespread condemnation of the banks and regulatory authorities, there appears to be little appetite among the general (presumably non-over-indebted) public for the wholesale writing off of debts. In the political sphere, the government's Personal Insolvency Bill reflects this view and embodies the concept of 'earned' fresh start which will only be granted after a considerable period (5-6 years) of repayment adherence.

To summarise, although culture in relation to indebtedness has changed, tolerance of over-indebtedness has not. Increased levels of over-indebtedness, therefore, appear to have more to do with socio- and macroeconomic factors, and associated demographics, than with cultural ones.

13.4 CONSEQUENCES OF OVER-INDEBTEDNESS

13.4.1 Consequences for affected households

The consensus among respondents was that the most important consequences for over-indebted households are reduced standard of living, deteriorating well-being and mental health, financial exclusion, utility disconnection, family breakdown/divorce and reduced labour market activity.

Much of the qualitative research carried out in Ireland predates the financial crisis, but there is evidence of these consequences or effects in such research; it should also be noted that the majority of these consequences can also be causes.⁵³⁵ Isolation, social exclusion and basic deprivation have been strongly identified among those experiencing over-indebtedness in Ireland;⁵³⁶ a recent study suggests that basic deprivation is an increasing issue in general for households above the poverty line.⁵³⁷ Repossessions remain low for reasons discussed earlier, but these may 'take-off' if and when forbearance measures come to an end and/or the property market begins to recover. Fuel disconnection, imprisonment for non-payment of fines and repossession of goods are also experienced by over-indebted households, although it is difficult to access reliable, current data on their extent. While it used to be fairly common to imprison defaulting debtors for a period of up to three months, this has changed since a 2009 High Court decision.⁵³⁸

⁵³⁵ See for example: Stamp, S., *Personal Debt, Poverty and Public Policy in Ireland*, Chapter 7 - "The Causes and Consequences of Over-indebtedness in Ireland" – Thesis Submitted to the National University of Ireland, Maynooth in fulfilment of the requirements for the degree of Doctor of Philosophy in the Faculty of Social Sciences, August 2009);

⁵³⁶ Russell, H. and Maitre, B., *Financial Exclusion and Over-indebtedness in Irish Households*, Dublin: Economic and Social Research Institute, 2011; Stamp (2009), supra.

⁵³⁷ Central Statistics Office, *Survey on Income and Living Conditions Preliminary Results 2010*. Cork: Central Statistics Office, 2011.
http://www.cso.ie/en/media/csoie/releasespublications/documents/silc/2010/prelimsilc_2010.pdf

⁵³⁸ Oireachtas Library and Research Centre, 'Debt part 3: The Imprisonment of Civil Debtors', 2010.

One of the interviewees who emphasised financial as a major consequence was concerned both about impaired credit rating and the closure of associated bank accounts. Another interviewee said:

Financial exclusion is a huge issue, both from the supply side (many banks have limited funds to lend) and the demand side (many consumers now have very poor credit ratings). More broadly, many people are stuck - even if they can continue to make their house payments they have few options.

Levels of financial exclusion are very high in Ireland (by European standards); this is a concept strongly associated with over-indebtedness.⁵³⁹ Research by the ESRI reveals for example that 20% of Irish households in 2008 did not have a bank current account.⁵⁴⁰ A national strategy on financial inclusion has been developed in response,⁵⁴¹ and a basic bank account (referred to as a Basic Payment Account) is being piloted at the time of writing. Ireland has a significant sub-prime lending market and use of moneylenders is widespread, particularly among those on low income.⁵⁴² Use of such credit sources appears to be increasing as people's options from other quarters narrow considerably.

13.4.2 Consequences of over-indebtedness for the financial services industry

As already discussed, high levels of over-indebtedness (and particularly mortgage over-indebtedness) are resulting in reduced lending activities by Irish financial institutions.

Two respondents referred to "internal" difficulties that banks are experiencing in dealing with the extent of the arrears problem. One financial industry stakeholder referred to the "negative impact on morale of front-line staff dealing with struggling borrowers". Another interviewee commented that "while lenders are often very good at giving loans, they can be very bad at dealing with over-indebted people because their loans arrears teams are not nearly big enough". Large scale job losses in one of the 'pillar banks'⁵⁴³ can only serve to compound such difficulties.⁵⁴⁴ It is also

⁵³⁹ Gloukoviezzoff, G., *Understanding and Combating Financial Exclusion and Over-indebtedness in Ireland: A European Perspective*. Dublin: The Policy Institute, Trinity College Dublin, 2012.

http://www.tcd.ie/policy-institute/assets/pdf/BP26_Financial_Exclusion_Gloukoviezzoff.pdf

⁵⁴⁰ Russell, H. and Maitre, B., *Financial Exclusion and Over-indebtedness in Irish Households*, Dublin: Economic and Social Research Institute, 2011, p15.

⁵⁴¹ Department of Finance, *Strategy for Financial Inclusion- Final Report*, Dublin: Department of Finance, 2011.

<http://www.finance.gov.ie/documents/publications/reports/2011/Fininclusreport2011.pdf>

⁵⁴² See: Corr, C., *Financial Exclusion in Ireland: An Exploratory Study and Policy Review*, Dublin: Combat Poverty Agency, 2006; also, Financial Regulator, *A Report on the Licensed Moneylending Industry*, Dublin: Financial Regulator, 2007.

http://www.cpa.ie/publications/FinancialExclusionInIreland_2006.pdf

⁵⁴³ Bank of Ireland and AIB/EBS. See statement by the Minister for Finance 6th April 2011:

<http://www.finance.gov.ie/viewdoc.asp?DocID=6765>

⁵⁴⁴ 'AIB announces redundancy terms', *Irish Times*, 18th May 2012.

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unfortunate that the rollout of the basic payment account pilot (a core component of the National Financial Strategy)⁵⁴⁵ should coincide with such turmoil.

13.4.3 Economic and social consequences of over-indebtedness for society

A majority of respondents referred to a loss in confidence in the financial services industry, and there has been a palpable loss of trust in banking institutions in Ireland, which are widely considered to be a major cause of our current crisis as a consequence of their 'leveraging' and lending activities. As regards the economy, where growth remains flat, an independent expert referred to the associated "reduction in aggregate demand (due to reduced households' consumption) with knock-on consequences for economic growth and employment". Irish consumer sentiment remains low, although there are some tentative signs of improvement at the time of writing. The ESRI/KBC Consumer Sentiment Index which measures consumer confidence, reached an all-time high of 130.9 in January of 2000 before plummeting to a record low of 39.6 in July 2008; four years later (in July 2012) it stood at 67.7.⁵⁴⁶ As a result, there is greater precautionary saving rather than spending.

The potential impact of over-indebtedness on employee productivity was referred to by one interviewee. Increased demands on health services as a result of above mentioned health difficulties associated with over-indebtedness,⁵⁴⁷ growing demands for publicly-funded debt advice services,⁵⁴⁸ and increased demands on the social welfare system (e.g. for assistance with mortgage interest payments)⁵⁴⁹ were referenced by various interviewees. Finally, concerns have been expressed in respect of the capacity of the social housing system in Ireland to cope with the demands of a significant rise in the rate of repossessions.⁵⁵⁰

<http://www.irishtimes.com/newspaper/breaking/2012/0518/breaking30.html>

⁵⁴⁵ Department of Finance, *Strategy for Financial Inclusion- Final Report*, Dublin: Department of Finance, 2011.

⁵⁴⁶ Economic and Social Research Institute and KBC Bank, *Consumer Sentiment Index, July 2012*, Dublin: Economic and Social Research Institute and KBC Bank, 2012; Economic and Social Research Institute and KBC Bank, *Consumer Sentiment Index Indices Report, January 2013*, Dublin: Economic and Social Research Institute and KBC Bank, 2012.

http://www.esri.ie/irish_economy/consumer_sentiment/latest_consumer_sentiment/CSI_Report_2012July.pdf

⁵⁴⁷ See for example: Women's Health Council and MABS National Development Limited, *Women, Debt and Health*, Dublin: Women's Health Council and MABS National Development Limited, 2007.

http://www.dohc.ie/publications/pdf/WHC_MABS.pdf

⁵⁴⁸ MABS publishes periodic data on waiting lists and waiting times for appointments. See: http://www.mabs.ie/fileadmin/user_upload/documents/About_MABS/MABS_Statistics/QTR_1_2012_Client_Waiting_Times_29_Feb_2012__2_.pdf

⁵⁴⁹ In March 2012, there were 18,117 recipients of mortgage interest supplement; this compares to a figure of 4,111 at the end of 2007 prior to the financial crisis.

See ; <http://debates.oireachtas.ie/dail/2012/04/25/00103.asp>

⁵⁵⁰ 'Personal and Mortgage Debt: Nine key principles to overcome the personal debt crisis: A statement by organisations & researchers working for those in debt'

<http://www.flac.ie/download/pdf/20111020090157.pdf>

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13.4.4 Debt collection practices

There is anecdotal evidence that some creditors are attempting to pre-empt the government's personal insolvency legislation by seeking judgements on unsecured debts. A majority of interviewees referred to what they perceived to be more aggressive debt collection practices by certain creditors, resulting from a range of different institutions chasing a lot of unsecured debt and the outsourcing of collection activities. One interviewee referenced the lack of regulation of such activities in Ireland:

The Irish debt collection industry is entirely unregulated, meaning that little official data is available relating to debt collection practices. However, court records, media reports and political debate have provided examples of cases suggesting that aggressive debt collection practices have risen significantly in recent years.⁵⁵¹

13.5 MEASURES IN FORCE TO ALLEVIATE THE IMPACT OF OVER-INDEBTEDNESS

13.5.1 Early identification of households at risk

The number of re-structured mortgages that are performing (discussed earlier) and utility payment plans that have been entered into (also discussed earlier) suggest that early intervention strategies are having some impact. Financial industry stakeholders noted that there is increased loan book monitoring by financial institutions; however, according to one such interviewee there are "very few pre-arrears structures in place". Borrowers facing difficulty are consistently encouraged by institutional spokespersons, regulators, debt advice/consumer agencies and others to make contact with their lender as soon as possible and seek advice if needed; such encouragement is given through the media and in published materials.⁵⁵² A civil society stakeholder noted that "energy utilities follow a detailed debt cycle process involving numerous forms and occasions for communication with customers in arrears".

In terms of consumer credit, an independent expert explained that:

regulatory codes establish requirements for lenders to engage with consumers in arrears, which include a duty of immediate communication with consumers within 10 business days of arrears first arising (e.g. Consumer Protection Code (2012), Chapter 8). As regards mortgages, the Code of Conduct on Mortgage Arrears (2011)

⁵⁵¹ This issue was highlighted by the Law Reform Commission in its Interim Report. See Law Reform Commission, *Interim Report on Personal Debt Management and Debt Enforcement*, Dublin: Law Reform Commission, 2010.

http://www.lawreform.ie/_fileupload/Reports/irDebt.pdf

⁵⁵² See for example: http://www.keepingyourhome.ie/overview_for_homeowners.html.en (Citizens Information Board website) and: <http://www.nca.ie/nca/debt-action-plan> (National Consumer Agency website).

applies both to borrowers in arrears and to "pre-arrears" borrowers, consisting of borrowers who contact their lenders to indicate that they are in danger of falling into mortgage arrears. A specified Mortgage Arrears Resolution Process (MARP) must be applied to 'pre-arrears' cases, and to other mortgage arrears cases in which arrears remain outstanding 31 days from the date on which they first arose.

However in terms of 'pre-arrears' cases, the reality is that it would be up to a borrower to contact the lender and not the other way round; as an interviewee who works for a government agency pointed out, "most lenders would not have access to enough data to assess risk of over-indebtedness". The Irish Credit Bureau,⁵⁵³ a member-based credit reference agency, is consulted by prospective lenders when credit applications are made; whether it is used by institutions to monitor risk of over-indebtedness among existing customers, is unclear. In the case of local authority (social) rents, a set of guidelines published over a decade ago, stresses the need for early intervention where tenants are beginning to run into arrears.⁵⁵⁴ Finally, presumably in recognition of the extent of mortgage arrears on local authority mortgages, a guide for local authorities in dealing with these was published in August 2012 by the Department of Environment, Community and Local Government. The guidance "acknowledges that it is in the interests of both the local authority, as the lender, and the borrower to address financial difficulties as speedily and as effectively as circumstances allow".⁵⁵⁵

13.5.2 Advice offered to over-indebted households

Availability and costs

Personalised debt advice - face-to-face

The main providers of personalised face-to-face debt advice in Ireland are state-funded Money Advice and Budgeting Services (MABS), first established in 1992. There are 51 of these services across the country (plus 2 national support services) operating as individual companies out of 60 offices nationwide; each service is managed by a voluntary board, limited by guarantee. A non-judgmental, client-centred, rights-based approach is adopted towards clients.

Funding is provided by the Department of Social Protection to a statutory independent body, the Citizens Information Board (CIB), which was assigned responsibility for MABS in July 2009. These services have a primary target group of "social welfare recipients and other low-income households" and most operate a

⁵⁵³ See: <http://www.icb.ie/>

⁵⁵⁴ The Housing Unit, *Rent Assessment, Collection, Accounting and Arrears Control*, Dublin: The Department of the Environment and Local Government and The City and County Managers Association, 2001.
<http://www.environ.ie/en/Publications/DevelopmentandHousing/Housing/FileDownload,2061,en.pdf>

⁵⁵⁵ See: <http://www.environ.ie/en/Publications/DevelopmentandHousing/Housing/FileDownload,30943,en.pdf>, p4.

client account in conjunction with local credit unions. In addition to the CIB, services are supported in terms of training, development, policy, practice and materials by MABS National Development Ltd (MABSndI) and, in the case of clients from the Irish Traveller Community, by National Traveller MABS. A technical support panel (under the auspices of MABSndI) assists advisers by providing a steer to services on legal, social welfare and other issues that arise through client casework. Statistics and policy issues arising are collated centrally (by MABSndI and CIB); statistics on service users are published quarterly. Moves are currently in train to address quality assurance standards, accreditation and evaluation procedures. Services are free to the end user/client and a service level model is used which aims to match the level of support provided with the capacity of the client.

Over the last few years, as the economic downturn has worsened, a number of private fee-paying debt management companies have established themselves in Ireland. Concerns have been expressed about their activities, charges and the potential for exploitation of vulnerable consumers.⁵⁵⁶ There is no licensing system for such companies.

Another development in the context of mortgage arrears is the establishment (in late 2010) of a group of lawyers, financial and business persons called "New Beginning",⁵⁵⁷ which aims to help people facing legal action to repossess their homes. Initially set up on a pro-bono basis, it appears that the group now charges for its services.⁵⁵⁸ A recently established "Mortgage Advice Service",⁵⁵⁹ funded by the banks, enables people to access free, "once off", face to face advice from an accountant in relation to an 'advanced forbearance proposal' put forward by their mortgage lender.

Personalised debt advice - by telephone

MABS services deal with telephone enquiries at local level. At national level, a MABS Helpline provides free advice and self-help materials.⁵⁶⁰ In July 2012, the government established a (free) Mortgage Arrears Information Helpline, under the auspices of the Citizens Information Board (CIB).⁵⁶¹ There are costs for the calls to these Helplines.

⁵⁵⁶ 'Concerns over unregulated debt companies', *The Irish Examiner*, 27th May 2011.

<http://www.irishexaminer.com/ireland/concerns-over-unregulated-debt-companies-155940.html>

See also: Law Reform Commission, *Interim Report on Personal Debt Management and Debt Enforcement*, Dublin: Law Reform Commission, 2010, p.36. http://www.lawreform.ie/_fileupload/Reports/irDebt.pdf

⁵⁵⁷ See <http://www.newbeginning.ie/>.

⁵⁵⁸ 'Free mortgage service to cost €250', *Irish Times*, 26th May 2012.

<http://www.irishtimes.com/newspaper/finance/2012/0526/1224316732535.html>

⁵⁵⁹ See press release: <http://www.welfare.ie/EN/Press/PressReleases/2012/Pages/pr060912.aspx>

⁵⁶⁰ See: <http://www.mabs.ie/about-mabs/>

⁵⁶¹ See: http://www.keepingyourhome.ie/about_MAIH.html.en

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Personalised debt advice - by email / online chat

The MABS Helpline deals with email enquiries as part of its service.⁵⁶²

Web-based tools targeted at over-indebted households

There are a number of web-based tools that are specifically targeted at over-indebted households. There is an interactive MABS self-help guide which takes users through the various steps of dealing with debt.⁵⁶³ In addition, there is the Citizens Information Board's website [keepingyourhome.ie](http://www.keepingyourhome.ie), which has been designated by Government as the key online resource for general mortgage information including dealing with arrears.⁵⁶⁴ The National Consumer Agency has produced a number of web-based tools to help with money management and dealing with the debt including a 'debt action plan',⁵⁶⁵ 'budget planner',⁵⁶⁶ 'financial health check',⁵⁶⁷ and 'economiser'.⁵⁶⁸ In the context of living standards, the Vincentian Partnership for Social Justice has produced a web-based tool that enables households to calculate the amount of minimum income they require to be able to afford household goods and services to an acceptable level.⁵⁶⁹

Printed information targeted at over-indebted households

MABS, the Citizens Information Board and the National Consumer Agency all produce printed information targeted at over-indebted households (examples of which can be found using the websites referenced in the footnotes). Free Legal Advice Centres (FLAC) have produced a number of accessible guides of use to over-indebted households, for example in relation to the Code of Conduct on Mortgage Arrears, terminating hire purchase agreements, and moneylending and the law.⁵⁷⁰

Demand for debt advice as assessed by stakeholders

Demand for debt advice has increased considerably in recent years following the financial crisis. MABS statistics show that 26,881 new clients used MABS services in 2011 compared with 19,041 in 2008, an increase of 41%. As regards the MABS helpline, in 2011 the Helpline dealt with 29,636 calls, compared with 10,943 in 2008

⁵⁶² See: <http://www.mabs.ie/contact-mabs/>

⁵⁶³ See: <http://www.mabs.ie/self-help-guide/>

⁵⁶⁴ See: <http://www.keepingyourhome.ie/>

⁵⁶⁵ See: <http://www.nca.ie/nca/debt-action-plan>

⁵⁶⁶ See: <http://www.nca.ie/nca/budget-planner>

⁵⁶⁷ See: http://www.nca.ie/media/financial_health_check1.pdf

⁵⁶⁸ See: <http://www.nca.ie/nca/economiser>

⁵⁶⁹ See: <http://www.misc.ie/>

⁵⁷⁰ See: <http://www.flac.ie/publications/category/legalinformation/>

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(its first full year of operation), an increase of 170%.⁵⁷¹ Data are not available for other sources of debt advice.

There have been calls for increased funding for MABS services for reasons to do with both increased numbers of people needing advice and the complexity of their financial problems (including the sheer numbers of creditors involved in individual cases).⁵⁷² Stakeholders interviewed for this study frequently commented on the impact of increased demand for debt advice in terms of waiting lists, waiting times and demands on existing staff. As regards the increased demands on MABS services, one interviewee noted:

The issue with MABS is that there is too much demand and it is all at one time and more complex than previously. [The traditional client] base might be people on welfare, with social payments, with one loan and maybe utility arrears or just problems with managing financing. Now they have clients with multiple debt problems.

In the context of the private sector, a financial industry stakeholder commented that "there is an avalanche of people that need debt advice but there are not that many institutions offering good advice".

Effectiveness as assessed by stakeholders

There was a general sense among respondents that MABS is playing a highly significant role in alleviating the impact of over-indebtedness and is making the best use of the resources available to it; media coverage of MABS is generally very positive and the service is highly regarded by politicians. A recent study in relation to the experience of mortgage arrears among MABS clients identified a number of specific impacts of MABS' interventions from the clients' perspective, including alleviation of stress and improved money management skills.⁵⁷³ However, such enquiries are rare in the context of over-indebtedness as a whole. One civil society stakeholder noted that "the views of indebted people as to the effectiveness of the services available to them are rarely sought". Another interviewee commented that the MABS approach (perceived to be centred on buying time/forbearance) has certain limitations in that it "does not necessarily work with chronic problems", a response which is more a commentary on the lack, heretofore, of systemic options for dealing with such problems in Ireland.

⁵⁷¹ MABS, 'Pre-Budget Submission 2012', p.2; MABS, 'National Stats Report 2012 Q1', p.1.

⁵⁷² 'Personal and Mortgage Debt: Nine key principles to overcome the personal debt crisis: A statement by organisations & researchers working for those in debt, p.5.

<http://www.flac.ie/download/pdf/20111020090157.pdf>

⁵⁷³ Norris, M. and Brooke, S., *Lifting the Load: Help for people with mortgage arrears*, Dublin: Waterford MABS, Citizens Information Board and MABSndI, 2011, pp.107-113.

A recent study which reported on an evaluation of MABS debt advice interventions before the financial crash concluded that MABS interventions and their impacts are very significant, but that they cannot be expected to resolve complex debt problems on their own in the absence of ancillary measures:⁵⁷⁴

Debt advice plays a major role in alleviating personal over-indebtedness and its effects ... however, the government's objective that it should facilitate financial independence is unrealistic. For such debt advice to be effective, complimentary legal and institutional solutions to debt problems are required in Ireland. The dearth of financial options and resources available (to people) also needs to be addressed.

Funding of debt advice

As discussed earlier, there are concerns that MABS requires more funding given the scale of the debt crisis Irish households are currently facing. One independent expert commented that more resources are required, "particularly in middle class areas which are not traditionally associated with over-indebtedness". An interviewee from public authorities proposed: "Increase funding of MABS and broaden the scope of the agency's work and remit."

Around 18 million Euro was provided to fund MABS in 2008⁵⁷⁵, and a further 19 posts (most part-time) were funded in 2009.⁵⁷⁶ However, it does not appear that significant additional funding has been made available to MABS services since then. One financial industry stakeholder described MABS as "overwhelmed".

It is therefore questionable whether MABS services, as currently funded and constituted, have the capacity to take on further roles that may be assigned to them, such as that of approved intermediary for the administration of Debt Relief Notices as proposed in the government's Personal Insolvency Bill. One solution, recommended by an independent expert, is to broaden the funding net in line with the 'polluter pays' principle:

Advice services are funded entirely by the State. The obvious solution is to require creditors to contribute to a fund which could be used to contribute to the funding of the service. It would be important however that the service remains entirely independent from creditor influence, and so creditor contributions could be collected through a levy imposed by the State on lenders, rather than through

⁵⁷⁴ Stamp, S., The Impact of Debt Advice as a Response to Financial Difficulties in Ireland. *Social Policy and Society*, Volume 11, Issue 01, January 2012, p93.

⁵⁷⁵ See Departmental press release (September 2008):

<http://www.welfare.ie/EN/Press/PressReleases/2008/Pages/pr180708.aspx>

⁵⁷⁶ See Citizens Information Board press release (August 2009):

<http://www.citizensinformationboard.ie/news/news20090811.html>

direct creditor payment. There are different ways to do this. "Polluter pays" is an interesting approach (similar to Belgium). I think there should be some creditor contribution to the services, considering that they also obtain benefit from them as debt advice is serving as a collection service as well to a certain degree.

13.5.3 Key measures in place to alleviate the impact of over-indebtedness

Availability and costs

Informally brokered arrangements between the debtor and creditors such as a repayment plan, a debt management plan or debt write-off that may be brokered by a debt counsellor

Informally-brokered arrangements between debtors and creditors, generally in the form of payment plans, are by and large undertaken with the support of MABS services. Potential advantages and disadvantages of such arrangements to the consumer were noted by respondents. It was felt that low-cost and an absence of stigma are welcome aspects of such arrangements; however, these arrangements are not binding on creditors. According to one respondent "substantial debt relief or a fresh-start is rarely provided". According to the most recent data available, in 2011, over 22,000 MABS clients were supported in such arrangements.⁵⁷⁷ There are no data currently available on the content or success of such arrangements.

Informal arrangements brokered by the MABS sometimes follow a semi-formal protocol designed by MABS and the Irish Banking Federation;⁵⁷⁸ a separate protocol following the same principles has been agreed between MABS and utility providers.⁵⁷⁹ Such protocols are voluntary in nature, however according to MABS spokespersons they are very successful in practice.

Formal procedures for debt settlement that do not take place in court

There are no such procedures available in Ireland to 'settle' debts at present, although the MARP and MABS protocols referred to above were noted by some respondents as examples of 'out of court' options. As already stated, a Personal Insolvency Bill is proceeding through the Irish parliament, the Oireachtas, at the time of writing.⁵⁸⁰

⁵⁷⁷ These are the 22,462 clients who have received help through MABS special account and budget negotiable schemes in 2011.
http://www.mabs.ie/fileadmin/user_upload/documents/About_MABS/MABS_Statistics/2011_Stats_Final.pdf

⁵⁷⁸ See: <http://www.ibf.ie/pdfs/IBF-MABS-Protocol-June09.pdf>

⁵⁷⁹ See: MABS, 'Personal Insolvency Bill -Submission to the Department of Justice and Equality', 2012, p19.
http://www.mabs.ie/fileadmin/user_upload/News_Press/Personal_Insolvency_Bill_-_MABS_Submission_-_210212.pdf

⁵⁸⁰ See: <http://www.oireachtas.ie/documents/bills28/bills/2012/5812/b58112d.pdf>

Legal procedures that take place in court (e.g. consumer insolvency proceedings)

As noted by various interviewees, Irish bankruptcy provisions are "very strict", "very restrictive", "not fit for purpose", "very unattractive", "practically unused", "wholly unsuited to addressing situations of household debt" and are therefore "being reformed". This is also the conclusion of many reports which have examined this area.⁵⁸¹ There is a 12 year discharge period for bankruptcy under the Bankruptcy Act 1988. Very few 'consumer' bankruptcies take place in Ireland as a result.

The Personal Insolvency Bill contains a provision for automatic discharge from bankruptcy after 3 years, except in cases of non-co-operation or fraud, on which the court officials would adjudicate. As noted by FLAC,⁵⁸² an income payments order may be made at any time during the 3 years of bankruptcy; the order can last up to 5 years.

Financial support for households to repay debts/arrears (e.g. by public fund)

As mentioned above, the main provision for financial support in the specific context of over-indebtedness is the mortgage interest supplement scheme for certain social welfare recipients. However, again as referenced earlier, access to this supplement has been restricted as a result of the government's austerity measures. A rent supplement scheme is also provided to assist social welfare recipients in privately rented accommodation with the costs of their rent, although again there have been a tightening of criteria in 2012; for example, minimum contributions by tenants have been increased, and eligible rent limits reduced.⁵⁸³ Other state support relevant to debt (as opposed specifically to income), again limited to certain social welfare recipients (primarily older and disabled persons), are allowances for electricity/gas/telephone and a free television licence.⁵⁸⁴ Exceptional or urgent needs payments, administered by the statutory Community Welfare Service under the Supplementary Welfare Allowance (SWA) Scheme, may be made in certain circumstances but these payments are discretionary and conditions may be attached.⁵⁸⁵

⁵⁸¹ Joyce, P., *An End Based on Means*. Dublin: Free Legal Advice Centres, 2003; Law Reform Commission, *Interim Report on Personal Debt Management and Debt Enforcement*, Dublin: Law Reform Commission, 2010.

⁵⁸² See: <http://www.flac.ie/news/2012/06/29/relief-at-insolvency-law-reform-wary-on-bank-veto-debtor-supports/>

⁵⁸³ See:

http://www.citizensinformation.ie/en/social_welfare/social_welfare_payments/supplementary_welfare_schemes/rent_supplement.html

⁵⁸⁴ See:

http://www.citizensinformation.ie/en/social_welfare/social_welfare_payments/extra_social_welfare_benefits/household_benefits_package.html

⁵⁸⁵ See: http://www.hse.ie/eng/services/find_a_service/entitlements/cwo/

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Charitable support is accessed by many to assist with debt problems. The Society of St Vincent de Paul (SVP)⁵⁸⁶ provides financial assistance to thousands of families each year. For example, in 2010, the Society spent 8.8 million Euro assisting households with energy related costs and arrears.⁵⁸⁷

Effectiveness as assessed by stakeholders

The effectiveness of the proposed personal insolvency legislation will only become apparent once it is enacted, projected to be by the end of 2012. As already stated, there are some concerns, particularly given the 'veto' that may be held by large creditors. In this regard, it is of some concern that it is currently proposed to review the Personal Insolvency Act only after a 5 year period has elapsed.

In terms of informal arrangements, it is difficult to assess their effectiveness in the absence of evaluation processes. There are suggestions that in some cases, consumers' financial statements⁵⁸⁸ are being queried in fine detail,⁵⁸⁹ items of expenditure are being questioned and unrealistic payments are being requested. One interviewee speculated on the possible reasons for such responses:

From what I am hearing, banks have been very slow to sit down with people and get to solutions. I think they do not want to realise the losses, and, secondly, they do not have the systems and the staff to do it. They are struggling with their own business models, with huge changes (redundancies), changes at the top ... And this finding of alternative solutions is a very particular skill - to do it right. They are also under pressure in terms of write-off. They are facing questions such as: "Do we need more capital?" and if they do, there is a big political problem. They are under pressure to return to profitability.

13.5.4 Changes in response to over-indebtedness

Changes in response to over-indebtedness have already been discussed under various headings above. To summarise, since the financial downturn, responsibility for MABS has been assigned to the Citizens Information Board (in 2009, having previously been the responsibility of the Department for Social Protection) which since August 2012, has additional responsibility for the provision of a new Mortgage Arrears Information Helpline. As of September 2012, the Helpline is to be complemented by a new mortgage advice service,⁵⁹⁰ funded by the banks, provided

⁵⁸⁶ See: <http://www.svp.ie>

⁵⁸⁷ Society of St Vincent de Paul (SVP), 'Submission to the Department of Justice and Equality of the Personal Insolvency Bill', March 2012, p. 4.

⁵⁸⁸ The submission of a Standard Financial Statement (SFS) is a requirement of the MARP. See:

<http://www.centralbank.ie/consumer/info/documents/industry%20standard%20financial%20statement.pdf>

⁵⁸⁹ See: <http://www.flac.ie/download/pdf/20111020090157.pdf>, p5.

⁵⁹⁰ See press release: <http://www.welfare.ie/EN/Press/PressReleases/2012/Pages/pr060912.aspx>

through participating accountants who will be paid a once off fee for providing a consultation; consumer groups have criticised the measure as flawed and inadequate.⁵⁹¹ MABS has entered into formal operational protocols with the Irish Banking Federation and the major energy utilities. Codes of Conduct on Mortgage Arrears (2009, 2010 and 2011)⁵⁹² and a Consumer Protection Code (2012) have been introduced; however, personal insolvency legislation has only recently been published, some four years after the advent of the financial crisis. The response to consumer over-indebtedness has largely been characterised by “forbearance” and “advanced forbearance”.⁵⁹³

Recent projections that mortgage arrears are expected to increase considerably during 2013,⁵⁹⁴ coupled with an increase in the numbers experiencing arrears each quarter on quarter since 2009 (as evidenced in Central Bank reports), suggest that measures to alleviate over-indebtedness have been largely unsuccessful to date, although repossessions have remained low for pragmatic, policy, legal and possibly historical reasons as discussed earlier. The Central Bank has initiated the Mortgage Arrears Resolution Strategy (MARS), which involves individual banks putting forward (to the government and to the Central Bank) proposals to address mortgages in serious, long-term arrears; it appears that this is still work in progress at the time of writing. Whether such policy measures, and the proposed personal insolvency provisions, will have any significant impact given the scale of the problem is, at this stage, a matter for conjecture.

An additional measure, announced in June 2012 by the government, is the Mortgage to Rent Scheme⁵⁹⁵ to facilitate people in ‘unsustainable’ mortgage situations to remain in the family home; this ‘final option’ will involve purchase of the family home by a housing association which will rent it back to the family at an ‘affordable rent’. The initial target figures mentioned by the Minister for Housing and Planning suggest that this initiative may only be able to assist a small number of those in trouble, at least in the short-term:

⁵⁹¹ See: <http://www.irishtimes.com/newspaper/ireland/2012/0907/1224323695599.html>

⁵⁹² In February 2009, a Code of Conduct on Mortgage Arrears was introduced for all mortgage lenders. This Code was effective from 27 February 2009 to 16 February 2010. On 17 February 2010, an amended Code of Conduct on Mortgage Arrears was introduced for all mortgage lenders. This Code was effective from 17 February 2010 to 31 December 2010. On 1 January 2011, a revised Code of Conduct on Mortgage Arrears came into effect.

<http://www.centralbank.ie/regulation/processes/consumer-protection-code/Pages/codes-of-conduct.aspx>

⁵⁹³ See for example the recommendations of the Cooney Report referenced earlier: Department of Finance, *Final Report of the Expert Group on Mortgage Arrears and Personal Debt*, Dublin: Department of Finance, 2010. <http://www.finance.gov.ie/viewdoc.asp?DocID=6583>

⁵⁹⁴ ‘20% of Irish mortgages to default, predicts Fitch’, *Irish Times*, 2nd August 2012.

<http://www.irishtimes.com/newspaper/finance/2012/0802/1224321295760.html>

⁵⁹⁵ See Government Information Brochure:

http://www.mabs.ie/fileadmin/user_upload/documents/Information_Leaflets_and_Factsheets/12.07.31_MTR_DL_rz_web.pdf

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*Since February my Department has operated a pilot scheme. More than 60 cases are currently going through various stages of the process and the pilot scheme has enabled us to test the model and ensure it delivers. We are currently budgeting for a take up of approximately 100 families this year.*⁵⁹⁶

13.5.5 Types of households of over-indebted consumers not reached by current measures

Stakeholders identified four main groups who are not being reached by current measures, although again the extent is difficult to quantify in the absence of robust data. These are firstly “middle income” borrowers who are employed but “struggling”; secondly, “non-nationals”, although according to one interviewee “this is not a consequence of targeting by the state, rather it is caused by a reluctance on the part of non-national groups to engage with the state and sometimes by language difficulties”. Thirdly, there is a group of “small business debtors” who are personally liable for some or all of their business debts and/or who may have had to use their personal assets as collateral for business loans; social welfare support is limited for small business people and the self-employed. Finally, one stakeholder identified a group of “parents of grown-up children” who are liable (as guarantors, or who allowed their home to be used as additional security) for loans taken on by, or for, their children during the boom (relating to first-time house purchase for example).

It is almost certainly the case that the overwhelming policy focus on mortgages and thereby mortgage holders has resulted in a lack of focus both on other types of debt, particularly unsecured debt, and on those in other types of tenure/accommodation, such as social (e.g. local authority) tenants⁵⁹⁷ and members of the Traveller Community.⁵⁹⁸

13.5.6 Best practices

The MABS service was commended by several interviewees; it has also been recognised as a model of best practice by a Peer Review at European level.⁵⁹⁹ One stakeholder referred to the Code of Conduct on Mortgage and the associated MARP. Another interviewee highlighted a need to focus more on financial capability and

⁵⁹⁶ Government Press Release 28th June 2012.

<http://www.environ.ie/en/DevelopmentHousing/Housing/News/MainBody,30623,en.htm>

⁵⁹⁷ Stamp, S., ‘National and European Policy Responses to Over-indebtedness’, 2011. [Presentation]. Conference hosted by the Economic and Social Research Institute, *Financial Exclusion and Over-indebtedness: Challenges and Policy Responses*, Dublin, 8th March 2011. http://www.esri.ie/docs/Financial_Excl_Stamp.pdf

⁵⁹⁸ National Traveller MABS, *Issues of Personal Finance within the Traveller Community*, Dublin: National Traveller MABS, 2012.

http://www.mabs.ie/fileadmin/user_upload/documents/Reports___Submissions/MABS_Reports_Documentation/Travellers_and_Personal_Finance.pdf

⁵⁹⁹ Korczak, D., *The Money Advice and Budgeting Service Ireland - Synthesis Report of the Peer Review Meeting in Cork*, 18-19 November 2004. Report for DG Employment, Social Affairs and Equal Opportunities, Brussels: European Commission, 2004.

consumer protection as 'indirect' methods of preventing future over-indebtedness, and the importance of building structures and institutions towards these ends.

13.6 OUTLOOK

The consensus among stakeholders was that the outlook is somewhat gloomy and that arrears on both secured and unsecured personal debts are likely to rise. In large part, the backdrop for such gloom is the macro-economic climate which, it is felt, is unlikely to improve significantly in coming years. As one interviewee explained:

Households have been running down savings to meet current commitments. As these resources become exhausted the position of more and more households will become untenable unless the macroeconomic climate improves.

Unless there is a significant improvement, respondents believe that high unemployment will continue to be a feature of the Irish social landscape, incomes will continue to stagnate or even decrease, house prices will remain depressed and continuing austerity will affect households further, particularly if energy prices continue to increase.

The key challenges for policymakers, therefore, in the context of over-indebtedness are to get the economy growing; to address growing (income and energy) poverty and inequality in Irish society; to ensure that new measures (such as the proposed property tax system) are fair and equitable; and to tackle the personal debt crisis. The latter will involve tackling the mortgage arrears issue more systemically, reforming personal insolvency legislation, and adequately resourcing the judicial and administrative frameworks necessary to ensure both its effective operation and that debtors availing of it are facilitated to make a genuine 'fresh-start'.

Some interviewees (primarily independent experts and civil society stakeholders) made specific suggestions as to how the proposed personal insolvency legislation could be improved from the debtor's perspective. These suggestions include: incorporating an adequate living standard into the provisions to ensure that people are able to "live with dignity" whilst repaying debts; widening access to debt relief by reducing creditor control/veto; and appointing a "debt ombudsman" with responsibility for determining what is actually sustainable. Ireland's system for dealing with the enforcement of personal debt through the courts is also widely recognised as being in radical need of overhaul.⁶⁰⁰

⁶⁰⁰ Joyce, P., *An End Based on Means*. Dublin: Free Legal Advice Centres, 2003; Law Reform Commission, *Interim Report on Personal Debt Management and Debt Enforcement*, Dublin: Law Reform Commission, 2010.

In terms of the commercial lending sphere, suggestions by informants included the establishment of a national credit register;⁶⁰¹ the regulation of commercial debt advice, management and collection companies; the introduction of maximum interest rates (particularly for sub-prime moneylending loans); and the tightening of measures for the supervision of responsible lending, so that if and when credit becomes more widely available again, it is extended more responsibly than heretofore.

In respect of utilities, there was an overriding consensus among respondents that this issue needs to be better addressed and “policed”, to ensure both responsible arrears management and that supply is not disconnected unless absolutely a last resort. Reference was made to entitlement to utilities being in effect a public health issue. An independent expert commented:

The state has an obligation to ensure that people have access to water, basic electricity, heat, etc. We need to be very careful not to reach a situation when they are turning off utilities.

As regards housing, the implementation of a more pluralist/less segmented approach is needed to implement the ethos of the government’s National Housing Policy Statement.⁶⁰² Stakeholders considered that changes are needed both in the private and public housing sector. In the case of the former, one interviewee commented that the international operation of mortgage providers needs to be acknowledged and better dealt with. As regards mortgage arrears, one respondent felt strongly that mortgage lenders should be required to accept the significant reductions in the (current) values of properties on which mortgage loans are secured⁶⁰³ and to “recognise that write-downs (to current market value) of the principal sums owed under mortgages may be necessary in many cases”. As regards social housing, the shortage and quality of such housing are issues to be addressed. This is likely to become a more pressing issue in the event of a rise in the number of repossessions of family homes. Improvements to the rent supplement scheme (described above) are also needed; proposals for reform have been put forward by Threshold (the National Housing Charity) among others.⁶⁰⁴

⁶⁰¹ An important development in this regard is the imminent issuing of a Credit History Reporting Bill (creating a new national Central Credit Register), which is to be published by the end of September 2012. This is to comply with a commitment under the EU/ECB/IMF (Troika) Programme of Financial Support for Ireland. According to the Minister for Finance (see: <http://www.finance.gov.ie/viewdoc.asp?DocID=7280>): “[T]he proposed new Credit Register will support more informed lending decisions and development of improved insolvency procedures, while also providing an important tool for banking supervision. The data set to be collected will be comprehensive in scope, will include information on restructured as well as new loans and will be covered by robust measures to protect personal information.”

⁶⁰² See: <http://www.environ.ie/en/DevelopmentHousing/Housing/PublicationsDocuments/FileDownload,26867,en.pdf>

⁶⁰³ The launch of a National House Price Register in September this year will provide, for the first time in Ireland, a publicly available database of actual property sale prices.

<http://www.irishtimes.com/newspaper/weekend/2012/0225/1224312358444.html>

⁶⁰⁴ See: <http://www.threshold.ie/campaigns/better-rent-supplement-scheme/>

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Finally, in the context of other non-regulatory measures that could be taken, a number of stakeholders stressed the importance of promoting financial inclusion and that in this context, there should be government support for social lending schemes⁶⁰⁵ (e.g. by way of support for credit unions and/or a crisis loan fund) and an obligation on financial service providers to offer basic bank accounts.⁶⁰⁶ Developing financial education and financial literacy initiatives is also important. Finally, one civil society stakeholder referred to the need for increased transparency in relation to credit provision, for example by requiring licensed firms operating in Ireland but based overseas, to report on how they generate their income in Ireland.

A lack of data and evaluation to facilitate evidence-based policymaking has been frequently highlighted throughout this report; it is also an issue that has been raised in policy studies.⁶⁰⁷ There are many innovative ways of tackling this deficit, including making better use both of administrative data (e.g. as gathered by MABS and local authorities) and of data held by other sources (such as the Irish Credit Bureau and regulated utilities). Overall, the Irish policy response to personal debt problems tends more towards supporting the individual to deal with what is largely perceived to be his/her problem, and less towards focusing on societal reform in recognition that underpinning this problem are primarily structural and institutional factors.

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⁶⁰⁵The Commission on Credit Unions (2012) made a number of recommendations in relation to the promotion of social lending in Ireland and the key role of the credit unions in this regard. See:

<http://www.finance.gov.ie/documents/publications/reports/2012/credunionrepar2012.pdf>

⁶⁰⁶ A pilot scheme is taking place at the time of writing as referred to in Section 1.4.1.

⁶⁰⁷ See: Stamp, S., A Policy Framework for Addressing Over-indebtedness, Dublin: Combat Poverty Agency, 2009, pp.7-8, also p36.

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ANNEX A: STATISTICAL DATA FROM EU SOURCES

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Ireland

I. Eurobarometer¹

	Ireland	EU average	Lowest EU value	Highest EU value
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Households *at risk* of being over-indebted

Respondents feeling at risk of over-indebtedness in 2010	↗ 30%	25%	7%	52%
Respondents feeling at risk of over-indebtedness in 2009	↗ 28%	27%	9%	53%

II. EU SILC standard survey data²



III. EU SILC 2008 module: Over-indebtedness and financial exclusion³

	Ireland	EU average	Lowest EU value	Highest EU value
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Proportion of people in households with bank overdrafts, outstanding balances on credit cards or in arrears on other loans of over 100% of household disposable income

Overdrawn bank account (% of people in households overdrawn)	↘ 1.3%	2.2%	0.0%	7.7%
Credit or store card (% of people in households with outstanding balances)	↗ 2.1%	1.1%	0.0%	8.6%
Other loan/credit payments (% of people in households in arrears)	↗ 0.4%	0.3%	0.0%	1.1%

Proportion of people in households in arrears in servicing housing-related loans and bills and in paying other bills of over 100% of household disposable income

Housing bills (% of people in households in arrears)	↘ 0.4%	0.5%	0.0%	2.9%
Other payments (% of people in households in arrears)	↘ 0.1%	0.4%	0.0%	1.7%

Households living with outstanding debts and/or arrears of over 100% of household disposable income

Total (% of households with outstanding debts/arrears)	↘ 3.9%	4.6%	0.0%	11.8%
Income above 60% median (% of households with outstanding debts/arrears)	↘ 3.0%	4.2%	0.0%	11.3%
Income below 60% median (% of households with outstanding debts/arrears)	↗ 8.9%	7.0%	0.2%	13.7%
Materially deprived (% of households with outstanding debts/arrears)	↘ 8.1%	9.0%	0.1%	27.4%

Proportion of those in broad age groups with outstanding debts of over 100% of household disposable income

Households with all adults aged 25-39 (% of households with outstanding debts)	↘ 4.4%	6.3%	0.0%	17.2%
Households with all adults aged: 40-64 (% of households with outstanding debts)	↘ 3.3%	5.8%	0.0%	10.9%
Households with all adults aged: 65+ (% of households with outstanding debts)	↘ 0.2%	1.2%	0.0%	2.8%

Proportion of those in different types of household with outstanding debts of over 100% of household disposable income

Living alone (% of people in households with outstanding debts)	↘ 2.5%	4.3%	0.0%	8.2%
Single parent (% of people in households with outstanding debts)	↘ 7.0%	9.5%	0.0%	27.1%
Other (% of people in households with outstanding debts)	↘ 3.7%	4.8%	0.0%	12.1%

Proportion of those in households with outstanding debts of over 100% of household disposable income by marital status

Never married (% of people in households with outstanding debts)	↘ 3.1%	5.0%	0.0%	15.4%
Married (% of people in households with outstanding debts)	↘ 3.5%	4.1%	0.0%	9.7%
Separated/divorced (% of people in households with outstanding debts)	↘ 7.1%	7.5%	0.1%	13.9%
Widowed (% of people in households with outstanding debts)	↗ 2.0%	1.7%	0.0%	4.3%

Proportion of those in households with outstanding debts of over 100% of household disposable income by housing tenure

Owner occupied without mortgage (% of people in households with outst. debts)	↗ 3.5%	3.2%	0.0%	9.6%
Owner occupied with mortgage (% of people in households with outst. debts)	↘ 4.2%	6.3%	0.0%	16.1%
Market rent (% of people in households with outstanding debts)	↘ 2.6%	8.2%	0.0%	16.0%
Subsidised rent (% of people in households with outstanding debts)	↘ 5.1%	8.7%	0.0%	17.9%
Rent-free housing (% of people in households with outstanding debts)	↗ 8.1%	2.3%	0.0%	15.1%

Proportion of those in households with outstanding debts of over 100% of disposable income by work intensity

Work intensity of 0 - 0.19 (% of people in households with outstanding debts)	↘ 2.6%	5.7%	0.0%	10.6%
Work intensity of 0.20 - 0.50 (% of people in households with outstanding debts)	↗ 6.1%	5.7%	0.0%	15.3%
Work intensity of 0.51 - 0.74 (% of people in households with outstanding debts)	↘ 2.2%	5.4%	0.0%	13.5%
Work intensity of 0.75 - 1.0 (% of people in households with outstanding debts)	↘ 3.9%	5.3%	0.0%	14.3%

Proportion of those in over-indebted households that experienced a major drop in income over the preceding year

Over-indebted (% of people in households that experienced drop in income)	↗ 59.1%	33.3%	0.0%	77.6%
Other (% of people in households that experienced drop in income)	↘ 18.7%	19.2%	5.9%	32.5%

IV. Loans and credit outstanding⁴



Notes:

- (1) Eurobarometer 72.1 (2009) and Eurobarometer 74.1 (2010). Note: Those who answered 'very at risk' or 'fairly at risk' to the question 'Please tell me how much you feel at risk of being over-indebted'.
- (2) Eurostat, SILC. Data as of December 2012.
- (3) European Commission, Research Note 4/2010, Over-indebtedness new evidence from the EU-SILC special module.
- (4) European Commission, Research Note 4/2010, Over-indebtedness new evidence from the EU-SILC special module. European Credit Research Institute (ECRI), Lending to households in Europe, 1995-2009 and Eurostat, National accounts.

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<i>Document</i>	The over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact - Country report Italy
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14.1 DEFINITION OF OVER-INDEBTEDNESS

Over-indebtedness was defined in January 2012 in Italian legislation⁶⁰⁸ as “a situation of persistent imbalance between obligations and assets that can be promptly liquidated to meet them, and the definitive inability of the obligor to regularly meet its obligations”. This was also the definition most commonly used by stakeholders who took part in an interview for the study, of whom the majority used a specific definition.

It is important to point out that “obligations” means not only commitments related to outstanding secured and unsecured debt, but also other commitments, such as utility bills, rent, or housing expenses. Thus, the concept of over-indebtedness is closer to a broader concept of financial distress, that takes into account not only over-commitment due to excess indebtedness but also other conditions of financial instability, such as the inability to face monthly expenses and balance the budget, arrears in paying utility bills, and difficulties in shopping for food or paying the rent. Similarly, the concept of risk of over-indebtedness is closer to a concept of financial fragility, that is, households’ risk of default on their commitments, especially when hit by adverse income shocks.

This definition of over-indebtedness, though substantially capturing the nature of the phenomenon, does not allow us to distinguish between “active over-indebtedness” and “passive over-indebtedness”. The first is caused by excess debt on the part of an individual due to extensive use of credit in the belief of improved future economic and financial conditions. The second is due to the existence of exogenous factors over which the individual has no control (e.g. job loss, death, illness), which negatively impact repayment capacity and make what was once a manageable liability no longer sustainable. Clearly this distinction is not always easy to make, but it is important to bear it in mind, especially during the crisis period, and it may imply different priorities in terms of public intervention.

Only very few stakeholders used a definition of households at risk of over-indebtedness. However, around half of stakeholders considered that there was a need for a better definition of households that are at risk of becoming over-indebted. For example, one stakeholder stressed that such a definition would help banks and other financial intermediaries avoid giving households too much credit.

⁶⁰⁸ Law no. 3 of January 27, 2012 “Disposizioni in materia di usura ed estorsione, nonché di composizione delle crisi da sovraindebitamento” [Provisions on usury and extortion, and provisions for the settlement of over-indebtedness crisis].

14.2 LEVEL OF OVER-INDEBTEDNESS

Traditionally Italian households are reluctant to borrow. According to a Bank of Italy survey,⁶⁰⁹ in 2010 the percentage of households that owed money to financial intermediaries for reasons not related to business activity was 26% (27.8% in 2008). As reported by the Bank of Italy, “despite the growth in household debt under way for more than a decade now, households’ participation in the credit market is still low in Italy by comparison with the other main industrial countries, particularly as regards mortgages.”

According to the Bank of Italy survey, “vulnerable households, conventionally defined as those with debt service payments greater than 30 per cent of income, made up 11.1 per cent of all indebted households, or 2.4 per cent of all households”. This percentage is about the same as in the 2008 survey.⁶¹⁰

Data from EU-SILC show the above-mentioned trends in Italy: the level of mortgages and consumer credit outstanding is well below the EU average.⁶¹¹ Similarly, the level of arrears on mortgages and consumer credit is lower than the EU average and trends are almost stationary. However, if we define over-indebtedness as persistent inability to meet all obligations the picture is definitively worse.

In the last few years, a growing number of families report having problems making ends meet, being unable to face unexpected expenses, having utility bills or rent in arrears, or having difficulties in repaying loans.⁶¹² Note that EU-SILC data shows that in Italy the level of arrears on utility bills is higher than the EU average.⁶¹³ These worsening trends are mainly due to specific factors related to the fragility of the economic environment, rather than to a high level of household debt.

A recent study on Italian households’ financial fragility gives a clear picture of this worsening situation in Italy.⁶¹⁴ According to the authors of the study, 50% of respondents reported that they had some problems “getting to the end of the month” and could only just manage to make ends meet. A further 15% of respondents faced more serious difficulties, meaning that they had to make use of their savings, while 6.1% indicated that they had “a lot of problems” and had found it necessary to borrow money or ask for help. Only 2.8% of respondents reported that

⁶⁰⁹ Bank of Italy, ‘SHIW - Survey on Household Income and Wealth’, 2012, pp. 25-27.

⁶¹⁰ Bank of Italy, ‘SHIW - Survey on Household Income and Wealth’, 2012, p. 3. See p. 27 for more data on financial vulnerability.

⁶¹¹ Fondeville, N., Özdemir, E., and Ward, T., ‘Over-indebtedness. New evidence from the EU-SILC special module’, 2010, pp. 9 - 11.

⁶¹² Bank of Italy, ‘SHIW - Survey on Household Income and Wealth’, 2012, p.19 and highlights; Bank of Italy, Annual Report, 2012, pp. 120-125.

⁶¹³ Eurostat, ‘Arrears on Utility Bills’ (code: ilc_mdse07).

⁶¹⁴ Anderloni et al, ‘Household financial vulnerability: an empirical study,’ *Research in Economics* 66, 2012, pp. 284-296. Empirical estimates are based on a national survey carried out by Ania – the Italian Association of Insurance Companies – in September 2009; a total number of 3,102 households make up the sample.

their financial condition allowed them to make ends meet without difficulty and indeed to save quite a bit.

This study suggests a worse picture than that given by EU-SILC figures. According to these, only 38.1% of the population in Italy was having difficulties making ends meet in 2011. However, this does represent an increase on the figures from 2007 (37.1%).⁶¹⁵

The above-mentioned study on the financial fragility of Italian households also reports that 20% of heads of households would be unable to deal with a substantial unexpected payment, while 50% would only be able to do so with difficulty. Only 28% of heads of households would be able to meet such an expense without experiencing problems.

14.3 NATURE AND DRIVERS OF OVER-INDEBTEDNESS

14.3.1 Most common types of households that are over-indebted

According to stakeholders, the most common types of households that are over-indebted/have on-going difficulties in meeting their financial commitments are lower-income households, with one or two unemployed persons, and with a low level of net wealth. They also commented that over-indebtedness is higher among young people (mainly between the ages of 25 and 39), those with children, and those living in rented accommodation or in owner-occupied housing with mortgages. Finally, research shows that over-indebtedness increases when moving from the north to the centre or south of Italy; this is likely due to the weaker economic conditions and greater likelihood of financial fragility.⁶¹⁶

At present, middle class households find themselves at risk of over-indebtedness more than before, as salaries no longer guarantee the living standards such households were used to. Moreover, their budget sustainability is at risk of being affected by external shocks, like unemployment, reduction in working hours, separation, death, or illness. These factors can eliminate or reduce an income source and/or determine unexpected liabilities and consequently shift a household's situation from a sustainable to a critical budget.

14.3.2 Causes of households' over-indebtedness

Macro-economic factors

Among macro-economic factors that contribute to over-indebtedness, stakeholders interviewed in Italy most regularly cited unemployment level and wage level. These

⁶¹⁵ Eurostat, 'Inability to make ends meet' (code: ilc_mdcs09).

⁶¹⁶ See for example Anderloni et al, 'Household financial vulnerability: an empirical study,' Research in Economics 66, 2012; D'Alessio and Iezzi, 'Over-indebtedness in Italy: definition and measurement with Italian data', 2012.

macro-economic factors are related to lower income levels that make it difficult for households to repay debts and balance the budget.

In the last quarter of 2011 the unemployment rate rose to 9.6% (from 8.7% a year earlier) according to the Bank of Italy.⁶¹⁷ In the first quarter of 2012 unemployment increased again: to 10.8%. The unemployment rate among those who are between 15 and 24 years old is especially high, at 29.1%, and it rose significantly (by 1.3%) in the most recent observed period.

Concerning the second major factor – wage levels – the Bank of Italy has published data which reveals a drop of 1.3% in real terms in actual earnings per full-time equivalent employee in 2011.⁶¹⁸ This was the first such drop since 1995.

Cost of living

The cost of living, especially in terms of utility costs and housing costs, was pointed out by the stakeholders as another important cause of over-indebtedness.

Statistical data shows that cost of living has been increasing.⁶¹⁹ Taking 2005 as the baseline for the cost of living index (i.e. as the starting value of 100), this index increased to 108 by 2008 and to 113.8 in 2011.

Cost of living can increase in relative terms (in relation to the disposable budget) due to a reduction in income following unexpected or adverse events. Such events are principally the result of a change in employment conditions, for instance job loss or a reduction in working hours, a change in household composition such as the birth of a child or separation, or to other negative shocks like death, illness or injury.

Types of credit/loan taken out by households

As far as types of loans are concerned, both outstanding mortgages and consumer credit were cited in stakeholder interviews as possible causes of over-indebtedness.

However, while the outstanding aggregate stock of unsecured debt of the household sector (mainly in the form of credit cards and personal loans) is small compared to secured debt, it is likely that unsecured debt is held by households not able to borrow elsewhere.⁶²⁰ This is because they have either exhausted their mortgage capacity or are considered high risk. In the above-mentioned study on household financial

⁶¹⁷ Bank of Italy, 'Annual Report', 2012, pp.72-74.

⁶¹⁸ Bank of Italy, 'Annual Report', 2012, pp.75-78.

⁶¹⁹ Eurostat, 'HCIP (2005 = 100)' (code: prcp_hicp_aind).

⁶²⁰ Anderloni et al, 'Household financial vulnerability: an empirical study,' Research in Economics 66, 2012.

vulnerability⁶²¹ this aspect is specifically analysed and the results show that unsecured debt is a driver of over-indebtedness more than secured debt is.

One possible explanation is that while secured debt decisions last for a long time and will follow the life cycle, consumer credit may be associated with indebted households' increasingly inadequate financial and economic positions, which renders them vulnerable to the possible adverse evolution of their income. To support this idea there is the fact that in recent years there has been an expansionary trend in non-specific purchase-targeted consumer credit products.⁶²² These loans are not linked to specific purchases (i.e., revolving credit cards, or pay day loans but are suitable to finance daily consumption needs. This tendency appears to indicate that a large share of households' indebtedness in terms of consumer credit is not due to purchases of investment goods but is rather associated with a shortage of liquidity for daily needs.

Personal circumstances

Drop in income caused by unemployment or business failure and decreasing or stagnant income while costs of living steadily increase were identified by a majority of stakeholders to be among the most important causes of over-indebtedness. These were followed by poverty, drop in income caused by other reasons (such as illness or divorce) and incapacity to deal with financial products. A few stakeholders specified that there was a lack of financial education and literacy in Italy.

The issue of financial literacy has gained the attention of a wide range of policy makers in recent years. They are concerned that individuals do not have the knowledge of financial concepts necessary to make decisions best suited to their economic well-being. Indeed, such financial literacy deficiencies can affect individuals' day-to-day money management, their ability to put in place savings or insurance solutions designed to safeguard their financial future, and the capacity to understand the risks and consequences of borrowing decisions. According to the Bank of Italy Survey on Household Income and Wealth⁶²³ 40% of respondents answered questions aimed at measuring their financial competences incorrectly. No significant difference in the percentage of correct answers was found compared to 2008.

Concerning households' behaviour, a growing number of studies in the field of behavioural economics⁶²⁴ suggest that individual financial choices are influenced not

⁶²¹ Anderloni et al, 'Household financial vulnerability: an empirical study,' *Research in Economics* 66, 2012.

⁶²² This trend has been evident for several years (see Vandone, D., *Consumer credit in Europe*, Springer, 2009). In the latest annual report, the Bank of Italy noted: "Consumer credit continued to expand both in the form of personal loans and in that of loans backed by the assignment of one fifth of salary, which serve to finance more general types of expenditure not necessarily connected with the purchase of a good." (Bank of Italy, *Annual Report*, 2012, p.124).

⁶²³ Bank of Italy, 'SHIW - Survey on Household Income and Wealth', 2012. p.23-24.

⁶²⁴ See for example: Meier, S., & Sprenger, C., *Impatience and credit behaviour: evidence from a field experiment*, Centre for Behavioral Economics and Decision Making, Federal Reserve Bank of Boston, Working Paper, 2007, 07-3; Meier, S., & Sprenger, C., 'Present-

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only by socio-demographic and economic variables, but also by psychological factors. These factors may induce individuals to behave in a way that conflicts with traditional notions of economic rationality. One of the main aspects that influences household decision-making is that individuals tend to systematically overvalue immediate costs and benefits and undervalue those in the future. In other words, individuals' preferences are not time-consistent, as stated by traditional economic models such as the Life-Cycle Theory (proposed by Modigliani and Brumberg in 1954) and the Permanent Income Hypothesis (proposed by Friedman in 1957).⁶²⁵ People tend to give greater importance to present events in comparison with those in the future. In the field of psychology this concept is linked to impulsivity. The underlying idea is that the more impulsive people are the higher their degree of financial vulnerability, because impulsive persons pay less attention to the consequences of their financial and spending decisions. Household debt decisions, specifically consumer credit decisions, may also be influenced by impulsivity traits, considering that impulsivity is associated with a reduced reflection on the consequences of our own choices. One can say that unsecured debt holding is not in itself a cause of vulnerability. However, it may become a determinant for impulsive persons who are pushed to choose 'buy now, pay later' solutions that bring immediate gratification at a future cost, without being fully aware of the level of sustainability of the debt taken on.⁶²⁶

14.3.3 Changes relevant for levels of over-indebtedness

The main changes in the last five years that were identified by the stakeholders in Italy are:

- ▶ Changes in the macro-economic situation - mostly changes that increased the level of over-indebtedness (i.e. increased unemployment and reduced income in real terms due to economic crisis and austerity measures); to a lesser extent stakeholders identified changes mitigating the level of over-indebtedness, primarily referring to the low level of interest rates.
- ▶ More restrictive lending practices, related to banks' difficulties in obtaining funds because of the sovereign debt crisis and to banks' balance sheet constraints;

biased preferences and credit card borrowing', *American Economic Journal: Applied Economics* 2, 2010, pp. 193–210; Norvilitis, J. M., Merwin, M. M., Osberg, T. M., Roehling, P. V., Young, P., & Kamas, M. M., 'Personality factors, money attitudes, financial knowledge, and credit-card debt in college students', *Journal of Applied Social Psychology* 36, 2006, pp. 1395–1413; Worthy, S. L., Jonkman, J., & Blinn-Pike, L., 'Sensation-seeking, risk-taking, and problematic financial behaviors of college students', *Journal of Family and Economic Issues* 31, 2010, pp. 161–170.

⁶²⁵ The central idea of these models is that households make their consumption choices (and consequently those relating to saving and indebtedness) on the basis of their wealth, current disposable income and future income expectations so as to guarantee a uniform level of consumption over their lifetimes. Consumption choices are "rational": rationality, as a concept adopted in economic theory, consists of a series of hypothetical regularised preferences on the part of an individual described by their utility function.

⁶²⁶ On this topic see, for theory and empirical evidence, Ottaviani C. and D. Vandone, 'Impulsivity and household indebtedness: evidence from real life', *Journal of Economic Psychology*, 32(5), 2011. See also Anderloni et al., 2012.

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- ▶ Increased accumulation of arrears in paying utilities, telecommunication services, and rent due to their increased costs;
- ▶ Increased use of informal loans (for example from relatives and friends);
- ▶ Increasing co-operation between households at risk of over-indebtedness and creditors to reach a solution.

Since the interviews took place there has been a major change in the regulatory environment regarding household over-indebtedness, as the result of the extension of Law n.3 from January 2012 to consumers. This enables consumers to apply for personal insolvency (see section 3.5.3).

14.3.4 Cultural attitude towards debt and actual level of households' (over-)indebtedness

On the one hand, it was reported by stakeholders that the Italian cultural attitude toward household debt helps keep the level of over-indebtedness low. In addition, strong family relationships still play an important role in financial support, although the importance and effectiveness of this "safety net" is progressively decreasing. On the other hand, some stakeholders mentioned that culture and attitudes were changing, mainly among the younger generations: higher propensity for indebtedness and lower possibility for saving may lead to an increase in over-indebtedness.

14.4 CONSEQUENCES OF OVER-INDEBTEDNESS

14.4.1 Consequences for affected households

Stakeholders pointed to financial exclusion, reduced standard of living and deteriorating well-being as particularly important consequences of over-indebtedness.

Financial exclusion is undoubtedly a risk. Over-indebted households are listed in a central credit register,⁶²⁷ since they are people in arrears with loan repayments. Consequently, they have problems getting new credit since banks can check this register before granting new credit; over-indebted households may have to pay very

⁶²⁷ In Italy there are two positive credit databases: the Central Credit Register – CCR and CRIF. The Central Credit Register (Centrale dei Rischii) is a *public* credit registry run by a department of the Bank of Italy since 1962. It collects data on borrowers from their lending banks. The reporting banks file detailed information on each borrower with total loans and credit lines above a threshold of 75,000 Euro. Bad loans are defined on a customer to customer basis and therefore include all the outstanding credit to borrowers considered insolvent. CRIF is a *private* credit bureau, founded in 1989, which collects data on payment behaviour and on all consumers' and small businesses' credit requests. It collects economic and financial information from official sources throughout Italy, brought together in in-depth, constantly updated tables. It is available in two versions. The *impresa* (business) report provides real time public information on the economic, financial and business situation of any Italian company. The *consumatori* (consumers) report collects information on individuals' economic and financial situations from the chambers of commerce and land registry offices and courts from throughout the country. Data are not publicly available.

high risk premiums or they may be completely cut off from credit (even if they are willing to pay higher interest rates).

Moreover, also when a situation of financial distress is not yet clear, but the applicant presents many elements of economic and financial weakness, commercial banks are less interested in serving them. Consequently these households may apply to alternative financial providers that offer credit services with high interest rates and charges, but short repayment terms. In addition, the limited amounts these providers offer often mean that the number of different contracts signed by one person or household multiplies. This can feed a vicious circle of over-indebtedness, payment difficulties, insolvency and financial exclusion.

On the demand side, those who experience over-indebtedness may be induced to quit the financial market: negative experience in managing debts and dealing with banks may generate a fear of losing control, and a preference for managing the family budget using cash only.

14.4.2 Consequences of over-indebtedness for the financial services industry

For the financial services industry the most highly ranked consequence of over-indebtedness that emerged from the stakeholder interviews is the cost of defaulted credits for creditors.

According to the most recent Bank of Italy Annual Report,⁶²⁸ the flow of new bad debts of banks and financial companies operating in Italy amounted to 32.2 billion Euro (11.2% is the ratio of non-performing loans to total exposures to customers);⁶²⁹ this figure represents a significant increase with respect to pre-crisis values, which averaged 11.3 billion Euro per year in 2000-07. The proportion of bad debt is kept high in part by the slowness of procedures to recover non-performing loans. In fact, the costs of defaulted credits is a critical point in Italy, as the justice system is not efficient in terms of the years it takes to close proceedings.⁶³⁰ The length of justice procedures is now a very important topic in Italy but it is hard to forecast when this problem will be solved.

⁶²⁸ Bank of Italy, 'Annual Report 2011', 2012, p.155.

⁶²⁹ According to the Bank of Italy, non-performing loans include bad debts, substantial loans, restructured loans and overdue exposure.

⁶³⁰ Bank of Italy, 'Annual Report 2011', 2012, p.83: "Civil justice. – The recently approved measures aim to increase the efficiency of the civil justice system with organizational reforms and to reduce the caseload. The July 2011 public finance adjustment package (Law 111/2011 converting Decree Law 98/2011) introduced incentives to increase the productivity of courts' offices. With the second adjustment package of the summer, Law 148/2011 converting Decree Law 138/2011, the Government was mandated to reorganize the distribution of the court offices across Italy. The long-awaited measure is expected to produce economies of scale and of specialization by merging smaller offices. In pursuit of greater specialization, "business courts" will be set up to deal with highly complex litigation (Law 27/2012 converting the "Grow Italy" decree). To reduce caseloads, in the summer of 2011 the single fee for bringing a case was increased and specific measures regarding social security cases were introduced (Law 111/2011). On 21 March 2012 the mediation/conciliation regulations entered fully into force with the extension of compulsory conciliation to cases involving condominiums and claims for damages as a result of road accidents.

Another consequence of over-indebtedness for the financial services industry is that the amount of new credits outstanding is lower. On the supply side, banks have adopted more restrictive credit supply policies and reduced the amount of credit granted to households in the last few years. On the other side, households have reduced their demand in response to both: 1) the worsening of the economic cycle that is affecting households' willingness to borrow; and 2) a sizable increase in risk premiums and, consequently, interest rates.

14.4.3 Economic and social consequences of over-indebtedness for society

According to stakeholders' assessments, the most important consequences of over-indebtedness for society are loss of consumer confidence in the financial services industry, the legal costs associated with over-indebtedness, the costs associated with assisting households to repay debts/arrears and the costs for provision of debt advice services.

No surveys could be identified that would help measure the phenomenon so it is difficult to quantify the relevance of these consequences. In general, as one independent expert pointed out, very little has been done in Italy to deal with over-indebtedness and only few and sporadic initiatives have been launched to assist over-indebted households. In this sense the direct costs to society so far have been small, while indirect costs are difficult to proxy.

14.4.4 Debt collection practices

Two thirds of stakeholders who provided an answer reported that they had noted increasingly aggressive debt collection practices in the previous five years.

Banks have adopted stricter rules for households in arrears with the repayment of their loans and now start credit collection procedures as soon as they detect the first signs of financial stress. Stricter rules do not apply to households under the Moratorium (see section 1.5.3).

14.5 MEASURES IN FORCE TO ALLEVIATE THE IMPACT OF OVER-INDEBTEDNESS

14.5.1 Early identification of households at risk

At present, measures to early identify households at risk are solely the remit of the financial services industry. As stated by a public authority stakeholder, "there are no measures to identify over-indebtedness other than those made by lenders prior to loan applications"; an interviewee from the financial industry added that:

the first creditworthiness assessment is usually done prior to contracting a credit agreement; in addition creditors use some specific tools and indicators of level of

indebtedness (based on scoring models). Moreover creditors have started to use early collection practices that allow them to identify consumers and households with high potential of criticality, allowing immediate intervention (e.g. revision of the instalment plan, debt consolidation, etc.).

Stakeholders reported that consumer associations provide services in order to advise and help households at risk or already in difficulty, while the government (e.g. social services) does not offer any such initiatives.

Each bank has its own procedures for evaluating the creditworthiness of people who apply for credit and for monitoring the situation. Generally, the analysis is based on an evaluation of the financial, economic and wealth situation of the customer, taking into consideration the value of the guarantees and information provided by credit databases.

One stakeholder reported how, in recent years, banks have started to use indicators to identify the level of households' indebtedness linked not only to their financial situation and the existence of other outstanding debts, but also to the compositions of households (number of members, presence of children, etc.) and typical expenses (utility costs, housing costs, transport, food and education). The stakeholder considered this method to be a better means of identifying the level of debt service affordable to households given their disposable income and those expenses that they would find it difficult to reduce (such as housing costs or utility bills), allowing lenders to support responsible lending.

14.5.2 Advice offered to over-indebted households

The majority of interviewees were either unable to comment on the availability of most types of personalised debt advice, or did not consider such advice to exist. Regarding face-to-face advice, the majority of stakeholders did feel that it was available to some extent, but not widely.

This is related to the current lack of organizations (public or private) offering advice to over-indebted households at the country level and on a regulated basis. There are only a few initiatives by consumer associations and non-profit organizations, such as Adiconsum and Caritas Bolzano, that offer personalised debt advice. In particular, Adiconsum offers consultancy and free psychological support for over-indebted households that apply for financial support from the Usury Prevention Fund (Fondo di Prevenzione Usura). This fund was established in 2007 and is targeted at over-indebted households. By providing guarantees, the fund allows banks to grant loans to individuals and households that would otherwise be excluded from the formal credit circuit. It receives funding from the Ministry of Economy and Finance.

Demand for debt advice as assessed by stakeholders

The majority of stakeholders who commented on the question of whether demand for debt advice had changed in the last five years indicated that it had fairly increased. However, one stakeholder from the financial industry commented that households do not know what kind of tools are available to help them with their financial difficulties. The stakeholder explained that, "people seek advice only when they are encountering problems in getting new credit, and even in that situation, only in some cases. They do not even know what instruments there are to get support or fix their problem".

Funding of debt advice

It was reported that there is no funding for debt advice in Italy, as it does not exist. There are no specific funds available except for the Usury Prevention Fund, which was mentioned above.⁶³¹ One stakeholder from the financial services industry commented that, "the Government should find funds in order to reinforce the role of consumer associations in informing, training, consulting and supporting consumers and households on credit".

14.5.3 Key measures in place to alleviate the impact of over-indebtedness

In Italy, legal or formal procedures to alleviate the impact of over-indebtedness have recently been introduced by Law n.3 of January 27th, 2012 (mentioned in Section 3.1).⁶³²

Law n.3 introduces debt settlement procedures for consumers. According to these procedures, the debtor draws up a proposed debt repayment plan with the involvement of the "bodies in the composition of crisis-indebtedness." These consist of ad hoc entities entered in a special register; they offer assistance activities aimed at helping the debtor to overcome the liquidity crisis; they also supervise the fulfilment of the debt repayment plan.

The court accepts the debt repayment plan if the applicant can demonstrate his/her good faith and if the debt repayment plan is reasonable in terms of fulfilment of the obligations. Moreover, the debt repayment plan is accepted by the court if there is agreement from creditors representing at least 70% of the debt. If the court approves the agreement, individual proceedings are suspended for the next three years.

If the consumer has already applied to the above mentioned debt-settlement procedure within the previous five years, he/she can ask the court for the liquidation

⁶³¹ According to Usury Law 103/1996, funds for the prevention of usury are given from the government to consumer associations or foundations entered in a register kept by the Ministry of Economy.

⁶³² At first, Law n.3 of January 27th, 2012 [Provisions on usury and extortion, and provisions for the settlement of over-indebtedness crisis] applied only to small business owners and professionals. However, in March 2012 the Italian Council of Ministers proposed to extend this law to consumers (D.L. A.C. 5117). An amended version of the law, also applying to consumers, came into effect on January 18th, 2013.

of all its assets and credits. The liquidation procedure frees the over-indebted consumer from all remaining debts to creditors.

Prior to the extension of Law n.3 to consumers, the only notable measure in place to alleviate the impact of household over-indebtedness was the Moratorium on households' mortgages.

The Moratorium was agreed and signed in December 2009 by the Italian Banking Association (Associazione Bancaria Italiana; ABI) and the main consumer associations. It is a measure aimed at supporting families in difficulty because of the financial crisis. It provides the suspension of mortgage repayments for at least 12 months and the lengthening of the repayment plan equal to the period of suspension. Events leading to suspension are: dismissal, suspension of work, or reduction of working hours, or death or injury of at least one of the joint holders of the mortgage. The mortgage must be on the first home and not greater than 150,000 Euro, while the taxable annual income of the debtor must not be greater than 40,000 Euro.

So far the Moratorium has provided important support to the beneficiary households. According to the April 2012 Financial Stability Report of the Bank of Italy:

...between February 2010 and January 2012, this agreement enabled 60,000 households to suspend repayments amounting to 1 per cent of the loans granted in the same period; the moratorium provided important support to the beneficiary households, which received financial relief estimated at around 25 per cent of their disposable income. The measure also appears to have improved the creditworthiness of the participating households: some 62 per cent of those behind on payments prior to the suspension resumed regular payments at the end of the moratorium period.⁶³³

According to another stakeholder from the financial industry, a further practice commonly used by lenders is to offer a new credit agreement to consolidate outstanding debts and/or to modify the terms of the loan to reduce pressure in the short term. This practice started before the 2008 crisis but has become more common since then.

As mentioned above, the Usury Prevention Fund provides guarantees for over-indebted households so that they are able to access loans from banks.

14.5.4 Changes in response to over-indebtedness

The majority of stakeholders considered that there had been changes in the response to over-indebtedness in the last five years. Both the new law on insolvency and the Moratorium were introduced in response to the economic and financial crisis to face over-indebtedness.

⁶³³ Bank of Italy, 'Financial Stability Report No 3', April 2012, p. 17.

14.5.5 Types of households of over-indebted consumers not reached by current measures

Around a third of stakeholders considered there were specific types of households that were not reached by current measures, such as very poor households, immigrants and households living in rural areas.

Furthermore, the Moratorium applies only to households with financial debt, in particular secured debt. Households that are over-indebted because they are not able to meet other commitments (utilities, rent, and so on) are not reached by this measure. Those households are the most financially fragile and poor. Indeed, as well known, literature highlights a positive correlation between debt and net wealth⁶³⁴; conversely, households with a low level of wealth do not have access to financial debt.

14.5.6 Best practices

One measure mentioned by stakeholders as a measure to alleviate over-indebtedness that represents best practice is the Moratorium. Interviewees also stressed the importance of financial education.

Financial education seeks to improve individuals' capacity to understand financial information, raise awareness about the risks and consequences of borrowing decisions; and help individuals choose the financial products appropriate for their needs. Moreover, financial education sets out to limit the negative impact that unexpected events can have on household finances. It can be argued that increased financial knowledge helps individuals manage their finances more effectively. It also helps them to put into place savings, insurance or other solutions designed to safeguard their financial future.

14.6 OUTLOOK

The majority of stakeholders expected the number of over-indebted households to increase in the next five years.

There are two factors pushing in opposite directions. On the one hand, over-indebtedness may increase because, as a consequence of the economic crisis, households' financial conditions will remain weak. Disposable income will not increase because of difficulties in the labour market and the austerity measures adopted by the Italian government to reduce the sovereign debt. On the other hand,

⁶³⁴ See for example: Crook J.N., 'Household Debt Demand and Supply', in Bertola G., R. Disney and C. Grant (eds), *The Economics of Consumer Credit*, Cambridge/MA, MIT Press, 2006; Fabbri, D. and M. Padula, 'Does Poor Legal Enforcement Make Households Credit-Constrained?', *Journal of Banking and Finance* 28(10), 2004; Leece, D., 'Choice of Mortgage Instrument, Liquidity Constraints and the Demand for Housing Debt in the UK', *Applied Economics* 32(9), 2000.

as one stakeholder put it, a "decline in credit demand and selective credit supply policies" can be expected as a result of the crisis; this credit crunch might help reduce over-indebtedness.

Regarding the challenges to be faced in the future, some stakeholders considered that policy makers should work on preventive measures to raise awareness of the implications of debt and to help households to fix levels of debt that do not lead to financial difficulties. Stakeholders also mentioned there was a need for curative measures, such as debt management schemes that provide individuals in difficulty with the possibility of restructuring their debts, although it should be noted that the interviews took place before the extension of insolvency law to consumers in late 2012. Other issues brought up in the interviews were the necessity of extending the availability of debt advice and the need for more transparency regarding loan terms and conditions. Finally, one stakeholder commented that a number of banks did not provide clear contract information, making it difficult for consumers to understand the real cost of a loan.

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ANNEX A: STATISTICAL DATA FROM EU SOURCES

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Over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact

Italy

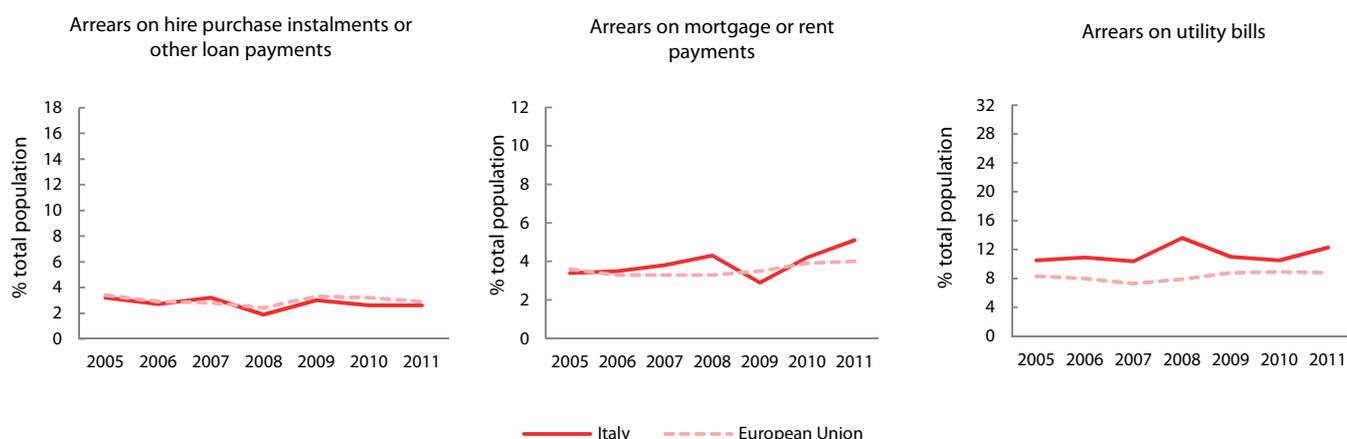
I. Eurobarometer¹

Italy EU average Lowest EU value Highest EU value

Households *at risk* of being over-indebted

Respondents feeling at risk of over-indebtedness in 2010	➔ 25%	25%	7%	52%
Respondents feeling at risk of over-indebtedness in 2009	➔ 24%	27%	9%	53%

II. EU SILC standard survey data²



III. EU SILC 2008 module: Over-indebtedness and financial exclusion³

Italy EU average Lowest EU value Highest EU value

Proportion of people in households with bank overdrafts, outstanding balances on credit cards or in arrears on other loans of over 100% of household disposable income

Overdrawn bank account (% of people in households overdrawn)	➔ 2.0%	2.2%	0.0%	7.7%
Credit or store card (% of people in households with outstanding balances)	➔ 0.1%	1.1%	0.0%	8.6%
Other loan/credit payments (% of people in households in arrears)	➔ 0.5%	0.3%	0.0%	1.1%

Proportion of people in households in arrears in servicing housing-related loans and bills and in paying other bills of over 100% of household disposable income

Housing bills (% of people in households in arrears)	➔ 0.8%	0.5%	0.0%	2.9%
Other payments (% of people in households in arrears)	➔ 0.1%	0.4%	0.0%	1.7%

Households living with outstanding debts and/or arrears of over 100% of household disposable income

Total (% of households with outstanding debts/arrears)	➔ 3.5%	4.6%	0.0%	11.8%
Income above 60% median (% of households with outstanding debts/arrears)	➔ 2.7%	4.2%	0.0%	11.3%
Income below 60% median (% of households with outstanding debts/arrears)	➔ 6.9%	7.0%	0.2%	13.7%
Materially deprived (% of households with outstanding debts/arrears)	➔ 9.8%	9.0%	0.1%	27.4%

Proportion of those in broad age groups with outstanding debts of over 100% of household disposable income

Households with all adults aged 25-39 (% of households with outstanding debts)	➔ 4.3%	6.3%	0.0%	17.2%
Households with all adults aged: 40-64 (% of households with outstanding debts)	➔ 3.4%	5.8%	0.0%	10.9%
Households with all adults aged: 65+ (% of households with outstanding debts)	➔ 0.7%	1.2%	0.0%	2.8%

Proportion of those in different types of household with outstanding debts of over 100% of household disposable income

Living alone (% of people in households with outstanding debts)	↘ 2.6%	4.3%	0.0%	8.2%
Single parent (% of people in households with outstanding debts)	↘ 6.5%	9.5%	0.0%	27.1%
Other (% of people in households with outstanding debts)	↘ 3.5%	4.8%	0.0%	12.1%

Proportion of those in households with outstanding debts of over 100% of household disposable income by marital status

Never married (% of people in households with outstanding debts)	↘ 3.1%	5.0%	0.0%	15.4%
Married (% of people in households with outstanding debts)	↘ 3.0%	4.1%	0.0%	9.7%
Separated/divorced (% of people in households with outstanding debts)	↘ 4.4%	7.5%	0.1%	13.9%
Widowed (% of people in households with outstanding debts)	↘ 1.5%	1.7%	0.0%	4.3%

Proportion of those in households with outstanding debts of over 100% of household disposable income by housing tenure

Owner occupied without mortgage (% of people in households with outst. debts)	↘ 2.2%	3.2%	0.0%	9.6%
Owner occupied with mortgage (% of people in households with outst. debts)	↘ 5.2%	6.3%	0.0%	16.1%
Market rent (% of people in households with outstanding debts)	↘ 5.4%	8.2%	0.0%	16.0%
Subsidised rent (% of people in households with outstanding debts)	↘ 6.5%	8.7%	0.0%	17.9%
Rent-free housing (% of people in households with outstanding debts)	↗ 4.5%	2.3%	0.0%	15.1%

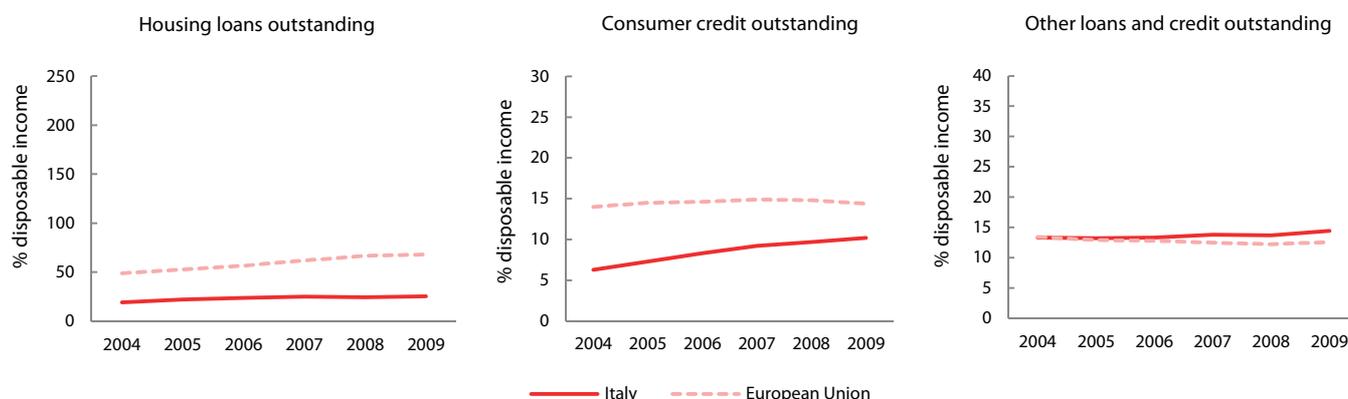
Proportion of those in households with outstanding debts of over 100% of disposable income by work intensity

Work intensity of 0 - 0.19 (% of people in households with outstanding debts)	↘ 4.2%	5.7%	0.0%	10.6%
Work intensity of 0.20 - 0.50 (% of people in households with outstanding debts)	↘ 5.1%	5.7%	0.0%	15.3%
Work intensity of 0.51 - 0.74 (% of people in households with outstanding debts)	↘ 3.5%	5.4%	0.0%	13.5%
Work intensity of 0.75 - 1.0 (% of people in households with outstanding debts)	↘ 2.8%	5.3%	0.0%	14.3%

Proportion of those in over-indebted households that experienced a major drop in income over the preceding year

Over-indebted (% of people in households that experienced drop in income)	↗ 50.8%	33.3%	0.0%	77.6%
Other (% of people in households that experienced drop in income)	↗ 32.5%	19.2%	5.9%	32.5%

IV. Loans and credit outstanding⁴



Notes:

(1) Eurobarometer 72.1 (2009) and Eurobarometer 74.1 (2010). Note: Those who answered 'very at risk' or 'fairly at risk' to the question 'Please tell me how much you feel at risk of being over-indebted'.

(2) Eurostat, SILC. Data as of December 2012.

(3) European Commission, Research Note 4/2010, Over-indebtedness new evidence from the EU-SILC special module.

(4) European Commission, Research Note 4/2010, Over-indebtedness new evidence from the EU-SILC special module. European Credit Research Institute (ECRI), Lending to households in Europe, 1995-2009 and Eurostat, National accounts.

15 LATVIA

Document The over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact - Country report Latvia

Prepared by Robert Graham

Finalised on 29th January 2013

Final report

Over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact

15.1 DEFINITION OF OVER-INDEBTEDNESS

There is no generally accepted specific definition of household over-indebtedness in Latvia, beyond the basic idea of persons who have difficulties meeting their financial commitments. However, one stakeholder noted that they considered households' inability to service their loans in full as an indicator of over-indebtedness. They based this assessment on loan quality analysis, macro level indicators of total household indebtedness, interest payments to MFIs, income and employment levels, as well as occasional survey evaluating indebted households' financial margins and sensitivity to various financial shocks.

The majority of stakeholders interviewed did not use a specific definition for over-indebtedness. Reasons given were that indebtedness as a concept was not stipulated in legislation, and that indebtedness relating to loans, utility bills, and housing costs is usually analysed separately in Latvia.

No respondents stated that they used a definition of households *at risk* of being over-indebted. One stakeholder said that instead of using one general definition, they did use various leading indicators to assess risk of becoming over-indebted, including credit developments, property price changes, confidence indicators, changes in household income, and changes in employment levels.

15.2 LEVEL OF OVER-INDEBTEDNESS

Despite the lack of a general definition of over-indebtedness in Latvia itself, it is possible on the basis of various EU-level indicators to estimate the level of over-indebtedness in the aspects specified by this study. Overall, levels of over-indebtedness have seen a significant increase since the financial crisis (see Annex A), with overall levels of arrears more than doubling from 10.3% in 2007 to 26.1% in 2011.⁶³⁵

Households' debt servicing burden in Latvia as going by EU-SILC module data in 2011 was slightly above EU average in consumer credit⁶³⁶ but the increase in levels was very high - from 14.3% in 2007 to 38.0% in 2011. The total proportion of household with outstanding debts/arrears of over 100% of household disposable income was however low in 2008 (1.8%), compared to the EU average of 4.6%.⁶³⁷

The EU-SILC survey data shows that the share of the Latvian population that has reported arrears on mortgage or rent payments increased 2.9% in 2007 to 6.9% in

⁶³⁵ Eurostat, 'Arrears (mortgage or rent, utility bills or hire purchase)' (code: ilc_mdcs05).

⁶³⁶ Eurostat, 'Percentage of households with heavy financial burden due to hire purchases or loans' (code: ilc_mdcd05).

⁶³⁷ In the Eurostat EU-SILC module, outstanding debts/arrears are calculated as the sum of overdrawn bank accounts, outstanding credit card balances and arrears on other credits or loans and on housing and other bills.

2011, a consistent increase of nearly 139%. This share was also markedly above the EU average of 4.0% (see Annex A).

The share of the population in arrears on utility bills was over twice the EU average of 8.8%. After declining to an all-time low of 8.8% in 2007, arrears increased considerably to 24.0% in 2011.

In addition, the share of the Latvian population in arrears on hire purchase instalments or other loan payments exceeded the EU average (of 2.9%) in 2011. More specifically, in 2007 this share equalled 1.4%, followed by an increase to 4.2% in 2011.

Subjective data from the Eurobarometer surveys of 2009 and 2010 on perceived sense of being at risk of over-indebtedness for Latvia was also twice as high as the EU average of 25% in 2010, at 52% of those surveyed. This share was only a slight increase (over 1%) since 2009.

15.3 NATURE AND DRIVERS OF OVER-INDEBTEDNESS

15.3.1 Most common types of households that are over-indebted

Reviewing data from the EU-SILC 2008 special module on over-indebtedness, a report commissioned for the European Commission found that low household income was a major factor in predicting over-indebtedness. Though well below the EU average at this time, in Latvia 2.4% of households with income of less than 60% of the median lived in households with outstanding debts of more than 100% of monthly income as compared with 1.7% of those with income above this level.⁶³⁸ The probability of households being over-indebted by this measure was higher when they were materially deprived.⁶³⁹ In the EU as a whole during this time, this was 9%, and 4% in Latvia.

Examining more recent time series data (the regular EU-SILC module 2005-2011), those households where income was 60% of the national equivalised median suffered from increasing arrears in both absolute terms and relative to those above 60% of the median national equivalised income. For example, in 2007, 14.4% of the lower income households (as defined above) suffered from arrears⁶⁴⁰, compared to 9.2% of the higher income ones. That is, higher income households were about one third less likely to suffer from arrears. However, in 2011, 44.8% of households with lower incomes were experiencing arrears, compared to 21.6% of higher income

⁶³⁸ Fondeville, N., Ozdemir, E. and Ward, T., *Over-indebtedness: New evidence from the EU-SILC social module*, European Commission, Directorate-general for Employment, Social Affairs and Equal Opportunities, Research Note 4/2010, 2010.

⁶³⁹ Defined as living households unable to afford 3 out of 9 basic items for which information is collected by the EU-SILC, or more precisely, unable to afford 7 items plus not being able to meet unexpected expenses and being in arrears on household housing expenses, household bills or loan repayments.

⁶⁴⁰ On home loan/rent repayments, utility bills, or hire purchase/other consumer loan.

households. This means that lower income households were now twice as likely as higher income ones to suffer from arrears, showing both an absolute and relative increase in levels of arrears for these households.

Age also played a role, with younger people being more likely to experience arrears. Based on 2011 data, of households comprising one adult younger than 65 years, 28.8% reported arrears, compared to 10.1% of households comprising one adult over 65 years old. Households with dependent children also reported arrears more frequently (32.0%) than those without (18.9%). Gender was also a factor, with over a quarter (25.3%) of single male households reporting arrears, compared to only 16.6% of single female households.

Stakeholders were unsure as to the most common types of households that were over-indebted. One stakeholder stated that it was hard to specify any type of household as the most common one, and that both young and old people had problems with debt, for different reasons. A lack of precise data, and a lack of data disaggregating households in regards their level of material deprivation were also mentioned.

However, citing statistical data from a housing loan survey that was carried out on the behalf of the Bank of Latvia,⁶⁴¹ one stakeholder reported that people below 25 and between the ages of 40 and 64 are slightly more likely to have problems with debts. They defined households with a financial margin of 0 (income plus savings, minus living expenses and loan servicing) as over-indebted for this purpose.

There was no clear consensus from stakeholders on whether the types of household had seen changes in the previous five years. However, one stakeholder commented that "there has been an increasing number of younger households (around 25) are facing financial problems. Before the 2008 crisis these people took a lot of credit and then became unable to repay their debts."

15.3.2 Causes of households' over-indebtedness

Macro-economic factors

The Latvian economy was severely affected by the financial crisis and the ensuing economic depression. Latvia suffered three consecutive years of depression from 2007-2010 (the most severe of which, in 2009, resulted in a 16.4% decrease in real GDP per capita), though growth (of 7.5% of real GDP) returned in 2011. The unemployment rate tripled from 6.5% in 2007, to a record high of 19.8% in 2010.⁶⁴² These later figures are well above the EU average, and indicate that Latvia is one of

⁶⁴¹ Bank of Latvia, *The results of the July 2011 bank lending survey*, 2011.

⁶⁴² Eurostat, 'Unemployment rate' and 'Real GDP per capita' (codes: tsdec450 and tsdec100).

the countries hardest-hit by the recession in the EU. These severe economic dislocations coincide with the major increase in arrears and proportion of those suffering financial difficulties since 2007.

Indeed, all stakeholders viewed unemployment level (in particular, the rapid increase in unemployment as a result of the crisis) as a macro-economic cause of household's over-indebtedness in Latvia. Not only unemployment as such but also cuts in income for those still employed and austerity measures⁶⁴³ were highlighted by a stakeholder working for a public authority:

The unemployment level increased since the crisis in 2008 and we had major cuts in wages that significantly influenced the ability of people to meet their financial obligations. The most strongly impacted household were those in the highest quantile who experienced major wage cuts and have therefore much more problems regarding their financial obligations.

Cost of living

Utility costs in particular were highlighted by stakeholders as a cause of household over-indebtedness. One stakeholder observed that the minimum wage was below minimal living costs and that after taxes, it was not enough to live on. This was combined with rises in cost of living over the last several years:

Price of electricity as well as VAT for electricity increased in 2011 quite significantly. Heating and gas prices have also increased, because Russia has increased the prices. Utility costs are one of the background problems for people with financial difficulties because they constitute high financial commitments that have to be met every month.

This picture was supported by relevant statistics. Median income⁶⁴⁴ decreased by nearly a quarter (23.4%) from their 2009 high to 2011, while cost of living as measured by the Harmonised Index of Consumer Prices increased over 4 basis points during the same period. This overall measure hides some much higher increases (since the HICP also includes reductions in house prices due to the bust), such as electricity prices, which increased by 64.2% from 2007 to 2011.⁶⁴⁵ Therefore, it is unsurprising that arrears on utility bills as measured by SILC nearly tripled (from 8.8% to 24.0%) in the years 2007 to 2011.

⁶⁴³ According to one analysis, cuts of 1.42 billion Euro were made as part of the EU/IMF rescue loan in 2009, mainly from severe reductions in public sector wages. A progressive income tax system, raising the tax rate for high-income earners, and an increase in VAT and Social Security contributions were further measures. (Laven, Z., and Santi, F., *EU austerity and reform: a country by country table*, European Institute, 2012.)

⁶⁴⁴ Eurostat, 'Mean and median income by household type' (code: ilc_di04).

⁶⁴⁵ Eurostat, 'Electricity prices for household consumers' (code: ten00115). This indicator presents electricity prices charged to final consumers. Electricity prices for household consumers are defined as average national price in Euro per kWh without taxes applicable for the first semester of each year for medium size household consumers.

Types of credit/loan taken out by households

Overall, the most frequently highlighted cause by stakeholders in regards the type of credit or loan taken out by households was that of home loans and mortgages.

Macro-economic statistics from Eurostat indicate that Latvian households have had a relatively low debt-to-income ratio compared to other Member States, but this level expanded considerably before the crisis. Since the crisis, as growth in lending reversed, debt-to-income levels decreased by nearly one fifth (19%) from 2007 to 2011. This was accompanied by a massive increase in the share of non-performing loans (NPL).⁶⁴⁶

A contributing factor to the Latvian crisis according to one interviewee was a lack of a credit register during the boom years, which may have added to the rapid expansion of mortgage debt. As a percentage of GDP, mortgage debt grew extremely rapidly from 0.7% in 1999 to a high of 36.7% in 2009, before falling sharply to 30% in 2011, as a result of the contraction in credit and associated recession.⁶⁴⁷ However, one stakeholder held that this factor, among others, was mostly historical, in that they caused over-indebtedness in pre-crisis and crisis years, but were now less relevant in contributing to over-indebtedness of households.

Concerning other types of financial products, one stakeholder highlighted payday and SMS loans as particularly problematic types of credit/loan taken out by households.

Personal circumstances

Accordingly, stakeholders saw drop in income caused by unemployment, poverty, or drop in income caused by unemployment or business failure as causes of household over-indebtedness relating to personal circumstances; financial literacy was mentioned as an issue important in Latvia by one interviewee.

15.3.3 Changes relevant for levels of over-indebtedness

Consistent with the above, stakeholder considered changes in certain factors relevant for levels of over-indebtedness in the past five years to have been very significant. This was the case for macro-economic factors, and utility costs. According to one interviewee, the "ratio of households that could not afford to cover bills of public utilities, rent or paid credit has almost doubled in all households, and more than doubled in households below the at-risk-of-poverty threshold."

⁶⁴⁶ The percentage of non-performing loans to total gross loans rose from 0.8% in 2007 to 18.4% in 2011. For source see IMF, 'Bank non-performing loans to total gross loans (%) for Member States (2005-2011)'.

⁶⁴⁷ European Mortgage Federation, Hypostat, 2011.

However, there was also the mitigating factor of lower interest rates to existing borrowers, as the Latvian Lat is pegged to the Euro and decreases in interest rates has decreased household loan servicing payments. According to a financial industry stakeholder, credit institutions imposed stricter lending practices during the crisis, and demand for loans was seen as significantly lower, potentially dampening over-indebtedness. On the other hand, the popularity of unregulated lenders was seen by stakeholders as increasing significantly, because regulated institutions credit standards had become tighter.

15.3.4 Cultural attitude towards debt and actual level of households' (over-)indebtedness

Stakeholders identified two major changes that influenced the cultural attitude towards debt in Latvia. These were the fall of the communist regime, and accession to the EU. Both these events were seen as changing attitudes of consumers to view the taking out of credit in a more positive light.

Particularly as regards accession to the EU, stakeholders highlighted the role of lower interest rates and the activities of foreign owned banks competing for market share through aggressive marketing. These activities arrived at a stage when private lending was still undeveloped, and so people became more open to taking out credits and loans. This process was bound up with pressures of consumerism, over-optimism, and concerns over social status. According to one stakeholder:

The fact that people today tend to consider taking loans a very common phenomenon is also related to the social status in consumer society when not having brand new products means social exclusion in certain groups. In the past, people would be very afraid of having financial obligation and not being able to repay. Nowadays, it is common that consumers do not make any long-term plans as far as their money management goes, are not cautious enough and become over-indebted.

However, one stakeholder observed that in the post-crisis period, consumers was becoming more prudent in their attitudes to debt, and that the crisis functioned in a crude way as a financial education.

15.4 CONSEQUENCES OF OVER-INDEBTEDNESS

15.4.1 Consequences for affected households

Based on an average rating of perceived consequences of over-indebtedness for households attributed by interviewed stakeholders, in Latvia the most highly rated consequence for affected households was in the form of home repossession, followed by reduced standard of living.

15.4.2 Consequences of over-indebtedness for the financial services industry

The consequence rated most highly by stakeholders for the financial services industry was that of costs of arrears and agreed repayment/debt management plans for creditors, while lower demand for credits and increased costs for financial services providers through stricter regulation of credit were the least highly rated. Quantifying these differences was seen as difficult, with one stakeholder commenting that they could not commend due to lack of relevant data. However, one regulatory consequence mentioned was the Loan-to-Value (LTV) cap of 90% for household mortgage loans, introduced in 2007 at the start of the crisis.

15.4.3 Economic and social consequences of over-indebtedness for society

Legal costs associated with over-indebtedness were assessed most highly by stakeholders, in terms of the economic and social consequences of over-indebtedness for society in Latvia. A loss of consumer confidence in the financial services industry was also rated highly, based on the average scoring given by stakeholders. As one stakeholder explained:

People are not as confident about financial services as they used to be. We have experienced two bank bankruptcies by banks that were generally considered well established on the market and reliable.

However, other effects not covered in the multiple choice categories was the second most highly rated consequence. One stakeholder explained that the major social consequence in Latvia was emigration - people were leaving the country because of their problem with debts.

The issue of demographic change is supported by statistical data - according to Eurostat estimates,⁶⁴⁸ the total population of Latvia in 2007 was 2.28 million persons, but this had decreased to 2.04 million by 2012. Research has shown that most emigrants are young, leaving an increasingly aging population behind, and the proportion of the highly educated among emigrants increased significantly during the crisis.⁶⁴⁹

15.4.4 Debt collection practices

According to the Latvian Association of Extrajudicial Debt Collectors, the number of cases dealt with by its members decreased by 9% in 2011 compared with 2010, while

⁶⁴⁸ See Eurostat statistics, 'Population at 1 January' (code: tps00001).

⁶⁴⁹ Hazans, M., 'The changing face of Latvian emigration, 2000-2010'. In: B. Zepa and E. Klave (eds.), *Latvia. Human Development Report 2010/2011: National Identity, Mobility and Capability*. Riga: Univ. of Latvia Press, 2011, pp. 70-91.

the total amount decreased by 23%, because of decreased lending volumes and tighter lending standards.⁶⁵⁰

Stakeholders were divided as to potential changes in debt collection practices in the previous 5 years. They reported cases of aggressive debt collection practices, such as contacting employers and informing them of financial problems of their employees, visiting debtors in their homes in order to shame them in public, and even threatening people.

However, one interviewee noted that as a result of the increasing amount of aggressive debt collection, recent regulatory changes had been introduced to limit extrajudicial debt collection and associated aggressive debt collection practices.

⁶⁵⁰ PAUS, '2011 indicators of the debt collection industry', Press release 25-09-2012, Riga, 2012.

15.5 MEASURES IN FORCE TO ALLEVIATE THE IMPACT OF OVER-INDEBTEDNESS

15.5.1 Early identification of households at risk

Specific measures to identify households at risk of becoming over-indebted at an early stage were not seen as common by stakeholders. Privately owned credit databases recording repayment problems are available⁶⁵¹ and the Central Bank of Latvia has operated a national credit register since 2008⁶⁵² which stores data on the customers and customers' guarantors, their liabilities and performance thereof. Accordingly, one stakeholder commented that identification of households at risk was left to the competence of the lenders.

15.5.2 Advice offered to over-indebted households

Debt advice, whether face-to-face or by any other method, was only seen as partially available in Latvia according to stakeholder interviewees. One non-governmental and voluntary organisation (Latvijas Kredītņēmēju Apvienība, or LAKRA)⁶⁵³ specifically offers financial and legal advice to help consumers deal with bank, leasing companies, and debt recovery procedures; these services are provided to members, membership costing between 24 and 72 Lat per year.⁶⁵⁴ Though the first consultation is free of charge, subsequent consultations were priced at 5 Lat per visit.⁶⁵⁵ The organisation also specifically lobbies for the rights of borrowers and the reform of various laws and procedures to make it easier for consumers to be released from debt. Informational content was provided online by some other private organisations,⁶⁵⁶ however the effectiveness of their services was not well known according to stakeholders interviewed.

Though noting the lack of advice available generally, one civil society stakeholder noted that banks also provided a de facto debt advice service by working more closely and individually with their customers.

Regarding demand for debt advice, most stakeholders agreed that demand had increased in the last five years. One stakeholder cited an increase in insolvency proceedings as an important cause of this, while another stated that though demand had increased, current services could not deal with all the debtors who were asking for help, and that more independent debt advice was needed. Stakeholders also

⁶⁵¹ E.g. CreditInfo, Risk.lv.

⁶⁵² Bank of Latvia, 'On the Credit Register', Riga, 2013. At: <http://www.bank.lv/en/about-the-bank-of-latvia/on-the-credit-register>

⁶⁵³ Website: <http://www.kreditnemeji.lv/>

⁶⁵⁴ Between 34 and 100 Euro (Fixed exchange rate of 1.43 Lat to Euro, 28.01.2013).

⁶⁵⁵ Approximately 7 Euro (*supra.*)

⁶⁵⁶ E.g. Paradukonsultants.lv, www.kreditnemejs.lv

believed that funding of debt services was insufficient; one stakeholder stated that debt advice would be better for consumers, since personal insolvency was very expensive in Latvia.

15.5.3 Key measures in place to alleviate the impact of over-indebtedness

Availability and costs

Informally brokered arrangements such as restructuring of loans were reported to be fairly common by a majority of stakeholders, though their effectiveness was questioned. However, formal out-of-court procedures were not considered to be available (outside of various debt-restructuring arrangements already mentioned). However, formal legal procedures were considered widely available. Specifically, this referred to the consumer insolvency procedure, which was reformed and became effective on 1 November 2010. According to a review of insolvency procedures in the Baltics,⁶⁵⁷ one of the main aims of the reform was to make the insolvency process more accessible to individuals. This was achieved through reducing the insolvency administrator fee (to a single payment of €570), and shortening the duration of the process (debts are extinguished after a maximum of 3.5 years).

The process is divided into two stages: bankruptcy, followed by a procedure for settling liabilities. The administrator first sells the bankrupt individuals assets, which may take up to six months.⁶⁵⁸ During the second stage, the debtor pays their remaining debts partly or in full under a repayment plan. The term of the procedure depends on the amount of debt to be paid; after all debts under the plan are paid off, they are granted a discharge from remaining unsettled liabilities plus the cancellation of any further debt collection measures.

Other measures, such as financial support for households to repay debt or arrears were not seen as available by stakeholders. However, one respondent claimed that it was sometimes possible to write off interest arrears for public utility debts, since these services were usually offered by local governments who were interested in receiving at least some amount of repayment.

Effectiveness as assessed by stakeholders

The reform of the consumer insolvency procedure has dramatically increased its popularity. According to official statistics,⁶⁵⁹ the number of procedures brought by

⁶⁵⁷ Kallas, K., Petkevicius, M., and Ruda, G., 'Treatment of insolvency for private individuals: developments in the Baltics', *Insolvency and Restructuring International*, Vol 5 No 2, 2011, p.33.

⁶⁵⁸ Further details available in the consolidated text: The Parliament of the Republic of Latvia, *Insolvency Law*, State Language Centre, 2011.

⁶⁵⁹ See: www.lursoft.lv/exec?act=MNR_STAT&stat_id=533

natural persons increased nearly four times from 53 cases in 2009, to 199 in 2010. However, this had increased to 1,374 cases in 2012. Despite this, these cases were still mostly on-going at time of writing; one stakeholder claimed that the first private insolvency case was finished only in October of 2012. Therefore, the overall impact of the personal insolvency reform is impossible to judge at this stage.

15.5.4 Types of households of over-indebted consumers not reached by current measures

Generally, stakeholders did not know what specific types of over-indebted households were not yet reached by current measures. One stakeholder emphasised that:

It is hard to tell for us which types of households are not reached by the current measures as we do not have sufficient data to identify any types. However, there must be some types as there are only few measures available and most of them are expensive.

15.5.5 Best practices

No specific measures currently applied in Latvia were cited as representing best practices. Instead, stakeholders looked to Finland as a possible model for a complete system. Specifically, public-funded and independent debt advisors in every municipality were held as an example that was lacking in Latvia. The loan restructuring system in Finland administered by the Guarantee Foundation⁶⁶⁰ and funded by the national Slot Machine Association was also specifically mentioned.

⁶⁶⁰ The Guarantee Foundation is a national social organisation which assists private persons struggling with a financial crisis in solving their debt and payment problems. The objective is to improve management of personal finances and promote independent coping in the society. The operations are mostly financed by Finland's Slot Machine Association (RAY). (Takuu-Säätiö, *Slideshow about the Guarantee Foundation*, 2013.) At: http://www.takuu-saatio.fi/@Bin/116775/Slideshow_Guarantee_Foundation_2011.pptx

15.6 OUTLOOK

Stakeholders did not generally expect that over-indebtedness would worsen in the next five years, rather that it would decrease. Stakeholders expected that an improving socio-economic situation would decrease the overall number of households suffering from over-indebtedness, as households continue to repair their balance sheets. The European Commission forecasts growth of 3.6% for 2013, and noted that the Latvian economy in 2012 was again the fastest growing in the EU, of about 4.3%.⁶⁶¹ Taking into account various factors, year-average unemployment was projected to drop to 14.3% in 2013, and 12.7% in 2014.

However, one stakeholder sounded a note of caution:

"The boom of credits is not over yet and people will go on taking loans and credits so it is very likely that the number of over-indebted households will increase."

Looking forward, specific regulatory measures to be enacted suggested by stakeholders include:

- ▶ The reform of the national credit register to include wider information about the credit history of borrowers, debt repayments from utility providers, and implementing other new features;
- ▶ The regulation of quick or 'SMS' loans;
- ▶ Reform of public utilities to offer lower prices for low-income consumers;
- ▶ Continuing reform of prudential lending rules, for example an additional ratio of loan servicing payments to income for new loans.

As non-regulatory policy measures, one stakeholder suggested the development of government guarantee programs to help new households with children acquire their first housing, as this would have the knock on effect of helping over-indebted households improve their financial situation by selling their real-estate to repay debt. The provision of debt advice and its funding was also mentioned by one stakeholder as something that should be addressed by policy-makers.

⁶⁶¹ See European Commission, European Economic Forecast Autumn 2012.

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Over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact

ANNEX A: STATISTICAL DATA FROM EU SOURCES

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Latvia

I. Eurobarometer¹

	Latvia	EU average	Lowest EU value	Highest EU value
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Households *at risk* of being over-indebted

Respondents feeling at risk of over-indebtedness in 2010	↗ 52%	25%	7%	52%
Respondents feeling at risk of over-indebtedness in 2009	↗ 51%	27%	9%	53%

II. EU SILC standard survey data²



III. EU SILC 2008 module: Over-indebtedness and financial exclusion³

	Latvia	EU average	Lowest EU value	Highest EU value
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Proportion of people in households with bank overdrafts, outstanding balances on credit cards or in arrears on other loans of over 100% of household disposable income

Overdrawn bank account (% of people in households overdrawn)	↘ 0.6%	2.2%	0.0%	7.7%
Credit or store card (% of people in households with outstanding balances)	↘ 0.1%	1.1%	0.0%	8.6%
Other loan/credit payments (% of people in households in arrears)	↘ 0.1%	0.3%	0.0%	1.1%

Proportion of people in households in arrears in servicing housing-related loans and bills and in paying other bills of over 100% of household disposable income

Housing bills (% of people in households in arrears)	↗ 0.8%	0.5%	0.0%	2.9%
Other payments (% of people in households in arrears)	↘ 0.2%	0.4%	0.0%	1.7%

Households living with outstanding debts and/or arrears of over 100% of household disposable income

Total (% of households with outstanding debts/arrears)	↘ 1.8%	4.6%	0.0%	11.8%
Income above 60% median (% of households with outstanding debts/arrears)	↘ 1.7%	4.2%	0.0%	11.3%
Income below 60% median (% of households with outstanding debts/arrears)	↘ 2.4%	7.0%	0.2%	13.7%
Materially deprived (% of households with outstanding debts/arrears)	↘ 4.0%	9.0%	0.1%	27.4%

Proportion of those in broad age groups with outstanding debts of over 100% of household disposable income

Households with all adults aged 25-39 (% of households with outstanding debts)	↘ 3.1%	6.3%	0.0%	17.2%
Households with all adults aged: 40-64 (% of households with outstanding debts)	↘ 1.4%	5.8%	0.0%	10.9%
Households with all adults aged: 65+ (% of households with outstanding debts)	↘ 0.8%	1.2%	0.0%	2.8%

Proportion of those in different types of household with outstanding debts of over 100% of household disposable income

Living alone (% of people in households with outstanding debts)	↘ 1.9%	4.3%	0.0%	8.2%
Single parent (% of people in households with outstanding debts)	↘ 3.7%	9.5%	0.0%	27.1%
Other (% of people in households with outstanding debts)	↘ 1.7%	4.8%	0.0%	12.1%

Proportion of those in households with outstanding debts of over 100% of household disposable income by marital status

Never married (% of people in households with outstanding debts)	↘ 2.5%	5.0%	0.0%	15.4%
Married (% of people in households with outstanding debts)	↘ 1.0%	4.1%	0.0%	9.7%
Separated/divorced (% of people in households with outstanding debts)	↘ 2.9%	7.5%	0.1%	13.9%
Widowed (% of people in households with outstanding debts)	↘ 1.2%	1.7%	0.0%	4.3%

Proportion of those in households with outstanding debts of over 100% of household disposable income by housing tenure

Owner occupied without mortgage (% of people in households with outst. debts)	↘ 1.2%	3.2%	0.0%	9.6%
Owner occupied with mortgage (% of people in households with outst. debts)	↘ 4.3%	6.3%	0.0%	16.1%
Market rent (% of people in households with outstanding debts)	↘ 3.6%	8.2%	0.0%	16.0%
Subsidised rent (% of people in households with outstanding debts)	↘ 6.8%	8.7%	0.0%	17.9%
Rent-free housing (% of people in households with outstanding debts)	↘ 0.0%	2.3%	0.0%	15.1%

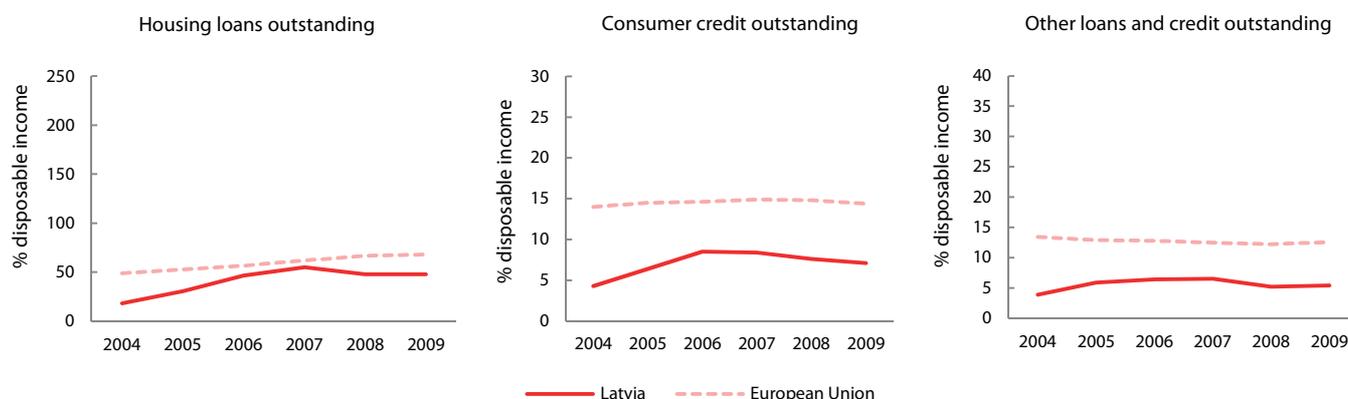
Proportion of those in households with outstanding debts of over 100% of disposable income by work intensity

Work intensity of 0 - 0.19 (% of people in households with outstanding debts)	↘ 2.8%	5.7%	0.0%	10.6%
Work intensity of 0.20 - 0.50 (% of people in households with outstanding debts)	↘ 2.2%	5.7%	0.0%	15.3%
Work intensity of 0.51 - 0.74 (% of people in households with outstanding debts)	↘ 2.7%	5.4%	0.0%	13.5%
Work intensity of 0.75 - 1.0 (% of people in households with outstanding debts)	↘ 1.5%	5.3%	0.0%	14.3%

Proportion of those in over-indebted households that experienced a major drop in income over the preceding year

Over-indebted (% of people in households that experienced drop in income)	↗ 44.9%	33.3%	0.0%	77.6%
Other (% of people in households that experienced drop in income)	↗ 21.3%	19.2%	5.9%	32.5%

IV. Loans and credit outstanding⁴



Notes:

(1) Eurobarometer 72.1 (2009) and Eurobarometer 74.1 (2010). Note: Those who answered 'very at risk' or 'fairly at risk' to the question 'Please tell me how much you feel at risk of being over-indebted'.

(2) Eurostat, SILC. Data as of December 2012.

(3) European Commission, Research Note 4/2010, Over-indebtedness new evidence from the EU-SILC special module.

(4) European Commission, Research Note 4/2010, Over-indebtedness new evidence from the EU-SILC special module. European Credit Research Institute (ECRI), Lending to households in Europe, 1995-2009 and Eurostat, National accounts.

16 LITHUANIA

<i>Document</i>	The over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact - Country report Lithuania
<i>Prepared by</i>	Robert Graham
<i>Finalised on</i>	25 June 2013

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Over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact

16.1 DEFINITION OF OVER-INDEBTEDNESS

As of May 2012, the introduction of a law on bankruptcy of natural persons has defined the status of an "insolvent" person in Lithuania. This is where a natural person who cannot fulfil their liabilities which are overdue and whose amount is more than 25 minimum monthly salaries.⁶⁶²

Stakeholders were split as to whether they used a specific definition for over-indebtedness themselves. Although stressing that a common definition for over-indebtedness of households was not used, one stakeholder working for a public authority used data from the Bank of Lithuania Survey of Households with a Housing Loan to calculate a financial margin of households. If this margin was negative or close negative, households were considered to be facing financial difficulties. A stakeholder from the financial industry used a more pragmatic definition - over-indebted persons were those who qualified for the individual bankruptcy procedure, while another stakeholder said that "there is no specific definition in the Lithuanian language. We use a definition that broadly refers to the number of liabilities for which payments are overdue beyond a certain date."

Generally, stakeholders felt that compared to the definition used for this study, their definition referred to the individual person, and not the household. In light of this, it is not surprising that the majority of interviewees who expressed an opinion stated that there was a need for a better definition, emphasising the importance of a level "playing field" regarding data to ensure an objective analysis.

The majority of stakeholders did not use a specific definition of households *at risk* of becoming over-indebted. Furthermore, they saw little need to distinguish between those over-indebted and those at risk of being so, and the majority of interviewees used the same definition for both. The majority of stakeholders also thought that there was a need for a better definition of households at risk of being over-indebted, one stakeholder suggesting a definition based on those persons with low creditworthiness ratings.

16.2 LEVEL OF OVER-INDEBTEDNESS

Despite the confusion over the general definition of over-indebtedness, it is possible on the basis of EU-level indicators such as EU-SILC to estimate the level of over-indebtedness in the aspects specified by this study. It was found that overall, levels of over-indebtedness have increased since the financial crisis (see Annex), with

⁶⁶² Text of the relevant law available at (in Lithuanian):

http://www3.lrs.lt/pls/inter3/dokpaieska.showdoc_l?p_id=424561&p_query=&p_tr2=2

frequency of arrears on all types of key commitments rising from a low of 8.1% in 2008 to 13.1% in 2011, following a steep decline from 2005-2008.⁶⁶³

Breaking arrears on key commitments down into their component parts, the share of the population in arrears on utility bills doubled from 5.9% in 2008 to 11.9% in 2011. This rise was proportionally higher than the EU average and in absolute terms higher than the EU average of 8.8% in 2011.

The EU-SILC survey data also shows that the proportion of the Lithuanian population with arrears on mortgage or rent repayments increased from a low of 0.5% in 2008, to 1.5% in 2011, although this was considerably below the EU average of 4% in 2011. For consumer credit, the picture is similar, with arrears on hire purchase and other loan payments increasing to a high of 2.6% in 2008 but then falling to 1.6% in 2011. These figures were also lower than the EU average, which was 2.9% in 2011.

Regarding more subjective indicators of financial difficulty shows more serious levels of over-indebtedness than looking at arrears alone. Eurobarometer surveys in 2009 and 2010 asked respondents to rate how much they felt at risk of being over-indebted. For Lithuania, this was slightly lower (23%) than the EU average (of 27%) in 2009, but had increased to become higher (29%) than the EU average (of 25%) in 2010. This was also the third largest absolute increase of all Member States for these surveys.

EU-SILC data also assesses the general perceived ability of households to make ends meet,⁶⁶⁴ namely by paying for its usual necessary expenses with its combined total income. Summing the answers "with difficulty" or "with great difficulty", it was found that 35% of those surveyed found it difficult to make ends meet in 2011, up from 24% in 2007 - one of the largest proportionate increases amongst the EU Member States. This was also significantly higher than the EU average of 26% in 2011, but lower than the worst affected Member States like Greece (63%), Bulgaria (62%), and Latvia (56%). When examining perceived debt burden, this was slightly less serious for consumer credit than for housing costs, but both had increased significantly during the crisis.⁶⁶⁵

That over-indebtedness had increased was confirmed by the stakeholders interviewed, who all believed that it had increased over the previous five years. Citing Central Bank statistics, one stakeholder stated that "[since] 2009 overdue loans

⁶⁶³ Eurostat, 'Arrears (mortgage or rent, utility bills or hire purchase)', (code: ilc_mdcs05).

⁶⁶⁴ Eurostat, 'Percentage of total population with inability to make ends meet' (code: ilc_mdcs09).

⁶⁶⁵ In 2007, 26% of those surveyed indicated that housing costs were a heavy burden for them, compared to the peak in 2010 of 40%. Eurostat: 'Financial burden of the total housing cost' (code: ilc_mdcd04). For hire purchase and other loans, this was a heavy burden for 38% of those surveyed in 2010, notably higher than the EU average of 30% in 2010. Eurostat: 'Financial burden due to hire purchases or loans' (code: ilc_mdcd05).

Research from the Bank of Lithuania found that at the beginning of 2012, an average share of household's income allocated for the repayment of its housing loan made up 22.6% of the household's disposable income, a slight decrease of 3.3% compared to corresponding period in 2011. See: Bank of Lithuania, *Survey of households with a housing loan*, 2012.

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increased 3 times (and even 6 times overdue loans to quick credit granting companies). In June 2012 overdue loans of the households were over 3 billion Litass (about 870 million Euro)."

16.3 NATURE AND DRIVERS OF OVER-INDEBTEDNESS

16.3.1 Most common types of households that are over-indebted

Previous research has found that age and level income are major factors in predicting over-indebtedness.⁶⁶⁶

This was in agreement with stakeholder opinions. In the experience of interviewees, households consisting of people between the ages of 25 and 39 were among the most common types of household that were over-indebted. Tenure status was also seen as important by stakeholders, with the majority highlighting households with mortgages as among the most common types of households that were over-indebted, followed by households with two unemployment persons. Children were also seen as a risk factor, both for one and two-person households.

According to one stakeholder, it was their opinion that "the age range 25 to 39 is most commonly affected by over-indebtedness because this is a group that more often has mortgages and is most affected by unemployment. This is also a consequence of the economic crisis. This is also the age group that is most likely to have children." A couple of stakeholders had also seen a significant change in the types of households affected by over-indebtedness in the past five years. According to these stakeholders, this was primarily due to the crisis, and "what could be considered to be 'normal' household is now also effected by over-indebtedness [...] Middle class families are more and more affected".

16.3.2 Most important causes of households' over-indebtedness

Macro-economic factors

As with the other Baltic Member States, Lithuania was severely affected by the financial crisis and the consequences of the economic depression that followed it. This can be clearly seen by examining economic growth and unemployment figures. In 2008, real GDP per capita reached an all-time high 8,000 Euro per capita, but this fell steeply to 7,100 Euro by 2010 (a drop of 11%), before rising again slightly in 2011. Meanwhile, the unemployment rate according to Eurostat estimations soared from 3.8% in 2007 to 18% in 2010. This rate is nearly twice the EU average, though recent figures estimate a declining trend in the last two years (to about 13% in the last

⁶⁶⁶ See synthesis report for detailed review of research, and also Fondeville, N., Ozdemir, E., and Ward, T., *Over-indebtedness: New evidence from the EU-SILC special module*, Directorate-General for Employment, Social Affairs and Equal Opportunities, Research Note 4/2010, 2010.

quarter of 2012). These figures obviously coincide with the increases in arrears and self-reported financial difficulties since 2008.

Indeed, all stakeholders considered unemployment and wage levels as among the most important causes of households' over-indebtedness. All of the interviewees also saw a significant change in the macro-economic situation that increased the level of over-indebtedness over the previous five years. Stakeholder commented on the crisis increasing unemployment, but also decreases in salaries in both the public and private sector.

Cost of living

Utility costs were highlighted by stakeholders as an important cause of over-indebtedness. This was especially difficult for those unemployed and because of heating bills during the long winter period, and according to one stakeholder, was compounded by high prices and a lack of credit risk management rules in utility companies.

Statistics show a decline in median income since 2009 (when it was 4,807 Euro) to 2011 (where it was 4,005). However, utility prices have not decreased proportionately. In fact the opposite is true: the general cost of living as measured by the Harmonised Index of Consumer Prices (HICP) rose 7 basis points during this period, compared to 5 points for the EU as a whole. Compared to the year 2005 (which was set as the baseline at 100 points), heat energy costs rose especially highly, from 194 points in 2009 to 240 in 2012. During this period, the consequence was that the frequency of utility arrears as measured by EU-SILC rose from 8.5% to 11.9% of the total population.

Types of credit/loan taken out by households

The most frequently highlighted cause of over-indebtedness in regards type of credit or loan taken out by household was that of home loans/mortgages, followed by regulated credit with average or high interest rates.

Macro-economic statistics from Eurostat indicate that Lithuanian households have had about half the debt-to-income ratio compared to other Member States, but this level rose steadily before the crisis, to a peak of 46% in 2009. Since then, it has decreased to 41% in 2011. This has been accompanied by an explosion in non-performing loans (NPLs), increasing from only about 1% before to the crisis to one fifth (19%) of all loans in 2011.

Lithuania has a very high owner-occupation rate (93% in 2010), and according to the bank of Lithuania, 11.6% of households have taken out a mortgage.⁶⁶⁷ As a percentage of GDP, mortgage debt increased steadily from 1% in 2000 to a high of

⁶⁶⁷ Bank of Lithuania, *Survey of households with a housing loan*, 2012.

23% in 2009. This reflects a significant upsurge in housing loans issued from 2006 to 2008. However, it has since declined, reflecting a deleveraging process, to 19% in 2011 (this is still significantly lower than the EU average of 28%).⁶⁶⁸ However, not only one type of loan was a problem, according to one stakeholder: "Common problem in Lithuania is that people have mortgages and at the same time they take other credits too."

In terms of changes, stakeholders saw significant changes in lending practices of credit providers. As an example, one stakeholder highlighted that "At the end of 2008, lending standards were significantly tightened as a result of the crisis breakthrough; afterwards, at the beginning of 2010 they started to ease. Prudent Lending Principles set the standards that introduced the best lending practice (e. g. LTV [Loan-to-value ratio] was set to 85 per cent; DTI [Debt to income ratio] - 40 per cent)." Another stakeholder highlighted that this was not due to legislation, but rather individually by the credit institutions themselves.

However, several stakeholders highlighted the role played by "quick" or "SMS" type loans both before and after the crisis. Before they were used to pay part of the monthly loans to bank and so become over-indebted. They were newly regulated in 2011, and this had reduced the interest rates demanded and their incidence. Reliable data on these lenders was hard to come by, and one stakeholder emphasised that they played a relatively minor role.

Personal circumstances

Not only macro-economic factors or practices of the financial industry were important. Several stakeholders also highlighted the importance of financial literacy. As one stakeholder said in relation to students, "Students do not have enough financial education and they do not think about what they are doing. They take credit because it is very easy - it is in fact granted by the state - but they have to return the money one day." Lack of personal money management skills was highlighted as a problem that caused issues in conjunction with the financial crisis, and that the financial crisis was not the only cause of recent over-indebtedness.

16.3.3 Cultural attitude towards debt and actual level of households' (over-) indebtedness

Stakeholders interviewed all believed that there was a relationship in Lithuania between the cultural attitude towards debt (e.g. the significance attributed to being debt-free) and the actual level of household over-indebtedness. Stakeholders distinguished between a post-Soviet mentality and general trend of increased borrowing from banks over last 10-15 years, but also a generational difference: "Older people don't use debt or try to pay the debts on time; younger generations use debt

⁶⁶⁸ European Mortgage Federation, *Hypostat 2011, 2012*.

and do not have a high responsibility to pay it on time." According to one stakeholder, there have been some changes in the previous five years: "more education measures are applied in media channels to encourage responsible lending".

16.4 CONSEQUENCES OF OVER-INDEBTEDNESS

16.4.1 Consequences for affected households

Based on an average rating of perceived consequences of over-indebtedness, for households attributed by stakeholders interviewed, in Lithuania the most highly rated consequences for households was that of home repossession, followed by reducing standard of living and deteriorating well-being. Least important going by this metric were family breakdown and divorce, and recourse to addictive behaviours. Regarding home repossession, one stakeholder emphasised the seriousness of this when it does occur: "For Lithuanians it is a cultural mentality to have a flat owned by oneself - so losing one's house is a big consequence of over indebtedness in that it is socially looked-down upon".

16.4.2 Consequences of over-indebtedness for the financial services industry

The consequence rated most highly by stakeholders for the financial services industry was that of the costs of defaulted credits for creditors, followed by costs of arrears and debt management plans. A loss of consumer confidence in the financial services industry was also rated highly, based on the average scoring given by interviewees.

Specific examples of these costs were given by stakeholders. A major example was new Bank of Lithuania regulation in 2011, establishing that the loan-to-value of pledged assets ratio of credits for the acquisition of assets cannot exceed 85 per cent of the market value or price of pledged assets.⁶⁶⁹ This was part of a package of responsible lending regulations in general introduced since the crisis, which among other things, obligate lenders to perform consistent assessments of the borrower's ability to repay, and apply a maximum debt to income ratio of 40% of the income of the person or household.⁶⁷⁰

16.4.3 Economic and social consequences of over-indebtedness for society

Going by average scores, costs of measures to alleviate the impact of over-indebtedness were seen as the most important economic and social consequences of over-indebtedness for society. Reduced productivity at work was also mentioned by one stakeholder, as "people are less able to be productive at work if they have to think

⁶⁶⁹ See Bank of Lithuania, 'The Bank of Lithuania approved Regulations for Responsible Lending', Press release September 6, 2011. At: http://www.lb.lt/the_bank_of_lithuania_approved_regulations_for_responsible_lending

⁶⁷⁰ Bank of Lithuania, 'Responsible Lending Regulations', *Valstybes žinios (Official Gazette)* No. 111-5262, 2011. At: http://www.lb.lt/responsible_lending_regulations

constantly about how to pay their bills." A specific example of costs incurred by alleviating mortgage debts was cited by one stakeholder. The government-owned institution "Company for Housing Mortgage Insurance" (*Būsto paskolų draudimas*, or BPD) was set up in 1998, in order to help solve housing problems in Lithuania by offering mortgage loan insurance to families. Due to the financial crisis, the remit of the BPD was expanded in 2009 to assist people facing temporary financial difficulties, for example by paying the debt accrued or interest payments to the banks.⁶⁷¹

16.4.4 Debt collection practices

There was no clear consensus on whether stakeholders had noted increasingly aggressive debt collection practices in the previous five years. However, one stakeholder noted that a number of debt collection agencies had been established, and that banks have strengthened their debt collection departments.

16.5 MEASURES IN FORCE TO ALLEVIATE THE IMPACT OF OVER-INDEBTEDNESS

16.5.1 Early identification of households at risk

Specific measures to identify households at risk were seen as relatively common by stakeholders. However, these were identified at the stage of loan issuance by lenders, through responsible lending standards or checking the credit ratings of consumers. As stated by one stakeholder, "Before providing a loan to a customer all creditors check the credit history at the Credit registry maintained by the Bank of Lithuania and other private registries that have entries about customers who were late with payments to utilities/various services like mobile phone bills/ postponed payments for credit and etc. Moreover, banks and credit unions assess the applicant for the credit/loan according to the Prudent Lending Principles." Indeed, both private and national credit bureaus are in operation in Lithuania. CreditInfo is the main private credit bureau in Lithuania.

16.5.2 Advice offered to over-indebted households

According to research from the University of Mainz, the state does not finance debt advice for consumers and lacks a legal framework for doing so. The only available route is through the use of governmental legal aid, which provides free legal advice for those on a low income; this is particularly relevant when undergoing insolvency procedures.⁶⁷²

⁶⁷¹ See: www.bpd.lt

⁶⁷² Forschungs- und Dokumentationsstelle für Verbraucherinsolvenz und Schuldnerberatung - Schuldnerfachberatungszentrum (SFZ), 'Debt advice in Europe', at: http://www.sfz.uni-mainz.de/2626.php#L_Lithuania

This is consistent with responses from stakeholders, who reported only partial availability for debt advice services, whether face-to-face or otherwise. Furthermore, this advice was generally either paid for or provided by credit institutions. An example given was the Personal Finance Institute set up by Swedbank, who opened a branch in Lithuania in 2010.⁶⁷³ As one stakeholder said:

Some banks provide budgeting services, but until this moment there are only a few agencies that provide advice. There are no really public organisations that would give such advice in Lithuania. There are certain companies where one can buy advice for managing one's credit - mostly mortgage loans - where one pays a certain amount of money to receive advice on how to best structure one's mortgage payments. Banks have software to calculate the optimal payment of liabilities according to individual cases.

Another stakeholder mentioned that the central bank was an active participant in increasing financial literacy of the population as a whole through various initiatives.⁶⁷⁴

Regarding demand for debt advice, stakeholders assessed this as high and that it had increased over the previous five years. Furthermore, and in line with the lack of state provision, the stakeholders assessed the funding situation as not sufficient; the financial situation of the state was cited as an obstacle in this regard.⁶⁷⁵

16.5.3 Key measures in place to alleviate the impact of over-indebtedness

Stakeholders saw informal measures to alleviate the impact of over-indebtedness as partly available. Informal measures were understood as stemming from individual initiative, whereby "people who have problems with debt repayments go straight to the bank and try to make the arrangements. Usually they change the conditions of their loan, postpone payments, change loan maturity, change the currency etc. Usually it is negotiated and arranged between the creditor and the debtor. If a person has a possibility to be a non-defaulted customer with these changes, they try to achieve this." One stakeholder, referring to changes in measures to alleviate over-indebtedness in the past five years, mentioned "gentlemen's agreements" between the Bank of Lithuania and private bank to seek the best solution for all parties, so as to prevent homelessness.

⁶⁷³ Swedbank, 'Swedbank's sustainability work', Board of Directors' Report, 2010.

⁶⁷⁴ According to the bank, "the Bank of Lithuania has issued a number of books, contributed to the preparation of school manuals, prepares and disseminates on a permanent basis educational information publications for various target groups. Bank employees participate in public discussions, publish articles in newspapers and on the web, give lectures to students at universities, organise seminars for journalists, business people and other target groups about the country's macroeconomic situation, finances, and banking." See: <http://www.lb.lt/education>

⁶⁷⁵ According to official figures, the general government deficit narrowed to 5.5% of GDP in 2011 from 7.2% in 2010, which was slightly worse than forecast. See European Commission, Spring 2012 economic forecast: http://ec.europa.eu/economy_finance/eu/forecasts/2012_spring/lt_en.pdf

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Regarding more formal court-based measures such as a consumer insolvency procedure, until very recently Lithuania was the only country in the Baltics, and one of the few countries in Europe which had no law regulating insolvency of private individuals.⁶⁷⁶ Rather, individuals had to fulfil their obligations to creditors till the end of their life.⁶⁷⁷ Given the effects of the economic crisis, introduction of appropriate regulation took on some urgency and an IMF report⁶⁷⁸ in 2010 recommended the introduction of a Personal Bankruptcy Act with a clear insolvency threshold, a discharge repayment period of between 3 to 6 years, and the provision of debt counselling and financial education for individuals affected.

Consequently, in March 2011 the Lithuanian Ministry of Economy prepared a Draft Law on Bankruptcy of Natural Persons, based on the "Earned Fresh Start" natural person model.⁶⁷⁹ Under the proposed regulation, bankruptcy for natural persons would involve a judicial procedure for those facing financial difficulties with debts exceeding approximately 5,800 Euro. A repayment plan is then agreed, and must not exceed five years, after which remaining debts are written off. During this period the debtors' assets would be administered and disposed of by a bankruptcy administrator.

However, the effectiveness of this new law remains to be seen in practice. This is because, as one stakeholder noted, the personal bankruptcy procedure has not yet entered force, and this is foreseen only from 2013.

16.5.4 Types of households of over-indebted consumers not reached by current measures

Regarding specific types of households not reached by current measures, stakeholders did not arrive at a clear consensus on the issue. Nevertheless, a few exceptions were highlighted. These included the case where a loophole in the law meant that although a household with children up to the age of 18 could not be left homeless, other households were not covered, and banks did not distinguish these types of households when attempting to recover debt. People with a lower level of education were also considered by one stakeholder to have very little access to such measures.

⁶⁷⁶ Ruda, G., Kallas, K., and Petkevicius, M., 'Treatment of insolvency for private individuals: developments in the Baltics', *Insolvency and Restructuring International*, Vol 5. No. 2, 2011.

⁶⁷⁷ Gruodyte, E., Kirsienė, J., 'Application of "Fresh start" Doctrine for Individual Debtors in Lithuania: EU and US perspective', *Inzinerine Ekonomika-Engineering Economics*, 21(3), 2010, pp.263-273.

⁶⁷⁸ Abjornsson, R., and Christopherson, K., 'Proposals for Reforming the Insolvency Regime', Legal department, International Monetary Fund, July 2010.

⁶⁷⁹ Paukštė, R., and Streckytė, A., 'Bankruptcy of a natural person in Lithuania: enforcement of decisions adopted in other Member States regarding natural persons' bankruptcy'. LAWIN publication, March 2012.

16.5.5 Best practices

Given the lack of debt advice and other infrastructure to help prevent or alleviate household over-indebtedness in Lithuania, it was not surprising that few examples of best practice were highlighted by stakeholders. However, one collection of best practices also identified earlier were the Prudent Lending Principles introduced by the Bank of Lithuania.

16.6 OUTLOOK

Lithuania was not as heavily affected by the effects of the economic recession as the other Baltic States, and the most recent economic forecast from the European Commission⁶⁸⁰ predicted GDP to grow by 0.7% in 2013 and 1.5% in 2014, based on increasing external demand for exports and an expansion in domestic demand. This was reflected in the views of stakeholders, the majority of whom expected that over-indebtedness would remain stable or decrease in the next five years. This was seen as due to the financial deleveraging of the household sector as well as the relatively stable economic situation, but one stakeholder warned that "there might be another economic crisis and this might bring other problems. People who survived the crisis in 2008 were lucky enough, but people still tend to take credits and therefore if there is another big world-wide economic crisis in near future, the situation can change very rapidly".

Stakeholders were split as to whether there were specific new challenges to be addressed by policy-makers, and those who did see a need cited the importance of collecting and providing more detailed information on the problem, or continuing to enforce responsible lending and ensuring macro-economic stability.

⁶⁸⁰ European Commission, *European Economic Forecast Autumn 2012*, European Economy 7, European Union, 2012, pp.80-83.

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ANNEX A: STATISTICAL DATA FROM EU SOURCES

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Lithuania

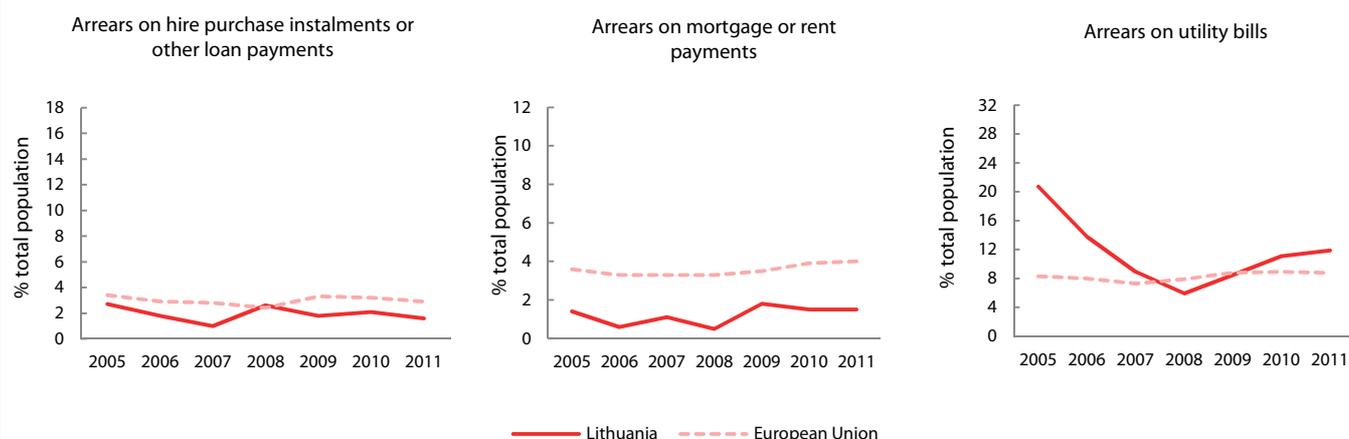
I. Eurobarometer¹

Lithuania EU average Lowest EU value Highest EU value

Households *at risk* of being over-indebted

Respondents feeling at risk of over-indebtedness in 2010	↗ 29%	25%	7%	52%
Respondents feeling at risk of over-indebtedness in 2009	↘ 23%	27%	9%	53%

II. EU SILC standard survey data²



III. EU SILC 2008 module: Over-indebtedness and financial exclusion³

Lithuania EU average Lowest EU value Highest EU value

Proportion of people in households with bank overdrafts, outstanding balances on credit cards or in arrears on other loans of over 100% of household disposable income

Overdrawn bank account (% of people in households overdrawn)	:	2.2%	0.0%	7.7%
Credit or store card (% of people in households with outstanding balances)	↘ 0.0%	1.1%	0.0%	8.6%
Other loan/credit payments (% of people in households in arrears)	↘ 0.0%	0.3%	0.0%	1.1%

Proportion of people in households in arrears in servicing housing-related loans and bills and in paying other bills of over 100% of household disposable income

Housing bills (% of people in households in arrears)	:	0.5%	0.0%	2.9%
Other payments (% of people in households in arrears)	:	0.4%	0.0%	1.7%

Households living with outstanding debts and/or arrears of over 100% of household disposable income

Total (% of households with outstanding debts/arrears)	↘ 0.1%	4.6%	0.0%	11.8%
Income above 60% median (% of households with outstanding debts/arrears)	↘ 0.0%	4.2%	0.0%	11.3%
Income below 60% median (% of households with outstanding debts/arrears)	↘ 0.2%	7.0%	0.2%	13.7%
Materially deprived (% of households with outstanding debts/arrears)	↘ 0.2%	9.0%	0.1%	27.4%

Proportion of those in broad age groups with outstanding debts of over 100% of household disposable income

Households with all adults aged 25-39 (% of households with outstanding debts)	↘ 0.0%	6.3%	0.0%	17.2%
Households with all adults aged: 40-64 (% of households with outstanding debts)	↘ 0.4%	5.8%	0.0%	10.9%
Households with all adults aged: 65+ (% of households with outstanding debts)	↘ 0.0%	1.2%	0.0%	2.8%

Proportion of those in different types of household with outstanding debts of over 100% of household disposable income

Living alone (% of people in households with outstanding debts)	↓ 0.0%	4.3%	0.0%	8.2%
Single parent (% of people in households with outstanding debts)	↓ 0.8%	9.5%	0.0%	27.1%
Other (% of people in households with outstanding debts)	↓ 0.0%	4.8%	0.0%	12.1%

Proportion of those in households with outstanding debts of over 100% of household disposable income by marital status

Never married (% of people in households with outstanding debts)	↓ 0.1%	5.0%	0.0%	15.4%
Married (% of people in households with outstanding debts)	↓ 0.0%	4.1%	0.0%	9.7%
Separated/divorced (% of people in households with outstanding debts)	↓ 0.3%	7.5%	0.1%	13.9%
Widowed (% of people in households with outstanding debts)	↓ 0.1%	1.7%	0.0%	4.3%

Proportion of those in households with outstanding debts of over 100% of household disposable income by housing tenure

Owner occupied without mortgage (% of people in households with outst. debts)	↓ 0.1%	3.2%	0.0%	9.6%
Owner occupied with mortgage (% of people in households with outst. debts)	↓ 0.0%	6.3%	0.0%	16.1%
Market rent (% of people in households with outstanding debts)	↓ 0.0%	8.2%	0.0%	16.0%
Subsidised rent (% of people in households with outstanding debts)	↓ 0.0%	8.7%	0.0%	17.9%
Rent-free housing (% of people in households with outstanding debts)	↓ 0.0%	2.3%	0.0%	15.1%

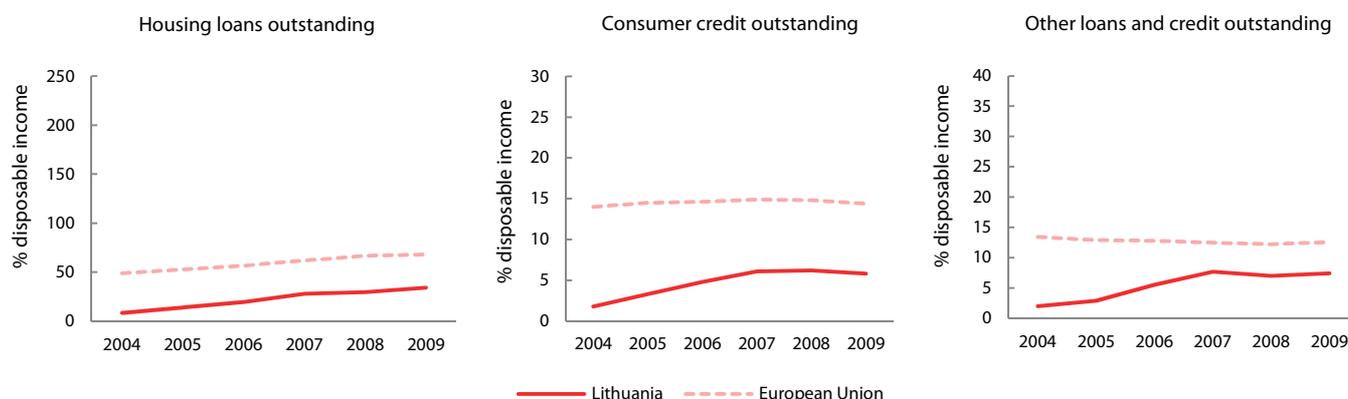
Proportion of those in households with outstanding debts of over 100% of disposable income by work intensity

Work intensity of 0 - 0.19 (% of people in households with outstanding debts)	↓ 0.0%	5.7%	0.0%	10.6%
Work intensity of 0.20 - 0.50 (% of people in households with outstanding debts)	↓ 0.0%	5.7%	0.0%	15.3%
Work intensity of 0.51 - 0.74 (% of people in households with outstanding debts)	↓ 0.0%	5.4%	0.0%	13.5%
Work intensity of 0.75 - 1.0 (% of people in households with outstanding debts)	↓ 0.1%	5.3%	0.0%	14.3%

Proportion of those in over-indebted households that experienced a major drop in income over the preceding year

Over-indebted (% of people in households that experienced drop in income)	↓ 0.0%	33.3%	0.0%	77.6%
Other (% of people in households that experienced drop in income)	↑ 23.0%	19.2%	5.9%	32.5%

IV. Loans and credit outstanding⁴



Notes:

(1) Eurobarometer 72.1 (2009) and Eurobarometer 74.1 (2010). Note: Those who answered 'very at risk' or 'fairly at risk' to the question 'Please tell me how much you feel at risk of being over-indebted'.

(2) Eurostat, SILC. Data as of December 2012.

(3) European Commission, Research Note 4/2010, Over-indebtedness new evidence from the EU-SILC special module.

(4) European Commission, Research Note 4/2010, Over-indebtedness new evidence from the EU-SILC special module. European Credit Research Institute (ECRI), Lending to households in Europe, 1995-2009 and Eurostat, National accounts.

17 LUXEMBOURG

Document The over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact - Country report Luxembourg

Prepared by Anna Kaxira

Finalised on 1 July 2013

Final report

Over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact

17.1 DEFINITION OF OVER-INDEBTEDNESS

Over-indebtedness in Luxembourg is defined in national legislation by Article 2 of the law of 8 December 2000, which defines over-indebted persons as those who have lasting difficulties meeting the totality of their existing non-professional debts.⁶⁸¹

Article 2 also indicates the conditions under which the law is applicable. Namely, the law applies to a natural person, who is resident in Luxembourg⁶⁸² and has lasting financial difficulties in the medium and long term. Financial difficulties includes due debts and signed contracts which accrue debt relating to natural persons, i.e. individuals not households. However, according to one stakeholder, it does not preclude the possibility of a household becoming indebted, as it takes into consideration persons who are married or are in a civil partnership.

According to an alternative definition that emerged from the stakeholder interviews, a person or household can be considered over-indebted if their net monthly income is insufficient for their monthly or long term financial commitments after the deduction of their living costs⁶⁸³ (including rent or monthly mortgage charges). For example, one stakeholder commented that household over-indebtedness takes place when the difference between net income and life-cost expenses does not meet their specific financial commitments.

Stakeholders agreed that there is no need for the creation of a better definition for households at risk of currently being over-indebted. In two cases the definition used by stakeholders for households that are over-indebted was the same as their definition for households at risk of over-indebtedness.

17.2 LEVEL OF OVER-INDEBTEDNESS

The number of households that are over-indebted or have ongoing difficulties meeting their financial commitments has increased in Luxembourg over the last five years, according to stakeholders.

The PSELL- 3/2008⁶⁸⁴ survey conducted by CEPS indicates that 3% of households were indebted before the crisis in the first quarter of 2008. Data from Eurostat supports this, as it shows that a similar percentage of the population was in arrears in

⁶⁸¹ "La procédure de règlement collectif des dettes est ouverte à toute personne physique, autorisée à résider sur le territoire du Grand-Duché de Luxembourg, éprouvant des difficultés financières durables pour faire face à l'ensemble de ses dettes non professionnelles exigibles et à échoir." See: <http://www.legilux.public.lu/leg/a/archives/2000/0136/a136.pdf>

⁶⁸² Although the law accounts for the fact that debts can be accrued in other countries.

⁶⁸³ The cost of living is defined by the legislation on the RMG (Guarantee of Minimum Income).

⁶⁸⁴ The PSELL- Socio Economic Panel " Liewen zu Lëtzebuerg " 3/2008 conducted a survey involving 3500 households. The results of the survey were presented in CEPS No 67- September 2010.

2007 (2.7%). By 2011, however, the figure had increased to 3.9%. This remained significantly lower than the EU average (11.4%).⁶⁸⁵

One stakeholder that took part in an interview and provides advice to over-indebted households indicated that it had experienced an increase in the number of persons counselled on issues of debt. While in 2007 it had provided personalised face-to-face debt advice to 456 individuals, by 2011 this had increased to 681. Another stakeholder recorded that it had received an increasing number of cases in the years immediately following the financial crisis, but that this had begun to decrease again in 2010.

The Special Eurobarometer survey also indicates a reduction in over-indebtedness in 2010. While 27% of respondents felt at risk of over-indebtedness in 2009, by the following year this had sunk to 22%. This is below the EU average of 25% (see Annex A).

17.3 NATURE AND DRIVERS OF OVER-INDEBTEDNESS

17.3.1 Most common types of households that are over-indebted

According to all stakeholders, the most common types of households who are over-indebted or have on-going difficulties meeting their financial commitments include one person households with children, households consisting of people aged between 25 and 39 years of age, households living in rented accommodation and households at risk of poverty.⁶⁸⁶ Households with one or two unemployed persons and households where the highest education level is secondary school were also considered to be more frequently affected by over-indebtedness.

According to one stakeholder, the type of household most likely to be affected is aged between 25 and 45 years old, married, and with two children. In particular, the stakeholder commented, over-indebted households are more likely to live in rented accommodation, although this may simply be a reflection of the fact that around three quarters of the population in Luxembourg rent their housing. In fact, data from Eurostat shows that households living in private rental accommodation are only marginally more likely to over-indebted than households in owner-occupied housing with mortgages.⁶⁸⁷

Stakeholders commented that there had been a change in the types of households affected by over-indebtedness in the last five years. In particular, there had been an increase in the number of over-indebted households in the age range 23 to 30,

⁶⁸⁵ Eurostat, 'Arrears (mortgage or rent, utility bills or hire purchase)' (code: ilc_mdcs05).

⁶⁸⁶ A household disposable income of less than 60% of the national median is the conventional EU measure for risk of poverty.

⁶⁸⁷ In 2008, 0.9% of households in private rental accommodation had outstanding debts/arrears amounting to 100% of household income. This was the case for 0.8% of households in owner-occupied housing with mortgages.

according to one stakeholder. Also, an increase in the number of unemployed households with financial difficulties was recorded.

17.3.2 Causes of households' over-indebtedness

Macro-economic factors

The unemployment level was most frequently identified as a macro-economic cause of over-indebtedness. Although the unemployment rate in Luxembourg is around half the EU average, it did increase in the period 2007 to 2011, from 4.2% to 4.8%. It reached a peak in 2009, when it rose to 5.1%.⁶⁸⁸ In addition, around half of stakeholders indicated that the wage level was a cause of over-indebtedness. Generally, real GDP per capita sunk for four out of the five years in the period 2007 to 2011, in 2009 by as much as 5.8%.⁶⁸⁹

Cost of living

Stakeholders most frequently referred to housing costs, in terms of the costs of living that cause over-indebtedness. In particular, one stakeholder commented that the cost of renting was very high in Luxembourg, with the average rent at around €1,100. This is almost two thirds of the minimum wage (€1,800).⁶⁹⁰ Stakeholders also referred to the costs of healthcare and other costs of living (such as food and transport). Only one stakeholder mentioned utility costs as a cause of over-indebtedness.

Types of credit/loan taken out by households

Regulated consumer credit (particularly credit with high interest rates) and home loans/mortgages were identified by stakeholders as causes of over-indebtedness in Luxembourg. One stakeholder commented that credit itself should not be seen as the main cause, although an accumulation of credit may be a potential cause of over-indebtedness. Another stakeholder commented that consumers who do not have further access to credit in Luxembourg frequently take out credit from lenders in Belgium, where interest rates are significantly higher.

Personal circumstances

Data from Eurostat shows that 43.1% of over-indebted households had experienced a drop in income in the preceding year, compared to only 12.7% of other households (see Annex A). Correspondingly, a drop in income caused by unemployment, business failure or other reasons (e.g. illness, divorce/separation) was characterised as

⁶⁸⁸ Eurostat, 'Unemployment as a percentage of the labour force' (code: tsdec450).

⁶⁸⁹ Eurostat, 'Real GDP per capita - growth' (code: tsdec100).

⁶⁹⁰ "The guaranteed minimum wage for an unqualified employee of 18 years or older is 1,801.49€ a month". See: <http://www.luxembourg.public.lu/en/living-luxembourg/working/index.html>.

a cause of indebtedness by all stakeholders involved in the survey. The other factor most commonly mentioned by stakeholders as a cause of over-indebtedness in Luxembourg was poverty. For example, one stakeholder commented that real average wages had declined and that rental costs represented a real burden, although government transfers increased households' purchasing power. Stakeholders also referred to other personal circumstances, such as lack of money management skills and behavioural biases.

17.3.3 Changes relevant for levels of over-indebtedness

During the past five years, there has been a fairly significant change in the macro-economic situation, as explained above. There has been a reduction in economic growth and an increase in unemployment. This has led to an increase in the level of over-indebtedness, according to stakeholders. In particular they referred to a rise in the number of households in arrears with their utility and rent payments. They also indicated that it had led to a change in the lending practices of credit providers, specifically to a reduction in the availability/accessibility of credit. Accordingly, the number of consumers taking out credit from unregulated lenders had increased.

There were also some positive developments observed by stakeholders. Firstly, the reduction of interest rates by the European Central Bank had led to a decrease in the interest rates of loans granted to individuals and a reduction in mortgage repayments. In addition, the impact of increasing over-indebtedness had been lessened by an increasing cooperation between creditors and indebted households in order to reach an amicable solution.

17.3.4 Cultural attitude towards debt and actual level of households' (over-) indebtedness

None of the stakeholders interviewed indicated that there is a relationship between the cultural attitude towards debt and the actual level of households' (over-) indebtedness in Luxembourg.

17.4 CONSEQUENCES OF OVER-INDEBTEDNESS

17.4.1 Consequences for affected households

The consequences of over-indebtedness most highly rated by stakeholders, in terms of their effect on households, were deteriorating well-being or mental health, family breakdown/divorce, reduced standard of living and financial exclusion. The least important consequences for affected households were home repossession and homelessness. One stakeholder observed that this is related to legislation that protects indebted persons from homelessness, and the existence of a specialised

institution providing them with support (i.e. SICS - Les Services d' Information et de Conseil en matière de Surendettement).

17.4.2 Consequences of over-indebtedness for the financial services industry

The consequence of over-indebtedness for the financial services industry most highly rated by stakeholders was the cost of defaulted credits incurred by the creditor. Other consequences identified were increased costs for financial services providers through stricter regulation of credit, the loss of potential customers through more restrictive lending practices and costs of arrears or agreed repayment/debt management plans for creditors.

17.4.3 Economic and social consequences of over-indebtedness for society

The most highly rated consequence of over-indebtedness for society, in terms of its economic and social impact, was identified as the costs associated with assisting households to repay debts/arrears. For example, one stakeholder referred to the fact that over-indebted households can receive a consolidation loan to help them repay their debts, as is laid out in the law of 8 December 2000.⁶⁹¹

Other consequences identified were the increased use of health care services due to poor mental or physical health caused by over-indebtedness, reduced productivity at work and the costs of debt advice services provision. Furthermore, it was recorded that there are costs incurred in the provision of social welfare for over-indebted households, such as housing allowances.

However, one stakeholder commented that, as over-indebtedness is a limited phenomenon in Luxembourg, the costs of funding services for over-indebted households are also limited, as in fact are the overall social and economic consequences.

17.4.4 Debt collection practices

Stakeholders had not observed an increase in the use of aggressive debt collection practices in the last five years.

17.5 MEASURES IN FORCE TO ALLEVIATE THE IMPACT OF OVER-INDEBTEDNESS

17.5.1 Early identification of households at risk

Stakeholders reported that lenders in Luxembourg do not usually identify households at risk of becoming over-indebted at an early stage, partially due to the

⁶⁹¹ Association des Banques et Banquiers, Luxembourg, 'Over-indebtedness'. See: <http://www.abbl.lu/node/2583>.

fact that there are few effective measures to help in the identification of persons at risk. However, banks are able to monitor movements in current accounts and this could serve as a means of identification of over-indebtedness, according to stakeholders.

17.5.2 Advice offered to over-indebted households

Availability and costs

According to the stakeholders, personalised debt advice face-to-face is widely available, generally free of charge and fairly well-known. Demand is high and it was considered to be effective. Other types of personalised advice, such as by telephone and by email/online chat were also considered to be available, generally well-known and free of charge. However, stakeholders tended to consider these forms of advice to be less effective than face-to-face advice.

Demand for debt advice as assessed by stakeholders

Stakeholders explained that the last five years had witnessed an increase in the demand for debt advice, with substantial impacts for debt advice services and the people seeking advice. In particular, one stakeholder specified that the waiting time to see a debt advisor had increased.

It was observed that debt reduction or prevention activities are essential to provide individuals or households with the advice and support they need at an early stage, in order to avoid a deterioration of their situation. Delays in seeking support can consequently have a negative impact on individuals and creditors, according to stakeholders.

Funding of debt advice

The majority of stakeholders characterised the funding of debt advice services as sufficient. However, one stakeholder considered it to be inadequate and stressed the necessity of providing psychological support to over-indebted consumers. This, the stakeholder observed, was not an objective of current policies.

17.5.3 Key measures in place to alleviate the impact of over-indebtedness

Stakeholders agreed that informally brokered arrangements between the debtor and creditor(s) are widely available and generally free of charge. The majority considered them to be effective.

They also agreed that formal and legal procedures were widely available and generally free of charge.

The current framework for formal and legal debt settlement procedure is laid out in the law from 8 December 2000. It consists of two stages. The first of these begins when the debtor makes an application to the over-indebtedness information and advisory services (Service d'information et de Conseil en surendettement - SIC). A draft recovery plan is drawn up by the SIC, which requires the agreement of all parties. If this agreement is not given, the process moves into the second stage, which involves an application to the courts.⁶⁹² The court will then draw up a recovery plan that will be valid for a period of up to seven years.⁶⁹³

Stakeholders generally considered the above procedure to be effective. However, some criticism was expressed. For example, one stakeholder indicated that the judge had no power to declare a reduction of the total debt. Another stakeholder stated that the length of the process should be shortened from seven to five years.

It should be noted that the current procedure was revised by a law that will come into force on 1 March 2014. This abolishes the previous system and introduces a procedure for consumer insolvency.⁶⁹⁴

Finally, stakeholders indicated that financial support for households to repay debts/arrears is partly available, generally free of charge and effective. The social offices of municipalities may decide to provide help and support services such as the payment of doctors' fees or electricity bills. As explained above, there is a possibility for over-indebted households to receive a debt consolidation loan to help repay their debts.

17.5.4 Changes in response to over-indebtedness

According to the stakeholders, responses to over-indebtedness in terms of measures to alleviate its impact have not changed during the past five years.

17.5.5 Types of households of over-indebted consumers not reached by current measures

Over-indebted consumers not reached by current measures (according to stakeholders) include professional traders with old debts, self-employed individuals with business debts and independent professionals (such as farmers and craftsmen). Under the current measures, these over-indebted consumers have no access to consumer insolvency proceedings, which are only accessible for persons with non-business debts.

⁶⁹² Association des Banques et Banquiers, Luxembourg, 'Over-indebtedness'. See: <http://www.abbl.lu/node/2583>.

⁶⁹³ European Judicial Network, 'Bankruptcy - Luxembourg', 2005.

See: http://ec.europa.eu/civiljustice/bankruptcy/bankruptcy_lux_en.htm

⁶⁹⁴ Schumacher, C., 'Overindebtedness - First personal bankruptcy law in Luxembourg', European Coalition for Responsible Credit, 2013. See: <http://www.responsible-credit.net/index.php?id=1980&viewid=48222>

17.5.6 Best practices

Stakeholders mentioned various measures that they considered to represent best practice. For example, one stakeholder was in favour of creditors waiving the interest on the loans of over-indebted households, which reduced their repayment costs. Another stakeholder praised the social support mechanisms provided to indebted households. Finally, the provision of information on consumer issues and awareness raising on financial issues in schools to teach young people about the importance of budget management and savings was also considered to be beneficial.

17.6 OUTLOOK

Real GDP per capita is forecast to sink by 1.2% in 2013 and remain stable in 2014.⁶⁹⁵ Some recovery is expected in the labour market, but job creation is not predicted to take place at a fast enough rate to keep up with the increase in the active population. As a result, the European Commission's 'European Economic Forecast' for Winter 2013 foresees an increase in the unemployment rate to 5.7% in 2014.⁶⁹⁶

For these reasons, stakeholders predicted that the number of over-indebted households in Luxembourg would increase in the next five years. Additionally, one stakeholder raised the possibility that the European Central Bank would put up interest rates, which would lead to higher repayments for households in Luxembourg and increase the impact of indebtedness.

In terms of challenges to be addressed by policymakers, stakeholders referred to several issues, for example the need to implement a procedure for consumer insolvency and to address the problem of high renting costs. For example, one stakeholder specified that it is necessary for the government to extend the system of social housing. Finally, it was reported that measures were needed to raise consumer knowledge and understanding, as the best way to prevent over-indebtedness.

17.7 REFERENCES

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⁶⁹⁵ Eurostat, 'Real GDP per capita - growth' (code: tsdec100).

⁶⁹⁶ European Commission, 'European Economic Forecast: Winter 2013', 2013, p. 63.

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ANNEX A: STATISTICAL DATA FROM EU SOURCES

Final report

Over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact

Luxembourg

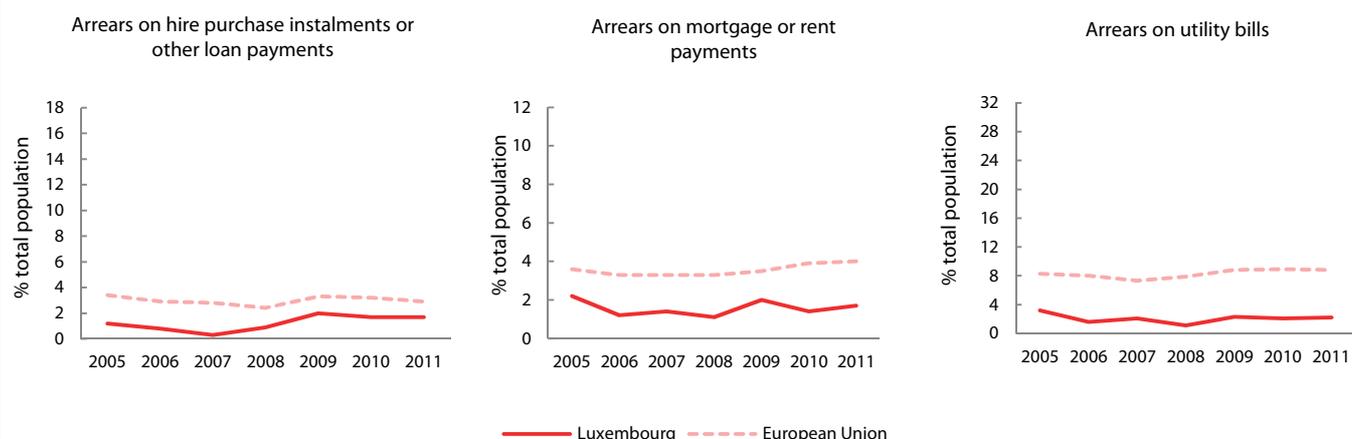
I. Eurobarometer¹

Luxembourg EU average Lowest EU value Highest EU value

Households *at risk* of being over-indebted

Respondents feeling at risk of over-indebtedness in 2010	↘	22%	25%	7%	52%
Respondents feeling at risk of over-indebtedness in 2009	↔	27%	27%	9%	53%

II. EU SILC standard survey data²



III. EU SILC 2008 module: Over-indebtedness and financial exclusion³

Luxembourg EU average Lowest EU value Highest EU value

Proportion of people in households with bank overdrafts, outstanding balances on credit cards or in arrears on other loans of over 100% of household disposable income

Overdrawn bank account (% of people in households overdrawn)	↘	0.3%	2.2%	0.0%	7.7%
Credit or store card (% of people in households with outstanding balances)	↘	0.1%	1.1%	0.0%	8.6%
Other loan/credit payments (% of people in households in arrears)	↘	0.1%	0.3%	0.0%	1.1%

Proportion of people in households in arrears in servicing housing-related loans and bills and in paying other bills of over 100% of household disposable income

Housing bills (% of people in households in arrears)	↘	0.1%	0.5%	0.0%	2.9%
Other payments (% of people in households in arrears)	↘	0.0%	0.4%	0.0%	1.7%

Households living with outstanding debts and/or arrears of over 100% of household disposable income

Total (% of households with outstanding debts/arrears)	↘	0.7%	4.6%	0.0%	11.8%
Income above 60% median (% of households with outstanding debts/arrears)	↘	0.5%	4.2%	0.0%	11.3%
Income below 60% median (% of households with outstanding debts/arrears)	↘	2.0%	7.0%	0.2%	13.7%
Materially deprived (% of households with outstanding debts/arrears)	↘	5.3%	9.0%	0.1%	27.4%

Proportion of those in broad age groups with outstanding debts of over 100% of household disposable income

Households with all adults aged 25-39 (% of households with outstanding debts)	↘	0.8%	6.3%	0.0%	17.2%
Households with all adults aged: 40-64 (% of households with outstanding debts)	↘	0.1%	5.8%	0.0%	10.9%
Households with all adults aged: 65+ (% of households with outstanding debts)	↘	0.0%	1.2%	0.0%	2.8%

Proportion of those in different types of household with outstanding debts of over 100% of household disposable income

Living alone (% of people in households with outstanding debts)	↘	0.6%	4.3%	0.0%	8.2%
Single parent (% of people in households with outstanding debts)	↘	0.5%	9.5%	0.0%	27.1%
Other (% of people in households with outstanding debts)	↘	0.7%	4.8%	0.0%	12.1%

Proportion of those in households with outstanding debts of over 100% of household disposable income by marital status

Never married (% of people in households with outstanding debts)	↘	0.6%	5.0%	0.0%	15.4%
Married (% of people in households with outstanding debts)	↘	0.5%	4.1%	0.0%	9.7%
Separated/divorced (% of people in households with outstanding debts)	↘	1.4%	7.5%	0.1%	13.9%
Widowed (% of people in households with outstanding debts)	↘	0.2%	1.7%	0.0%	4.3%

Proportion of those in households with outstanding debts of over 100% of household disposable income by housing tenure

Owner occupied without mortgage (% of people in households with outst. debts)	↘	0.1%	3.2%	0.0%	9.6%
Owner occupied with mortgage (% of people in households with outst. debts)	↘	0.8%	6.3%	0.0%	16.1%
Market rent (% of people in households with outstanding debts)	↘	0.9%	8.2%	0.0%	16.0%
Subsidised rent (% of people in households with outstanding debts)	↘	0.1%	8.7%	0.0%	17.9%
Rent-free housing (% of people in households with outstanding debts)	↗	3.3%	2.3%	0.0%	15.1%

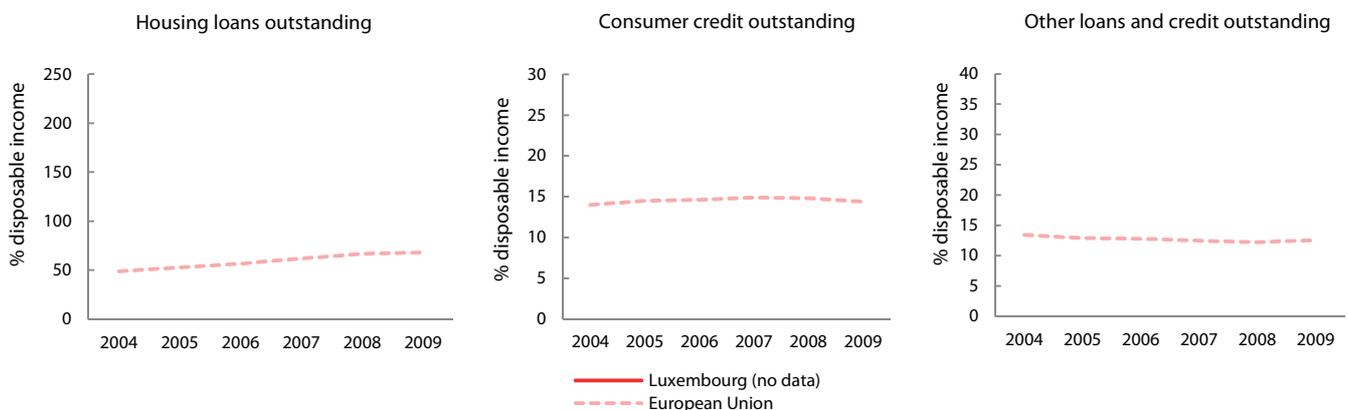
Proportion of those in households with outstanding debts of over 100% of disposable income by work intensity

Work intensity of 0 - 0.19 (% of people in households with outstanding debts)	↘	0.6%	5.7%	0.0%	10.6%
Work intensity of 0.20 - 0.50 (% of people in households with outstanding debts)	↘	0.8%	5.7%	0.0%	15.3%
Work intensity of 0.51 - 0.74 (% of people in households with outstanding debts)	↘	1.6%	5.4%	0.0%	13.5%
Work intensity of 0.75 - 1.0 (% of people in households with outstanding debts)	↘	0.4%	5.3%	0.0%	14.3%

Proportion of those in over-indebted households that experienced a major drop in income over the preceding year

Over-indebted (% of people in households that experienced drop in income)	↗	43.1%	33.3%	0.0%	77.6%
Other (% of people in households that experienced drop in income)	↘	12.7%	19.2%	5.9%	32.5%

IV. Loans and credit outstanding⁴



Notes:

- (1) Eurobarometer 72.1 (2009) and Eurobarometer 74.1 (2010). Note: Those who answered 'very at risk' or 'fairly at risk' to the question 'Please tell me how much you feel at risk of being over-indebted'.
- (2) Eurostat, SILC. Data as of December 2012.
- (3) European Commission, Research Note 4/2010, Over-indebtedness new evidence from the EU-SILC special module.
- (4) European Commission, Research Note 4/2010, Over-indebtedness new evidence from the EU-SILC special module. European Credit Research Institute (ECRI), Lending to households in Europe, 1995-2009 and Eurostat, National accounts.

18 MALTA

<i>Document</i>	The over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact - Country report Malta
<i>Prepared by</i>	Robert Graham
<i>Finalised on</i>	23 August 2013

Final report

Over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact

18.1 DEFINITION OF OVER-INDEBTEDNESS

According to the Maltese Commercial Code, a person is said to be bankrupt when he or she suspends payment of their debts.⁶⁹⁷ However, this legal definition was not really used by stakeholders themselves. Rather, more general definitions focused on individuals rather than households were employed. As an example, one stakeholder said that "Someone is over-indebted if over a long period of time cannot meet his/her financial commitments with ease and without impinging on the quality of life and lifestyle normally accepted by society and thus could create stress which may bring about a deterioration in behaviour. Such a situation may well trigger the person to solve the problem in the short run but with serious problems in the long (e.g. usury)".

However, some stakeholders did see a need for a better definition of households being over-indebted or at risk of being so. These interviewees highlighted the usefulness of a common definition for social practitioners and also to facilitate comparison between countries.

18.2 LEVEL OF OVER-INDEBTEDNESS

Going by the indicators used for this study to measure aspects of over-indebtedness (such as EU-SILC), over-indebtedness has increased over the past several years. From an institutional point of view, the percentage of non-performing loans increased from 5.1% of total gross loans in 2007 to 7.3% in 2011.⁶⁹⁸ This was consistent with household and individual level data. Using socio-economic panel data (EU-SILC), the proportion of the population suffering from arrears on all types of key commitments increased from 7.9% in 2007 to 9.1% in 2011. These values are lower than the EU average and the growth in arrears, while significant, is exactly at the EU average.⁶⁹⁹

Subjective assessments by households of their financial burden provide a more nuanced picture. According to Eurobarometer surveys,⁷⁰⁰ the proportion of respondents feeling at risk of being over-indebted was below the EU average in both 2009 and 2010. But according to EU-SILC data, the proportion of respondents who were able to make ends meet with only difficulty or great difficulty was significantly higher than the EU average, and nearly double the average in 2009.⁷⁰¹

This seemed to be linked to housing loans: the proportion of those surveyed who found housing costs a "heavy burden" was high (54% in 2011 as against 35% for the

⁶⁹⁷ See: http://ec.europa.eu/civiljustice/bankruptcy/bankruptcy_mlt_en.htm

⁶⁹⁸ International Monetary Fund data.

⁶⁹⁹ Eurostat, 'Arrears on key commitments' (code: ilc_mdcs05).

⁷⁰⁰ European Commission, Special Eurobarometer 321 & 355.

⁷⁰¹ Eurostat, 'Inability to make ends meet, (code: ilc_mdcs09).

EU) and doubled in frequency between 2007 and 2011.⁷⁰² It is notable that in contrast, the proportion of those surveyed who found debts from general consumer credit a heavy burden remained stable during the same period.⁷⁰³ This seems to indicate that Maltese consumers are more pessimistic regarding the sufficiency of their finances regarding housing costs than is reflected in concrete statistics on arrears.

The majority of stakeholders assessed that the numbers of households that are over-indebted had increased over the past five years, but stakeholders cited lack of precise data to properly assess any increases on the national level. One stakeholder held that there was very little change, and that Malta was unaffected by macro-economic problems from elsewhere:

Again, if you are referring to households: I do not know, but referring to individuals I do not think that in the last five years there were any major changes. You have to keep in mind that we did manage the crisis very well so this may differ from other countries. So during the last five years there were no major changes as regards OI for individuals and companies. To the contrary - the banks are making big profit and huge margins - we are doing really well. If I had to compare this year or last with five years ago, there were no big changes. The demand has changed - utility prices went up - but there were no major changes from five years ago.

18.3 NATURE AND DRIVERS OF OVER-INDEBTEDNESS

18.3.1 Most common types of households that are over-indebted

Regarding the most common types of households that are over-indebted in Malta, stakeholders highlighted households of those between the ages of 25 and 64, households with children, and households with unemployed members, which is consistent with European literature on over-indebtedness.⁷⁰⁴

The reasons for this were consistent with other studies, such as the problem of families with young children having a higher need to borrow to invest in living space and household equipment is one other generations do not face:

The main problem for people who are (becoming) over-indebted is paying off their property. That is also the reason for why we have chosen the age categories between 25 and 39, and 40 to 64 years. Younger people under 25 years of age are hardly ever buying property as they are usually staying with their parents. Older people over 64 usually have their property paid off already and do not have to deal with such a financial commitment anymore.

⁷⁰² Eurostat, 'Percentage with heavy financial burden due to housing costs' (code: ilc_mdmed04).

⁷⁰³ Eurostat, 'Percentage with heavy financial burden due to hire purchases or loans' (code: ilc_mdmed05).

⁷⁰⁴ See synthesis report for a summary of the literature.

Another stakeholder cited the lack of official data, but claimed that younger generations still are more likely to take out risky credit. In terms of changes in types of households suffering from debt problems, there was no clear consensus - one stakeholder however, claimed that more middle-class families with higher education levels were affected than before the crisis.

18.3.2 Most important causes of households' over-indebtedness

Macro-economic factors

As elsewhere in Europe, stakeholders cited unemployment and wage levels as macro-economic factors that were amongst the most important causes of households over-indebtedness. That said, one stakeholder commented that unemployment was quite low, wages were generally sufficient, and that a good level of social welfare existed. Low interest rates were also cited as a positive factor in mitigating over-indebtedness.

Statistics tend to bear out this assertion on a general level. The total unemployment rate stayed at low levels compared to the EU throughout the crisis, and also did not increase. In fact, unemployment in 2011 was lower than in 2006, before the crisis.⁷⁰⁵

That said, youth unemployment doubled between 2007 (when it was 10.2%, below the EU average), and 2011, when it stood at 22.4% and was higher than the EU average. This indicates that debt problems amongst young people may yet increase in the future. One stakeholder also cited deteriorating work conditions and an increase in 'self-employed' workers in precarious conditions.

Cost of living

Increases in cost of living were cited by stakeholders as amongst the causes of over-indebtedness. Although the general cost of living going by all items on the HICP⁷⁰⁶ was no higher than the EU average, one stakeholder commented that "Utility costs are on the increase so some people may have problems- and even food and transport are getting more expensive so I think those are the major two issues which may cause problems to individuals. Here in Malta a good number of people own their houses. We do not pay for education - health is the same thing - we have free health care. The only issue is utilities and other costs of living."

This seemed to be corroborated by statistical data, where price indices for electricity, gas, fuels, and heat energy were all markedly higher than the EU average, and showed strong increases from 2008 to 2010. Arrears on utilities going by EU-SILC data did

⁷⁰⁵ Eurostat, 'Unemployment rate' (code: tsdec450).

⁷⁰⁶ Eurostat, 'Harmonised Consumer Price Index' (code: prc_hicp_ind).

increase in Malta by about 17% from 2007 to 2011, but this increase was slightly lower than in the EU overall.⁷⁰⁷

Another stakeholder had a different opinion on housing costs, saying that "no matter whether one lives in one's own house/flat, is buying one or pays rent, prices have gone up very much and housing is very expensive for everyone. Inability to meet financial commitments related to housing are often one of the main problems for over-indebtedness." However, going by Eurostat house price indices,⁷⁰⁸ levels were at the EU average but not higher; arrears on housing or rent payments was about one third of the EU level during the same period.⁷⁰⁹ Median equivalised net income values, however, are significantly lower than the EU average, so housing costs are therefore higher in real terms than in other Member States.⁷¹⁰

Types of credit/loan taken out by households

In terms of types of credit taken out by households, stakeholders did not consider particular types of credit to be problematic. Rather, as one stakeholder said, "In Malta banks were always very strict with lending", limiting potential problems. This, however, was contradicted by the comments of another stakeholder, who stated that "with the introduction of more competition in the banking sector lending has been extended".

According to one stakeholder, this had led to an increase in usury, where unregulated lenders charging high interest rates had become more accessible and easily found. Two stakeholders also stated that a significant change had been seen in people falling back on extended family for informal loans, and that this was historically a common approach in Malta.

18.3.3 Cultural attitude towards debt and actual level of households' (over-) indebtedness

The majority of stakeholders in Malta stated there was a link between the cultural attitude towards debt and households' over-indebtedness. As elsewhere in Europe, a change in this attitude had been observed over the past several years. In general, the emphasis on saving and avoiding debt was seen as changing.

Whereas in the past any kind of debt was not viewed positively, individuals were now "opting to go on credit as if tomorrow would never come", as one stakeholder put it. Stakeholders cited changing lifestyle expectations, lack of long-term planning, and ease of getting bank loans as contributory factors.

⁷⁰⁷ Eurostat, 'Arrears on utility bills', (code: ilc_md07).

⁷⁰⁸ Eurostat, 'House price index', (code: prc_hpi).

⁷⁰⁹ Eurostat, 'Arrears on mortgage or rent', (code: ilc_md06).

⁷¹⁰ Eurostat, 'Mean and median income', (code: ilc_di03).

18.4 CONSEQUENCES OF OVER-INDEBTEDNESS

18.4.1 Consequences for affected households

Recourse to addictive behaviours, followed by utility disconnection and family breakdown or divorce were ranked by stakeholders as the most important consequences for households of over-indebtedness. Regarding consequences for the financial services industry, higher costs because of stricter regulation of credit were the most highly ranked consequence. One stakeholder commented that the financial services sector was already highly regulated and operated prudently.

Regarding economic and social consequences, stakeholders highlighted reduced productivity at work and increased use of health care services due to poor health as well as social exclusion and poverty.

18.4.2 Debt collection practices

The majority of stakeholders felt that debt collection practices had become increasingly aggressive over the previous five years. According to one interviewee, firms were becoming much stricter in collecting dues. Another stakeholder explained how:

Creditors are becoming more vigilant to protect their cash flow and profit. [...] Once they grant credit, they are monitoring on a daily basis their clients and are becoming more vigilant. They react proactively - sending letters, chasing up by telephone calls, going to the debtors' houses and knocking on their doors.

18.5 MEASURES IN FORCE TO ALLEVIATE THE IMPACT OF OVER-INDEBTEDNESS

Apart from the relevant EU legislation in the form of the Consumer Credit Directive which was transposed into Maltese law in 2010, measures to alleviate the impact of over-indebtedness were limited in Malta according to stakeholders interviewed. Stakeholders claimed that debt advice services hardly existed as such. Instead, consumers used either services provided by creditors, or by charities.

Regarding charities, one of the main providers of debt advice identified was Caritas Malta, who operate a Foundation for Victims of Usury, which was set up in 2000 to support through counselling and social work people seeking help. This help includes assistance in reaching agreements with creditors, offering legal assistance, and other support such as psychological counselling.⁷¹¹

⁷¹¹ See: <http://www.caritasmalta.org/?m=services&id=22>

Regarding creditors, according to one stakeholder they provided these services "to protect their own interests. So the only available service in this case are creditors themselves. There are, of course, lawyers and some accountants but to my knowledge there is no specific organisation or firm which specialises in these types of advice, such as a governmental body."

Another stakeholder noted that individuals rarely asked for over-indebtedness advice from authorities, due in part to social stigma:

It is the Maltese culture to turn on social work agencies in order to tackle the issues. Generally, the problem of over-indebtedness in Malta is not something that would be publicly discussed enough. People are not noticing the problem, it has only begun to slowly come up. Consumers do not search for debt advice as they do not even know that there is or should be such a kind of service.

18.5.1 Changes in response to over-indebtedness and best practices

According to stakeholders, there were few if any changes in measures to alleviate over-indebtedness during the previous five years. One stakeholder blamed the low level of attention paid to the topic in political discourse: "Most people in high places including the government believe the problem is only in one's imagination. They do not want to see the problem and deal with it."

Another stakeholder offered a different explanation: "Over-indebtedness is still a new issue in Malta, so there basically are not many measures in place to alleviate its impacts. There are also no common practices of tackling the problems." Accordingly, stakeholders could not identify any best practices, due to the paucity of existing measures to deal with over-indebtedness.

18.6 OUTLOOK

Stakeholders expected that the number of over-indebted households in Malta would mainly remain stable in the next five years. This was seen as due to the fact that Malta was a very small market economy that had so far weathered the crisis successfully. However, future macro-economic trends were uncertain. As one stakeholder put it, "It depends on the economic performance. If there is a national economic growth in the future, the problem of over-indebtedness will be reduced. The problem of over-indebtedness is closely related to rising cost of living (including rising rate of taxation) and deterioration of the conditions of work and thus a reduction in the real wage." However, one stakeholder dissented, expecting an increase: "We expect that the number will fairly increase as we are not preventing certain issues and people are taking them for granted; they are not cautious enough when taking loans and credits."

Looking forward, a couple of stakeholders saw a need for policymakers to raise more awareness of the Consumer Credit Directive, and to prioritise financial education, especially in school. Regulation of utilities was also cited as a priority: "utilities together with the regulator need a radical change. The regulator needs to consider its main function to create an environment where people can afford such basic utilities". State support for social housing was also seen as important by more than one stakeholder.

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Final report

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Malta

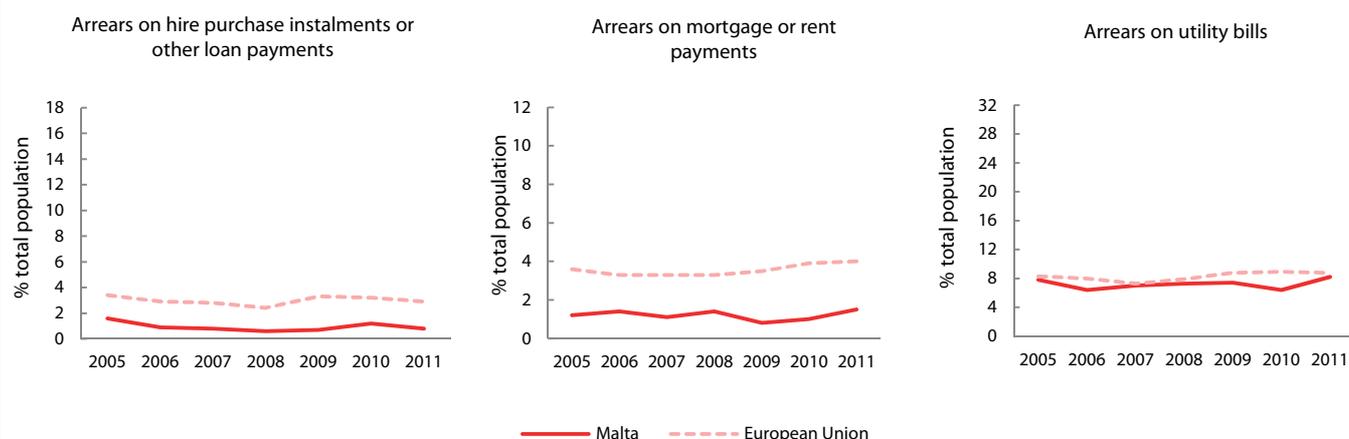
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Income below 60% median (% of households with outstanding debts/arrears)	↘ 2.0%	7.0%	0.2%	13.7%
Materially deprived (% of households with outstanding debts/arrears)	n.a.	9.0%	0.1%	27.4%

Proportion of those in broad age groups with outstanding debts of over 100% of household disposable income

Households with all adults aged 25-39 (% of households with outstanding debts)	:	6.3%	0.0%	17.2%
Households with all adults aged: 40-64 (% of households with outstanding debts)	:	5.8%	0.0%	10.9%
Households with all adults aged: 65+ (% of households with outstanding debts)	:	1.2%	0.0%	2.8%

Proportion of those in different types of household with outstanding debts of over 100% of household disposable income

Living alone (% of people in households with outstanding debts)	:	4.3%	0.0%	8.2%
Single parent (% of people in households with outstanding debts)	:	9.5%	0.0%	27.1%
Other (% of people in households with outstanding debts)	:	4.8%	0.0%	12.1%

Proportion of those in households with outstanding debts of over 100% of household disposable income by marital status

Never married (% of people in households with outstanding debts)	:	5.0%	0.0%	15.4%
Married (% of people in households with outstanding debts)	:	4.1%	0.0%	9.7%
Separated/divorced (% of people in households with outstanding debts)	:	7.5%	0.1%	13.9%
Widowed (% of people in households with outstanding debts)	:	1.7%	0.0%	4.3%

Proportion of those in households with outstanding debts of over 100% of household disposable income by housing tenure

Owner occupied without mortgage (% of people in households with outst. debts)	:	3.2%	0.0%	9.6%
Owner occupied with mortgage (% of people in households with outst. debts)	:	6.3%	0.0%	16.1%
Market rent (% of people in households with outstanding debts)	:	8.2%	0.0%	16.0%
Subsidised rent (% of people in households with outstanding debts)	:	8.7%	0.0%	17.9%
Rent-free housing (% of people in households with outstanding debts)	:	2.3%	0.0%	15.1%

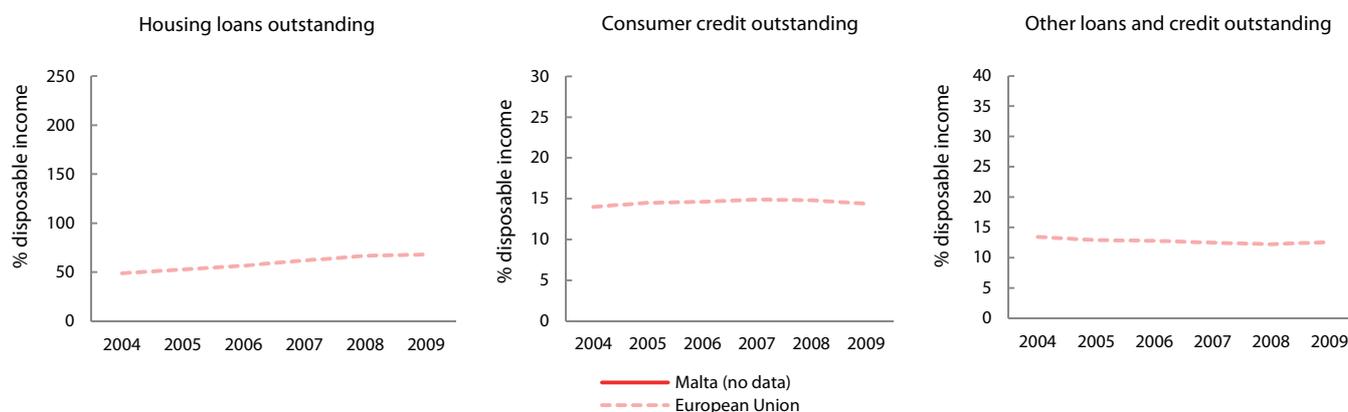
Proportion of those in households with outstanding debts of over 100% of disposable income by work intensity

Work intensity of 0 - 0.19 (% of people in households with outstanding debts)	:	5.7%	0.0%	10.6%
Work intensity of 0.20 - 0.50 (% of people in households with outstanding debts)	:	5.7%	0.0%	15.3%
Work intensity of 0.51 - 0.74 (% of people in households with outstanding debts)	:	5.4%	0.0%	13.5%
Work intensity of 0.75 - 1.0 (% of people in households with outstanding debts)	:	5.3%	0.0%	14.3%

Proportion of those in over-indebted households that experienced a major drop in income over the preceding year

Over-indebted (% of people in households that experienced drop in income)	:	33.3%	0.0%	77.6%
Other (% of people in households that experienced drop in income)	:	19.2%	5.9%	32.5%

IV. Loans and credit outstanding⁴



Notes:

(1) Eurobarometer 72.1 (2009) and Eurobarometer 74.1 (2010). Note: Those who answered 'very at risk' or 'fairly at risk' to the question 'Please tell me how much you feel at risk of being over-indebted'.

(2) Eurostat, SILC. Data as of December 2012.

(3) European Commission, Research Note 4/2010, Over-indebtedness new evidence from the EU-SILC special module.

(4) European Commission, Research Note 4/2010, Over-indebtedness new evidence from the EU-SILC special module. European Credit Research Institute (ECRI), Lending to households in Europe, 1995-2009 and Eurostat, National accounts.

19 THE NETHERLANDS

Document The over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact - Country report the Netherlands

Prepared by Prof. Stefan Hochguertel

Finalised on 30 September 2012

Final report

Over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact

19.1 DEFINITION OF OVER-INDEBTEDNESS

Over-indebtedness of households is a somewhat elusive concept. Relating the stock of debt outstanding to the capacity to pay back the debt as scheduled, in full, and including interest and applicable charges, calls for operationalization.

Capacity is commonly measured by disposable income, but may also include the sale of assets. Since both asset prices and incomes are stochastic, over-indebtedness will in practice be determined *ex-post*, based on the observation that a person or a household had been delinquent for a given period of time. The *ex-ante* equivalent of facing a high likelihood of being unable to serve contractual obligations in the future is then separately treated as the risk of being over-indebted. The distinction is important for debt counsellors and other practitioners as the legal consequences are different: those who have become delinquent are in contractual violation, whereas those that are *at risk* are not.⁷¹²

Such aspects are reflected in the responses of the interviewed stakeholders, who use different definitions, if they use a definition at all. Half of all respondents do not use a specific definition, while the other half does. Only 2 stakeholders (of 5 who indicated that they used specific definitions) explained what definitions they had in mind. One of them refers to general guidelines (code of conduct) of the financial industry. Both these stakeholders, coming from public authorities and civil society, consider those with *problematic debt* as being over-indebted. This term (i.e. problematic, or sometimes, risky, debt) is commonly encountered in various policy reports. Problematic debt may involve both *ex-post* and *ex-ante* concepts, and, according to an interviewee working for a public authority, it may also include non-debt arrears on bills or rent.

The majority of responses to the question of whether stakeholders used a specific definition for a household that was at risk of becoming over-indebted was "no". There is no unanimous consent on where to draw the line between being over-indebted and being at risk of becoming over-indebted.

Conversely, respondents typically do not see the need for employing a better definition. This may indicate that domain-specific definitions are the most appropriate way to broach the subject from different perspectives.⁷¹³

⁷¹² In addition, there is a choice aspect, since debts can be reduced by reducing consumption (standard of living). Effective debt relief is a function of consumers' comprehension, motivation and willingness to cooperate. Standard economic theory would predict that choices are determined by preferences and (institutional) constraints and incentives. Madern and van der Schors illustrate this in: *Kans op financiële problemen*, Report, National Institute for Family Finance Information (NIBUD), Utrecht, 2012.

⁷¹³ Academic research - such as that conducted by Lusardi and Tufano (who used US micro survey data) in *Debt Literacy, Financial Experience, and Overindebtedness*, NBER Working Paper No.14808, 2009, or Gathergood (who used UK micro data) in 'Self-control, financial literacy and consumer over-indebtedness', *Journal of Economic Psychology*, No 33, 2012, pp. 590-602 - has to rely on the availability of proxy measures in the data such as debt levels or delinquencies.

19.2 LEVEL OF OVER-INDEBTEDNESS

Incurring debt is widespread in the Netherlands, and in particular the level of housing debt is high in international comparison, despite a modest home ownership rate (2012: 57%). The vast majority of home owners have at least one mortgage, and the amounts involved are substantial: the average (median) mortgage debt outstanding for mortgaged households amounted to 186,000 (160,000) Euro, while average assets amounted to 265,000 (175,000) Euro in 2011.⁷¹⁴ The ratio of mortgage debt outstanding to disposable household income is - at 180% - the highest among Euro-zone countries (and only second to Denmark in the EU).

An important reason for the accumulation of high mortgage debt is strong tax incentives. The Netherlands is one of the few countries that allow mortgage interest rate payments to be fully deducted from the income tax base, provided that the mortgage is secured by the main owner-occupied residence.⁷¹⁵ Banks have developed an array of financial products to maximize the tax advantage, and they have betted, in the past, on rising house and stock market prices. Amortisation-free (interest-only) mortgages that only redeem the principal at the end of the contract period maximize the tax benefit and were strongly advertised. Combining mortgages with stock market investments increased the expected return in times of rising stock markets, at the cost of increased exposure of households to macroeconomic risks. In addition, banks have in the past allowed home owners to carry mortgages worth 120% of the current value of the residence. Changed regulations and industry standards as to mortgage terms have recently reduced access to high-leverage loans and accelerated a fall in average house prices. Between 2008 and 2012 average house prices fell by 15%,⁷¹⁶ and a continuing trend may put a large number, possibly a quarter, of owner-occupied households at risk of carrying negative home equity.⁷¹⁷

Other types of loans, including consumer credit loans, are not as widespread as elsewhere in Europe; the 2009 figure for consumer credit outstanding to disposable income is 8.4%, which is 60% of the EU average (see Annex A). The financial services industry has made access to unsecured credit facilities easier during the last decade, but tax-incentives to hold such types of debt were reduced in 2001.

Existing data suggests that high levels of mortgage debt as such are, on average, not associated with high levels of over-indebtedness. The percentage of the population in arrears on credit repayment, rent or utility bills is clearly below the EU average.

⁷¹⁴ CBS, *Conjunctuurbericht 21 August 2012*, Statistics Netherlands (CBS), The Hague and Heerlen, 2012b.

⁷¹⁵ Bertola, G., Hochguertel, S., 'Household Debt and Credit: Economic Issues and Data Problems', *Economic Notes: Review of Banking, Finance, and Monetary Economics*, No 36, Vol 2, 2007, pp. 115-146; Vandevyvere, W., Zenthöfer, A., *The housing market in the Netherlands*, European Commission, Economic Papers 457, 2012.

⁷¹⁶ CBS, *Conjunctuurbericht 21 August 2012*, Statistics Netherlands (CBS), The Hague and Heerlen, 2012b.

⁷¹⁷ ING, *Opleving woningmarkt is tijdelijke oprisping*, Kwartaalmonitor Woningmarkt 2012K3, Amsterdam, ING Bank, 2012.

Final report

Over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact

Statistical data covering the years 2005-2010 (EU SILC) shows no clear trend (see Annex A). About 1.5% of the population is behind in loan repayments, about 3% is late on paying rent or mortgage payments and 2% is in arrears on utility bills. EU-SILC data further suggests a strong correlation between the standard of living and debt: on average, less than 2% of people live in households with outstanding debts and/or arrears of over 100% of disposable income, but nearly 16% of those classified as materially deprived are in such households. This latter figure is clearly above the EU average (9%).

Alternative survey data suggests that the number of households in arrears is substantially higher. It has recently been reported that 40% of respondents to a survey had been late with payments during the past 12 months, and 26% had been in arrears or overdrawn more than once during the past 12 months.⁷¹⁸ In another study, from 2011,⁷¹⁹ the number was estimated at 27.8% of all households, including revolving credit card balances and long-standing checking account overdrafts, and referring to households that missed a payment during the past 12 months. Of further interest in the Westhof *et al.* study is the fact that households in arrears are most likely to not pay their (compulsory) health insurance premium.⁷²⁰

Arrears are often, but not necessarily,⁷²¹ associated with an inability to repay debt. Conversely, there may be households that pay their bills and cannot repay their debt. On the basis of the data from 2008/2009, estimates have been made⁷²² as to the number of households with problematic debt, including:

- ▶ (i) Those that are in legal settlement procedures;
- ▶ (ii) Those that are at risk of becoming over-indebted (or having problematic debt);
- ▶ (iii) Those that are believed to have problematic debt but are not registered with debt counsellors;
- ▶ (iv) The cases known to debt counselling agencies.

Category (iv) is the smallest, accounting for 2.3% of all households; 7.5% of households are thought to be in category (iii)—these do not yet seek counselling but are estimated to be in problematic debt. A total of 13.4% of households may have problematic debt according to their mean estimates (comprising (i)-(iv)).

⁷¹⁸ Madern and van der Schors, *Kans op financiële problemen*, Report, National Institute for Family Finance Information (NIBUD), Utrecht, 2012.

⁷¹⁹ Westhof, F., Tom, M., and Vroonhof, P., *Monitor Betalingsachterstanden (Arrears Monitor)*, Panteia, Zoetermeer, 2011.

⁷²⁰ Ibid. See also GGN, *Zo betaalt Nederland*, Report, Hertogenbosch, Groep Gerechtsdeurwaarders Nederland (GGN), 2012.

⁷²¹ See *ibid.*

⁷²² Van Ommeren, C.M., de Ruig, L.S., and Vroonhof, P., *Huishoudens in de rode cijfers*, Report, Zoetermeer, Panteia, 2009.

Statistical data tends to be somewhat dated,⁷²³ and the comments of stakeholders seem to be shedding light on more recent developments not covered by the available statistical material. None of the 10 stakeholders found the number of over-indebted households to have remained the same or decreased over the last five years, whereas 7 reported an increase.⁷²⁴

19.3 NATURE AND DRIVERS OF OVER-INDEBTEDNESS

19.3.1 Most common types of households that are over-indebted

The various stakeholders give a range of answers to closed questions in the questionnaire on who is over-indebted or has difficulties in meeting their financial commitments. There appears to be some consensus in the standardized answers, however, in that 7 out of 10 respondents characterize the households in questions as (a) being in the age range 25-39; (b) single parent households; (c) living in rental accommodation; (d) comprising one or two unemployed members; and (d) having primary or secondary education as the highest level in the household. Six stakeholders also indicate that there is a tendency among households at risk of poverty to be over-indebted.

These impressions are in line with the available data (see Annex A) on the proportion of people in households with outstanding debts over 100% of their disposable income (which may or may not reflect the over-indebted households), and are consistent with other correlates of poverty. Additional external data also suggests that non-EU immigrants are particularly prone to being in the affected group.⁷²⁵ One stakeholder indicated that some small business owners also belong to this group.

Eight interviewees observed fairly or even very significant changes in terms of the composition of the pool of over-indebted households during the past five years

⁷²³ Recent media coverage suggests strong increases in debt servicing problem indicators, ranging from arrears on health insurance bills ('Steeds meer achterstand bij betalen van zorgpremie', nrc.nl (NRC Handelsblad), July 23, 2012) and wage garnishment ('Forse toename in loonbeslagen door krimp van inkomsten', nrc.nl (NRC Handelsblad), August 11, 2012) to expected surges in home evictions and foreclosures ('Tijdbom huizenmarkt: golf verkopen dreigt', parool.nl (Het Parool), October 15, 2011). Reliable data for meaningful statistical analysis is missing, however.

⁷²⁴ Over-indebtedness is not easy to measure in available micro data used for academic research. Whereas existing household financial surveys can in principle shed light on the issue, sample sizes are typically too small to allow meaningful analysis, especially as far as small-probability events consequential to unsustainable debt levels are concerned (utilities disconnections, in-court debt settlement procedures, home evictions, foreclosures, homelessness, etc.). This may be one important reason for the lack of academic research supplying structural insights for the Netherlands. Existing research from other countries relies on very specialized data sources (see footnote 713). However, since the welfare consequences or concomitants of over-indebtedness are potentially very severe for the households involved, the issue is distinctly on the radar of government and executing agencies. Specific surveys have been run, univariate statistics have been published on various websites and policy reports have been produced. It appears that research that tries to disentangle the various pathways to over-indebtedness from mere correlations, and that identifies the direction of causality between debt holding and well-being, consumption levels and health outcomes, has not been conducted. Individual choice processes have not been modelled. Likewise, there are no convincing studies that assess the efficacy and cost-effectiveness of various policy measures already in place.

⁷²⁵ Westhof, F., Tom, M., and Vroonhof, P., Monitor Betalingsachterstanden (Arrears Monitor), Panteia, Zoetermeer, 2011.

(roughly covering the period of the series of financial and economic crises). There was a common perception that over-indebtedness is no longer limited to households where a single parent with a low level of education lives on welfare, but is gradually becoming a middle-class phenomenon. The affected households are slightly getting older and are increasingly home owners with a mortgage and (two-parent) families.

Some stakeholders explicitly mentioned increasing phone bills and spending patterns by young household members; others pointed to the high level of mortgage debt that can become problematic when the household experiences adverse events (such as unemployment, divorce or a fall in income).

19.3.2 Causes of households' over-indebtedness

Macroeconomic factors

Unemployment level was mentioned as an important cause of over-indebtedness by 7 of 10 interviewed stakeholders, while three mentioned the level of social welfare. These observations are interesting in that unemployment is low relative to other EU countries, and benefit levels are generous in comparison. However, the unemployment rate has increased from 3.8% since the onset of the crises in 2008; in the first quarter of 2012 it was at 6.2% of the labour force according to official national statistics. The government has made access to and levels of social welfare benefits less generous over the years, which some stakeholders mentioned in the interviews. Macroeconomic effects of this sort typically work through to the micro-level and affect many consumers in terms of distribution of income, wealth and debt.

What is unclear, however, is whether stakeholders perceive unemployment or welfare traps (associated with overly generous benefit levels) as contributing to financial problems. There is substantive empirical evidence that Dutch benefit recipients can be induced to work for money if unemployment agencies strictly monitor their job search efforts and increase financial incentives for them to look for a job.⁷²⁶ The flip side is that the government policy offers incentives for people to stay in poverty.⁷²⁷ Such observations are perceived to be very relevant to the Dutch debate but were not addressed explicitly in the stakeholder interviews. The direct link between poverty traps and over-indebtedness has not been identified, yet some of the previously mentioned studies have unveiled strong correlations between being poor, not being able or willing to work, and being in debt.

⁷²⁶ Abbring, J.H., van den Berg, G.J., van Ours, J.C., 'The Effect of Unemployment Insurance Sanctions on the Transition Rate from Unemployment to Employment', *The Economic Journal*, 115, 2005, pp. 602-630; Van den Berg, G.J., van der Klaauw, B., van Ours, J.C., 'Punitive Sanctions and the Transition Rate from Welfare to Work', *Journal of Labor Economics*, No 22, 2004, pp. 211-241.

⁷²⁷ Allers, M., De Kam, F., 'Een kwaal van de verzorgingsstaat: de armoedeval', *Sociaal Bestek*, 2/2010, pp. 2-6.

Cost of living

Utility bills, childcare costs and health care are the most commonly cited components of household budgets that the majority of stakeholders associate with over-indebtedness. This is partly due to the institutional structure and rule changes. Child care facilities are available in private and heavily regulated markets.⁷²⁸ Subsidies for child care have been scaled down, however, affecting a large number of working females. Likewise, health insurance is privately organized and regulated, but compulsory.⁷²⁹ The government heavily subsidizes the system, but passes on an increasing proportion of the bill to households. Consumers notice this in ongoing political discussions regarding an increase of the deductible on health insurance premiums.⁷³⁰ The consequence of these changes are growing out-of-pocket health expenditures, as stakeholders also pointed out in the interviews.

Types of credit/loans taken out by households

Mortgages were most frequently mentioned in the interviews as the type of loan associated with over-indebtedness (8 of 10 stakeholders). This is despite the fact that renters have been characterized as being more prone to over-indebtedness (in the past).⁷³¹ Other types of regulated consumer credit were also cited, but much less frequently. The least commonly mentioned (only 1 or 2 interviewees) were informal and unregulated credit channels. One possible reason is the widespread availability of regulated credit with typically lower rates than in unregulated markets. Some ethnic groups were mentioned as being particularly prone to borrowing from friends and families.

Personal circumstances

Personal circumstances were very frequently cited by stakeholders as drivers of over-indebtedness. Both broad types of categories featured: what we may classify as, firstly, 'shocks' / 'changing circumstances' or, secondly, as 'bounded rationality' / 'habits and addictions'.

Among the changing circumstances of the household, experience of unemployment featured prominently in the interviewees' responses, as did a drop in income due to

⁷²⁸ Kok, L., Koopmans, C., Berden, C., Dosker, R., *Waarde van kinderopvang*, Report, SEO Economisch Onderzoek, Amsterdam, 2011.

⁷²⁹ Schäfer, W., Kroneman, M., Boerma, W., van den Berg, M., Westert, G., Devillé, W., van Ginneken E., 'The Netherlands: Health system review', *Health Systems in Transition*, No 12, Vol 1, 2010, pp. 1–229.

⁷³⁰ Referring to the amount that the insured must pay him- or herself to cover the cost of treatment before the insurance coverage begins regarding a specific medical problem.

⁷³¹ An interviewee working for a public authority explained: "People in rented accommodation are the main households with a problematic situation (they are most often on social welfare). In the Netherlands there is a complete system of social welfare whereby being on social welfare entails social support e.g. social renting accommodation - which has therefore meant a large social renting phenomenon in the Netherlands. However there is now a small increase of households in owner-occupied housing in problematic debt situations."

other reasons (such as illness or divorce). Eight stakeholders mentioned the lack of money management skills, five mentioned incapacity to deal with financial products, and five over-optimism (and other behavioural biases). Addictive behaviours were mentioned by six interviewees.

A number of stakeholders commented that affected consumers lack self-control and the ability to adapt their consumption levels to changing income paths. Presumably implicit in the comments of the stakeholders is the perception that income drops have a somewhat perpetual nature and should hence not be smoothed out using credit facilities. Several respondents explicitly mentioned marketing that is successful in enticing households to acquire goods they cannot afford to buy without altering the composition of their spending. A financial industry stakeholder, however, stressed that consumer credit in itself does not cause problematic debt.

19.3.3 Changes relevant for levels of over-indebtedness

Nearly all (9 of 10) stakeholders agreed that macroeconomic changes, such as rising unemployment, influenced the level of over-indebtedness. This is because the associated fall in income was not foreseen by consumers when contracting with a lender. The associated drop in interest rates that might mitigate consumers' exposure to high debt loads is typically not perceived as an important factor.

Supply side changes were perceived by only 3 stakeholders (reduced access to consumer credit and mortgages). One stakeholder explicitly mentioned factoring (debt collection) as a practice that has been increasingly used in the financial services industry.

Other changes, such as increased use of high-interest loans from regulated or unregulated lenders or usurers, were typically not deemed very relevant and only mentioned by 1 or 2 of the 10 interviewed stakeholders. However, 4 interviewees reported increases in the use of informal loans from friends or families.

In terms of outcomes, 6 of 10 stakeholders reported fairly or very significant changes in terms of increases in accumulated debts from utilities, telecommunication services or rent. Some interviewees explicitly referred to telecommunication bills (mobile and smart phones in particular).

19.3.4 Cultural attitude towards debt and actual level of households' (over-) indebtedness

A strong majority (8 of 10) stakeholders perceived cultural attitudes towards debt as a correlate of over-indebtedness and debt holding. Their comments suggested that 'culture' may have to do with ethnicity and heterogeneous cultural (possibly religious) backgrounds, or with attitudes to borrowing and saving that have changed over time. The general, traditional Dutch attitude is described as favourable to saving and debt-adverse. However, this has changed over the last few decades with the

increased availability of credit in various forms. One stakeholder observed that the current crisis in itself may lead to a reversal of this trend.

19.4 CONSEQUENCES OF OVER-INDEBTEDNESS

Consequences of over-indebtedness largely depend on the actions taken by both creditors and debtors. A household that is *ex-post* unable to serve its obligations is in most cases faced with the debt collection efforts of creditors. These can be associated with substantial administration and recovery costs that add to the overall debt exposure of the household and set off self-reinforcing dynamics, eventually leading to the seizure of assets, wage garnishment, foreclosure, home eviction, etc. However, the debtor may instead respond by seeking advice, and, supported by the intermediation of a debt counsellor, start an amicable debt restructuring procedure. This, in cases with multiple creditors, often involves prioritizing debts and asking the involved creditors for lenience with respect to repayment terms. In addition, the household can file for insolvency proceedings, after having started (and typically not successfully concluded) mediated amicable procedures. These are formal procedures regulated in the Consumer Insolvency Act (Wsnp)⁷³² involving a court decision and a financial administrator. They force the household to a standard of living corresponding to 90% of social assistance benefits. This level is the unassailable consumption floor that the government grants to any citizen. The delinquent borrower is held to serve his or her obligations for typically three years and can start again with a clean slate (i.e. the remaining debt is waived).⁷³³

19.4.1 Consequences for affected households

Stakeholders on average perceive the affected households to suffer from a reduced standard of living, deteriorating well-being, and deteriorating mental health. In terms of average scores (on the scale from 0 to 10), family breakdown/divorce and utility disconnection were also ranked among the main consequences of over-indebtedness (with average scores above 6), as were 'other consequences'. In the latter category, social exclusion was emphasised (partly due to no longer being able to afford participation in, for instance, social and sports events, and partly due to the feelings of shame).⁷³⁴

⁷³² Wet Schuldsanering Natuurlijke Personen.

⁷³³ See, for example, Combrink-Kuiters, L., Lalta, V., *Monitor WSnP*, Statistics Netherlands (CBS) and Raad voor Rechtsbijstand, Utrecht and The Hague, 2011; Kilborn, J.J., *Expert Recommendations and the Evolution of European Best Practices for the Treatment of Overindebtedness, 1984-2010*, Kluwer, Deventer, 2011.

⁷³⁴ One stakeholder commented: "Social exclusion is a very serious matter. We know numerous cases of people who are just sitting on their couch, with curtains closed so that nobody would know they are at home in case debt collectors appeared, they remove their mailboxes so as not to receive any more notifications, and then they sit there all alone ... This has a lot to do with the shame people feel because of their over-indebtedness."

As far as measurable outcomes (such as home repossessions) are concerned, available statistics do not (yet) show dramatic developments. Levels are low, even though some statistics show large growth rates.

AEDS reports the number of evictions from dwellings owned by social housing corporations.⁷³⁵ These own 31% of all dwellings in the country and have a market share of 70% in the rental sector. Social housing tenants have a probability of 8% of being in rental arrears and of 0.24% of being evicted. The latter number includes evictions for anti-social behaviour and crime. Numbers on evictions in the other sectors of the housing market are not readily available. One bank⁷³⁶ reports the percentage of foreclosure auctions among households with a mortgage to be at the low level of 0.08% in 2011, although there had been substantial increases during the previous six years. Homelessness is reported to affect 0.1% of the population in total;⁷³⁷ it received the lowest score (2.8) in the stakeholder interviews as a consequence of over-indebtedness.

19.4.2 Consequences of over-indebtedness for the financial services industry

The highest ranked consequences for the financial services industry were the cost of arrears and agreed repayment/debt management plans for creditors (6.7) and the loss of potential customers through more restrictive lending practices (6.1). Some stakeholders also pointed to the cost of defaulted credits which may reduce demand. Part of this may have to do with the cost of default being typically priced into credit contracts, and default rates on average not going up extremely strongly.

19.4.3 Economic and social consequences of over-indebtedness for society

In terms of broader consequences of over-indebtedness, the loss of consumer confidence in the financial services industry received the highest average score from the interviewed stakeholders (8.0), followed by legal costs associated with over-indebtedness (7.0) and costs for other measures to alleviate the impact of over-indebtedness (6.8).

19.4.4 Debt collection practices

Debt collection is an unregulated industry and there is no data readily available on debt collection activities.

More than half of all interviewed stakeholders (6 of 10) perceived very or fairly significant changes in terms of increasingly aggressive debt collection practices. Their comments appear to suggest that a part of this perception has to do with debt

⁷³⁵ AEDS, *Huurachterstand en huisuitzetting*, Information Sheet, AEDS, The Hague, 2010.

⁷³⁶ ING, *Opleving woningmarkt is tijdelijke oprisping*, Kwartaalmonitor Woningmarkt 2012K3, Amsterdam, ING Bank, 2012.

⁷³⁷ CBS, *De Nederlandse Samenleving 2010*, Report, Statistics Netherlands (CBS), The Hague and Heerlen, 2010.

collection being taken more seriously and professionally, through outsourcing or sale of claims to third parties.

It has been pointed out elsewhere⁷³⁸ that certain debts (such as study loans) are excepted from discharge even in the formal debt settlement procedures; it has also been reported that the impact on settlement outcomes may have been strongly affected by the non-forgiving attitude of government fine collection agencies in the past. Some authors⁷³⁹ argue that different creditors are not on a level playing field anymore, as special provisions give certain creditors (such as government agencies) *de facto* precedence. If some creditors can directly access a debtor's bank account (as one stakeholder mentioned), the likelihood of the debtor falling to or below subsistence level increases, leaving no room for other, competing interests. Hence, it is conceivable that this increases the competitive pressure among the remaining creditors that respond by trying to increase their recovery rate.

19.5 MEASURES IN FORCE TO ALLEVIATE THE IMPACT OF OVER-INDEBTEDNESS

19.5.1 Early identification of households at risk

Half of all interviewees perceived early-warning measures to be fairly or very common. One stakeholder mentioned information-sharing through centralized credit bureaus (at the credit scoring stage), others mentioned lenders getting in touch early on with delinquent households that miss a mortgage payment or another bill.

19.5.2 Advice offered to over-indebted households

Availability and costs

As pointed out above, requirements for starting consumer insolvency procedures typically involve debt restructuring efforts mediated by debt counsellors.

All stakeholders reported that face-to-face debt advice was available in the Netherlands, and most of them said the same about personalised debt advice by telephone. Printed brochures and Internet websites offering free information and possibly generic advice are also widespread.

⁷³⁸ See, for example, Kilborn, J.J., *Expert Recommendations and the Evolution of European Best Practices for the Treatment of Overindebtedness, 1984-2010*, Kluwer, Deventer, 2011.

⁷³⁹ See, for example, Jungmann, N., Moerman, A.D., Schruer, H.D.L.M., Van den Berg, I., *Paritas passé*, Report, Koninklijke Beroepsorganisatie van Gerechtsdeurwaarders, The Hague, 2012.

Among those who reported on the costs, most stakeholders indicated that partly free and partly as paid services were available to households, or that these services are generally free of charge.

As of July 2012, a new law (Wgs)⁷⁴⁰ came into force that obliges municipalities to offer debt counselling services.⁷⁴¹ Apart from decentralizing debt counselling and introducing closer integration with other municipal tasks (such as welfare benefit payments), the law also foresees extended possibilities for moratoria.

Several municipalities have piloted initiatives involving volunteers and integral debt counselling (including psycho-social attention) and prevention practices at a municipal, district and neighbourhood level. Volunteers are predominantly used for helping households administering their financial accounts.⁷⁴²

Demand for debt advice as assessed by stakeholders

It is unclear from stakeholder interviews to what extent debt advice possibilities are known among consumers, and what the level of demand is. However, there was agreement among stakeholders⁷⁴³ that there has been an increase in the demand for debt advice over the last five years.

Effectiveness as assessed by stakeholders

Stakeholders interviewed were sceptical as to the effectiveness of particular channels of debt advice provision. One commented that the portfolio of advice and information channels as a whole is effective whereas single measures taken in isolation may not be. Another stakeholder suggested that affected persons have a tendency to postpone seeking advice, possibly beyond a point where advice and counselling can offer effective remedies.

However, research available shows that debt advice has a positive impact. For example, a cost-benefit calculation from 2011 based on the data from five above-average sized municipalities.⁷⁴³ This calculation suggests that each Euro spent on debt counselling activities returns more than 2 Euro in social benefits. Similarly, another cost-benefit calculation from 2011 based on the data from three debt-advise

⁷⁴⁰ Wet Gemeentelijke Schuldhulpverlening.

⁷⁴¹ Combrink-Kuiters, L., Lalta, V., *Monitor WSnp*, Statistics Netherlands (CBS) and Raad voor Rechtsbijstand, Utrecht and The Hague, 2011.

⁷⁴² See Nederland, T., Bulsink, D., Stavenuiter, M., *Kwaliteitsverbetering schuldhulpverlening*, Report, Verwij Jonker Instituut, Utrecht, 2012.

⁷⁴³ Van Geuns, R., Jungmann, N., Kruis, G., Calkoen, P., Anderson, M., *Schuldhulpverlening loont!*, Regioplan, Amsterdam, 2011.

projects suggests that each Euro spent on debt counselling returns between 1.30 Euro and 2.90 Euro in social benefits.⁷⁴⁴

Further simple and qualitative evaluations are available for specific debt counselling initiatives that have been launched locally.⁷⁴⁵ Some projects achieve a higher contact rate with the focus group of affected households, and the use of volunteers may help households avoid formal debt counselling and mediation programs. However, formal evaluation is lacking: there is no quantification and measurement of outcomes.

Funding of debt advice

Debt advice and counselling, as well as mediation services, are typically government funded. Nobody interviewed considered funding to be fully sufficient; but conversely only one stakeholder assessed funding as being not sufficient at all. Suggestions were made to increase reaching out to households at earlier stages.

As mentioned, debt counselling is a task of municipalities. The decentralized execution and budgeting means that there are no aggregate statistics readily available that allow an assessment of the total number of cases and amounts involved. A study from 2012⁷⁴⁶ quoted (1) an estimate of 400,000 Euro per municipality (implying a total of 166 million Euro); and (2) an estimate of 100,000 applications for debt counselling. NVVK reported over 76,000 applications in 2011.⁷⁴⁷

19.5.3 Key measures in place to alleviate the impact of over-indebtedness

Availability and costs

Stakeholders perceived both formal (in- and out-of-court) and informal debt settlement procedures to be available. As explained earlier, entry to formal in-court procedures is regulated by the Act on Consumer Insolvency (Wsnj), and requires a mediated amicable procedure to have been initiated. The legal cost to the household is typically borne by the tax payer.

Effectiveness as assessed by stakeholders

Effectiveness is hard to measure and few stakeholders provided their assessments. All four stakeholders who assessed the effectiveness of informally brokered

⁷⁴⁴ Kruis, G., Jungmann, N., and Blommesteijn, M. *Social Economic Benefit of Volunteer Projects Within Debt Aid*, Social Force and Regioplan, Amsterdam, 2011.

⁷⁴⁵ See Nederland, T., Bulsink, D., Stavenuiter, M., *Kwaliteitsverbetering schuldhulpverlening*, Report, Verwij Jonker Instituut, Utrecht, 2012.

⁷⁴⁶ Groenewoud, M., Blommesteijn, M., Jungmann, N., *Tijdelijke middelen schuldhulpverlening 2009-2011*, Report, Regioplan, Amsterdam, 2012.

⁷⁴⁷ NVVK, *Jaarverslag 2011*. Vereniging voor Schuldhulpverlening en Sociaal bankieren (NVVK), The Hague, 2012.

arrangements indicated that they were effective, and all six who assessed legal procedures that take place in court said that these were effective. Three interviewees thought the same about formal out-of-court procedures for debt settlement, whereas one said that they were hardly effective. The interviewee explained that this was the case because too many people were entering these procedures in the hope of final debt discharge while not being prepared to accept the consequences of budget administration and living on the poverty line.

It is noteworthy in this regard that conditional on finalising a debt settlement procedure, about 70% of all cases end with a clean slate (i.e. a discharge of the remaining debt).⁷⁴⁸

19.5.4 Changes in response to over-indebtedness

Half of the interviewees said that there had been changes in response to over-indebtedness during the past five years. One of them explained that municipalities are now obliged to provide debt advice services.

19.5.5 Types of households of over-indebted consumers not reached by current measures

Opinions of interviewees who responded to the question of whether some types of households of over-indebted consumers are not reached by current measures were evenly split between those who thought that was not the case and those who answered affirmatively. One interviewee from the latter group explained that the initiative for contact has to come from consumers themselves, which often happens too late. Another stakeholder explained that there are some families with an array of social problems, of which over-indebtedness is but one.

19.5.6 Best practices

Every other interviewee (5 of 10) responded affirmatively to the question of whether there were specific measures in place to alleviate over-indebtedness that could be considered to represent best practices.

Codes of conduct for mortgage lending and the provision of consumer credit were suggested by one interviewee. One stakeholder illustrated best practices with a model involving advice services contacting people (on the basis of information provided by lenders) if problems with payments arise. Another interviewee referred to SchuldHulpMatje, a project that was developed in 2009:

... when the Dutch government and almost all churches came together to address the issue of debt which had become a big problem. A three-day training program

⁷⁴⁸ Combrink-Kuiters, L., Lalta, V., Monitor WSnp, Statistics Netherlands (CBS) and Raad voor Rechtsbijstand, Utrecht and The Hague, 2011.

was developed for volunteers which then become the debt aid/budget buddies ... In 2011, 1,200 volunteers were trained, and an additional 400 in the first part of 2012, so in total already 1,600 volunteers who are now connected to people in debt. On average, each volunteer is connected to 2.8 people and so far, about 70% of people have reached the goal of getting out of over-indebtedness.

According to the interviewee, volunteers are currently active in 50 cities and towns in the Netherlands, but the plan is to unfold the program throughout the country.

19.6 OUTLOOK

A majority (6 of 10) stakeholders expected the number of over-indebted households to increase over the next 5 years, partly attributing their expectations to unfavourable macroeconomic conditions that are not predicted to improve soon. Seven stakeholders answered affirmatively to the question of whether there were any specific new challenges to be addressed by policy makers, but few concrete examples were provided. They included households with debts due to loss of income and decline in housing prices; and the challenge of balancing the need "on the one hand, to protect the consumer from getting into financial difficulties and, at the same time, to make credits and mortgages reasonably accessible".

Overall, stakeholders made a case for changes in regulation in at least one of the two mentioned domains. The EU was predominantly seen as the most important level of policy coordination in the domain of utilities, whereas housing market regulation was predominantly seen as an important national task.

Lastly, among the non-regulatory measures, stakeholders explicitly mentioned ways to improve financial education and measures aimed at improving financial literacy.

In summary, stakeholder interviews reflect recent trends that are not yet observable in the published data. They give some indication of what might be expected in the future. Households are often seen to be overextended with respect to mortgage debt, and thus being very vulnerable to shocks (predominantly unemployment) that become more likely during times of economic crises. The Netherlands has so far weathered the crises better than some other countries in Europe, but overall debt levels of households (and especially mortgages) are a concern. To effectively support the resilience of households to shock exposure, major allocative problems in the housing market, the tax system and the labour market will also have to be addressed.

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ANNEX A: STATISTICAL DATA FROM EU SOURCES

Final report

Over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact

Netherlands

I. Eurobarometer¹

Netherlands EU average Lowest EU value Highest EU value

Households *at risk* of being over-indebted

Respondents feeling at risk of over-indebtedness in 2010	↓	13%	25%	7%	52%
Respondents feeling at risk of over-indebtedness in 2009	↓	13%	27%	9%	53%

II. EU SILC standard survey data²



III. EU SILC 2008 module: Over-indebtedness and financial exclusion³

Netherlands EU average Lowest EU value Highest EU value

Proportion of people in households with *bank overdrafts, outstanding balances on credit cards or in arrears on other loans* of over 100% of household disposable income

Overdrawn bank account (% of people in households overdrawn)	↓	1.0%	2.2%	0.0%	7.7%
Credit or store card (% of people in households with outstanding balances)	↓	0.2%	1.1%	0.0%	8.6%
Other loan/credit payments (% of people in households in arrears)	↓	0.1%	0.3%	0.0%	1.1%

Proportion of people in households in *arrears in servicing housing-related loans and bills and in paying other bills* of over 100% of household disposable income

Housing bills (% of people in households in arrears)	↓	0.1%	0.5%	0.0%	2.9%
Other payments (% of people in households in arrears)	↓	0.2%	0.4%	0.0%	1.7%

Households living with *outstanding debts and/or arrears* of over 100% of household disposable income

Total (% of households with outstanding debts/arrears)	↓	1.8%	4.6%	0.0%	11.8%
Income above 60% median (% of households with outstanding debts/arrears)	↓	1.4%	4.2%	0.0%	11.3%
Income below 60% median (% of households with outstanding debts/arrears)	↓	5.8%	7.0%	0.2%	13.7%
Materially deprived (% of households with outstanding debts/arrears)	↑	15.7%	9.0%	0.1%	27.4%

Proportion of those in broad *age groups* with outstanding debts of over 100% of household disposable income

Households with all adults aged 25-39 (% of households with outstanding debts)	↓	2.5%	6.3%	0.0%	17.2%
Households with all adults aged: 40-64 (% of households with outstanding debts)	↓	1.8%	5.8%	0.0%	10.9%
Households with all adults aged: 65+ (% of households with outstanding debts)	↓	0.3%	1.2%	0.0%	2.8%

Proportion of those in different types of household with outstanding debts of over 100% of household disposable income

Living alone (% of people in households with outstanding debts)	↓	3.2%	4.3%	0.0%	8.2%
Single parent (% of people in households with outstanding debts)	↓	5.2%	9.5%	0.0%	27.1%
Other (% of people in households with outstanding debts)	↓	1.4%	4.8%	0.0%	12.1%

Proportion of those in households with outstanding debts of over 100% of household disposable income by marital status

Never married (% of people in households with outstanding debts)	↓	2.7%	5.0%	0.0%	15.4%
Married (% of people in households with outstanding debts)	↓	1.1%	4.1%	0.0%	9.7%
Separated/divorced (% of people in households with outstanding debts)	↓	3.0%	7.5%	0.1%	13.9%
Widowed (% of people in households with outstanding debts)	↓	0.3%	1.7%	0.0%	4.3%

Proportion of those in households with outstanding debts of over 100% of household disposable income by housing tenure

Owner occupied without mortgage (% of people in households with outst. debts)	↓	1.1%	3.2%	0.0%	9.6%
Owner occupied with mortgage (% of people in households with outst. debts)	↓	1.0%	6.3%	0.0%	16.1%
Market rent (% of people in households with outstanding debts)	↓	3.5%	8.2%	0.0%	16.0%
Subsidised rent (% of people in households with outstanding debts)	↓	0.0%	8.7%	0.0%	17.9%
Rent-free housing (% of people in households with outstanding debts)	↔	3.9%	2.3%	0.0%	15.1%

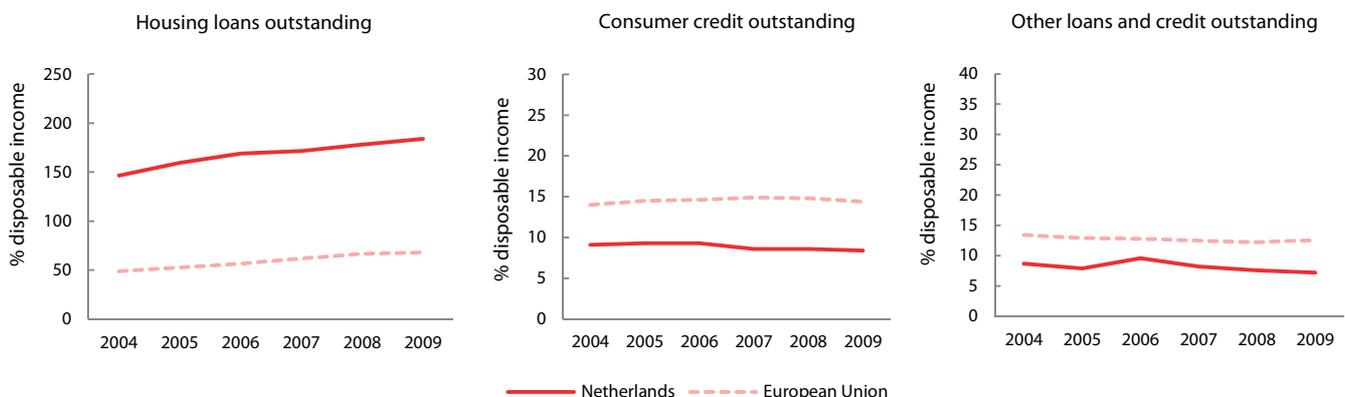
Proportion of those in households with outstanding debts of over 100% of disposable income by work intensity

Work intensity of 0 - 0.19 (% of people in households with outstanding debts)	↓	4.5%	5.7%	0.0%	10.6%
Work intensity of 0.20 - 0.50 (% of people in households with outstanding debts)	↓	1.3%	5.7%	0.0%	15.3%
Work intensity of 0.51 - 0.74 (% of people in households with outstanding debts)	↓	1.5%	5.4%	0.0%	13.5%
Work intensity of 0.75 - 1.0 (% of people in households with outstanding debts)	↓	1.8%	5.3%	0.0%	14.3%

Proportion of those in over-indebted households that experienced a major drop in income over the preceding year

Over-indebted (% of people in households that experienced drop in income)	↓	26.7%	33.3%	0.0%	77.6%
Other (% of people in households that experienced drop in income)	↓	9.3%	19.2%	5.9%	32.5%

IV. Loans and credit outstanding⁴



Notes:

- (1) Eurobarometer 72.1 (2009) and Eurobarometer 74.1 (2010). Note: Those who answered 'very at risk' or 'fairly at risk' to the question 'Please tell me how much you feel at risk of being over-indebted'.
- (2) Eurostat, SILC. Data as of December 2012.
- (3) European Commission, Research Note 4/2010, Over-indebtedness new evidence from the EU-SILC special module.
- (4) European Commission, Research Note 4/2010, Over-indebtedness new evidence from the EU-SILC special module. European Credit Research Institute (ECRI), Lending to households in Europe, 1995-2009 and Eurostat, National accounts.

20 POLAND

<i>Document</i>	The over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact - Country report Poland
<i>Prepared by</i>	Katarzyna Majkut and Anna Kaxira (ICF-GHK Consulting)
<i>Finalised on</i>	19 December 2012

Final report

Over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact

20.1 DEFINITION OF OVER-INDEBTEDNESS

A variety of definitions of over-indebtedness were used by the stakeholders who took part in interviews for the study. For example, one financial industry stakeholder defined individuals as being indebted if they were at least 60 days late with the payment of their debts, as long as these amounted to at least 200 Polish Zloty (around 50 Euro). A public authority stakeholder indicated a definition according to which a household could be considered over-indebted if the cost of servicing their debts amounted to more than 40% of their disposable income. Another financial industry stakeholder pointed out that, although it does not lay down a specific definition of over-indebtedness, the Polish Financial Supervision Authority imposes a ceiling on monthly repayment instalments of 50% of the income of those earning below the average national salary, and 65% for those earning more.

Just over half of stakeholders considered that there was a need for a better definition both of being over-indebted and of being at risk of over-indebtedness. One independent expert that took part in an interview considered that a clearer definition of over-indebtedness would be helpful to consumers, by indicating to them the risks they were exposed to and encouraging them to plan their finances better. Another independent expert felt that there was a need for a definition of over-indebtedness that included a reference to the minimum costs of living in Poland.

20.2 LEVEL OF OVER-INDEBTEDNESS

The majority of stakeholders acknowledged that there had been an increase in the number of over-indebted households in Poland in the last five years.

Statistics from Eurostat show that there was indeed an increase in the percentage of the total population with arrears from 11.3% to 14.2%, in the period 2008 to 2011, although the figure for 2011 is in fact lower than that from 2007 (18.2%).⁷⁴⁹ Figures from InfoDlug, a report produced by the economic information bureau BIG InfoMonitor together with the credit information bureau BIK and the Polish Bank Association, show an even more significant increase in arrears. According to the latest InfoDlug report, there were 2,215,356 persons temporarily failing to meet their obligations in August 2012, an increase of more than 100% in comparison with the figures for August 2007 (less than 950,000).⁷⁵⁰

⁷⁴⁹ Eurostat, 'Percentage of total population with arrears (mortgage or rent, utility bills or hire purchase)' (code: ilc_mdcs05).

⁷⁵⁰ InfoDlug, 'Ogólnopolski Raport o Zaległym Zadłużeniu i Klientach Podwyższonego Ryzyka (Październik 2012)'; Windykacja.pl, 'Złe długi Polaków rosła coraz wolniej - 20 edycja InfoDlug' (<http://www.windykacja.pl/index.php?module=raporty&opt1=zle-dlugi-polakow-rosna-coraz-wolniej---20-edycja-infodlug&printable=yes>). The InfoDlug report is based on data gathered by BIG Infomonitor, BIK and the Bank Register of the Polish Bank Association. If the information is provided by lenders or mass service providers then it refers to debts of at least 200 Polish Zloty which are at least 60 days overdue. If provided by consumers it is confirmed by enforcement order.

In terms of the European context, the percentage of the Polish population with arrears in 2011 was almost three percentage points higher than the EU average (11.4%).⁷⁵¹ The percentage of Polish households having great difficulties making ends meet was also higher than the EU average in 2011 (10%), despite the reduction in the preceding five years.⁷⁵²

20.3 NATURE AND DRIVERS OF OVER-INDEBTEDNESS

20.3.1 Most common types of households that are over-indebted

According to the stakeholders, the most common types of households in Poland that are over-indebted and/or have on-going difficulties meeting their financial commitment are households consisting of people between the ages of 25 and 64, households with one or more children, households living in owner-occupied housing with mortgages, households with two unemployed persons and households where the education level is elementary (primary) school or less.

Regarding the age of over-indebted households, some stakeholders mentioned that younger households (i.e. those between the ages of 25 and 39) were more likely to face problems because they had higher living expenses, had been more affected by the economic crisis or had a more relaxed attitude to taking on debt. However, other stakeholders pointed out that older people were also increasingly affected by over-indebtedness, in particular as the result of providing support to younger relatives who were having financial problems due to the crisis. For example, one civil society stakeholder stated that:

Specifically within the senior group there have been more cases of over-indebtedness. Older people took credits to help younger members of their families. Mortgage credits for 30-35 years were taken out by young and senior groups together - banks offered credits to pay off until the age of 80. Within one year - August 2009 to August 2010 - over-indebtedness among seniors (above 60 years of age) increased by 75%.

A majority of stakeholders agreed that households with a low education level and households affected by unemployment were more likely to be over-indebted. One independent expert claimed that this was partly due to the exclusion of low income groups from cheap forms of credit, which led to them taking out high interest loans from non-bank lenders.

⁷⁵¹ Eurostat, 'Percentage of total population with arrears (mortgage or rent, utility bills or hire purchase)' (code: ilc_mdcs05).

⁷⁵² Eurostat, 'Households making ends meet with great difficulty' (code: ilc_mdcs09)

20.3.2 Most important causes of households' over-indebtedness

Macro-economic factors

Poland was affected relatively lightly by the financial crisis, in terms of economic growth, and maintained positive growth rates throughout the period 2007 to 2011.⁷⁵³ Nonetheless, all stakeholders considered macro-economic factors to be important causes of over-indebtedness in Poland, in particular unemployment level. Indeed, between 2008 and 2011 the unemployment rate in Poland increased from 7% to 9.6%.⁷⁵⁴ In addition, a majority of stakeholders highlighted the importance of movements in exchange rates. These were considered to be important as many households in Poland had taken out loans in foreign currency, in particular in Swiss Francs. Between December 2007 and December 2011 the value of the Swiss Franc rose from 2.19 Polish Zloty to 3.67 Polish Zloty, leading to a significant increase in repayments for households who had taken out loans in Swiss Francs.⁷⁵⁵

Cost of living

The costs of living were frequently considered by stakeholders to be important causes of household over-indebtedness in Poland. In particular, stakeholders stressed the importance of utility costs, followed by the general costs of living (food, transport, etc.) and housing costs. Some stakeholders felt that the costs of living were increasing, and indeed the HCIP in Poland in 2011 was 120.1, against a figure of 103.9 in 2007, and higher than the EU 2011 average of 115.4.⁷⁵⁶ In the period 2007 to 2011, the price of gas per gigajoule increased from 8.76 Euro to 10.46 Euro and the price of electricity per kWh from 0.09 Euro to 0.11 Euro.⁷⁵⁷ The same period did in fact see a reduction in the percentage of the total population with utility arrears (from 16.7% to 12.9%), however the figure for 2011 represents an increase in comparison with 2008 (10%).⁷⁵⁸

Types of credit/loan taken out by households

The period 2007 to 2010 showed an increase in the gross debt-to-income ratio, from 35% to 52%. During the period 2009 to 2010, the number of households considering themselves to be at risk of over-indebtedness increased by 2%. According to a civil

⁷⁵³ Eurostat, 'Real GDP growth rate - volume' (code: tec00115)

⁷⁵⁴ Eurostat, 'Unemployment as percentage of the labour force' (code: tsdec450)

⁷⁵⁵ During the period 03.12.2007 to 01.12.2011. Source: Polish National Bank, 'Average exchange rates table in 2007', 'Average exchange rates table in 2011'

⁷⁵⁶ Eurostat, 'HCIP', (code: prc_hicp_aind).

⁷⁵⁷ Eurostat, 'Gas prices for household consumers' (code:ten00113); Eurostat, 'Electricity prices for household consumers (EUR per kWh)' (code: ten00115).

⁷⁵⁸ Eurostat, 'Percentage of total population with utility arrears' (code: ilc_mdcs07)

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According to a civil society stakeholder that provides assistance to over-indebted households, the number of their clients unable to manage their debts on-time increased by 30% between the third quarter of 2009 and the third quarter of 2011. However, the percentage of households that described themselves as having great difficulties making ends meet in 2011 (12.4%) represents a reduction in comparison both to 2007 and to 2008 (17% and 14% respectively).

In terms of the type of credit/loan taken out by households, stakeholders most frequently stressed the importance of home loans and mortgages. Statistics from EU-SILC show that the percentage of the population in arrears with their mortgages increased in the period 2007 to 2011. Although the figure fell from 1.2% in 2007 to 0.6% in 2008, by 2011 it had risen to 1.5%.⁷⁵⁹ The period 2007 to 2010 also saw a large increase in the volume of doubtful mortgages, from 360 million Euro to 1,226 million Euro.⁷⁶⁰ One financial industry stakeholder pointed out that foreign currency loans, which proved problematic for some consumers as a result of exchange rate fluctuations, were frequently taken out in order to purchase homes.

Other types of credit/loans frequently referred to by stakeholders as the most important causes of over-indebtedness were regulated consumer credit with high interest rates and predatory or usurious types of credit and loans. Several stakeholders indicated that there had been an increase in the use of short-term, high-interest rate loans from non-bank providers in the last few years. These tended to be taken out by people with lower incomes who could not access loans from banks. Some stakeholders linked the development of this type of credit with the financial crisis, as this had led banks to implement more restrictive lending practices. One public authority stakeholder commented:

There has been a rapid development of the non-banking sector with extremely high interest rates of up to 150%. Their services are used by financially excluded consumers who cannot afford to go to a bank. They very often take a loan to pay back loans they already have. This is a recent phenomenon because after the crisis banking practices have become stricter and more cautious, resulting in many people not being able to obtain a loan.

Personal circumstances

Stakeholders most frequently considered poor money management or a decrease in income due to unemployment/business failure to be important causes of household over-indebtedness in Poland. A majority of stakeholders also referred to poverty, a decreasing or stagnant income while the costs of living steadily rise and incapacity to deal with financial products. According to one financial industry stakeholder there is not enough provision of financial education in Polish schools, especially in relation to

⁷⁵⁹ Eurostat, 'Percentage of total population with arrears on mortgage or rent payments' (code:ilc_mdcs06)

⁷⁶⁰ EMF, 'Study on Non-Performing Loans in the EU', 2011.

credit cards. The stakeholder felt that this meant that many people who use credit cards do not really understand how they operate and get into financial difficulties as a result.

20.3.3 Changes relevant for levels of over-indebtedness

Stakeholders highlighted many changes over the past five years that have influenced the level of over-indebtedness and numbers of households with on-going difficulties meeting their financial commitments.

First of all, there have been significant changes in the lending practices of credit providers which reduce the accessibility of credit, partly as the result of new legislation. According to Article 9 of Consumer Loan Act of 12 May 2011,⁷⁶¹ before entering a consumer loan contract, the lender is obliged to assess the credit risk on the basis of information received from the consumer or held in the lender's database or data set. One public authority stakeholder pointed out that recommendations have been issued by the Polish Financial Supervision Authority to improve the assessment of the borrower's creditworthiness and reduce the availability of high-risk loans, for example by setting limits on the acceptable level of debt-to-income ratios.

Secondly, stakeholders also indicated that there has been a significant change regarding the availability of loans in foreign currencies. According to a financial industry stakeholder, credits in foreign currencies were very popular in the few years before 2008 and were mainly denominated in Swiss Francs. These led to problems for some consumers as movements in exchange rates caused their repayments to increase significantly. However, access to these sorts of loans has now been significantly restricted, partly due to a re-assessment by the banks of the risks involved, according to a public authority stakeholder. While 78% of mortgage loan sales in the third quarter of 2008 were denominated by Swiss Francs, by the second quarter of 2011 this had sunk to 6%.⁷⁶²

Several stakeholders also stated that there had been significant changes in terms of the general economic situation. They felt that the economic crisis has been a major driver of indebtedness and has resulted in a decrease in the demand for loans, which was quite high during the period 2005-2008. Although growth rates in Poland remained positive after the financial crisis, there has been an increase in unemployment since 2008.⁷⁶³ Stakeholders also referred to rising living costs and a slow growth in incomes. As mentioned above, several stakeholders mentioned that currency depreciation had increased the debt burden on Polish households, due to the high prevalence of foreign currency loans.

⁷⁶¹ This Act takes effect on 18 December 2011 implementing the provisions of Directive 2008/48/EC on credit agreements for consumers and repealing Council Directive 87/102/EEC.

⁷⁶² Eurofound, 'Housing debt advisory services in the Europe Union', 2012, p. 17.

⁷⁶³ Eurostat, 'Unemployment as percentage of the labour force' (code: tsdec450)

20.3.4 Cultural attitude towards debt and actual level of households' (over-) indebtedness

The majority of stakeholders felt that there is a relationship in Poland between cultural attitudes towards debt and the level of household (over-)indebtedness. Some stakeholders considered that taking out credit had traditionally been perceived negatively in Poland, and still was by many older people (above the age of 40 or 50). However, young people had a more relaxed attitude to credit and placed less emphasis on being debt-free. Some stakeholders felt that young people were more likely to be influenced by consumerism and/or to be willing to buy without thinking about the consequences. One independent expert commented:

There is a group of households, usually with members aged 50 or more, that never had a chance to operate in an environment with good accessibility to credit and is not willing to participate. In this group there is mostly the attitude that one should be debt-free. However, this is not the case for younger households. They are used to credit instruments and are more likely to be willing to participate in the credit market.

Two stakeholders linked this relaxed attitude towards debt among younger households with a lack of financial education.

20.4 CONSEQUENCES OF OVER-INDEBTEDNESS

20.4.1 Consequences for affected households

Stakeholders considered the most important consequences of over-indebtedness for affected households to be financial exclusion, reduced standard of living, deteriorating well-being and utility (water/electricity/gas/etc.) disconnection. In terms of financial exclusion, stakeholders referred mainly to exclusion from credit. One independent expert did point to the large number of people in Poland without access to a bank account (11% of the population in 2009),⁷⁶⁴ but one civil society stakeholder suggested that this meant exclusion from a bank account was less of an issue for those affected. Indeed, the low level of financialisation in Poland means that people without a bank account do not face the same socio-economic consequences as those in countries with a higher level of financialisation.⁷⁶⁵

The least important consequences for affected households, according to stakeholders, were homelessness, family breakdown/divorce and addictive behaviours.

⁷⁶⁴ Flash Eurobarometer 282, 'Attitudes towards crossborder sales and consumer protection: Analytical report', 2010, p.60.

⁷⁶⁵ Gloukoviezoff, G., 'The link between financial exclusion and over-indebtedness', 2009.

20.4.2 Consequences of over-indebtedness for the financial services industry

The most important consequence of over-indebtedness for the financial services industry, according to stakeholders, was the cost of defaulted credits for creditors. Stakeholders also frequently referred to the loss of potential customers through more restrictive lending practices, increased costs through the stricter regulation of credit and the cost of arrears and agreed repayment/debt management plans for creditors. The least important consequence was considered to be lower demand for credits because of high risk premiums. Regarding increased costs through the stricter regulation of credit, one financial industry stakeholder commented:

Because the banking sector or other credit providers need to reduce the risk and, secondly, secure their own interest and maintain a reserve for their activities, the cost of financial services offered to consumers will increase. This is also connected with the new Consumer Credit Act adopted in 2011, which is of course connected with the Consumer Credit Directive. Credit providers need to make changes, e.g. in terms of education about credit. Now they need to inform consumers about all the costs related to the credit and they need to check the credibility of consumers. So the work that needs to be done before the credit is granted is bigger and the cost of servicing such a credit is also higher.

20.4.3 Economic and social consequences of over-indebtedness for society

The most important economic and social consequence of over-indebtedness for society identified by stakeholders was loss of consumer confidence in the financial services industry. Other consequences considered to be important were the costs for measures to alleviate the impact of over-indebtedness (e.g. out of court debt settlements) and reduced productivity at work. The consequence ranked as least important by stakeholders was the cost for the provision of debt advice services. One civil society stakeholder specified that this was due to the absence of state provided debt advice in Poland.

20.4.4 Debt collection practices

There was no consensus among stakeholders regarding the question of whether debt collection practices had become more aggressive in the last five years. A few stakeholders felt that there had been an increase in the use of aggressive debt collection practices, but around half of stakeholders indicated that there had not been any significant change, while two stakeholders felt that debt collection practices had in fact become less aggressive. One of these specified that this was due to the introduction of new legislation in 2003 that clarified the legal framework for debt collection, which had previously been a grey area.⁷⁶⁶ This stakeholder also linked it

⁷⁶⁶ 2003 saw the introduction of the Insolvency and Recovery Law, which created a new regulatory framework for insolvency in Poland.

with an increase in the number of debt collection companies, as the result of a rise in the volume of unpaid debts.

20.5 MEASURES IN FORCE TO ALLEVIATE THE IMPACT OF OVER-INDEBTEDNESS

20.5.1 Early identification of households at risk

Stakeholders were asked about measures in place to identify households at risk of over-indebtedness at an early stage. Those stakeholders who were aware of such measures pointed primarily to the use of creditworthiness checks by banks prior to the granting credit to customers. One financial industry stakeholder referred to the Consumer Loan Act of May 2011, which requires lenders to check the financial situation of a customer before providing credit. However, one stakeholder indicated that there was no unified system for such identification of at-risk consumers and that the measures in place were mainly the result of the banks' own practices. Another stakeholder felt that the checks done on consumers' credit history were not always adequate and that in some cases the banks were in fact responsible for overly aggressive lending practices.

There are several organisations in Poland collecting data on arrears. One of these is the National Debt Register (KRD), which was established in 2003 under the Act on Access to Economic Information and operates under the auspices of the Ministry of Economy.⁷⁶⁷ The two other largest private credit bureaus in Poland are BIG Infomonitor and BIK, who both collect data on persons failing to meet their payment commitments.⁷⁶⁸

20.5.2 Advice offered to over-indebted households

Availability and costs

According to a 2010 comparison of debt advice in Europe by the University of Mainz, the debt advice sector in Poland is not particularly well developed. This means that most over-indebted households have to rely on non-governmental organisations or public authorities working in the general field of consumer protection, such as the Federacja Konsumentów.⁷⁶⁹ This position was shared by the stakeholders who commented on the availability of debt advice services in Poland. They did not consider them to be widely available, but felt that where they did exist they tended to be free of charge. One stakeholder specified that they were generally provided by a

⁷⁶⁷ See: <http://www.en.krd.pl/About-KRD/Our-activity.aspx>

⁷⁶⁸ See: <http://www.bik.pl/EN/About.aspx>; <http://en.infomonitor.pl/>.

⁷⁶⁹ Schuldenfachberatungszentrum,, Johannes Gutenberg-Universität Mainz, 'Debt Advice in Europe', 2010.

few non-governmental organisations, which offered legal advice to over-indebted consumers.

One example of debt advice provision in Poland is the National Network of Financial and Consumer Counselling Centres Project, which was launched by a non-governmental organisation with the help of public funding. With nine financial advice centres in different Polish cities, the network provides financial education and advice to over-indebted households.⁷⁷⁰

One financial industry stakeholder felt that the availability of debt advice in Poland had increased in the last few years and that it would probably continue to grow in the future.

In addition to the development of debt advice services in recent years, there has also been some preventative action taken against over-indebtedness, in particular against fraudulent lending. Under the auspices of governmental institutions and bank) a social campaign called "Before you sign" has been introduced, which encourages the use of free advice (by telephone, mail or chat) on legal aspects concerning loan contracts. The campaign website promotes financial self-education, for example providing short instructional films explaining how to sign a contract, guidelines for those who are about to sign a loan contract, a loan calculator and information on legal procedures concerning the financial market.⁷⁷¹

Demand for debt advice as assessed by stakeholders

The majority of stakeholders claimed that demand for debt advice had increased in the last five years. One reason given for this was a growing number of over-indebted households. In addition, some stakeholders pointed to higher levels of awareness regarding the existence of debt advice services, as the result of education and media campaigns. However, one financial industry stakeholder considered that awareness of debt advice was still fairly low and that most people would not know where to look for help. This stakeholder explained:

There is a greater awareness of the role of debt advice. There are a lot of new organisations providing this type of advice (both public and private ones) and we think they will continue to grow. However, they are not growing as rapidly as we might expect, and most people are probably not aware of them. If you ask someone on the street where they can go for advice about lowering their debts, they will not know that there is a public office that can help them. There is a need to promote this type of activity (as well as financial education).

⁷⁷⁰ ECDN, 'Lack of systematic solutions in Poland', *Money Matters*, 2007

⁷⁷¹ See: <http://www.zanim-podpiszesz.pl/>

Effectiveness as assessed by stakeholders

Those stakeholders that commented on the effectiveness of debt advice mentioned that it was generally helpful for over-indebted households, in particular face-to-face advice. However, one public authority stakeholder criticised that the advice was mostly on the costs of credit, rather than on the potential burden and risks it entails. Most stakeholders did not feel able to provide an answer on the effectiveness of debt advice.

Funding of debt advice

The majority of stakeholders did not know if resources assigned to debt advice services were sufficient. However, most of those who gave an answer felt that it was not sufficient. In particular, one civil society stakeholder criticised that funding for debt advice services was not only too low, but was also only provided for short-term periods (e.g. six months). This stakeholder also stressed that debt advice needed to be integrated into new legislation on consumer insolvency. An independent expert felt that the lack of funding was not currently such a problem due to the low level of demand for advice, but that more money needed to be invested in financial education and the advertisement of debt advice services.

20.5.3 Key measures in place to alleviate the impact of over-indebtedness

Although some stakeholders were unable to comment on the availability of measures to alleviate the impacts of over-indebtedness in Poland, other stakeholders indicated the existence of measures, such as informal arrangements between debtors and creditors, and consumer insolvency. One public authority stakeholder commented that informal arrangements were probably the most commonly used measures. With respect to legal procedures, the option of personal insolvency was introduced for consumers in 2009, but, according to a financial industry stakeholder, it is barely made use of by over-indebted households due to the strict nature of the procedure. One representative of a public authority confirmed that the measure was rarely used. Almost all stakeholders who commented on the effectiveness of legal procedures considered them either to be hardly effective or not at all effective.

20.5.4 Changes in response to over-indebtedness

Over half of stakeholders claimed that there had been no change in the last five years regarding responses to over-indebtedness, in terms of the measures used to alleviate its impact. One stakeholder highlighted that despite the introduction of consumer insolvency legislation there was still no effective way to deal with the problem of over-indebtedness. However, another interviewee indicated that over-indebtedness had now become an issue that was being analysed and addressed by policy.

20.5.5 Types of households of over-indebted consumers not reached by current measures

The majority of stakeholders did not feel able to comment on the question of whether particular types of over-indebted consumers were not reached by current measures. An independent expert considered that young people, in particular young families, were more likely to have financial problems and were not sufficiently taken into account by current measures.

20.5.6 Best practices

A few stakeholders were aware of measures that they would consider to represent best practice. For example, one independent expert mentioned that consumer insolvency and financial education were potentially very effective, but that their availability in Poland would have to be improved. In addition to this, two other practices were mentioned by stakeholders. One stakeholder, another independent expert, stressed the importance of monitoring and responding rapidly to the financial problems of households, such as by preparing a repayment scheme when households are still in the early stages of their difficulties. The other best practice that was recommended was to inform indebted households that they risked being entered into the credit register if they failed to pay back their debts within a certain time period.

20.6 OUTLOOK

Although in recent years the financial sector in Poland has been relatively "healthy", (according to one of the civil society stakeholders), the majority of stakeholders expected the number of over-indebted households to increase in the next five years. Many stakeholders linked this with the possibility of a deterioration in the general macro-economic situation, in particular in relation to unemployment, prices and wages. However, some stakeholders felt that the number of over-indebted households would remain stable. For example, one representative of a public authority argued that the number of over-indebted households had increased so sharply in recent years that it had probably peaked and would not continue to rise in the next five years.

Stakeholders listed many challenges for the Polish government in regard to the over-indebtedness of households. In particular, several stakeholders stressed the need for more control of unregulated lenders. One stakeholder, for example, indicated that these lenders frequently provided predatory loans with high-interest rates without doing sufficient credit checks. Additionally, stakeholders suggested improvements in consumer insolvency law and the provision of financial education. On the whole, stakeholders tended to feel that this action should be taken at the national level. A

minority of stakeholders also felt that legislation was necessary at the national level regarding housing and utilities, in order to reduce the costs of these for consumers.

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Final report

Over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact

ANNEX A: STATISTICAL DATA FROM EU SOURCES

Final report

Over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact

Poland

I. Eurobarometer¹

Poland EU average Lowest EU value Highest EU value

Households *at risk* of being over-indebted

Respondents feeling at risk of over-indebtedness in 2010	↘ 23%	25%	7%	52%
Respondents feeling at risk of over-indebtedness in 2009	↘ 21%	27%	9%	53%

II. EU SILC standard survey data²



III. EU SILC 2008 module: Over-indebtedness and financial exclusion³

Poland EU average Lowest EU value Highest EU value

Proportion of people in households with bank overdrafts, outstanding balances on credit cards or in arrears on other loans of over 100% of household disposable income

Overdrawn bank account (% of people in households overdrawn)	↘ 0.0%	2.2%	0.0%	7.7%
Credit or store card (% of people in households with outstanding balances)	:	1.1%	0.0%	8.6%
Other loan/credit payments (% of people in households in arrears)	:	0.3%	0.0%	1.1%

Proportion of people in households in arrears in servicing housing-related loans and bills and in paying other bills of over 100% of household disposable income

Housing bills (% of people in households in arrears)	↘ 0.0%	0.5%	0.0%	2.9%
Other payments (% of people in households in arrears)	:	0.4%	0.0%	1.7%

Households living with outstanding debts and/or arrears of over 100% of household disposable income

Total (% of households with outstanding debts/arrears)	↘ 0.0%	4.6%	0.0%	11.8%
Income above 60% median (% of households with outstanding debts/arrears)	↘ 0.0%	4.2%	0.0%	11.3%
Income below 60% median (% of households with outstanding debts/arrears)	↘ 0.2%	7.0%	0.2%	13.7%
Materially deprived (% of households with outstanding debts/arrears)	↘ 0.1%	9.0%	0.1%	27.4%

Proportion of those in broad age groups with outstanding debts of over 100% of household disposable income

Households with all adults aged 25-39 (% of households with outstanding debts)	↘ 0.0%	6.3%	0.0%	17.2%
Households with all adults aged: 40-64 (% of households with outstanding debts)	↘ 0.0%	5.8%	0.0%	10.9%
Households with all adults aged: 65+ (% of households with outstanding debts)	↘ 0.0%	1.2%	0.0%	2.8%

Proportion of those in different types of household with outstanding debts of over 100% of household disposable income

Living alone (% of people in households with outstanding debts)	↘ 0.1%	4.3%	0.0%	8.2%
Single parent (% of people in households with outstanding debts)	↘ 0.0%	9.5%	0.0%	27.1%
Other (% of people in households with outstanding debts)	↘ 0.0%	4.8%	0.0%	12.1%

Proportion of those in households with outstanding debts of over 100% of household disposable income by marital status

Never married (% of people in households with outstanding debts)	↘ 0.0%	5.0%	0.0%	15.4%
Married (% of people in households with outstanding debts)	↘ 0.0%	4.1%	0.0%	9.7%
Separated/divorced (% of people in households with outstanding debts)	↘ 0.1%	7.5%	0.1%	13.9%
Widowed (% of people in households with outstanding debts)	↘ 0.0%	1.7%	0.0%	4.3%

Proportion of those in households with outstanding debts of over 100% of household disposable income by housing tenure

Owner occupied without mortgage (% of people in households with outst. debts)	↘ 0.0%	3.2%	0.0%	9.6%
Owner occupied with mortgage (% of people in households with outst. debts)	↘ 0.0%	6.3%	0.0%	16.1%
Market rent (% of people in households with outstanding debts)	↘ 0.2%	8.2%	0.0%	16.0%
Subsidised rent (% of people in households with outstanding debts)	↘ 1.4%	8.7%	0.0%	17.9%
Rent-free housing (% of people in households with outstanding debts)	↘ 0.0%	2.3%	0.0%	15.1%

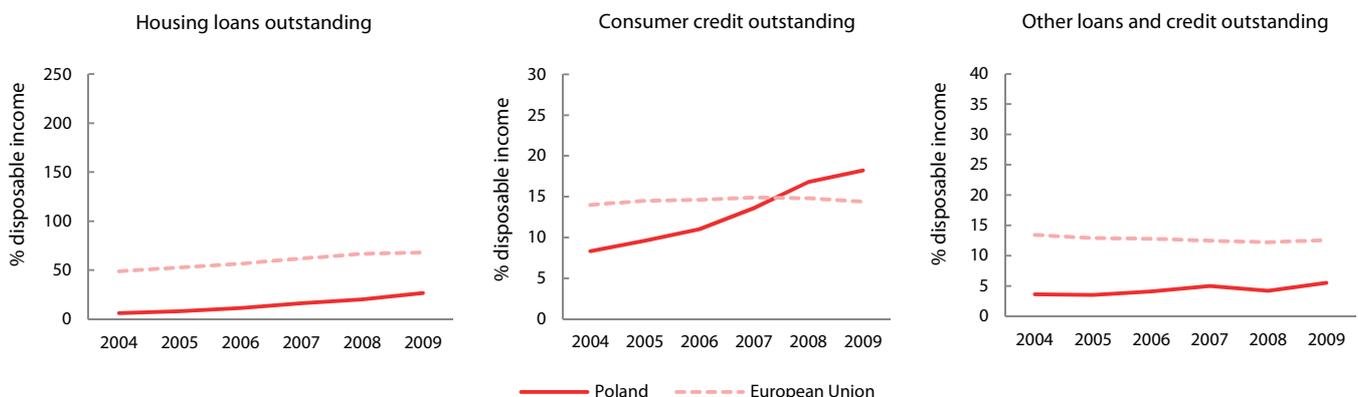
Proportion of those in households with outstanding debts of over 100% of disposable income by work intensity

Work intensity of 0 - 0.19 (% of people in households with outstanding debts)	↘ 0.2%	5.7%	0.0%	10.6%
Work intensity of 0.20 - 0.50 (% of people in households with outstanding debts)	↘ 0.0%	5.7%	0.0%	15.3%
Work intensity of 0.51 - 0.74 (% of people in households with outstanding debts)	↘ 0.0%	5.4%	0.0%	13.5%
Work intensity of 0.75 - 1.0 (% of people in households with outstanding debts)	↘ 0.0%	5.3%	0.0%	14.3%

Proportion of those in over-indebted households that experienced a major drop in income over the preceding year

Over-indebted (% of people in households that experienced drop in income)	:	33.3%	0.0%	77.6%
Other (% of people in households that experienced drop in income)	↘ 16.3%	19.2%	5.9%	32.5%

IV. Loans and credit outstanding⁴



Notes:

- (1) Eurobarometer 72.1 (2009) and Eurobarometer 74.1 (2010). Note: Those who answered 'very at risk' or 'fairly at risk' to the question 'Please tell me how much you feel at risk of being over-indebted'.
- (2) Eurostat, SILC. Data as of December 2012.
- (3) European Commission, Research Note 4/2010, Over-indebtedness new evidence from the EU-SILC special module.
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21 PORTUGAL

Document The over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact - Country report Portugal

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Final report

Over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact

21.1 DEFINITION OF OVER-INDEBTEDNESS

The majority of the interviewed stakeholders said that they did not use a specific definition of over-indebtedness. The main reasons for this are that they adopt a case-by-case approach and that they feel that current definitions of over-indebtedness are irrelevant for the purposes of their work.

More than half of those saying that they use a specific definition of over-indebtedness of individuals or households claimed that their definition is narrower than that used in this study, either because they only consider non-business debts or because they only provide help to a certain profile of over-indebted consumers (i.e. those whose financial difficulties are caused by external factors such as unemployment or illness).

Two thirds of stakeholders did not feel that there was a need for a better definition of over-indebtedness. This can be explained by the fact that most of them decide on a case-by-case basis. For example, one stakeholder commented:

We decide whether to mediate a possible arrangement between individuals/households and creditors depending on the situation (if the amount involved is not too high, if we have easy contact with the creditor, etc.).

However, almost half of stakeholders considered that it would be useful to introduce a definition of households at risk of over-indebtedness, in order to enable the early detection of over-indebtedness cases. This is particularly important as one of the most important barriers to the financial recovery of over-indebted households is that they only request help at a late stage.

21.2 LEVEL OF OVER-INDEBTEDNESS

Almost all stakeholders observed that the level of over-indebtedness in Portugal had increased significantly in the past five years.

This assessment is supported by data from EU-SILC, which shows an increase in the percentage of the population with arrears from 7% in 2007 to 10.2% in 2011. While this remains below the EU average of 11.4%, the gap between the two figures is smaller than in 2007, when the percentage of the EU population with arrears was 9.9%.⁷⁷²

Other indicators also suggest an increase in over-indebtedness. For example, data from the Ministry of Justice shows that there were 2231 cases of personal insolvency in the first quarter of 2012, compared to only 148 cases in the first quarter of 2008.⁷⁷³

⁷⁷² Eurostat, 'Percentage of total population with arrears' (code: ilc_mdcs05).

⁷⁷³ Direção-Geral da Política de Justiça, 'Boletim de Informação Estatística Trimestral 5. Estatísticas trimestrais sobre processos de falência, insolvência e recuperação de empresas (2007-2012)', 2012.

One civil society stakeholder that took part in an interview and provides advice to over-indebted households reported an increase in the number of households that received face-to-face advice on issues of debt from 1186 in 2008 to 9884 in 2011. The stakeholder also reported increases in the number of households advised by telephone or online.

Subjective indicators also tend to support an increase in households' financial distress in the period 2007 to 2011. While in 2007 the percentage of households having difficulties making ends meet was 37.5%, by 2011 this had risen to 41.8%. This is above the EU average of 25.6%.⁷⁷⁴ However, between 2009 and 2010 there was a slight decrease in the percentage of the Portuguese population that felt itself to be at risk of over-indebtedness (from 27% to 25%).⁷⁷⁵

Despite the increases in arrears and insolvency cases, as well as households having difficulties making ends meet, previous research shows that Portuguese households make much effort to keep repaying their debts to banks.⁷⁷⁶ They are willing to make sacrifices in their consumption patterns and to mobilise the support of friends and relatives to prevent credit default. This may have the effect of holding down credit default rates.

21.3 NATURE AND DRIVERS OF OVER-INDEBTEDNESS

21.3.1 Most common types of households that are over-indebted

Research shows that over-indebtedness is a problem affecting households of various educational, professional and income groups.⁷⁷⁷ This view is also suggested by the answers given by stakeholders, who listed a wide variety of households as commonly affected by over-indebtedness.

However, certain groups were considered by stakeholders to be more likely than others to be over-indebted. These included households between the ages of 25 and 64, households with children, households with at least one unemployed person, households with mortgages and households with a secondary school education. One stakeholder described the most common profile of an over-indebted household thus:

URL:http://www.dgpj.mj.pt/sections/siej_pt/destaques4485/sections/siej_pt/destaques4485/estatisticas-trimestrais8105/downloadFile/file/Insolv%C3%Aancias_trimestral_20120724.pdf?nocache=1343748154.65.

⁷⁷⁴ Eurostat, 'Inability to make ends meet' (code: ilc_mdcs09).

⁷⁷⁵ Special Eurobarometer 355, *Poverty and Social Exclusion Report*, 2010, p.42.

⁷⁷⁶ Frade, C., Lopes, C., Nogueira, C., Magalhães, S., & Brinca, P., 'Desemprego e sobreendividamento dos consumidores: Contornos de uma "ligação perigosa"', OEC/CES, 2006; Frade, C., Lopes, C., Jesus, F. & Ferreira, T., 'Um perfil dos sobreendividados em Portugal', OEC/CES, 2008.

⁷⁷⁷ Ibid.

The most common type of over-indebted households consists of people between the ages of 40 and 64. These people come to us most often and are generally middle-aged. They already have children and lots of commitments. They have several credits, a mortgage and educational bills. When one of them becomes unemployed, they struggle to pay off all their bills.

Data from EU-SILC supports the idea that households between the ages of 40 and 64 and households with mortgages are more likely to be over-indebted. It also shows that single parents, divorced/separated persons and households below the at-risk of poverty threshold are more commonly affected by over-indebtedness.⁷⁷⁸

However, in the past five years there have been some changes in the types of households most commonly affected by over-indebtedness. In particular, stakeholders reported that there has been an increase in the number of affected households with higher incomes and education levels and that would be seen as middle class. This is due to the effects of the crisis and increasing unemployment. Research shows that it is the middle class which is bearing the bulk of the cuts in income and social benefits.⁷⁷⁹ Their financial difficulties are triggering a domino effect as the ones who would usually support them (in particular their parents) are now having economic difficulties themselves.

21.3.2 Causes of households' over-indebtedness

Macro-economic factors

All stakeholders considered macro-economic factors to be an important cause of over-indebtedness, in particular unemployment level, wage level and social welfare level. Portugal is fulfilling an austerity program agreed with the European Union and the IMF that includes huge cuts in social benefits and in public servant salaries, tax increases and increased prices for transports and utilities. The Portuguese unemployment rate reached 15.8% in September 2012⁷⁸⁰ and the disposable income of private workers and civil servants has dropped considerably. Private consumption has fallen sharply and access to credit has decreased for both corporations and individuals.⁷⁸¹ The economy was in recession for three of the last six years and is forecast to shrink by a further 1.9% in 2013.⁷⁸²

⁷⁷⁸ Fondeville, N., Özdemir, E., and Ward, T., 'Over-indebtedness. New evidence from the EU-SILC special module', 2010,

⁷⁷⁹ Lopes, C., & Frade, C., 'The way into bankruptcy: Market anomie and sacrifice among Portuguese consumers', *Journal of Consumer Policy*, 35 (4), 477-496.

⁷⁸⁰ According to Statistics Portugal.

URL: http://www.ine.pt/xportal/xmain?xpid=INE&xpgid=ine_indicadores&indOcorrCod=0005599&selTab=tab0

⁷⁸¹ Bank of Portugal, Monthly Economic Indicators, 12/2012.

URL: http://www.bportugal.pt/en-US/EstudosEconomicos/Publicacoes/IndicadoresConjuntura/Publicacoes/ind_Dec_12_e.pdf. Direção-Geral da Política de Justiça, Destaque estatístico trimestral, Julho de 2012. URL:

Cost of living

In terms of the cost of living, the cost of utilities was chosen by almost all stakeholders as one of the most important causes of over-indebtedness. For example, one civil society stakeholder that offers advice to over-indebted households explained that it had experienced an increase in the number of households asking for help with the negotiation of electricity and water debts. Data from EU-SILC shows that there has been an increase in the percentage of the population with utility arrears between 2007 and 2011, from 5.2% to 6.7%.⁷⁸³

Other costs of living were also considered to be important causes of over-indebtedness by stakeholders, in particular housing costs, education costs and healthcare costs. Figures from Eurostat show that the HCIP in Portugal rose from 105.54 in 2007 to 112.72 in 2011, although this remains below the EU average of 115.38.⁷⁸⁴

Types of credit/loan taken out by households

Consumer credit and mortgages were identified by stakeholders as the most important causes of over-indebtedness in Portugal, in terms of the type of credit/loan taken out by households. In 2010, 19% of respondents to a survey indicated that there was a risk of them falling behind with their mortgage payments, while 22% felt that they might fail to meet the repayment of their consumer credits on time.⁷⁸⁵ A study from 2008 shows that some consumer credit is taken at high interest rates in order to repay other credits when households start to feel difficulties in fulfilling their financial obligations. This creates a “snowball” effect that eventually leads to a generalised default situation.⁷⁸⁶

Personal circumstances

In terms of personal circumstances, stakeholders most frequently considered a sudden drop in income as the result of unemployment or business failure to be an important cause of over-indebtedness. A majority of stakeholders also mentioned a drop in income as the result of other reasons (e.g. illness, divorce). Data from EU-SILC shows that 50.7% of over-indebted households in Portugal experienced a major drop

http://www.dgppj.mj.pt/sections/siej_pt/destaques4485/sections/siej_pt/destaques4485/estatisticas-trimestrais8105/downloadFile/file/Insolv%C3%A2ncias_trimestral_20120724.pdf?nocache=1343748154.65

⁷⁸² Eurostat, ‘Real GDP growth rate - volume’ (code: tec00115). The Portuguese economy shrunk in 2009, 2011 and 2012. It grew in 2007 and 2010.

⁷⁸³ Eurostat, ‘Arrears on utility bills’ (code: ilc_md07)

⁷⁸⁴ Eurostat, ‘HCIP (2005 = 100)’ (code: prc_hicp_aind)

⁷⁸⁵ Special Eurobarometer 355, *Poverty and Social Exclusion Report*, 2010, p. 46.

⁷⁸⁶ Frade, C., Lopes, C., Jesus, F. & Ferreira, T., ‘Um perfil dos sobreendividados em Portugal’, OEC/CES, 2008.

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in income in the preceding year, compared to only 24.9% of other households.⁷⁸⁷ This figure is also higher than percentage of over-indebted households in the EU as a whole that experienced a major drop in income in the preceding year (33.3%).

Additionally, stakeholders considered incapacity to deal with financial products, poor money management skills, stagnant or decreasing income while the costs of living steadily rise and poverty to be important causes of over-indebtedness.

21.3.3 Changes relevant for levels of over-indebtedness

Almost all stakeholders identified very significant changes in the general macro-economic situation during the last five years that have exacerbated households' financial difficulties. As discussed above, increases in unemployment rates and government austerity measures have placed many Portuguese households under financial pressure. In terms of economic developments that mitigate the level of over-indebtedness, stakeholders referred only to low EURIBOR rates. One independent expert stressed that this was particularly important as almost all mortgage loans contracted in Portugal are taken out with variable interest rates.⁷⁸⁸

In terms of lending practices, all stakeholders reported that there had been a significant change in the last five years. Before the economic crisis access to credit was much easier and lenders were less concerned with evaluating the borrower's ability to repay a loan. Competition was intense and bank employees had monthly commercial objectives to fulfil.⁷⁸⁹ However, banks today have adopted more stringent criteria for granting loans. They require more collateral, prefer short maturities, lowered loan-to-value ratio and increased spreads. These restrictions apply to new loans and to renegotiated contracts.⁷⁹⁰ One stakeholder commented:

About five years ago everybody had access to credit and mortgages. Everybody was changing their bank to have better options to take out consumer credit. Nowadays, it is very difficult to access credit. The banks are afraid and are only giving access to credit to people who are able to repay.

An additional change noted by stakeholders was the growing accumulation of debts related to utilities. As mentioned above, one civil society stakeholder had registered an increase in the number of households asking for help with the negotiation of water and electricity debts. Another stakeholder, an independent expert, linked the

⁷⁸⁷ Fondeville, N., Özdemir, E., and Ward, T., 'Over-indebtedness. New evidence from the EU-SILC special module', 2010, pp. 43 – 44.

⁷⁸⁸ See the National Program of Financial Training site.

URL: <http://www.todoscontam.pt/pt-PT/Principal/ContrairCredito/CreditoHabitacao/ContratarCH/Paginas/TaxaDeJuroFixaOuVariavel.aspx>.

⁷⁸⁹ Frade, C., 'A regulação do sobreendividamento', 2007.

⁷⁹⁰ Bank of Portugal, Bank Lending Survey, October 2012.

URL: http://www.bportugal.pt/en-US/EstudosEconomicos/Publicacoes/IBMC/Publications/Results_out12_e.pdf

increase in utility debts with social benefit cuts and increased unemployment, which were leaving people in a position where they could not afford to pay even basic expenses.

Finally, several stakeholders pointed to regulatory changes that had taken place in the last five years. In 2009 Directive 2008/48/EC on credit agreements for consumers and repealing Council Directive 87/102/EEC was transposed into Portuguese law (Decree-Law 133/2009). Among other things, this law obliged credit institutions to provide a standardized information sheet at the pre-contractual stage and to assess the creditworthiness of potential borrowers. Another law passed in the same year led to the creation of the Mediador do Crédito, which is appointed by the government to assist households with the restructuring of their loans (Decree-Law 144/2009). Legislation was also introduced in relation to housing, such as Decree-Law DL 103/2009, which provides emergency credit to keep households in their own homes in case of unemployment.

21.3.4 Cultural attitude towards debt and actual level of households' (over-)indebtedness

Until the early 1990s access to credit in Portugal was restricted.⁷⁹¹ Feelings towards credit and indebtedness tended to be negative. However, with changes in financial markets the use of credit became more widespread and the traditional aversion to credit softened. This increasing acceptance of credit was counterbalanced by a deep sense of honouring own commitments (*pacta sunt servanda*), which helped to prevent widespread credit default.

Several stakeholders, the majority of whom observed that there was a relationship between cultural attitude to debt and the actual level of (over-)indebtedness in Portugal, criticized what they considered to be an overly relaxed attitude to debt in Portugal. For example, one independent expert referred to the “illusion of easy consumption without consequences”, while another stakeholder commented that people were used to spending and not to saving. Nonetheless, other stakeholders reported there was a stigma attached to debt in Portugal that helped keep levels of indebtedness lower than they would be otherwise. One stakeholder observed that attitudes towards debt had previously been too lax, but were changing slowly again as the result of the economic crisis.

Another stakeholder, an independent expert, raised the possibility that the social stigma attached to debt could in fact be responsible for increased levels of over-indebtedness, as households chose to take on more debt to repay existing loans, rather than taking more appropriate measures.

⁷⁹¹ Marques, M. M., Neves, V., Frade, C., Lobo, F., Pinto, P., & Cruz, C. *Endividamento dos Consumidores*. Almedina. 2000.

21.4 CONSEQUENCES OF OVER-INDEBTEDNESS

21.4.1 Consequences for affected households

According to the stakeholders, the most important consequences of over-indebtedness for affected households were deterioration of well-being, home repossession and reduced standard of living. However these were closely followed by negative impacts on family relationships, employment and mental health. One stakeholder, an independent expert, indicated that social isolation and lack of access to cultural and leisure activities should be seen as important consequences for affected households. The stakeholder also pointed to lost education opportunities for children living in over-indebted households.

Those who are unable to repay their mortgages often lose their homes, either because they voluntarily settle the house to the creditor expecting to liquidate the mortgage or because they are declared bankrupt and the dwelling is not protected from seizure.⁷⁹² In most cases the house is the only asset belonging to the debtor with economic value, but this does not mean that other assets are protected from seizure. Portuguese law establishes very few exemptions, which means that debtors declaring insolvency may lose all their assets.

21.4.2 Consequences of over-indebtedness for the financial services industry

According to stakeholders, the most important consequences of over-indebtedness for the financial services industry are the costs of defaulted credits for creditors and lower demand for credits because of higher risk premiums. These were closely followed by the costs of arrears and agreed repayment/debt management plans for creditors and increased costs for financial services providers through stricter regulation of credit.

Despite the agreement among stakeholders that the costs of defaulted credits for creditors were the most important consequence for the financial services industry, one public authority stakeholder indicated that there were several factors mitigating the impact of credit default:

[T]he impact of households' credit default on the financial sector is mitigated by several factors. Mortgage loans, particularly loans for the purchase of the first home, in which the probability of default is lower, account for the major part of household credit. Moreover, a significant proportion of young households' mortgages have personal guarantees provided by family members. Additionally, the debt of the most vulnerable households, notably the young/low income, represents a relatively small proportion of the banking sector's credit portfolio.

⁷⁹² According to APEMIP, during the first nine months of 2012, 4.400 homes were settled to banks by households, real estate promoters and builders. URL: <http://www.apemip.pt/Not%C3%ADcias/tabid/121/language/pt-PT/Default.aspx>.

Finally, in Portugal house prices have evolved more or less in line with inflation so that there was not a sharp fall in prices after the beginning of the crisis.

21.4.3 Economic and social consequences of over-indebtedness for society

Considering the impacts of over-indebtedness on society, stakeholders considered the most important to be the costs related to the provision of an alternative dwelling for those losing their homes, the loss of labour productivity, and the legal costs associated with over-indebtedness. The loss of consumer confidence in the financial services industry, costs associated with assisting households to repay debts/arrears, cost for other measures to alleviate the impact of over-indebtedness and the increased use of health care services due to poor mental or physical health were also considered to be important. Recent research also shows these factors to be important, and additionally identifies costs related to increased use of social benefits as an important socio-economic consequence of over-indebtedness.⁷⁹³ There is also evidence that debt advice services are under a considerable amount of pressure due to a sharp increase in demand. Most do not receive any financial support from the state so they see their budgets being stretched to overcome the requests.⁷⁹⁴

21.4.4 Debt collection practices

The majority of stakeholders reported a significant increase in the use of aggressive debt collection practices in the past five years. One stakeholder from a public authority linked this with an increase in the volume of overdue debt in this period. Two stakeholders indicated that there was a trend towards the outsourcing of debt collection to third parties. For example, one of these commented:

Creditors first send a letter to their clients and then they hire debt collection agencies, which have come from nowhere. Suddenly there are hundreds of them that work for several companies.

Debt collection is an unregulated activity in Portugal and stakeholders reported that some debt collection agencies resort to abusive collection practices, such as phone calls to debtors' workplace or neighbours and relatives, repeated telephone calls, telephone calls at night or threats to seize the assets immediately (without any court order). One stakeholder commented that debtors often felt very pressured and scared by the activity of debt collection agencies. This stakeholder also commented that abusive collection practices were more frequent in the collection of overdue consumer credit than in the collection of overdue mortgages.

⁷⁹³ Frade, C., Lopes, C., Jesus, F. & Ferreira, T., 'Um perfil dos sobreendividados em Portugal', OEC/CES, 2008.

⁷⁹⁴ Eurofound, 'Household debt advisory services in the European Union', Dublin, 2012.

21.5 MEASURES IN FORCE TO ALLEVIATE THE IMPACT OF OVER-INDEBTEDNESS

21.5.1 Early identification of households at risk

Less than half of stakeholders considered that measures to identify at-risk households early were common in Portugal. According to one public authority stakeholder, financial institutions assess the risk and the creditworthiness when granting credit, but they hardly have any follow-up mechanisms. This helps to explain why the majority of households seeking support from debt advice services come when they are already in an extreme situation, with several credits in arrears and emotionally shattered.

In interviews conducted with indebted persons for other studies, interviewees reported that they contacted their credit institutions because they felt at risk of getting into arrears (e.g. they had lost their job) and the creditors refused to renegotiate because the debtors were still paying the instalments.⁷⁹⁵ However, a new regulation was recently adopted to prevent this from occurring. According to Decree-Law, n. 227/2012, of 25th October 2012, financial institutions are compelled to renegotiate new and affordable payment conditions with those clients considered to be at risk of default.

21.5.2 Advice offered to over-indebted households

According to stakeholders, the most common types of personalised debt advice in Portugal are those provided face-to-face or by telephone. Email advice is less widespread and web-based tools and printed information are rarely available.⁷⁹⁶ The most important debt advisory services usually combine two or more of these channels. For instance, telephone and email are often the chosen channels for the first contact of the debtor with the debt advisory service. In many cases this is then followed by a face-to-face session.

Personal contact has several advantages for debt advisors: it allows them to verify the information provided by the over-indebted person on the phone or internet, it gives an opportunity for the provision of emotional support to the debtor and, finally, it reinforces the commitment of the debtor to the strategy established by the debt advisor. However, the existence of other forms of debt advice (such as by telephone or on the Internet) is important, as it allows for individual consumer needs and can provide help to over-indebted households from a wide geographical range.

⁷⁹⁵ Frade, C., Lopes, C., Nogueira, C., Magalhães, S., & Brinca, P., 'Desemprego e sobreendividamento dos consumidores: Contornos de uma "ligação perigosa"', OEC/CES, 2006 ; Frade, C., Lopes, C., Jesus, F. & Ferreira, T., 'Um perfil dos sobreendividados em Portugal', OEC/CES, 2008.

⁷⁹⁶ DECO released its web portal for over-indebted consumers last July (<http://www.gasdeco.net/>).

In addition to free debt advice services provided by consumer associations, a small percentage of municipalities provide free of charge advice to local citizens facing economic hardship. Some of these have established partnerships with consumer associations, which help in providing counselling services.

Furthermore, the last five years have seen the proliferation of fee-charging companies offering debt counselling, as the result of the deterioration in the financial situation of Portuguese households. These services are currently not subject to any regulatory framework and there is some doubt about the quality of the services they provide. Suspected fraudulent activities have been reported to consumer organisations and the Bank of Portugal.

The Decree-Law, n. 227/2012, of 25th October 2012, referred to above, does represent a partial response to this issue, in that it foresees the creation of a network of debt advice services certified by public authorities. However, its details remain unknown, as does the future of the services that are not eligible for that network. Moreover, the institutions belonging to the network would be prohibited from renegotiating on behalf of the debtor.

Demand for debt advice as assessed by stakeholders

Debt advice services are facing a growing demand by households in financial difficulties, especially in the last two years, during which the crisis has become more salient. A majority of stakeholders indicated that demand for debt advice had very much increased in the last five years.

One independent expert commented that the increased demand for debt advice meant that counsellors had less time to spend with the over-indebted persons. The expert also indicated that increased demand had led to an increase in the number of fee-charging debt advice organisations.

Effectiveness as assessed by stakeholders

Face-to-face personalised debt advice was judged to be the most effective type of debt advice by stakeholders. This was followed by personalised debt advice by telephone. Stakeholders were most sceptical about the positive effect of web-based tools targeted at over-indebted households. However, this can perhaps be partially explained by the low availability of these in Portugal (as assessed by stakeholders).

Funding of debt advice

Stakeholders tended to feel that the funding of debt advice services was insufficient. They suggested that there should be more public investment and/or that there should be funding from the private sector for such services.

It is worth noting that the institutions included in the network established by Decree-Law, n. 227/2012, of 25th October 2012, will receive some funding from the national government (up to 80% of its total budget).

21.5.3 Key measures in place to alleviate the impact of over-indebtedness

A variety of measures are in place in Portugal to alleviate the impact of over-indebtedness.

Almost all stakeholders indicated that informally brokered arrangements were widely or partly available in Portugal. These tend to be free or very cheap when arranged by consumer associations or other social institutions, but are more expensive when mediated by specialised companies. In terms of their effectiveness, stakeholders expressed a range of opinions. The majority considered that they were very or fairly effective, but a few indicated that they were hardly effective. One difficulty is to convince people to seek help at an early stage and not when they are already in an advanced situation of financial and emotional distress. One public authority stakeholder commented:

[A] restructuring of debts that results in lower instalments (e.g. longer repayment period, consolidation of debts) which are affordable to the consumer is an effective measure. [However, t]hese types of measures may be difficult to apply for when the customer has too many credits and/or has been in arrears for too long before seeking for help.

In addition to informal arrangements, there are formal procedures for debt settlement that are available. The 2004 Bankruptcy Code prescribes that an insolvent debtor may propose a repayment plan to the creditors in order to avoid bankruptcy. However, this mechanism has failed to be effective, because debtors do not frequently choose this solution (they rarely have significant assets that they wish to protect), and because creditors nearly always refuse to accept the proposal.

Recently, legislation has been adopted to protect the homes of unemployed persons from repossession. According to Law n.60/2012, of 9th November 2012, houses can only be sold if the debtor has no other assets of a value sufficient to repay the amount due. Debtors can use their private pension plans to repay mortgages in case of arrears (Law n. 57/2012, of 9th November 2012) and creditors can only apply for foreclosure after three month of arrears (Law n.59/2012, of 9th November 2012). Debtors in economic hardship, due to specific reasons such as unemployment, are entitled to reschedule their payments with the mortgage lender (Law n.58/2012, of 9th November 2012).

In terms of financial support for households to repay overdue debts, social services sometimes provide an allowance towards the payment of rent, public utilities or school expenses. However, they do not help with the repayment of credits to banks. Moreover, these social benefits are infrequent, of a low level and mainly focus on the

most deprived households. They are out of reach of the increasingly impoverished middle class, precisely the social strata most affected by unemployment and the austerity measures in recent years.

Finally, over-indebted households in Portugal can make use of legal measures, in particular consumer insolvency proceedings. These are widely available, but they can be expensive. Unless a family is entitled to legal aid, which is not assured, court and legal fees can prevent many from accessing this instrument. One independent expert pointed out that the application for legal aid can be a slow and difficult process.

21.5.4 Changes in response to over-indebtedness

The majority of stakeholders observed that there had been changes in responses to over-indebtedness in the last five years. However, they focused on social or market responses and did not underline any particular legal measures.⁷⁹⁷ For example, one independent expert reported that more debt counselling services had appeared and that municipalities were increasing food support to households in more serious difficulties. One stakeholder from the financial services industry also pointed to the increased readiness of financial institutions to renegotiate contract terms.

In addition to the changes mentioned by stakeholders, there have been a variety of regulatory changes introduced in the last five years, as mentioned in Section 21.3.3.

21.5.5 Types of households of over-indebted consumers not reached by current measures

Around half of stakeholders considered that there were specific types of over-indebted consumers beyond the reach of current measures to deal with over-indebtedness. For example, they indicated that some households were not reached due to their geographical remoteness from debt advice services. Although the provision of debt advice on the internet helps to solve this problem, there are some groups without access to the internet.

21.5.6 Best practices

Very few stakeholders were aware of measures in place that could be considered best practice. Those who were able to suggest measures highlighted informal debt renegotiation arrangements and the provision of legal and psychological support.

⁷⁹⁷ We must take into account that interviews were made before the adoption of the aforementioned regulation (Decree-Law n. 227/2012, of 25th October 2012 and Laws n.º 57, 58, 59 and 60 of 9th November 2012). For that the responses don't reflect these new rules.

Some preventive measures like financial education and budgeting advice were also considered to represent best practice.⁷⁹⁸

21.6 OUTLOOK

Almost all the stakeholders expected an increase in the number of over-indebted households, particularly in the next two years. They based this on the harsh economic conditions that are expected in the coming years, due to the crisis and the austerity measures adopted in the country, and in particular on the expected increase in unemployment. These adverse circumstances are also expected to reduce the room for out of court renegotiation of the debts. One public authority stakeholder commented:

Although there is no specific research on the issue, it is likely that the number of over-indebted households increase will tend to increase in the next two years, due to a further deterioration of the macroeconomic situation in 2012, with a new reduction of disposable income. But it is expected to stabilize afterwards, partly as a result of more restrictive lending conditions.

Almost all stakeholders agreed that there were challenges that needed to be met by policy makers. Some stakeholders considered that it was necessary to make changes of a non-regulatory nature, such as with policies to promote economic growth and job creation. However, more frequently stakeholders stressed the need for new regulation. Some of the policies suggested by stakeholders were measures to better protect homes from repossession and to detect the risk of default. Several stakeholders reported that there was a need for more transparent and responsible lending behaviour by credit institutions. A majority of stakeholders indicated that changes in the regulation of utilities was required, for example to protect vulnerable households.

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⁷⁹⁸ Recently, the Bank of Portugal, the Portuguese Securities Market Commission and the Insurance and Pension Funds Supervisory Authority launched a National Program of Financial Training. See <http://www.todoscontam.pt/pt-PT/Principal/Paginas/Homepage.aspx>.

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ANNEX A: STATISTICAL DATA FROM EU SOURCES

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Over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact

Portugal

I. Eurobarometer¹

Portugal EU average Lowest EU value Highest EU value

Households *at risk* of being over-indebted

Respondents feeling at risk of over-indebtedness in 2010	➔ 25%	25%	7%	52%
Respondents feeling at risk of over-indebtedness in 2009	➔ 27%	27%	9%	53%

II. EU SILC standard survey data²



III. EU SILC 2008 module: Over-indebtedness and financial exclusion³

Portugal EU average Lowest EU value Highest EU value

Proportion of people in households with bank overdrafts, outstanding balances on credit cards or in arrears on other loans of over 100% of household disposable income

Overdrawn bank account (% of people in households overdrawn)	➔ 0.5%	2.2%	0.0%	7.7%
Credit or store card (% of people in households with outstanding balances)	➔ 0.1%	1.1%	0.0%	8.6%
Other loan/credit payments (% of people in households in arrears)	➔ 0.1%	0.3%	0.0%	1.1%

Proportion of people in households in arrears in servicing housing-related loans and bills and in paying other bills of over 100% of household disposable income

Housing bills (% of people in households in arrears)	➔ 0.2%	0.5%	0.0%	2.9%
Other payments (% of people in households in arrears)	➔ 0.1%	0.4%	0.0%	1.7%

Households living with outstanding debts and/or arrears of over 100% of household disposable income

Total (% of households with outstanding debts/arrears)	➔ 1.0%	4.6%	0.0%	11.8%
Income above 60% median (% of households with outstanding debts/arrears)	➔ 0.8%	4.2%	0.0%	11.3%
Income below 60% median (% of households with outstanding debts/arrears)	➔ 1.7%	7.0%	0.2%	13.7%
Materially deprived (% of households with outstanding debts/arrears)	➔ 3.5%	9.0%	0.1%	27.4%

Proportion of those in broad age groups with outstanding debts of over 100% of household disposable income

Households with all adults aged 25-39 (% of households with outstanding debts)	➔ 1.2%	6.3%	0.0%	17.2%
Households with all adults aged: 40-64 (% of households with outstanding debts)	➔ 1.6%	5.8%	0.0%	10.9%
Households with all adults aged: 65+ (% of households with outstanding debts)	➔ 0.0%	1.2%	0.0%	2.8%

Proportion of those in different types of household with outstanding debts of over 100% of household disposable income

Living alone (% of people in households with outstanding debts)	↘ 0.5%	4.3%	0.0%	8.2%
Single parent (% of people in households with outstanding debts)	↘ 6.9%	9.5%	0.0%	27.1%
Other (% of people in households with outstanding debts)	↘ 0.8%	4.8%	0.0%	12.1%

Proportion of those in households with outstanding debts of over 100% of household disposable income by marital status

Never married (% of people in households with outstanding debts)	↘ 0.9%	5.0%	0.0%	15.4%
Married (% of people in households with outstanding debts)	↘ 0.5%	4.1%	0.0%	9.7%
Separated/divorced (% of people in households with outstanding debts)	↘ 3.8%	7.5%	0.1%	13.9%
Widowed (% of people in households with outstanding debts)	↘ 0.3%	1.7%	0.0%	4.3%

Proportion of those in households with outstanding debts of over 100% of household disposable income by housing tenure

Owner occupied without mortgage (% of people in households with outst. debts)	↘ 0.2%	3.2%	0.0%	9.6%
Owner occupied with mortgage (% of people in households with outst. debts)	↘ 2.1%	6.3%	0.0%	16.1%
Market rent (% of people in households with outstanding debts)	↘ 1.3%	8.2%	0.0%	16.0%
Subsidised rent (% of people in households with outstanding debts)	↘ 1.7%	8.7%	0.0%	17.9%
Rent-free housing (% of people in households with outstanding debts)	↘ 0.1%	2.3%	0.0%	15.1%

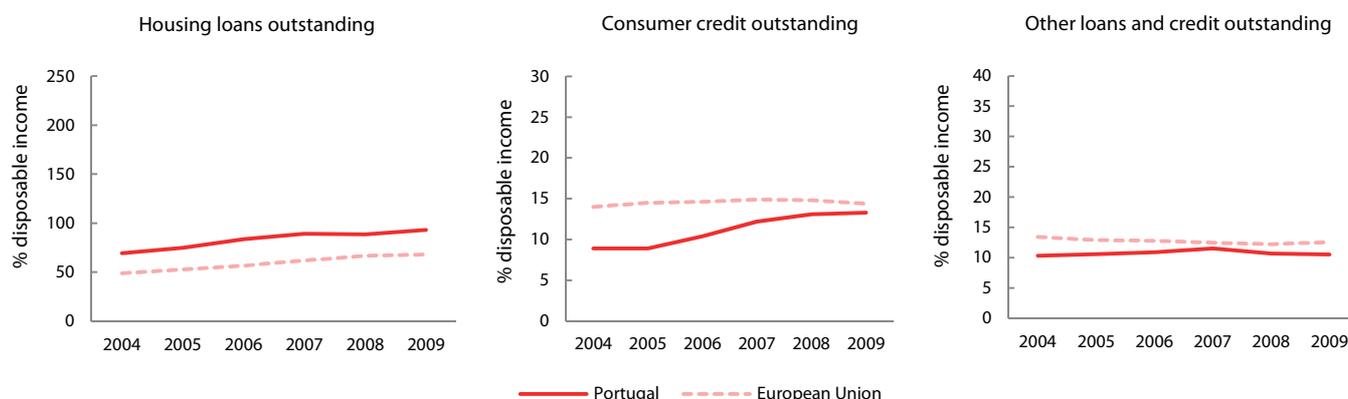
Proportion of those in households with outstanding debts of over 100% of disposable income by work intensity

Work intensity of 0 - 0.19 (% of people in households with outstanding debts)	↘ 2.0%	5.7%	0.0%	10.6%
Work intensity of 0.20 - 0.50 (% of people in households with outstanding debts)	↘ 1.3%	5.7%	0.0%	15.3%
Work intensity of 0.51 - 0.74 (% of people in households with outstanding debts)	↘ 1.2%	5.4%	0.0%	13.5%
Work intensity of 0.75 - 1.0 (% of people in households with outstanding debts)	↘ 0.8%	5.3%	0.0%	14.3%

Proportion of those in over-indebted households that experienced a major drop in income over the preceding year

Over-indebted (% of people in households that experienced drop in income)	↗ 50.7%	33.3%	0.0%	77.6%
Other (% of people in households that experienced drop in income)	↗ 24.9%	19.2%	5.9%	32.5%

IV. Loans and credit outstanding⁴



Notes:

(1) Eurobarometer 72.1 (2009) and Eurobarometer 74.1 (2010). Note: Those who answered 'very at risk' or 'fairly at risk' to the question 'Please tell me how much you feel at risk of being over-indebted'.

(2) Eurostat, SILC. Data as of December 2012.

(3) European Commission, Research Note 4/2010, Over-indebtedness new evidence from the EU-SILC special module.

(4) European Commission, Research Note 4/2010, Over-indebtedness new evidence from the EU-SILC special module. European Credit Research Institute (ECRI), Lending to households in Europe, 1995-2009 and Eurostat, National accounts.

22 ROMANIA

<i>Document</i>	The over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact - Country report Romania
<i>Prepared by</i>	François Lejeune, Dominique Spaey (Van Dijk Management Consultants)
<i>Finalised on</i>	17 January 2013

Final report

Over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact

22.1 DEFINITION OF OVER-INDEBTEDNESS

A variety of definitions of over-indebtedness were used by the stakeholders who took part in interviews for the study. In three cases, stakeholders based their definition on the debt-to-income ratio (DTI). However, there was not a consensus on how high this ratio could be before it became an indicator of over-indebtedness. For example, one industry stakeholder stated that a level of debt amounting to around 50 to 60% of monthly income was an indicator of over-indebtedness, while an independent expert stated that a DTI of 35% was already too high.

In addition to definitions of over-indebtedness as a ratio of debt to income, several other definitions were used by the interviewed stakeholders. For example, one stakeholder from the financial industry suggested that a person could be seen as over-indebted if they were having difficulties servicing their debts (i.e. they had arrears or were sacrificing basic needs in order to meet their payments). Another stakeholder, an independent expert, suggested that it could be an indicator for over-indebtedness if a household's debts were higher than its assets.

The majority of stakeholders mentioned there was a need for a better definition of over-indebtedness, as well as a better definition of being at risk of over-indebtedness. For example, one independent expert stressed that if there was an accepted definition of over-indebtedness it would be possible to track its prevalence and consequently prevent its occurrence. However, one civil society stakeholder who supported the introduction of an official definition also mentioned there were risks involved:

My personal opinion is that such situations [i.e. financial difficulties] are so common in Romania that any attempt to define household over-indebtedness would somehow limit or underestimate the situation of most people who have difficulties in paying their day to day bills. However, I do feel that there is a need to define or distinguish between debt categories.

22.2 LEVEL OF OVER-INDEBTEDNESS

It is difficult to draw a clear picture of over-indebtedness in Romania today, as there is no official definition of the term, nor any official statistics on the number of households which are over-indebted. Nonetheless, almost all stakeholders acknowledged that over-indebtedness had increased significantly in the last five years.

This is also supported by statistics from EU-SILC, which show a threefold increase in the percentage of the population with arrears between 2007 and 2011 (10.1% to 30.2%), with the largest annual increase between the years 2007 and 2008 (10.1% to

25.4%).⁷⁹⁹ According to a stakeholder from the financial industry, this upwards trend is confirmed by the data from the Biroul de Credit, which indicates an increase in the number of people with more arrears of more than 30 days from 410,000 in October 2008 to 720,000 by the end of 2010. However, this figure did decrease somewhat to 690,000 by December 2011.

Figures from the Bank of Romania's 2012 Financial Stability Report show that household indebtedness as a ratio of liabilities to disposable income increased significantly between 2007 and 2011. The ratio of liabilities to disposable income increased from approximately 50% in 2007 to more than 70% in 2011. If one goes back as far as 2003 the increase is even more significant, from less than 10%.⁸⁰⁰

Subjective indicators also suggest an increase in indebtedness in the last few years. Between 2009 and 2010 there was an increase in the percentage of the population who felt at risk of being over-indebted from 40% to 47%.⁸⁰¹ However, the percentage of the population who described themselves as unable to make ends meet did not increase during the period under question. Indeed, during the period 2007 to 2011 this figure decreased slightly, from 49.3% to 48.5%.⁸⁰²

In comparison with other EU countries, over-indebtedness in Romania appears to be quite high. For example, the percentage of the population feeling at risk of over-indebtedness in 2010 was more than 20 percentage points higher than the EU average (25%).⁸⁰³ The percentage of the population with arrears in 2011 was almost three times the average across the EU (11.4%).⁸⁰⁴ Nonetheless, the ratio of debt to disposable income remains somewhat less than the level in the Eurozone, which was approaching 100% in 2011.⁸⁰⁵

22.3 NATURE AND DRIVERS OF OVER-INDEBTEDNESS

22.3.1 Most common types of households that are over-indebted

According to stakeholders, the types of household most likely to be affected by over-indebtedness were households in owner-occupied housing with mortgages, households with two unemployed persons and households between the ages of 25 and 39. The group of households considered least likely to be over-indebted were

⁷⁹⁹ Eurostat, 'Percentage of total population with arrears (mortgage or rent, utility bills or hire purchase)' (code: ilc_md05).

⁸⁰⁰ National Bank of Romania, 'Financial Stability Report', 2012, p. 123.

⁸⁰¹ Special Eurobarometer 355, 'Poverty and Social Exclusion Report, 2010, p. 42.

⁸⁰² Eurostat, 'Inability to make ends meet' (code: ilc_md09).

⁸⁰³ Special Eurobarometer 355, 'Poverty and Social Exclusion Report, 2010, p. 42.

⁸⁰⁴ Eurostat, 'Percentage of total population with arrears (mortgage or rent, utility bills or hire purchase)' (code: ilc_md05).

⁸⁰⁵ National Bank of Romania, 'Financial Stability Report', 2012, p. 123.

households not at risk of poverty (i.e. with an income of more than 60% of the median income).

Figures from the National Bank of Romania show that low income households are more likely to be over-indebted than those with higher incomes. In June 2012 the ratio of non-performing consumer loans among households with a monthly income of less than 700 Romanian Lei was almost one quarter. This was higher than the percentage in all other income categories and double the percentage in the next highest category (households with a monthly income of between 700 and 1500 Romanian Lei).⁸⁰⁶

Data from EU-SILC shows that in 2008 the group most likely to be affected by over-indebtedness in Romania, when grouped according to housing tenure, was households living in subsidised rented accommodation (8.5% with outstanding debts of over 100% of household disposable income). Among households in owner-occupied housing with mortgages this figure was only 2.5%.⁸⁰⁷ However, several stakeholders pointed to an increase in problematic mortgages in the last few years. This is confirmed by data from the National Bank of Romania which shows that there was an increase in the ratio of non-performing mortgage loans between December 2010 and June 2012, from 5.9% to 8.5%.⁸⁰⁸ Stakeholders linked this to fluctuations in exchange rates (as mortgage loans had frequently been taken out in foreign currency) as well as a deterioration in the economic situation.

In terms of age, households between the ages of 25 and 39 were considered to be most affected by over-indebtedness, closely followed by households below the age of 25. This is consistent with EU-SILC data on the at-risk-of-poverty rate in Romania, which shows households below the age of 25 and between the ages of 25 and 49 to be the most at risk.⁸⁰⁹ A few stakeholders linked the increased prevalence of over-indebtedness among younger households with the fact they were more likely to be affected by unemployment and salary cuts. For example, one stakeholder from the financial industry commented:

According to central bank reports, people under 25 years are the most affected by arrears on loans. In general, they have troubles repaying consumer loans (the non-performing loans ratio reached 25% in June 2011). Central bank reports show a strong correlation between non-performing loans and the unemployment rate. In the case of people under 25 years of age, the unemployment rate is the highest (near 25%). People between the ages of 25 and 45 are also exposed to over-indebtedness. In this case, the rate of non-performing loans is over 10% (for consumer loans).

⁸⁰⁶ National Bank of Romania, 'Financial Stability Report', 2012, p.124.

⁸⁰⁷ Fondeville, N., Özdemir, E., and Ward, T., 'Over-indebtedness. New evidence from the EU-SILC special module', 2010, p.39.

⁸⁰⁸ National Bank of Romania, 'Financial Stability Report', 2012, p.132.

⁸⁰⁹ Eurostat, 'At-risk-of-poverty rate, by age group' (code: tsdsc230).

Final report

Over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact

22.3.2 Most important causes of households' over-indebtedness

Three macro-economic factors were identified by stakeholders as the most important causes of (over-)indebtedness in Romania. The combination of these factors which appeared during the crisis has increased the level of (over-)indebtedness in the country since 2008, according to stakeholders.

Firstly, the Romanian government implemented significant cuts in public spending, starting with a 25% decrease cut in wages paid to all public sector employees.⁸¹⁰ The government also raised VAT by 5%, from 19% to 24%.⁸¹¹ These measures were accompanied by cuts in social welfare. According to one civil society stakeholder, the wage cut implemented in the public sector "induced a similar reaction in the private sector" which led to a general decrease in the level of income in the country.

Secondly, unemployment has increased in recent years, from 6.4% in 2007 to 7.4% in 2011.⁸¹² Young people in particular are the most affected by unemployment (23.7% of people below the age of 25 were unemployed in 2011).⁸¹³ Overall, unemployment rates in Romania were lower than the EU average in 2011 (9.7%), yet several stakeholders considered unemployment to be an important cause of over-indebtedness.⁸¹⁴

Thirdly stakeholders highlighted movements in exchange rates as a major cause of over-indebtedness. Foreign currency loans represented 68% of total loans in Romania in June 2012.⁸¹⁵ These were mainly denominated in Euro and, to a lesser extent, in Swiss Francs.⁸¹⁶ During the crisis, the Romanian Leu depreciated in value, meaning that repayments for loans in foreign currency were revised upwards. The value of the Euro in relation to the Romanian Leu rose from 3.13 in July 2007 to 4.5 in July 2012.⁸¹⁷

Finally, three interviewees pointed to the end of the communist era in Romania as playing a major role in terms of increasing (over-)indebtedness in the country. Firstly, under communism, banking services were virtually non-existent. Therefore, people were not educated about financial services and consumer protection was not (and, according to some stakeholder, is still not) a priority. Secondly, with the opening of the domestic market that followed the fall of communism, people wanted to own

⁸¹⁰ Government of Romania, 'Letter of Intent', 16 June 2010.

⁸¹¹ Government of Romania, 'Supplementary Letter of Intent', 29 June 2010.

⁸¹² Eurostat, 'Unemployment as percentage of the labour force' (code: tsdec450).

⁸¹³ Eurostat, 'Unemployment rate by age group' (code: tsdec460)

⁸¹⁴ Eurostat, 'Unemployment as percentage of the labour force' (code: tsdec450).

⁸¹⁵ National Bank of Romania, 'Financial Stability Report', 2012, p.14.

⁸¹⁶ National Bank of Romania, 'Financial Stability Report', 2012, p.128.

⁸¹⁷ European Central Bank, Euro exchange rates RON, available online at <http://www.ecb.int/stats/exchange/eurofxref/html/eurofxref-graph-ron.en.html>

their home and buy household electrical goods. The combination of both factors led to relatively high level of (over-)indebtedness in the country.

22.3.3 Changes relevant for levels of over-indebtedness

As explained above, the crisis has had a major negative impact on the level of over-indebtedness in Romania through an increase in unemployment, a decline in incomes (e.g. the salary cut of 25% in the public sector) and the depreciation of the Romanian Leu (which had strong negative effects on loan repayments).

In order to alleviate over-indebtedness in the country, the Romanian government has adopted measures to protect consumers and reduce access to loans (in particular, the Ordonanta de Urgenta⁸¹⁸ nr 50/2010 - OUG50/2010). Two changes introduced by OUG50/2010 (which transposes Directive 2008/48/EC on credit agreements for consumers and repealing Council Directive 87/102/EEC in national legislation) are the abolition of early repayment fees for credit with variable rates and the calculation of interest rates based on a transparent benchmark index (EURIBOR, ROBOR, LIBOR, etc.), to which a fixed margin can be added.⁸¹⁹ The law OUG50/2010 also introduced the mandatory assessment of a customer's creditworthiness by the lenders.⁸²⁰ But, according to one stakeholder, these measures were introduced too late, so that their effects on the current level of over-indebtedness in the country cannot be assessed.

22.3.4 Cultural attitude towards debt and actual level of households' (over-)indebtedness

There was no consensus among stakeholders regarding the question of whether there is a relationship between cultural attitude towards debt and the actual level of households' (over-)indebtedness in Romania. However, around half of stakeholders indicated that there was such a relationship. Two stakeholders contrasted the period before 1989 with the period that came after. According to these stakeholders, being debt-free was natural before 1989, as the banking system was virtually non-existent and saving was the only way to purchase expensive goods. To be indebted was virtually unknown and people had an aversion to debt, according to these stakeholders. However, after the end of the communist era, this aversion tended to disappear and people started to see debt as a way to increase their level of consumption of goods and services. Loans were "seen as a ticket to a better standard of living," according to one stakeholder from the financial industry.

⁸¹⁸ The emergency ordinance.

⁸¹⁹ Autorităţii Naţionale pentru Protecţia Consumatorilor, 'A intrat in vigoare Ordonanta de Urgenta nr 50/2010 privind contractele de credit pentru consumatori', 2010. Available online at http://www.anpc.gov.ro/index.php?option=com_content&view=article&id=259:oug-50-2010-contracte-credit-consumatori&catid=23:comunicate-de-presa&Itemid=51

⁸²⁰ Mihai, E., 'The formation of credit agreements for consumers', in Curentul Juridic, No. 1 (44), 2011, pp. 130-142. Available online at <http://revcurentjur.ro/index.php?page=arhiva&lang=ro>

22.4 CONSEQUENCES OF OVER-INDEBTEDNESS

22.4.1 Consequences for affected households

According to the stakeholders, the main consequences for over-indebted households were a reduced standard of living and a deterioration of well-being. Financial exclusion and home repossession were also seen as important consequences for households. Regarding financial exclusion, one stakeholder from the financial industry commented that when somebody cannot repay a loan, his/her name is recorded in an official database of Biroul de Credit and he/she cannot easily access credit anymore. Another stakeholder from the financial industry commented, regarding home repossessions, that banks do not always immediately resell the houses, due to the current low market prices, but that they nonetheless repossess them and leave them empty. In addition to the aforementioned consequences, stakeholders also considered homelessness, deterioration of mental health and utility disconnection to be important for over-indebted households.

22.4.2 Consequences of over-indebtedness for the financial services industry

The main effect on financial services industry, according to the interviewees, is the costs of defaulted credits. Recent data from National Bank of Romania shows that the non-performing loans ratio increased during the financial crisis, climbing by 5 percentage points in 2009 and continuing to rise throughout the following years (by June 2012 16.8% of loans).⁸²¹

22.4.3 Economic and social consequences of over-indebtedness for society

According to the stakeholders, the loss of consumer confidence in the financial services industry was by far the most important consequence of over-indebtedness for Romanian society. Two other consequences considered by stakeholders to be important were reduced productivity at work and the legal costs associated with over-indebtedness. One independent expert also pointed to the migration of people who cannot pay their loans as a negative impact on Romanian society, in particular the migration of people who are active on the labour market.

22.4.4 Debt collection practices

The majority of respondents noticed an increase in aggressive debt collection practices during the last five years. Three stakeholders specified that debt collection generally has become more widespread, in response to an increase in the volume of arrears. According to a few stakeholders, banks outsource the collection of unpaid debts to specialised debt collection companies, which are not subject to any regulation. Therefore, debt collectors can use aggressive practices, such as phone

⁸²¹ National Bank of Romania, 'Financial Stability Report', 2012, p.8.

calls at any time of day and night or contact with neighbours or employer. One stakeholder pointed to the letter of intent sent by the Romanian government to the IMF in March 2011, in which it committed itself to "make efforts to avoid adopting legislative initiatives such as (...) proposals for the debt collecting law, which could undermine debtor discipline."⁸²²

22.5 MEASURES IN FORCE TO ALLEVIATE THE IMPACT OF OVER-INDEBTEDNESS

22.5.1 Early identification of households at risk

Over half of stakeholders who commented on the availability of measures for the early identification of households at risk of over-indebtedness in Romania stated that they were hardly common or not common at all. However, one public authority stakeholder did think that they were fairly common and pointed to the new regulation 24/2011 on loans to households, according to which creditors have to more stringently assess debtors' ability to repay their loans. The regulation strengthens the evaluation of the households' creditworthiness introduced by OUG50/2010 and imposes different DTIs and LTVs depending on the type of loan. For example, it imposes a DTI of 10% for foreign currency loans.⁸²³ One representative of the financial industry also referred to recent government regulations, as well as credit scoring, as an example of the early identification of at-risk households.

22.5.2 Advice offered to over-indebted households

Availability and costs

There was a general agreement among stakeholders that personalised debt advice was not widely available in Romania. A couple of stakeholders pointed to the availability of information on credits or general financial advice on the Internet, such as from loan comparison websites. According to a stakeholder from the financial industry, such websites might offer advice via email, for example to advise consumers that they should apply for a loan restructuring plan. Two stakeholders also commented that consumers might be able to receive financial advice from banks. However, one of these noticed that this could be problematic, as the advice was being received from the same person who was selling the product. One independent expert summarised the development of debt advice in Romania thus:

It cannot be said that this activity is very well developed. And it is carried out mostly... by means of websites with general information which cannot be applied

⁸²² Government of Romania, 'Letter of Intent, and Technical Memorandum of Understanding', March 10, 2011, p. 8.

⁸²³ IMF, 'Annual Report on Exchange Arrangements and Exchange Restrictions 2012', p. 2220.

to the particular cases of each consumer. We are just talking about informing consumers about credit. We have not yet come to the point of informing about over-indebtedness.

A 2010 comparison of debt advice in Europe prepared by the Schuldnerfachberatungszentrum at the Johannes Gutenberg University of Mainz reported that there are no official debt advisers in Romania, but that over-indebted households can look for help from social welfare offices or NGOs that offer social services. These would examine their situation, provide them with psychological help and cover their most urgent needs. Another option would be to seek legal advice from a lawyer, although the report noted that this could be expensive.⁸²⁴

Demand for debt advice as assessed by stakeholders

On the whole, stakeholders did not consider that there was a high demand for debt advice in Romania. One civil society stakeholder commented that "There is not even demand for this in Romania, as well as no supply". However, almost two thirds of stakeholders assumed that the demand had increased in the last five years (in most cases "fairly increased").

This is consistent with a study on financial literacy in Romania carried out in 2010. According to the study, more than half of the population gets information on financial products before buying them. However, only a minority looks for advice from a professional adviser or information published in the mass media. Of those persons interviewed for the study, 65% stated that they would be interested in learning how not to be over-indebted. This percentage was driven up by people with high income and high levels of education.⁸²⁵

Effectiveness as assessed by stakeholders

The majority of stakeholders who provided an answer considered face-to-face advice to be fairly effective. Regarding web-based tools they were split evenly between those who considered them to be fairly effective and those who felt them to be hardly effective. When asked about other forms of advice, such as via email or telephone, stakeholders tended to comment that they were ineffective. One stakeholder from a private company offering financial advice commented that banks would offer financial advice on the telephone, but that this was hardly "personalised".

Funding of debt advice

A majority of stakeholders considered that the funding of debt advice in Romania was insufficient. One civil society stakeholder pointed to the low level of government

⁸²⁴ Schuldnerfachberatungszentrum,, Johannes Gutenberg-Universität Mainz, 'Debt Advice in Europe', 2010.

⁸²⁵ Stanculescu, M., 'Financial Literacy in Romania 2010', in Social Research Reports, vol. 16, 2010, pp. 3-57.

spending on consumer issues generally. In 2010 government spending on social protection in Romania amounted to 14.9% of GDP, five percentage points lower than the EU average (19.9%). In 2011, Romania was ranked as one of countries in the EU with the lowest total level of government spending (as a percentage of GDP).⁸²⁶

One stakeholder commented that lack of funding for debt advice was the main obstacle to the development of a debt advice sector in Romania. As indebted people were facing budget pressures by definition they had little money to spare for financial advice. This stakeholder suggested a solution according to which the provision of debt advice by the state could be funded by charging for some services while offering others free of charge. Two other stakeholders suggested that banks and other credit suppliers should contribute towards the financing of these services.

22.5.3 Key measures in place to alleviate the impact of over-indebtedness

Half of stakeholders who provided an answer considered informal arrangements between debtor and creditor to be widely or partly available in Romania. Regarding these arrangements, one stakeholder commented:

The only solution available to over-indebted customers is to apply for a restructuring offer from the lender. The lender decides whether it will approve the request, after a credit analysis. If the request is accepted, in most cases, the loan can be rescheduled for a longer period or a grace period for interest can be available for a few years. If the loan has arrears, banks usually avoid offering a restructuring solution. If you have arrears of more than 30 days it is very difficult to get your loan restructured.

In terms of legal procedures, stakeholders tended to describe these as not available. In Romania there is no possibility for consumers to apply for personal insolvency. According to one stakeholder, a draft law on consumer insolvency was discussed in the Romanian parliament in 2009 but later abandoned. In its letter of intent to the IMF from March 2011, the Romanian government expressed its decision to refrain from implementing the current draft of the law, in order not to undermine debtor discipline.⁸²⁷

The majority of stakeholders agreed that financial support for over-indebted households or other measures to alleviate over-indebtedness were not available at all in Romania.

⁸²⁶ European Commission (Eurostat), General government expenditure statistics, April 2012. Available online at http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/General_government_expenditure_statistics

⁸²⁷ Government of Romania, 'Letter of Intent, and Technical Memorandum of Understanding', March 10, 2011, p. 8.

22.5.4 Changes in response to over-indebtedness

The majority of stakeholders felt that the response to over-indebtedness in Romania has changed during the last five years. For example, three stakeholders referred to new legislation, such as the adoption of the law OUG50/2010, referred to above, by the Romanian government. This improves transparency relating to lenders' fees and limits access to credit by obligating lenders to carry out an assessment of a customer's creditworthiness. In addition, one stakeholder from a public authority pointed to the increased use of credit restructuring by banks.

22.5.5 Types of households of over-indebted consumers not reached by current measures

Just under half of stakeholders consider that there were specific types of households that were not affected by the current measures. Two stakeholders referred to households who had taken out loans in foreign currency. Another type of household mentioned as not reached by current measures was households whose bank had refused a restructuring of their loan. Due to their poor credit rating they would not be able to get their loan refinanced by another bank and they had no remaining options. Finally, one stakeholder from the financial industry indicated that households from rural areas did not have access to necessary information about credit.

22.5.6 Best practices

Four stakeholders were able to suggest measures that they considered to be best practice. One of these, an independent expert, referred to the OUG50/2010 legislation introduced in 2010 (which was discussed above). The other stakeholders referred to measures that they considered to be best practice but which had not yet been implemented in Romania. These included consumer insolvency procedures, regulation of foreign currency denominated loans (in line with the recommendations of the European Systemic Risk Board in its Decision ESRB/2011/1) and free of charge debt advice services.

22.6 OUTLOOK

There was no consensus among stakeholders on how the level of over-indebtedness in Romania would develop in the next five years. Four stakeholders stated that it would increase while four stakeholders thought that it would decrease. However, data from the National Bank of Romania shows that annual increases in the ratio of non-performing loans have slowed down in the last few years (while the ratio of non-performing loans increased by 5 percentage points in 2009, in 2011 it only increased by 2.5%).⁸²⁸ According to its Financial Stability Report for 2012, "[t]he indebtedness

⁸²⁸ National Bank of Romania, 'Financial Stability Report', 2012, p. 8

degree tended to stabilise in 2011 and 2012 Q1" and "[t]he likelihood that households' indebtedness may rise in the coming future is low".⁸²⁹

Stakeholders who expected the level of over-indebtedness in Romania to decrease during the next five years most commonly referred to two factors. Firstly, they referred to predictions of economic growth in the coming years (the Romanian economy is forecasted to grow by 1.6% in 2013 and 2.5% in 2014),⁸³⁰ which it was hoped would lead to improvements in the wage and unemployment levels. One stakeholder from the financial services industry commented that government salary cuts were expected to be reversed soon. Secondly, some stakeholders felt that the reduced accessibility of credit would have a positive effect on the over-indebtedness level.

However, other stakeholders pointed to increasing utility prices, the depreciation of the Romanian Leu in relation to the Euro and the continuation of high unemployment and low salaries as factors that could lead to an increase in the level of over-indebtedness.

Almost all stakeholders felt that there were challenges that needed to be addressed by policy makers in Romania. In particular, stakeholders called for tighter regulation of foreign currency denominated loans and the debt collection sector, the provision of debt advice for over-indebted households and an improvement in the transparency and comparability of credit offers (for example the way in which APR is displayed). One stakeholder called for the implementation of a law on consumer insolvency, although another stakeholder, from the financial industry, felt that such a law could be open to abuse.

In terms of the regulation of utilities, around half of stakeholders stated that there was a need for regulation to protect consumers, in particular vulnerable groups, from high prices and disconnection. Additionally, two thirds of stakeholders called for increased regulation of the housing sector. For example, one stakeholder from a private for-profit company pointed to the risks consumers faced when they paid for houses before they had been built. If the construction company became insolvent consumers lost the money they had spent. The stakeholder suggested, therefore, that construction companies should be obliged to take out insurance to protect their customers from this possibility.

⁸²⁹ National Bank of Romania, 'Financial Stability Report', 2012, pp. 123 - 124.

⁸³⁰ Eurostat, 'Real GDP growth rate - volume' (code: tec00115).

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Over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact

ANNEX A: STATISTICAL DATA FROM EU SOURCES

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Over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact

Romania

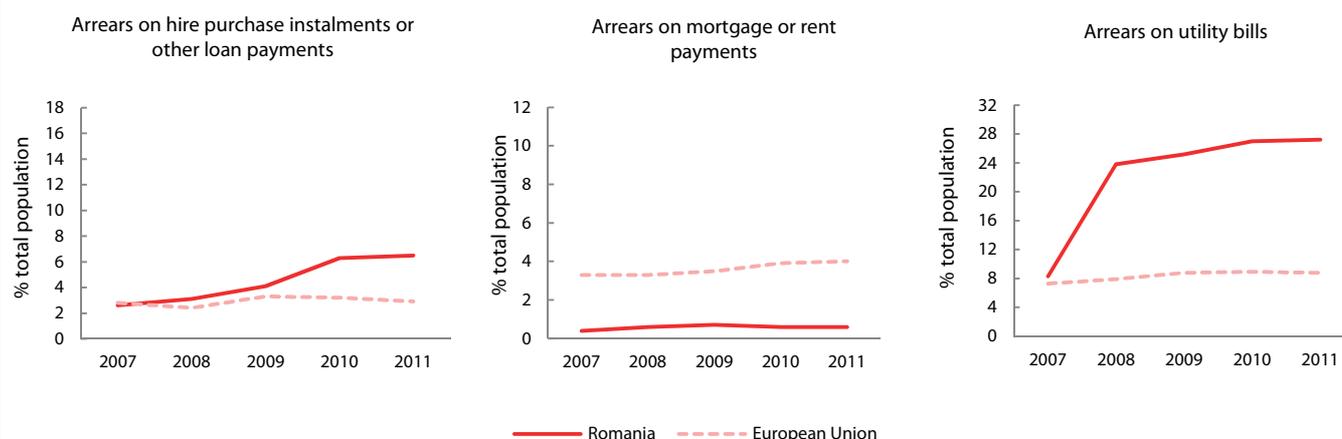
I. Eurobarometer¹

	Romania	EU average	Lowest EU value	Highest EU value
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Households *at risk* of being over-indebted

Respondents feeling at risk of over-indebtedness in 2010	↗ 47%	25%	7%	52%
Respondents feeling at risk of over-indebtedness in 2009	↗ 40%	27%	9%	53%

II. EU SILC standard survey data²



III. EU SILC 2008 module: Over-indebtedness and financial exclusion³

	Romania	EU average	Lowest EU value	Highest EU value
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Proportion of people in households with *bank overdrafts, outstanding balances on credit cards or in arrears on other loans* of over 100% of household disposable income

Overdrawn bank account (% of people in households overdrawn)	↘ 0.4%	2.2%	0.0%	7.7%
Credit or store card (% of people in households with outstanding balances)	↘ 0.1%	1.1%	0.0%	8.6%
Other loan/credit payments (% of people in households in arrears)	↘ 0.1%	0.3%	0.0%	1.1%

Proportion of people in households in *arrears in servicing housing-related loans and bills and in paying other bills* of over 100% of household disposable income

Housing bills (% of people in households in arrears)	↘ 0.3%	0.5%	0.0%	2.9%
Other payments (% of people in households in arrears)	↘ 0.2%	0.4%	0.0%	1.7%

Households living with *outstanding debts and/or arrears* of over 100% of household disposable income

Total (% of households with outstanding debts/arrears)	↘ 1.7%	4.6%	0.0%	11.8%
Income above 60% median (% of households with outstanding debts/arrears)	↘ 1.1%	4.2%	0.0%	11.3%
Income below 60% median (% of households with outstanding debts/arrears)	↘ 3.1%	7.0%	0.2%	13.7%
Materially deprived (% of households with outstanding debts/arrears)	↘ 2.7%	9.0%	0.1%	27.4%

Proportion of those in broad *age groups* with outstanding debts of over 100% of household disposable income

Households with all adults aged 25-39 (% of households with outstanding debts)	↘ 1.2%	6.3%	0.0%	17.2%
Households with all adults aged: 40-64 (% of households with outstanding debts)	↘ 1.6%	5.8%	0.0%	10.9%
Households with all adults aged: 65+ (% of households with outstanding debts)	↘ 0.4%	1.2%	0.0%	2.8%

Proportion of those in different types of household with outstanding debts of over 100% of household disposable income

Living alone (% of people in households with outstanding debts)	↓ 1.3%	4.3%	0.0%	8.2%
Single parent (% of people in households with outstanding debts)	↓ 7.3%	9.5%	0.0%	27.1%
Other (% of people in households with outstanding debts)	↓ 1.4%	4.8%	0.0%	12.1%

Proportion of those in households with outstanding debts of over 100% of household disposable income by marital status

Never married (% of people in households with outstanding debts)	↓ 1.8%	5.0%	0.0%	15.4%
Married (% of people in households with outstanding debts)	↓ 1.2%	4.1%	0.0%	9.7%
Separated/divorced (% of people in households with outstanding debts)	↓ 3.3%	7.5%	0.1%	13.9%
Widowed (% of people in households with outstanding debts)	↓ 0.9%	1.7%	0.0%	4.3%

Proportion of those in households with outstanding debts of over 100% of household disposable income by housing tenure

Owner occupied without mortgage (% of people in households with outst. debts)	↓ 1.4%	3.2%	0.0%	9.6%
Owner occupied with mortgage (% of people in households with outst. debts)	↓ 2.5%	6.3%	0.0%	16.1%
Market rent (% of people in households with outstanding debts)	↓ 0.0%	8.2%	0.0%	16.0%
Subsidised rent (% of people in households with outstanding debts)	↓ 8.5%	8.7%	0.0%	17.9%
Rent-free housing (% of people in households with outstanding debts)	↑ 2.7%	2.3%	0.0%	15.1%

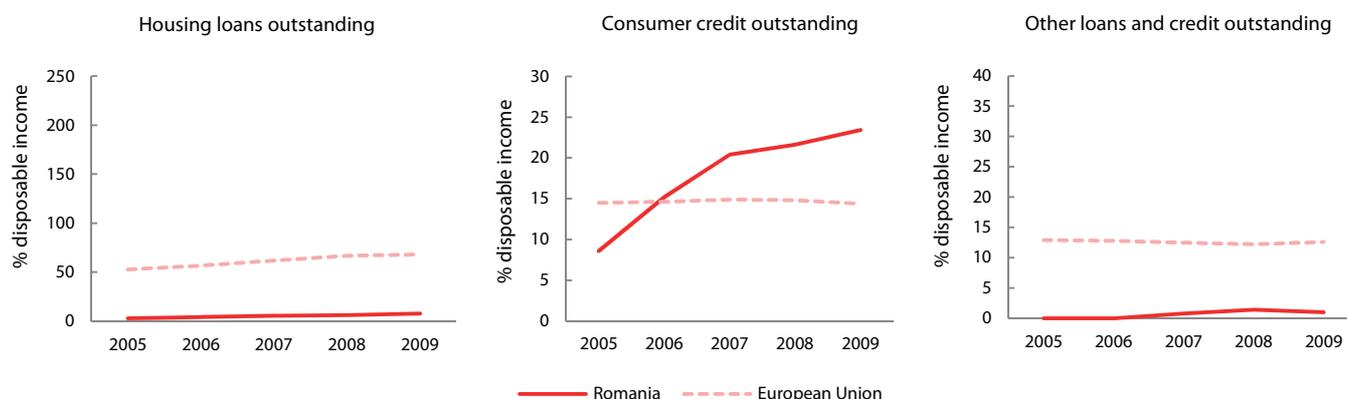
Proportion of those in households with outstanding debts of over 100% of disposable income by work intensity

Work intensity of 0 - 0.19 (% of people in households with outstanding debts)	↓ 2.9%	5.7%	0.0%	10.6%
Work intensity of 0.20 - 0.50 (% of people in households with outstanding debts)	↓ 2.2%	5.7%	0.0%	15.3%
Work intensity of 0.51 - 0.74 (% of people in households with outstanding debts)	↓ 1.1%	5.4%	0.0%	13.5%
Work intensity of 0.75 - 1.0 (% of people in households with outstanding debts)	↓ 1.0%	5.3%	0.0%	14.3%

Proportion of those in over-indebted households that experienced a major drop in income over the preceding year

Over-indebted (% of people in households that experienced drop in income)	↓ 19.5%	33.3%	0.0%	77.6%
Other (% of people in households that experienced drop in income)	↓ 5.9%	19.2%	5.9%	32.5%

IV. Loans and credit outstanding⁴



Notes:

(1) Eurobarometer 72.1 (2009) and Eurobarometer 74.1 (2010). Note: Those who answered 'very at risk' or 'fairly at risk' to the question 'Please tell me how much you feel at risk of being over-indebted'.

(2) Eurostat, SILC. Data as of December 2012.

(3) European Commission, Research Note 4/2010, Over-indebtedness new evidence from the EU-SILC special module.

(4) European Commission, Research Note 4/2010, Over-indebtedness new evidence from the EU-SILC special module. European Credit Research Institute (ECRI), Lending to households in Europe, 1995-2009 and Eurostat, National accounts.

23 SLOVAKIA

Document The over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact - Country report Slovakia

Prepared by Lenka Filipova

Finalised on 7 January 2013

Final report

Over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact

23.1 DEFINITION OF OVER-INDEBTEDNESS

There is no standard or widely used definition of over-indebtedness in Slovakia, which is reflected in the stakeholder responses. The majority of respondents stated that they did not use a specific definition, although one independent expert did indicate that their research institute uses approaches recommended by Eurostat, and one civil society stakeholder stated that they use a broad legal definition of a debtor as a natural or a legal person that owes a debt to a lender.

The most common reason provided for not using a specific definition of over-indebtedness was the absence of a common definition in Slovakia. Another reason was given by a financial industry stakeholder who cited that over-indebtedness is not an issue in the country and therefore no definition is needed. One civil society stated that they decide on a case-by-case basis.

None of the interviewed stakeholders reported that they used a specific definition of households at risk of over-indebtedness.

Despite the lack of a common definition, less than half of stakeholders saw a need for a better definition of household over-indebtedness. Two of these agreed that the common legal definition of a debtor is not sufficient and that a better definition should be designed in order to distinguish between indebted and over-indebted individuals or households.

Likewise, only a few stakeholders stated that a better definition for households at risk of being over-indebted was needed. A couple of these stakeholders argued that such a definition would help to develop appropriate measures to prevent over-indebtedness.

23.2 LEVEL OF OVER-INDEBTEDNESS

There was a common understanding among stakeholders who provided an answer that the level of over-indebtedness in Slovakia had moderately or significantly increased in the last five years. Stakeholders also agreed that the level of over-indebtedness in their country is closely related to the economic developments in the aftermath of the crises in 2008.

Stakeholders' responses are in line with data from Eurostat, which shows that the percentage of the population with arrears increased from 7.6% in 2007 to 13.4% in 2009, before dropping back somewhat to 8.5% in 2011 (which was below the EU average of 11.4%).⁸³¹

⁸³¹ Eurostat, 'Arrears (mortgage or rent, utility bills or hire purchase)' (code: ilc_mdcs05).

Additionally, there was a growth of outstanding household credit as a percentage of disposable income from 7.4% in 2002 to 35.5% in 2009. However, as above, this remained below the EU average (96.9% in 2009).⁸³²

Data from a Eurobarometer survey also tends to support the assessment that over-indebtedness has increased in Slovakia in the last five years. According to the survey, 21% of consumers felt at risk of being over-indebted in 2010, which is a slight increase from 2009, when 20% of consumers felt at risk of over-indebtedness. The figures for both years were lower than the figures across the EU (27% and 25% respectively, for 2009 and 2010).⁸³³

There was, however, little change between 2007 and 2011 regarding the proportion of households that considered themselves to be having difficulties making ends meet. This did increase between 2007 and 2008, from 30.6% to 35%, but by 2011 it had sunk to 30.4%.⁸³⁴

23.3 NATURE AND DRIVERS OF OVER-INDEBTEDNESS

Stakeholders provided varying responses as to what are the most common types of households that are over-indebted or have on-going problems meeting their financial commitments. Nonetheless, a common profile emerges from the responses, suggesting that the types of households most likely to become over-indebted were households between the ages of 25 and 39, two person households with children, those living in owner-occupied housing with mortgages and households with two unemployed persons. In terms of income, stakeholders indicated households at risk of poverty (less than 60% of median disposable income) as being more frequently affected by over-indebtedness. One interviewer pointed out that households consisting of members of the Roma minority should be considered another type of household commonly affected by financial difficulties.

Although several stakeholders commented that debts are a problem for all age groups, they further noted that people between the ages of 25 and 39 are particularly prone to having financial problems. According to stakeholders, consumers from this group typically want to settle down and start a family life, while tending to take credits and loans without carefully considering their ability to repay. This assessment corresponds with data from the EU-SILC 2008 special module, which shows that 2.8% of households in the age group 25 to 39 had outstanding debts amounting to at least 100% of household disposable income, more than with any other age group.⁸³⁵

⁸³² Fondeville, N., Özdemir, E., and Ward, T., 'Over-indebtedness. New evidence from the EU-SILC special module', 2010, p. 7.

⁸³³ Special Eurobarometer 355, Poverty and Social Exclusion Report, 2010, p. 42.

⁸³⁴ Eurostat, 'Inability to Make Ends Meet', (code: ilc_md09).

⁸³⁵ Fondeville, N., Özdemir, E., and Ward, T., 'Over-indebtedness. New evidence from the EU-SILC special module', 2010, p. 35.

Although data from EU-SILC shows that households above the age of 64 are less likely to be over-indebted, some stakeholders specifically referred to retired and elderly people as a group commonly affected by over-indebtedness. Several reasons were provided for the financial problems of this group, including sudden job loss, low pensions and difficulties understanding the terms and conditions of financial products.

In regard to both age groups (i.e. those between the ages of 25 and 39 and those above 64), stakeholders referred to insufficient financial education and a lack of money management skills as major issues.

The majority of stakeholders referred to households with low income as being particularly at risk of becoming over-indebted. This is broadly in line with the EU SILC data from 2008. This shows that 7.4% of households with an income of 60% or less than the median had outstanding debts or arrears amounting to more than 100% of household disposable income (above the EU average of 7%). The data also indicates that this was the case for 43.2% of households that had experienced a major drop in income in the preceding year, which is well above the EU average (33.3%).⁸³⁶

In terms of changes in types of households affected by over-indebtedness, the majority of stakeholders had noticed hardly any or no changes, or did not provide an answer. One stakeholder indicated that there has been a fairly significant change, in that one person households with children, households with unemployed person(s) and unemployed persons close to retirement age had become more likely to be affected by financial difficulties.

23.3.1 Causes of households' over-indebtedness

Macro-economic factors

The majority of stakeholders considered macro-economic factors to be causes of over-indebtedness in Slovakia, in particular unemployment level and wage level. According to the Statistical Office of the Slovak Republic, the level of unemployment increased from 8.4% in the fourth quarter of 2008 to 13.7% in the third quarter of 2012.⁸³⁷ Though this is not the highest rise of unemployment on the European level, it is well above the European average (10.7%) in October 2012.⁸³⁸

Unemployed persons were considered to be particularly prone to making poor consumer decisions when buying financial products. As one financial industry stakeholder reported:

⁸³⁶ Fondeville, N., Özdemir, E., and Ward, T., 'Over-indebtedness. New evidence from the EU-SILC special module', 2010, p. 32, p. 43.

⁸³⁷ See statistical data on unemployment at: <http://portal.statistics.sk/showdoc.do?docid=184>

⁸³⁸ Eurostat, unemployment statistics.

[The unemployed] might already have some loans from banks, because the banks might have lent you money, but then you lose your job. You think it's only temporary... and hope your situation will improve. But the banks won't lend you money anymore and people go to these non-banking systems.

Likewise, low income level was mentioned by several stakeholders as a reason for consumers taking on credits and loans from unregulated lenders that do not check consumer credit worthiness and offer loans at high interest rates.

Cost of living

Utility costs were considered to be a cause of over-indebtedness by almost all stakeholders. Some stakeholders specified that utility costs are generally high, and one public authority stakeholder noted that "*utility costs are increasing faster than salaries*". Between 2007 and 2012 the price of gas in Slovakia increased by 20%.⁸³⁹ Elderly people were considered by stakeholders to be particularly vulnerable to high utility bills due to the low level of their pensions.

In addition to utility costs, a majority of stakeholders considered housing costs to be a cause of over-indebtedness in Slovakia. Data from Eurostat shows that the housing cost overburden rate in 2009 was 9.4%, which is below the EU average of 12.2%. However, the housing cost overburden rate among households living in owner-occupied housing with a mortgage was significantly higher than the EU average (32.3% and 8.8% respectively).⁸⁴⁰

Other costs of living mentioned by stakeholders were transport and food, child related costs and healthcare costs, whereby healthcare costs were emphasized as especially problematic for retired people.

Types of credit/loan taken out by households

Among types of credit and loans causing over-indebtedness, interviewees referred mainly to predatory or usurious types of credits and loans. These were closely followed by both regulated consumer credits with high interest rates and home loans and mortgages. Non-usurious credit and loans from unregulated lenders were also mentioned as a cause of over-indebtedness.

In terms of usurious types of credits, stakeholders referred to various types of quick loan providers who do not check on consumer credit worthiness and provide loans and credits at extremely high interest rates. These type of practices, as some stakeholders emphasized, are closely related to a low financial awareness and a lack

⁸³⁹ Eurostat, 'Gas prices for household consumers' (code: ten00113).

⁸⁴⁰ Rybkowska, A. and Schneider M., 'Housing conditions in Europe in 2009', Eurostat, 2011, p.7.

of financial education among the Slovak population.⁸⁴¹ This is confirmed by a 2012 BEUC report that identifies unregulated, unscrupulous lenders as the most acute problem reported by both authorities and consumers in the country.⁸⁴²

In particular, usury within the Roma minority was referred to by stakeholders as a pressing issue. This was also highlighted as an acute problem to tackle in the proposal for Roma integration policy accepted by the Slovak government in 2012.⁸⁴³

One issue observed by stakeholders in relation to consumer credit was that these types of loans are sometimes accompanied by massive advertisement that tends to be manipulative. As one expert put it: "Among other causes... I would include massive advertising campaigns (that I would call deceptive) of both non-banking and banking entities". This view is confirmed by recent research conducted by the European Commission that reports on the prevalence of deceptive advertising in Slovakia.⁸⁴⁴

Stakeholders also pointed to mortgages and home loans as a cause of over-indebtedness. According to data from Eurostat, the percentage of the population with overdue mortgage and rent payments rose significantly in the aftermath of the financial crisis, from 3% in 2008 to 6.9% in 2009. It remained stable throughout 2010 before sinking slightly to 4.6% in 2011.⁸⁴⁵

Personal circumstances

Regarding personal circumstances, stakeholders mainly referred to poverty and a drop in income caused by unemployment or business failure as causes of over-indebtedness. These were followed by decreasing or stagnant income while the costs of living steadily increase, incapacity to deal with financial products and lack of money management skills.

⁸⁴¹ According to a media agency Media Group, research conducted by Focus research group shows that more than a third of the Slovak population has a very low level of financial literacy and is not able to understand basic terms and conditions of financial products. See: <http://partnersgroup.sk/viac-ako-tretina-slovakov-ma-nizku-financnu-gramotnost>

There has also been a substantial media coverage of this issue in Slovak media. See for example:
<http://openiazoch.zoznam.sk/cl/102458/Na-Slovensku-pretrvava-nizka-financna-gramotnost>
<http://www.webnoviny.sk/ekonomika/na-slovensku-pretrvava-nizka-financn/317638-clanok.html>

⁸⁴² See European Consumer Organisation, *Analysis of the Consumer Movement in Central, Eastern and South Eastern Europe (CSEEE)*, 2012, p. 37.

⁸⁴³ See p.40: <http://www.romovia.vlada.gov.sk/data/files/8477>. There has also been some media coverage of the issue, see for example: http://spravy.pravda.sk/karty-pre-romov-uzere-nezabrana-dqc-/sk_domace.asp?c=A110120_101520_sk_domace_p29

⁸⁴⁴ See European Commission, "Percentages of consumers who came across misleading or deceptive advertisements/offers" and "fraudulent advertisements/offers", 2012, p. 112.

⁸⁴⁵ Eurostat, 'Arrears on mortgage or rent payments' (code: ilc_mdse06).

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23.3.2 Changes relevant for levels of over-indebtedness

The changes most frequently noted by stakeholders pertained to a deterioration in the macro-economic situation. In agreement with the previous section on macro-economic causes of over-indebtedness, the majority of stakeholders considered the rising level of unemployment and low income level to be changes that had contributed to an increase in the level of over-indebtedness.

There was less consensus among stakeholders on the question of whether there had been other changes relevant for the level of over-indebtedness in Slovakia. For example, half of stakeholders who provided an answer stated that there had also been macro-economic developments that mitigated the level of over-indebtedness in Slovakia, such as low interest rates, while the other respondents indicated that there had been hardly any such developments.

In terms of the behaviour of creditors, half of stakeholders pointed to stricter lending practices that reduced the availability of credit. However, only one stakeholder noted the removal of specific practices or products in the financial services industry that cause or exacerbate over-indebtedness.

Other types of changes that respondents noted were related to high interest rates loans from unregulated lenders and predatory or usurious types of credits. Stakeholders predominantly referred to the easy accessibility of such loans against the backdrop of limited accessibility of credits from regulated financial service providers.

23.3.3 Cultural attitude towards debt and actual level of households' (over-)indebtedness

More than half of stakeholders believed that there was a relationship between the actual level of (over-)indebtedness and the cultural attitude to debt in Slovakia. There was a general understanding among interviewees that people in Slovakia tend to be conservative when it comes to taking out loans, but that the younger generation is becoming increasingly more liberal in its attitude to debt. As one civil society stakeholder put it:

The older generation attaches importance to being debt-free but the situation is changing dramatically and the younger generation is quite different. Young people want to be able to afford a lot of products and for this reason very often take consumer credit.

"Life on debt" as a lifestyle in consumer society was mentioned by one independent expert who further noted that there is a lack of public debate concerning this matter and therefore a low social awareness of potential risks related to consumption of financial products:

Life on debt is becoming a part of today's culture... There is a lack of social debate about financial problems that would raise social awareness of this matter. We have for example a great amount of deceptive advertising and unfair commercial practices but no one comments on that and consumers tend to be naive.

Mortgages were mentioned by one stakeholder who stated that consumers in Slovakia commonly want to own their own house or flats and therefore do not hesitate to take these loans.

23.4 CONSEQUENCES OF OVER-INDEBTEDNESS

23.4.1 Consequences for affected households

Based on an average rating of consequences of over-indebtedness for households attributed by interviewed stakeholders, financial exclusion and home repossession were the most highly rated consequences. These were followed by reduced standard of living, utility disconnection and addictive behaviour.

23.4.2 Consequences of over-indebtedness for the financial services industry

Costs of defaulted credits for creditors and loss of potential customers through more restrictive lending practices were rated most highly in terms of the consequences of over-indebtedness for the financial services industry. One of the stakeholders noted that the amount of credit defaults generally may not be so high but that it is still a significant problem for financial services providers.

23.4.3 Economic and social consequences of over-indebtedness for society

Regarding the economic and social consequences of over-indebtedness for society, stakeholders rated loss of consumer confidence in the financial services industry most highly. This was closely followed by costs of provision of housing for households affected by home repossession, although no stakeholder referred to concrete data on these costs. One independent expert also mentioned several other consequences for society, including increasing economic inequality leading to social unrest, social exclusion and marginalisation.

23.4.4 Debt collection practices

No clear picture emerged from the interviews regarding the use of aggressive debt collection practices in Slovakia, with stakeholders expressing contradictory opinions as to whether the use of these had increased.

23.5 MEASURES IN FORCE TO ALLEVIATE THE IMPACT OF OVER-INDEBTEDNESS

23.5.1 Early identification of households at risk

More than half of the interviewees considered measures to identify households at risk of becoming over-indebted either hardly common or did not comment on the extent of such measures. Those stakeholders who did consider such measures to be common noted that banks had become more cautious when giving loans. However, the only specific measure referred to was the use of the Banking Credit Bureau by banks to check on the creditworthiness of potential borrowers.

23.5.2 Advice offered to over-indebted households

Availability and costs

Stakeholders had little to say about the availability of debt advice in Slovakia, but the picture emerged that there was no established network of debt advice centres. One stakeholder noted that there are no civil society organisations focusing specifically on the provision of debt advice, but only consumer organisations that provide a variety of services and do not have enough funding or qualified staff members to focus on financial or debt advice.

This corresponds with the assessment given in a 2010 overview of debt advice in Europe by the Schuldnerfachberatungszentrum at the University of Mainz. According to this overview, "debt counselling still does not exist as a separate domain of advice" in Slovakia and is primarily offered by consumer organisations. However, it also pointed to free legal advice provided to citizens by the Ministry of Justice.⁸⁴⁶

The majority of stakeholders were not able to assess the costs of debt advice in Slovakia. The remaining stakeholders indicated that these services were partly free and partly paid.

Demand for debt advice as assessed by stakeholders

Stakeholders that provided an answer agreed that such services were not very well-known in Slovakia. One independent expert noted that many consumers face serious financial problems because they do not know about the existence of debt advice services. Generally, stakeholders who expressed a view considered that demand for debt advice had remained stable in the last five years, but that the services available were not sufficient to satisfy this demand.

⁸⁴⁶ Schuldnerfachberatungszentrum, Johannes Gutenberg-Universität Mainz, 'Debt Advice in Europe', 2010.

Effectiveness as assessed by stakeholders

In terms of effectiveness, available debt advice services were considered either hardly effective by the majority of stakeholders who provided an answer. Some of the respondents linked the lack of effectiveness of debt advice services to their low level of availability. A network of debt advice was suggested by some civil society stakeholders as a possible solution to this problem. However, some stakeholders reported that the government did not appear to them to be in favour of such measures as it is not willing to provide adequate support to existing consumer organisations to develop their services in such a way.

Funding of debt advice

The majority of those who expressed a view on the funding of debt advice considered it to be insufficient. Some of these commented that despite attempts of some civil societies to establish financial and debt advice centres, they did not receive support from either the government or the banking sector. One civil society stakeholder suggested that an EU-level program of funding consumer centres might help to establish effective debt advice system working to both mitigate and prevent effects of over-indebtedness.

23.5.3 Key measures in place to alleviate the impact of over-indebtedness

Availability and costs

The majority of stakeholders considered informally brokered arrangements to be widely or partly available in Slovakia. One of the interviewees noted that since the crises, banks have been more open to these kinds of arrangements. However, other respondents commented that banks are typically willing to reduce monthly payments, but they do not agree to debt write-offs.

The existence of a consumer insolvency procedure in Slovakia was recognised by the majority of stakeholders, but they did not tend to consider that it was widely available. Indeed, consumer insolvency proceedings were introduced in Slovakia in 2006, but the procedure is very expensive and takes a long time, which reduces its accessibility for over-indebted households.⁸⁴⁷

Stakeholders reported that financial support for households to repay debts or arrears is not available in Slovakia.

⁸⁴⁷ See <http://rieseniedlhov.webnode.sk/news/osobny-bankrot-na-slovensku/>

Effectiveness as assessed by stakeholders

No clear picture emerges from stakeholders' responses as to how effective the available measures are. Informally brokered arrangements received the most positive assessment, whereby the majority of stakeholders who provided an answer indicated that the measures were either very or fairly effective. For the other measures the majority of interviewees did not provide an answer at all.

23.5.4 Changes in response to over-indebtedness

The majority of stakeholders who provided an answer reported that there have been no changes in responses to over-indebtedness in terms of measures to alleviate its impacts. As one of them reported: "On the legal level, there have been no changes to mitigate the level of over-indebtedness". An independent expert noted that not enough attention has been paid to such responses in Slovakia.

23.5.5 Types of households of over-indebted consumers not reached by current measures

Stakeholders had little to say on whether there were any types of households that are not reached by current measures. Two interviewees reported that households consisting of less educated persons, with low income and in danger of execution, are not reached by current measures.

23.5.6 Best practices

When asked about best practice, stakeholders largely expressed their suggestions of potentially effective measures for the future. One of the chief measures mentioned was the creation of a network of debt advice centres to help mitigate the effects of over-indebtedness. Informally brokered arrangements were considered another effective measure for households that are already indebted, but stakeholders pointed out that more measures should be introduced to prevent over-indebtedness. In this respect, references were made to the absence of financial education in Slovakia. Interviewees emphasized that more attention should be devoted to questions concerning individual money management skills and understanding financial products.

23.6 OUTLOOK

The majority of stakeholders expected that the number of over-indebted households will increase in the next few years. They noted that Slovakia is still experiencing the aftermath of the crises and that the macro-economic situation is not likely to radically improve. They specifically referred to continually high unemployment, real incomes stagnation, poverty growth and austerity measures of the Slovak government. One

stakeholder expressed a view that the number of over-indebted households would remain stable and explained that due to low incomes, consumers are not likely to take on excessive loans.

A majority of stakeholders agreed that there are specific challenges that need to be addressed by policy makers. They mainly called for more regulation of non-bank lenders and better protection of consumer rights. Another problem, according to interviewees, is the currently insufficient number of financial and debt advice centres in Slovakia. They felt that this should be increased. Low financial literacy was acknowledged as another challenge. Several stakeholders spoke about the necessity to improve both legal and financial literacy and emphasized that financial education should be available to all generations.

The majority of stakeholders referred to additional changes needed in the regulation of credit and specific commercial practices. For example, stakeholders specifically referred to the need to regulate interest rates and the transparency of terms and conditions by loans, as well as the need to regulate deceptive advertising. In addition, half of stakeholders argued that it would be necessary to implement changes to the regulation of utilities. Most of these indicated that the costs of utilities should be regulated as they generally tend to be very high. Regarding regulation of the housing sector, only a few stakeholders stated that additional changes were needed. Those who indicated changes were needed mainly spoke about regulations of housing costs and creating a system of low-cost housing for low-income or over-indebted households.

23.7 REFERENCES

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Over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact

ANNEX A: STATISTICAL DATA FROM EU SOURCES

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Over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact

Slovakia

I. Eurobarometer¹

Slovakia EU average Lowest EU value Highest EU value

Households *at risk* of being over-indebted

Respondents feeling at risk of over-indebtedness in 2010	↘ 21%	25%	7%	52%
Respondents feeling at risk of over-indebtedness in 2009	↘ 20%	27%	9%	53%

II. EU SILC standard survey data²



III. EU SILC 2008 module: Over-indebtedness and financial exclusion³

Slovakia EU average Lowest EU value Highest EU value

Proportion of people in households with bank overdrafts, outstanding balances on credit cards or in arrears on other loans of over 100% of household disposable income

Overdrawn bank account (% of people in households overdrawn)	↘ 1.1%	2.2%	0.0%	7.7%
Credit or store card (% of people in households with outstanding balances)	↘ 0.1%	1.1%	0.0%	8.6%
Other loan/credit payments (% of people in households in arrears)	↘ 0.1%	0.3%	0.0%	1.1%

Proportion of people in households in arrears in servicing housing-related loans and bills and in paying other bills of over 100% of household disposable income

Housing bills (% of people in households in arrears)	↘ 0.4%	0.5%	0.0%	2.9%
Other payments (% of people in households in arrears)	↘ 0.1%	0.4%	0.0%	1.7%

Households living with outstanding debts and/or arrears of over 100% of household disposable income

Total (% of households with outstanding debts/arrears)	↘ 1.9%	4.6%	0.0%	11.8%
Income above 60% median (% of households with outstanding debts/arrears)	↘ 1.3%	4.2%	0.0%	11.3%
Income below 60% median (% of households with outstanding debts/arrears)	↗ 7.4%	7.0%	0.2%	13.7%
Materially deprived (% of households with outstanding debts/arrears)	↘ 4.2%	9.0%	0.1%	27.4%

Proportion of those in broad age groups with outstanding debts of over 100% of household disposable income

Households with all adults aged 25-39 (% of households with outstanding debts)	↘ 2.8%	6.3%	0.0%	17.2%
Households with all adults aged: 40-64 (% of households with outstanding debts)	↘ 2.3%	5.8%	0.0%	10.9%
Households with all adults aged: 65+ (% of households with outstanding debts)	↘ 0.0%	1.2%	0.0%	2.8%

Proportion of those in different types of household with outstanding debts of over 100% of household disposable income

Living alone (% of people in households with outstanding debts)	↘ 1.4%	4.3%	0.0%	8.2%
Single parent (% of people in households with outstanding debts)	↘ 5.8%	9.5%	0.0%	27.1%
Other (% of people in households with outstanding debts)	↘ 1.9%	4.8%	0.0%	12.1%

Proportion of those in households with outstanding debts of over 100% of household disposable income by marital status

Never married (% of people in households with outstanding debts)	↘ 1.4%	5.0%	0.0%	15.4%
Married (% of people in households with outstanding debts)	↘ 1.6%	4.1%	0.0%	9.7%
Separated/divorced (% of people in households with outstanding debts)	↘ 3.0%	7.5%	0.1%	13.9%
Widowed (% of people in households with outstanding debts)	↘ 0.7%	1.7%	0.0%	4.3%

Proportion of those in households with outstanding debts of over 100% of household disposable income by housing tenure

Owner occupied without mortgage (% of people in households with outst. debts)	↘ 1.3%	3.2%	0.0%	9.6%
Owner occupied with mortgage (% of people in households with outst. debts)	↘ 6.1%	6.3%	0.0%	16.1%
Market rent (% of people in households with outstanding debts)	↘ 5.1%	8.2%	0.0%	16.0%
Subsidised rent (% of people in households with outstanding debts)	↘ 0.0%	8.7%	0.0%	17.9%
Rent-free housing (% of people in households with outstanding debts)	↗ 2.6%	2.3%	0.0%	15.1%

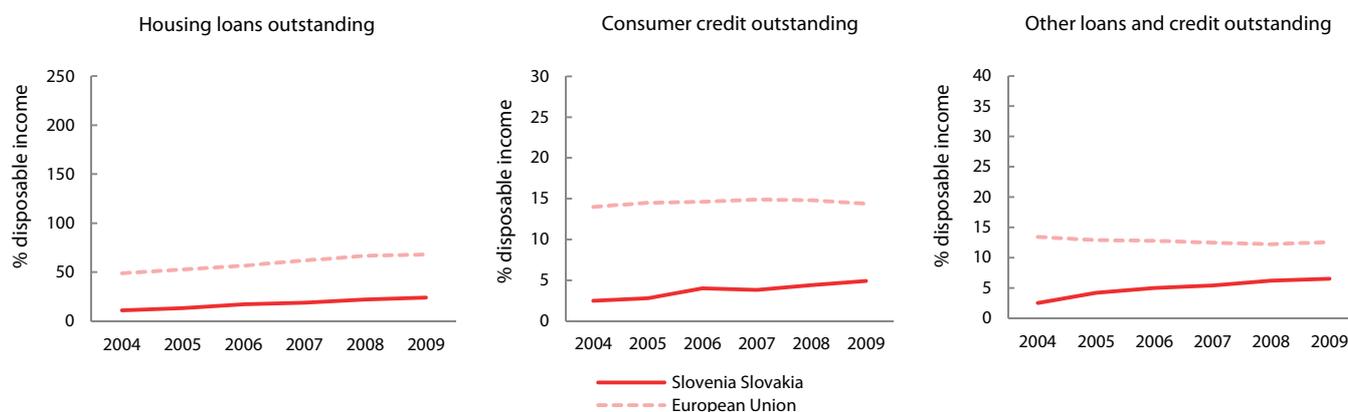
Proportion of those in households with outstanding debts of over 100% of disposable income by work intensity

Work intensity of 0 - 0.19 (% of people in households with outstanding debts)	↘ 3.1%	5.7%	0.0%	10.6%
Work intensity of 0.20 - 0.50 (% of people in households with outstanding debts)	↘ 2.0%	5.7%	0.0%	15.3%
Work intensity of 0.51 - 0.74 (% of people in households with outstanding debts)	↘ 2.2%	5.4%	0.0%	13.5%
Work intensity of 0.75 - 1.0 (% of people in households with outstanding debts)	↘ 2.0%	5.3%	0.0%	14.3%

Proportion of those in over-indebted households that experienced a major drop in income over the preceding year

Over-indebted (% of people in households that experienced drop in income)	↗ 43.2%	33.3%	0.0%	77.6%
Other (% of people in households that experienced drop in income)	↘ 16.5%	19.2%	5.9%	32.5%

IV. Loans and credit outstanding⁴



Notes:

(1) Eurobarometer 72.1 (2009) and Eurobarometer 74.1 (2010). Note: Those who answered 'very at risk' or 'fairly at risk' to the question 'Please tell me how much you feel at risk of being over-indebted'.

(2) Eurostat, SILC. Data as of December 2012.

(3) European Commission, Research Note 4/2010, Over-indebtedness new evidence from the EU-SILC special module.

(4) European Commission, Research Note 4/2010, Over-indebtedness new evidence from the EU-SILC special module. European Credit Research Institute (ECRI), Lending to households in Europe, 1995-2009 and Eurostat, National accounts.

24 SLOVENIA

Document The over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact - Country report Slovenia

Prepared by Boštjan Krisper

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Final report

Over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact

24.1 DEFINITION OF OVER-INDEBTEDNESS

No common definition of over-indebtedness exists in Slovenia, as there is no national policy on over-indebtedness and no institution that would systematically work on this issue. Some stakeholders pointed to the Financial Operations, Insolvency Proceedings and Compulsory Dissolution Act,⁸⁴⁸ referring to a situation in which the value of a person's assets is lower than the value of his or her liabilities. The function of this definition is solely to assess whether a consumer is insolvent and therefore can apply for personal insolvency. The interviewed stakeholders mostly agreed that there is a need to better define over-indebtedness as well as the risk of over-indebtedness. Without such a definition, no systematic policy on over-indebtedness is possible in Slovenia.

24.2 LEVEL OF OVER-INDEBTEDNESS

Stakeholders interviewed in Slovenia assessed that the number of over-indebted households had increased in the previous five years.

On the absolute level, the accumulated debt of the households has decreased in the last years due to a fall in their short term financial obligations, while their burden of repayment has increased. As in the EU, the growth in mortgages and consumer credit debt has been slowing down considerably in the last two years.⁸⁴⁹ In terms of debt maturity, long-term mortgage debt has been increasing in the last five years and has reached 55% of all bank credit. Also growing has been the average maturity of mortgage loans, having reached 19.2 years in 2011 for new contracts.⁸⁵⁰ Slovene households are quite exposed to interest rate fluctuations, because about 95% of mortgage credit are variable interest rate loans. An additional risk for households are foreign currency mortgages which - according to the central bank - at the time of reporting constitute about a quarter of the entire mortgage debt.⁸⁵¹

The ratio of household obligations from credit paid on time was at 91% in 2011 and relatively stagnant in the previous years, while loans in arrears higher than 90 days grew to 3.5%.⁸⁵²

An increase in financial pressure on the households is further evident from the rising figures on unemployment, as well as from the share of households having great

⁸⁴⁸ Zakon o finančnem poslovanju, postopkih zaradi insolventnosti in prisilnem prenehanju (Financial Operations, Insolvency Proceedings and Compulsory Dissolution Act), available at http://zakonodaja.gov.si/rpsi/r05/predpis_ZAK04735.html.

⁸⁴⁹ Bank of Slovenia, 'Financial Stability Review 2012', p.12.

⁸⁵⁰ Bank of Slovenia, 'Financial Stability Review 2012', p.13.

⁸⁵¹ Bank of Slovenia, 'Financial Stability Review 2012', p.18.

⁸⁵² Bank of Slovenia, 'Financial Stability Review 2012', p.77.

difficulties with making ends meet. By 2011, this ratio was at 9.3%, which is a significant change from 5.1% in 2007.⁸⁵³

Altogether, 4.4% of households in Slovenia were in arrears on key commitments that were higher than their disposable income in 2008 (see Annex A). In 2011, the total percentage of households in arrears on key commitments, at 19%, was lower than in the year before but nevertheless well above the EU average (11.4%). A similar observation can be made about arrears on utility bills, at 17.3% in 2011 according to the EU SILC data. In addition, 3.4% of households were in arrears on rent or mortgages repayments and 4.1% on loans and hire purchases.⁸⁵⁴

Finally, according to the figures available from the Agency of the Republic of Slovenia for Public Legal Records and Related Services (AJPES) 1,043 court procedures for personal insolvency were initiated in Slovenia in 2011, compared to 383 in 2009.⁸⁵⁵ It was noted by stakeholders that this increase could have partially taken place due to the fact that consumers have only been able to file for insolvency since 2008 and that they are only now becoming increasingly aware of this possibility.

24.3 NATURE AND DRIVERS OF OVER-INDEBTEDNESS

24.3.1 Most common types of households that are over-indebted

Very few micro data exist on the nature and drivers of over-indebtedness and interviewed stakeholders emphasized that their assessments were subjective. They overall pointed to households consisting of people over the age of 25 as being more commonly over-indebted.

Because of high costs of housing in relation to the income level,⁸⁵⁶ young people live with their parents for a long time and thus increase the financial burden of the families, as one interviewee pointed out. When they become independent, this often brings high financial pressures including long-term mortgages to which they dedicate a large portion of the income. According to the calculation of the Bank of Slovenia, a typical monthly instalment re-payment for a 2-room apartment acquired by mortgage credit in Slovenia constitutes 69% of the average net salary.⁸⁵⁷ Parents often assist with the financing and, due to stricter assessment of creditworthiness by the banks since the beginning of the financial crisis, parents very often also act as warrantors.⁸⁵⁸ As EU SILC data shows (see Annex A), households with children,

⁸⁵³ Eurostat, 'Households making ends meet with great difficulties' (code: ilc_mdcs09).

⁸⁵⁴ Eurostat (codes: ilc_mdcs06, ilc_mdcs07, ilc_mdcs08).

⁸⁵⁵ See 'Objave sklepov in pisanj izdanih v postopkih zaradi insolventnosti', at AJPES, <http://www.ajpes.si/eobjave/default.asp?s=51>.

⁸⁵⁶ Bank of Slovenia, 'Financial Stability Review 2011', pp. 16-17.

⁸⁵⁷ Bank of Slovenia, Financial Stability Review 2012, p. 18.

⁸⁵⁸ Bank of Slovenia, Financial Stability Review 2011, pp. 16-17.

especially single parent households are at a higher financial risk, as well as the ones renting their accommodation or financing their own housing with a mortgage. Unemployed, less educated, lower income and homeless households tend to be at a higher risk according to the assessment of the majority of the interviewed stakeholders.

Households that were interviewed for this study largely corresponded with this profile, in so far as the majority of the interviewees are from single parent households, renting social housing, unemployed, less educated and at risk of poverty.

24.3.2 Most important causes of households' over-indebtedness

Macro-economic factors

Unemployment (at 8.2 % in 2011, compared to 4.9% in 2007)⁸⁵⁹ was identified by all stakeholders as an important macro-economic factor that causes household over-indebtedness, followed by the social welfare and wage level.

Household interviewees in Slovenia cited low income, especially pensions and social welfare, as the main cause of their financial problems. For households with foreign currency loans (amounting to about a quarter of all households with a mortgage)⁸⁶⁰ strong Euro-Swiss Franc fluctuations have added to the stress.

Cost of living

Cost of living is another significant cause of households' financial problems. Utility costs emerged from the stakeholder interviews as especially problematic, but other costs were mentioned as well. Housing costs represented a heavy financial burden for 38.6% of Slovene households in 2011.⁸⁶¹ In the same year 17.3% of households reported arrears on utility bills.⁸⁶²

In the household interviews several interviewees indicated that they perceived the costs of living to be steadily increasing, while their income decreased or stagnated. Almost all of them were in arrears with their rent or utility bills at the time of the interview, or had been at some point in the past.

Types of credit/loan taken out by households

Among the lending patterns predatory or usurious loans, non-usurious loans from unregulated lenders and consumer credit with high interest rates were most

⁸⁵⁹ Eurostat, 'Unemployment as a percentage of the labour force' (code: tsdec450).

⁸⁶⁰ Bank of Slovenia, Financial Stability Review 2012, p.18.

⁸⁶¹ Eurostat, 'Financial burden of the total housing cost' (code: ilc_mdcd04).

⁸⁶² Eurostat, 'Arrears on utility bills' (code: ilc_mdcs07).

frequently indicated by the stakeholders as causes of over-indebtedness. Mortgages and foreign currency loans were also mentioned.

Available data also shows that household debt and the related financial pressure on households have increased. The ratio of debt to income of Slovene households grew from 39.9% to 46.8% between 2007 and 2010, while the ratio of debt to financial assets in 2011 was at 30.4%. Household debt, as well as lending in Slovenia, are still below EU average, especially when we look at the debt-to-income ratio of mortgages. However, financial assets of Slovene households are relatively low, which means that their safety buffer in case of trouble with debt repayment is not very large.

Because of a very underdeveloped rent market buying an apartment is often the only solution to resolving a young household's accommodation problem. To illustrate, the apartment ownership rate was at 77%, while the rate of rented apartments was at 9% in 2011.⁸⁶³ Many younger households have thus overburdened their income with loans, meaning that relatively small fluctuations in income or in their debt repayment can already lead to financial stress.

Although lending from non-bank credit providers has not been very widespread in Slovenia, numerous cases of usurious lending in the nonbanking sector have been reported.⁸⁶⁴

Personal circumstances

All interviewed stakeholders pointed to a drop in income due to unemployment or business failure as a cause of households' over-indebtedness. All but one also indicated poverty and decreasing or stagnant income while costs of living steadily increase. This was followed by a drop in income caused by other reasons, such as illness or divorce,⁸⁶⁵ an incapacity to deal with financial products and a lack of money management skills.

This assessment is supported by the findings from the household interviews. Namely, poverty, a drop in income due to unemployment or illness and a decreasing or stagnant income were most frequently mentioned as a cause of the interviewees' financial difficulties. On the other hand, none of the household interviewees cited lack of money management skills or incapacity to deal with financial products as a cause of their difficulties.

⁸⁶³ Statistical Office of the Republic of Slovenia, http://www.stat.si/novica_prikazi.aspx?id=4420.

⁸⁶⁴ See for example: Slovene Consumers Association, <http://www.zps.si/za-medije/izjave-za-javnost-2012/15.marec-svetovni-dan-potrosnikov-nas-denar-nase-pravice.html?Itemid=713>, Market Inspectorate of Republic of Slovenia, <http://www.ti.gov.si/nc/si/splosno/cns/novica/article/2537/5509/>.

⁸⁶⁵ See also Ferik, B., *Zadolževanje in prezadolženost prebivalstva*, Delovni zvezek 1/2007, UMAR, 2007, p.29.

24.3.3 Changes relevant for levels of over-indebtedness

Significant changes in the recent years have contributed to the levels of over-indebtedness. In terms of the macro-economic situation, unemployment and a decrease in income were seen by the interviewed stakeholders as the most important changes in the previous five years. Stricter rules on social benefits and austerity measures which cut into pensions and transfers such as unemployment benefit, maternity benefit or child subsidies were also named by one interviewee. Further, access to credit has become more restricted due to higher risk aversion of banks when granting loans. The consumer organization estimates that consumers whose loan applications are turned down by the banks have been turning to non-bank lenders where risks of predatory practices are higher.

Although the banks have practically stopped granting foreign currency loans since the appreciation of the Swiss Franc in 2008 that was followed by an intense public debate, the pressure on households with existing mortgages in Swiss Franc persists. Credit in general has grown more expensive due to higher risk premiums charged by the banks. Households buying such credit today will see their repayment costs increase considerably in case Euribor returns to levels prevalent before the financial crisis. Factors that might decrease the risk of over-indebtedness through lending are the introduction of the principle of responsible lending through the implementation of the Consumer Credit Directive and of a cap on the APRC of short-term loans, particularly targeting SMS-lending. The APRC that can be charged to consumers by nonbank lenders in Slovenia cannot be higher than 200% of the average APRC charged by the banks.⁸⁶⁶ This measure was introduced in 2004 with the objective of curbing high costs of nonbank credit.

24.3.4 Cultural attitude towards debt and actual level of households' (over-) indebtedness

There was broad agreement among stakeholders that there is a relationship between the cultural attitude toward debt and the actual level of households' (over-) indebtedness, but the precise nature of this relationship was unclear. One interviewee said: "Especially among older generations, being debt-free is still an important value." Another stakeholder pointed out that more and more households have been realizing there was need to change their lifestyle and reduce their spending in order to minimize the risk of financial problems.

⁸⁶⁶ Article 18.a of the Consumer Credit Act, <http://www.uradni-list.si/1/objava.jsp?urlid=200477&stevilka=3398>.

24.4 CONSEQUENCES OF OVER-INDEBTEDNESS

24.4.1 Consequences for affected households

The most important consequences of household over-indebtedness, as assessed by the stakeholders in Slovenia, are home repossession, a reduced standard of living, deteriorating well-being, financial exclusion and utility disconnection.

While no aggregated data on utility disconnections exists in Slovenia,⁸⁶⁷ the high level of arrears on utility payments (see Annex A) confirm that this is a relevant issue. Financial exclusion is most widespread for credit, with banks refusing loans to consumers without a permanent work contract or consumers with low disposable income. One interviewee working for a public authority reported that about 0.5% of accounts of recipients of financial social assistance are closed by banks every month and that indebted consumers are often forced to rotate their bank account among banks.

The Law on Execution and the Interim Protection of Claims⁸⁶⁸ states that the debtor's income in the amount equivalent to the legally defined minimum salary should be protected from legal action by the creditor. However, contractual clauses on credit and bank accounts typically allow the bank to dispose with the entire income of the debtor on his or her bank account in case of unpaid obligations. This means that a growing number of households need to cope with income well below the subsistence level.

In the household interviews almost all interviewees referred to a reduced standard of living as a consequence of financial difficulties. Household interviewees also reported severe psychological stress and overall the deteriorating well-being and mental health were among the most frequently reported consequences for the households that participated in this study.

24.4.2 Consequences of over-indebtedness for the financial services industry

In the stakeholder interviews the most highly rated consequence was the costs of defaulted credits for creditors. The quality of outstanding household debt has decreased in Slovenia recently, leading to cost through defaults and arrears, but households are still considered to be less risky debtors for banks than companies. According to the Institute of Macroeconomic Analysis and Development of the Republic of Slovenia, in 2011, about 85% of household debt was rated as highest quality, while non-performing loans were at 3.4%.⁸⁶⁹

⁸⁶⁷ Ferk, Barbara: Zadolževanje in prezadolženost prebivalstva, Delovni zvezek 1/2007, UMAR, p.66.

⁸⁶⁸ Zakon o izvršbi in zavarovanju, available at http://zakonodaja.gov.si/rpsi/r08/predpis_ZAK01008.html.

⁸⁶⁹ UMAR, Economic Issues, 2012, p. 125.

Lower demand for credit because of higher risk premiums and loss of potential customers through restrictive lending practices were also reported by the interviewees as notable consequences.

24.4.3 Economic and social consequences of over-indebtedness for society

The effects of over-indebtedness go well beyond the households' financial situation and manifest themselves in health problems, family breakdowns and reduced participation in economic and social life.

The demand for emergency housing units by households that have lost their home and are threatened by homelessness has grown significantly higher than the supply in the last years and investments are needed to ensure a suitable supply.⁸⁷⁰ The national budget for social assistance in cash and the number of social assistance recipients have increased since the beginning of the financial crisis.⁸⁷¹ In 2011, the Slovene courts reported a 26% increase in the costs of the free of charge legal aid.

The consumer organization in Slovenia encounters many households that are facing debt problems and considers that they were not properly informed by their banks about the risks related to taking out a loan, especially those who took out foreign currency loans or loans secured by financial instruments.

The stakeholders evaluated the economic costs of debt advice and other measures to alleviate impact of over-indebtedness as least important. This is not surprising given that such policies are not present in Slovenia.

24.4.4 Debt collection practices

Stakeholders who provided a response on the matter indicated that debt collection has become more aggressive. This could, however, be on the grounds of a higher sensibility to this issue. Sensibility may have increased because of the increased general activity of debt collection due to a general fall in payment discipline by companies and households.

The Human Rights Ombudsman reported in the latest annual report that not many irregularities were identified in the majority of received complaints on debt collection practices. Further, the Ombudsman concludes that the debtors in general have very poor knowledge of the collection procedure and are therefore seldom successful in the assertion of their rights. According to the Ombudsman's report debtors need

⁸⁷⁰ Human Rights Ombudsman, 'Annual Report 2011', 2012.

⁸⁷¹ Ministry of Labour, Family and Social Affairs.

http://www.mddsz.gov.si/si/uvcljavljanje_pravic/statistika/denarna_socialna_pomoc/

some sort of assistance and advice for controlling their debt and communicating with their creditors.⁸⁷²

One interviewee working for a public authority pointed to deficiencies in the system that lead to cases such as an individual losing his house due to non-payment of a 120 Euro bill to a public water company.

24.5 MEASURES IN FORCE TO ALLEVIATE THE IMPACT OF OVER-INDEBTEDNESS

24.5.1 Early identification of households at risk

Since 2008, the Slovene Credit Bureau SISBON has collected data on consumers' credit operations at banks and some leasing and payment services providers, as well as on debt collection and personal insolvencies. The purposes of aggregating and providing access to this data are primarily: a better assessment of credit-worthiness; ensuring responsible lending; and preventing over-indebtedness. Credit providers who are not part of the system can only access the data on negative events affecting the consumer's credit worthiness. It is quite common that the bank first checks the data on the consumer in the credit bureau and then further evaluates the consumer's disposable income and the stability of his or her work contract before granting credit.

24.5.2 Advice offered to over-indebted households

No institutional debt advice exists in Slovenia. The national consumer organization (Zveza potrošnikov Slovenije) offers legal assistance to their members in the field of disputes related to consumer credit and some printed or online information materials on issues such as debt or personal insolvency.

No research has taken place on the demand for debt advice. However, the statistics on household debt⁸⁷³ and reports on the households' low financial literacy,⁸⁷⁴ together with the growing complexity of financial products and personal situations allow for a conclusion that the demand for debt advice is or might become high. Assistance requests that the national consumer organization has received from consumers have been on the increase in the past five years, although statistics on this have not been systematically recorded.

⁸⁷² Human Rights Ombudsman, 'Annual Report 2012'.

⁸⁷³ UMAR, Economic Issues 2012, p. 124.

⁸⁷⁴ See for example National Financial Education Programme, p. 7.

http://www.mf.gov.si/fileadmin/mf.gov.si/pageuploads/sporocila/oecd/NPFI_EN.pdf.

24.5.3 Key measures in place to alleviate the impact of over-indebtedness

Debt repayment plans between a consumer and a bank are common where the bank estimates that the consumer can only temporarily not repay his or her debt or when difficulties can be resolved with a lower monthly instalment. Assistance in reaching informally brokered arrangement is offered by lawyers who charge a fee, while some specialized private firms appeared only recently. It is therefore too early to evaluate this service.

Consumer insolvency procedure was introduced into the Slovene legal system in 2008 and has been used by a growing number of households. Because it is a novelty in Slovenia it is not yet possible to assess how effective it is in alleviating the impact of over-indebtedness. The cost of the procedure, around 1,500 Euro, can be covered by free-of-charge legal aid if the household's income is too low to cover legal assistance without negative consequences for its financial safety.⁸⁷⁵ Consumers can apply for the free-of-charge legal aid when filing their applications for personal bankruptcy procedure. According to the consumer organization's experience the procedure of personal insolvency is quite difficult for consumers because they receive no specialized debt advice during the procedure. Nevertheless, some households report that filing for personal insolvency is less stressful because no harassment takes place from the side of the creditors and the claims are managed by a lawyer - trustee in bankruptcy.

Households in serious financial stress can apply for urgent financial assistance from the social security office. The sums that can be granted are however only enough to cover utility bills or lower rent arrears. The maximum amount of urgent financial help that can be granted to a family is 780 Euro for a period of up to 5 months.⁸⁷⁶ The only other source of financial assistance is humanitarian organizations.

24.5.4 Changes in response to over-indebtedness

One stakeholder pointed out the consumer insolvency procedure, which was introduced in 2008 as the main change in response to over-indebtedness in Slovenia. Others reported that there have been no such changes in the past five years and overall it was emphasised in the interviews that there is no systematic policy at the national level to combat over-indebtedness.

24.5.5 Types of households of over-indebted consumers not reached by current measures

With the exception of the legal insolvency procedure, no measures to alleviate the impact of over-indebtedness exist in Slovenia. Consequently no particular groups can

⁸⁷⁵ Law on Free of Charge Legal Aid, http://zakonodaja.gov.si/rpsi/r05/predpis_ZAKO1265.html.

⁸⁷⁶ http://www.mdds.gov.si/si/delovna_podrocja/sociala/denarna_socialna_pomoc/.

be singled out as not reached by current measures, apart from households in financial difficulties that are not granted the free-of-charge legal aid. These households could be prevented from accessing the procedure because of not being able to cover its costs.

24.6 OUTLOOK

The number of over-indebted households in Slovenia will increase in the next five years according to the assessment of the majority of stakeholders. Austerity measures, stricter social legislation and unfavourable economic situation were identified as the main factors of increasing risk of over-indebtedness.

In terms of changes needed in regulation of credit, the consumer organization calls for an active supervision of lending practices and the banning of certain products or practices in case these could lead to an increase in over-indebtedness. No changes, on the other hand, are needed on the housing market according to the interviewees. One interviewee pointed out that education programs targeting improved money management skills of households are desirable.

In conclusion, it can be assessed - as most stakeholders agreed - that the issue of over-indebtedness is of key importance and should be addressed by the public policy in Slovenia. It is necessary to first define over-indebtedness and assess the scope of the problem, and then to implement measures for its prevention and alleviation of its consequences. The lack of data on over-indebted households is seen as the most serious obstacle for the analysis of over-indebtedness. The provision of debt advice is one of the key policies proposed by those who participated in this present study.

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ANNEX A: STATISTICAL DATA FROM EU SOURCES

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Slovenia

I. Eurobarometer¹

Slovenia EU average Lowest EU value Highest EU value

Households *at risk* of being over-indebted

Respondents feeling at risk of over-indebtedness in 2010	↘ 15%	25%	7%	52%
Respondents feeling at risk of over-indebtedness in 2009	↘ 11%	27%	9%	53%

II. EU SILC standard survey data²



III. EU SILC 2008 module: Over-indebtedness and financial exclusion³

Slovenia EU average Lowest EU value Highest EU value

Proportion of people in households with bank overdrafts, outstanding balances on credit cards or in arrears on other loans of over 100% of household disposable income

Overdrawn bank account (% of people in households overdrawn)	↗ 3.4%	2.2%	0.0%	7.7%
Credit or store card (% of people in households with outstanding balances)	↘ 0.0%	1.1%	0.0%	8.6%
Other loan/credit payments (% of people in households in arrears)	↘ 0.0%	0.3%	0.0%	1.1%

Proportion of people in households in arrears in servicing housing-related loans and bills and in paying other bills of over 100% of household disposable income

Housing bills (% of people in households in arrears)	↘ 0.3%	0.5%	0.0%	2.9%
Other payments (% of people in households in arrears)	↘ 0.1%	0.4%	0.0%	1.7%

Households living with outstanding debts and/or arrears of over 100% of household disposable income

Total (% of households with outstanding debts/arrears)	↘ 4.4%	4.6%	0.0%	11.8%
Income above 60% median (% of households with outstanding debts/arrears)	↘ 4.0%	4.2%	0.0%	11.3%
Income below 60% median (% of households with outstanding debts/arrears)	↘ 6.9%	7.0%	0.2%	13.7%
Materially deprived (% of households with outstanding debts/arrears)	↗ 13.4%	9.0%	0.1%	27.4%

Proportion of those in broad age groups with outstanding debts of over 100% of household disposable income

Households with all adults aged 25-39 (% of households with outstanding debts)	↘ 4.3%	6.3%	0.0%	17.2%
Households with all adults aged: 40-64 (% of households with outstanding debts)	↘ 4.5%	5.8%	0.0%	10.9%
Households with all adults aged: 65+ (% of households with outstanding debts)	↘ 0.5%	1.2%	0.0%	2.8%

Proportion of those in different types of household with outstanding debts of over 100% of household disposable income

Living alone (% of people in households with outstanding debts)	↘ 3.2%	4.3%	0.0%	8.2%
Single parent (% of people in households with outstanding debts)	↗ 10.5%	9.5%	0.0%	27.1%
Other (% of people in households with outstanding debts)	↘ 4.2%	4.8%	0.0%	12.1%

Proportion of those in households with outstanding debts of over 100% of household disposable income by marital status

Never married (% of people in households with outstanding debts)	↘ 4.6%	5.0%	0.0%	15.4%
Married (% of people in households with outstanding debts)	↘ 3.3%	4.1%	0.0%	9.7%
Separated/divorced (% of people in households with outstanding debts)	↗ 7.6%	7.5%	0.1%	13.9%
Widowed (% of people in households with outstanding debts)	↗ 2.2%	1.7%	0.0%	4.3%

Proportion of those in households with outstanding debts of over 100% of household disposable income by housing tenure

Owner occupied without mortgage (% of people in households with outst. debts)	↗ 3.8%	3.2%	0.0%	9.6%
Owner occupied with mortgage (% of people in households with outst. debts)	↗ 8.7%	6.3%	0.0%	16.1%
Market rent (% of people in households with outstanding debts)	↘ 3.2%	8.2%	0.0%	16.0%
Subsidised rent (% of people in households with outstanding debts)	↗ 12.6%	8.7%	0.0%	17.9%
Rent-free housing (% of people in households with outstanding debts)	↗ 4.1%	2.3%	0.0%	15.1%

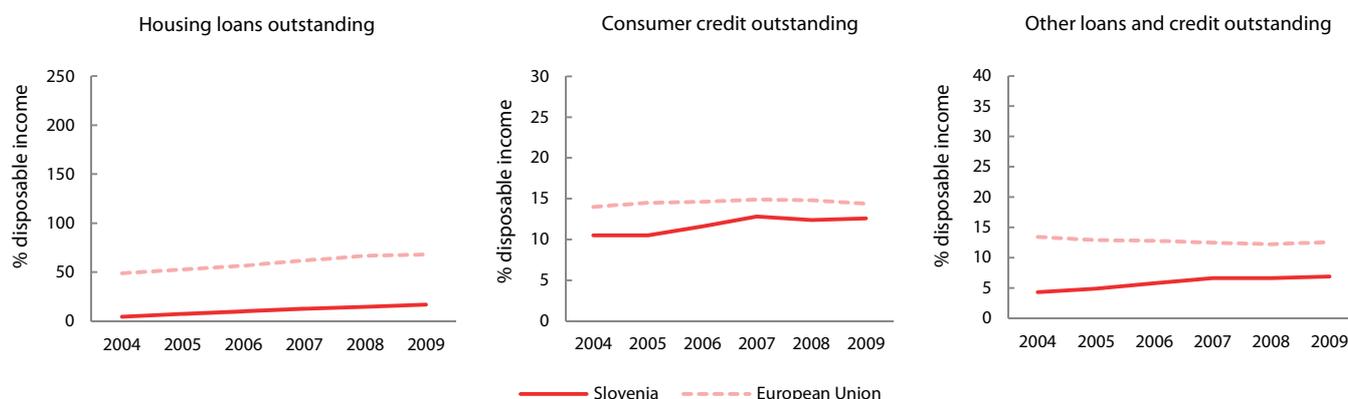
Proportion of those in households with outstanding debts of over 100% of disposable income by work intensity

Work intensity of 0 - 0.19 (% of people in households with outstanding debts)	↘ 5.2%	5.7%	0.0%	10.6%
Work intensity of 0.20 - 0.50 (% of people in households with outstanding debts)	↔ 5.7%	5.7%	0.0%	15.3%
Work intensity of 0.51 - 0.74 (% of people in households with outstanding debts)	↘ 4.6%	5.4%	0.0%	13.5%
Work intensity of 0.75 - 1.0 (% of people in households with outstanding debts)	↘ 4.2%	5.3%	0.0%	14.3%

Proportion of those in over-indebted households that experienced a major drop in income over the preceding year

Over-indebted (% of people in households that experienced drop in income)	↘ 23.6%	33.3%	0.0%	77.6%
Other (% of people in households that experienced drop in income)	↘ 11.8%	19.2%	5.9%	32.5%

IV. Loans and credit outstanding⁴



Notes:

(1) Eurobarometer 72.1 (2009) and Eurobarometer 74.1 (2010). Note: Those who answered 'very at risk' or 'fairly at risk' to the question 'Please tell me how much you feel at risk of being over-indebted'.

(2) Eurostat, SILC. Data as of December 2012.

(3) European Commission, Research Note 4/2010, Over-indebtedness new evidence from the EU-SILC special module.

(4) European Commission, Research Note 4/2010, Over-indebtedness new evidence from the EU-SILC special module. European Credit Research Institute (ECRI), Lending to households in Europe, 1995-2009 and Eurostat, National accounts.

25 SPAIN

Document The over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact - Country report Spain

Prepared by Julia Gumy

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25.1 DEFINITION OF OVER-INDEBTEDNESS

Spain does not have an official or legal definition of over-indebtedness. Currently, problematic debt situations fall within the consumer law domain and legal procedures are adopted only when individuals or businesses fail to meet their obligations. Thus, definitions contained within insolvency laws are the best approximation of a definition of over-indebtedness (e.g. the Law 22/2003 of 9 July states that debtors are declared insolvent if they cannot meet, on an on-going basis, their financial commitments).⁸⁷⁷

The lack of an official definition is to some extent reflected in the stakeholders' interviews. Most stakeholders agreed on the lack of a common definition. However, their understanding of over-indebtedness often coincided with that of over-commitment, that is, an excess of debt relative to disposable income. Individuals or households are therefore defined as over-indebted if they have more debts than they are able to repay. Debt-to-income ratios⁸⁷⁸ were therefore mentioned as instruments to determine whether individuals or households can afford to service their debts given their socio-economic circumstances. However, there was no consensus regarding the over-indebtedness threshold.⁸⁷⁹ For some stakeholders, individuals are also defined as over-indebted if they are persistently in arrears on expenses such as utility bills or mortgage payments.

However, in view of the financial crisis and growing unemployment – which has severely affected many Spanish households' budgets – stakeholders expressed the need for an official and broader definition that would take into account not only individuals' or households' level of debt and their income but also their changing life circumstances. The current crisis has highlighted that over-commitment is only part of the problem.

Many households with very few or no debts found themselves experiencing financial problems after an unexpected drop in household income or an increase in expenses and the cost of living. Stakeholders considered a definition that links financial behaviour to households' changing economic circumstances; such a definition would be crucial in identifying situations of vulnerability and facilitating action at both a legal and policy level.

⁸⁷⁷ For the definition (in Spanish) see: http://noticias.juridicas.com/base_datos/Privado/I22-2003.html

⁸⁷⁸ A threshold of around 30% is often used by banking authorities to determine whether a household has the capacity to service unsecured debts. The threshold increases to 50% if secured debts are added (e.g. mortgages). Over-indebted households would therefore have debt-to-income ratios above 30% or 50% depending on whether the debt includes mortgages.

⁸⁷⁹ For example, a financial industry stakeholder said that: "Based on common sense, over-indebtedness can be defined in terms of a loan-to-income ratio of 50-60%". In contrast, an independent expert considered that: "A household is over-indebted if debt service payments outstrip 40% of the income for more than a year". The same respondent stated that a better definition is needed.

25.2 LEVEL OF OVER-INDEBTEDNESS

Economic prosperity and indebtedness are strongly linked. Several authors have claimed that the increase in consumer credit both accompanied and was accompanied by economic growth. In other words, the favourable macroeconomic conditions experienced in the years preceding the financial crisis (e.g. increase in GDP per capita, increase in disposable income, low unemployment rates)⁸⁸⁰ stimulated households to accumulate debt.⁸⁸¹

Spain, like many other countries in Europe, is a good illustration of this relationship. Debt levels have strongly increased since the nineties, a period of economic boom and deregulation of the credit markets. Mortgage lending was the main driver of the increase in debt levels as – with an expanding housing market – households took advantage of low interest rates and easy access to credit.⁸⁸² Indeed, figures in Annex A of this country report show that housing loans made up between 50% and 100% of households' disposable income during the 2004-2009 period compared to around 10-15% of consumer credit loans.⁸⁸³ According to an interviewed expert, the rise in mortgage lending allowed individuals to use part of that credit for consumption purposes.

Over-indebtedness levels in Spain therefore closely followed housing market trends. The EU-SILC standard survey data (see Annex A) shows that the percentage of households in arrears on mortgage or rent payments peaked in 2009 at around 5% of the total population, after the burst of the housing bubble. Data from the Bank of Spain (Banco de España)⁸⁸⁴ also show that the percentage of doubtful loans to total loans for home purchases and acquisition of consumer durables increased during the 2007-2011 period. Figures from the General Council of the Judiciary (Consejo General del Poder Judicial) show that the number of individuals facing foreclosure increased by 126% between 2007 and 2008. Furthermore, according to the Eurobarometer, in 2009 49% of interviewees in Spain felt at risk of over-indebtedness,⁸⁸⁵ compared to 27% in the EU27 (see Annex A). Surprisingly, in 2010 the percentage of those feeling

⁸⁸⁰ Girouard, N., Kennedy, M., and Christophe, A., *Has the Rise in Debt made Households more Vulnerable?*, Economics Department Working Paper No. 535, 2007, Paris: OECD.

⁸⁸¹ See for instance: Brown, S., Garino, G., Taylor, K., and Wheatley-Price, S., 'Debt and Financial Expectations: An Individual and Household Level Analysis,' *Economic Inquiry*, Vol. 43, No. 1, pp. 100-120, 2005.

⁸⁸² Febrero, E. & Dejuán, O., *Endeudamiento Familiar y Crecimiento Económico: Un Patrón de Crecimiento Insostenible*, Working Paper DT-DAEF 2009/7, 2009, Spain: Universidad de Castilla la Mancha; Del Río, A., *El Endeudamiento de los Hogares Españoles*, Documento de trabajo No. 0228, 2002, Madrid: Banco de España.

⁸⁸³ The European Commission also states that in 2007 17% of the gross income of Spanish households went to the servicing of debt and it was 38% for the poorest households. Furthermore, almost 48% of those households with outstanding debt spent more than 40% of their income on servicing the debt. For more information see: Fondeville, N., Ozdemir, E. and Ward, T., *Over-indebtedness: New evidence from the EU-SILC social module*, European Commission, Directorate-general for Employment, Social Affairs and Equal Opportunities, Research Note 4/2010, 2010, p. 24.

⁸⁸⁴ Banco de España, Statistical Bulletin, Table 4.13. Available at: <http://www.bde.es/webbde/es/estadis/infoest/a0413e.pdf>.

⁸⁸⁵ The exact wording of question QA26b is: "Please tell me how much you feel you are at risk of being over-indebted."

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at risk of over-indebtedness decreased to 25%. This was the largest improvement in public confidence in the EU. In the European Commission's view, the Spanish government's attempts to tackle the recession caused people to feel more confident about their finances.⁸⁸⁶

The interviewed stakeholders also observed increases in over-indebtedness levels, although changes were particularly noted from the start of the global economic crisis. Thus, the increases were not linked to an increase in new debt acquisition but were rather interpreted as a consequence of years of abundance and consumerism halted by the burst of the housing bubble, an increase in housing interest rates, growing unemployment and cuts in social welfare.

25.3 NATURE AND DRIVERS OF OVER-INDEBTEDNESS

25.3.1 Most common types of households that are over-indebted

Most academic literature on over-indebtedness has examined problematic debtors in the United Kingdom and found that the typical profile of over-indebted households is made up of young individuals who are divorced/separated, have children and live in owner-occupied accommodation. Low income is also a characteristic feature of over-indebted households.⁸⁸⁷ Spanish interviewees and results from the EU-SILC survey also confirmed this characterisation, which shows that over-indebtedness profiles in Spain and in the United Kingdom broadly coincide.

As seen in Annex A, in 2008 Spain had a lower percentage of households with outstanding debts (i.e. overdrawn bank accounts, credit or store cards, other loans, housing bills) of over 100% of household disposable income than the EU27. However, the characteristics of households with these levels of debt appear to be the same as in the EU27 (e.g. working age adults, single parents, divorced/separated, in owner occupied accommodation). In contrast to the EU27, a very large percentage of individuals living in over-indebted households have experienced a drop in income over the preceding year (77.6% compared to 33.3% for the EU27). This means that in Spain, income fluctuations could be an important driver of over-indebtedness.

In terms of education, while most stakeholders indicated that individuals with low levels of education are more likely to experience over-indebtedness, most of the households at risk of over-indebtedness interviewed for this study in Spain (although limited in number) are university educated. The academic literature suggests that higher levels of education lead to higher paid jobs and accumulation of wealth and

⁸⁸⁶ Special Eurobarometer 355, 'Poverty and Social Exclusion Report' 2010, Brussels: European Commission, p. 41.

⁸⁸⁷ See for example: Boenheim, R., and Taylor, M., *My Home Was My Castle: Evictions and Repossessions in Britain*, 2000, Essex: Institute for Social and Economic Research; Bridges, S., and Disney, R., 'Use of Credit and Arrears on Debt among Low-Income Families in the United Kingdom,' *Fiscal Studies*, Vol. 25, No. 1, pp. 1–25, 2004; Brown, S., Garino, G., Taylor K., 2005. Kempson, E, *Overindebtedness in Britain*, 2002, United Kingdom: Department of Trade and Industry.

therefore greater access to loans and mortgages.⁸⁸⁸ Since the financial crisis, vulnerability may have increased amongst highly indebted but educated households – often first time buyers. Two thirds of interviewed stakeholders noted significant changes in the types of households that have been affected by over-indebtedness in the last five years. An independent expert spoke about the "shrinking middle class" and observed: "The main change has been the breakdown of the medium-level fringe of household, because of the explosion of the leveraged indebtedness ratio."

The question of immigration was also brought up by some stakeholders as immigrants – mostly employed in the construction sector – were the first group to experience unemployment and a fall in income. Furthermore, according to the European Commission,⁸⁸⁹ immigrants were hit significantly by the crisis as they were responsible for almost 40% of house purchases involving large mortgages.

25.3.2 Causes of households' over-indebtedness

Macro-economic factors

The Spanish unemployment rate rose to 25% in 2012.⁸⁹⁰ Indeed, the interviewed stakeholders most frequently identified unemployment as a cause of households' ongoing difficulties meeting their financial commitments. The loss of employment – and therefore income – of one or more members of a household reduces households' budgets, thereby limiting their ability to service debts. This is confirmed by another recent study⁸⁹¹ which found that an increase in the unemployment rate was the main driver behind an increase in default rates between 2007 and 2009.

Cost of living

Housing and utility costs were the most frequently cited causes of over-indebtedness amongst stakeholder interviewees, with other costs such as those related to childcare, healthcare and insurance regarded as less important.⁸⁹²

⁸⁸⁸ See for instance: Brown, S., and Taylor, K., 'Household Debt and Financial Assets: Evidence from Germany, Britain and the USA,' *Journal of the Royal Statistical Society*, Vol. 171, No. 3, pp. 615-643, 2008.

⁸⁸⁹ Fondeville, N., Ozdemir, E., and Ward, T., *Over-indebtedness: New evidence from the EU-SILC social module*, European Commission, Directorate-general for Employment, Social Affairs and Equal Opportunities, Research Note 4/2010, 2010.

⁸⁹⁰ See <http://www.ine.es/>.

⁸⁹¹ Blanco, R., and Gimeno, R., *Determinants of Default Ratios in the Segment of Loans to Households in Spain*, Documentos de Trabajo No. 1210, 2012, Madrid: Banco de España.

⁸⁹² It is noteworthy that in 1990 a regulation was promoted to provide free universal childcare to children aged under 3 years lessening the financial burden of childcare on families. Also, informal childcare provided by grandparents or relatives reduces the need for formal (and paid) childcare (see: <http://www.wiwi.hu-berlin.de/professuren/vwl/wtm2/brownbag/garciakuehn2012>).

Types of credit/loan taken out by households

Home loans or mortgages and credit loans from regulated lenders with average interest rates, which are the most commonly used credit products, were also identified frequently as causes of over-indebtedness.

Personal circumstances

Related to the macroeconomic section, most stakeholders most commonly identified a drop in income resulting from unemployment as an important personal cause of over-indebtedness. Increases in the cost of living and falls in income caused by illness or divorce/separation were rated as the next most important causes of over-indebtedness. This is confirmed by household interviews. Most household interviewees stated that general wage levels, unemployment and a stagnant economy, accompanied by an increase in the cost of living, were the main causes of their household's financial difficulties.

25.3.3 Changes relevant for levels of over-indebtedness

Stakeholders emphasised that unemployment and austerity measures had a strong negative impact on over-indebtedness levels. Furthermore, the austerity measures – which are affecting primary areas like health and education – oblige individuals to use disposable income to finance these services. This represents an additional burden on the household budget.

Changes in the lending practices of credit providers have reduced accessibility to credit by imposing additional creditworthiness requirements. According to a financial industry stakeholder: "These practices worsen the situation and hamper access to further solutions to alleviate over-indebtedness." This view was shared by four other stakeholders who commented that the reduced accessibility to credit has limited households' financial resources in a period in which households' needs have substantially increased.

In terms of improvements, the changes to the regulatory environment are considered by some of the interviewed stakeholders to protect individuals experiencing debt problems and encourage responsible lending.⁸⁹³

Other changes include the use of informal loans, such as loans from family members, friends and employers. Spanish families have traditionally been regarded as a complementary source of financial support to social welfare.⁸⁹⁴ This support, in the shape of informal loans, is perceived by stakeholder interviewees to have increased. Data from the Centre for Sociological Research (Centro de Investigaciones

⁸⁹³ See for instance EU Consumer Credit Directive 2009, the Real Decreto 6/12 and the Credit Agreements Relating to Residential Property (CARRP) as suggested by the stakeholders.

⁸⁹⁴ Esping-Andersen, G., *The Three Worlds of Welfare Capitalism*, 1990, United States: Princeton University Press.

Sociológicas; CIS) barometer (September 2010), published in a report, revealed that 13% of individuals had received economic (monetary) support from a family member in 2010.⁸⁹⁵ Moreover, the percentage of individuals who believe that it is better to borrow from family and friends than from a bank increased from 40% in 2004 to 50% in 2010. According to another study on behalf of La Fundación La Caixa, 56% of individuals believe that the family needs to take responsibility for economic support and care services.⁸⁹⁶ Economic support has predominantly been given to younger people (under 30s), who are considered to be the group most affected by the crisis. However, it was pointed out in the stakeholder interviews that these loans are regarded as financial aid rather than credit and do not generate more over-indebtedness.

Stakeholders had mixed opinions about whether there had been any changes in the accumulation of debt from utilities, telecommunication services and rent. Although there might have been an increase, it is not a source of persistent over-indebtedness as providers cut off services after two months of unpaid bills. In fact, the figures presented in Annex A show that the percentage of households in arrears on utility bills is lower than the EU-average and did not increase substantially after the crisis. An alternative explanation for these low levels could be attributed to a high percentage of young individuals (under 30s) living at home with their parents⁸⁹⁷ and not having to pay utility bills. As unemployment has mostly hit young people, levels of arrears would not be immediately affected.

25.3.4 Cultural attitude towards debt and actual level of households' (over-) indebtedness

Economic prosperity and easy access to credit have increased tolerance towards debt, according to most interviewed stakeholders. During the pre-crisis period being 'debt-free' was not considered a social value and over-indebtedness was not regarded as a problem, thus the spread of indebtedness. Debt tolerance is, however, mostly seen by the stakeholders as a consequence of economic prosperity, aggressive lending practices and lack of information rather than cultural factors *per se*. The financial crisis seems to have changed households' perceptions about debt, leading them to become more conservative and save more, according to an interviewed expert.

⁸⁹⁵ Fundación Encuentro, *Capítulo 3 - La Fortaleza de la familia como pilar ante la crisis económica in Fundación Encuentro, Informe España 2011, 2011.*

⁸⁹⁶ Meil, G., *Individualización y Solidaridad Familiar*, Colección Estudios Sociales No. 32, 2011, Barcelona: Obra Social La Caixa.

⁸⁹⁷ According to Meil (2011), 67% of young people in Spain (under 30) live with their parents.

25.4 CONSEQUENCES OF OVER-INDEBTEDNESS

The literature acknowledges that over-indebtedness affects society in many ways. For individuals or households over-indebtedness can produce a deterioration in well-being,⁸⁹⁸ that is in many cases related to poverty and social exclusion.⁸⁹⁹ At a societal level, an increasing number of over-indebted households challenges social protection systems and leads to increased demands for new legislation to protect vulnerable groups.⁹⁰⁰

25.4.1 Consequences for affected households

Empirical literature explaining the consequences of over-indebtedness in households is very scarce. Most of the evidence comes from qualitative studies collecting information on non-representative samples of individuals or from studies examining the impact of bankruptcy proceedings.⁹⁰¹ Moreover, many of the qualitative studies were undertaken in the United States or the United Kingdom, where debt policies and legislation differ from those in Spain, thus the 'importance' of the consequences of over-indebtedness may not entirely coincide.

Based on an average rating of consequences of over-indebtedness for households attributed by interviewed stakeholders, in Spain the most highly rated consequences for affected households were home repossession, a reduction in the standard of living and reduced labour market activity. The least highly rated consequences were a development of addictive behaviour (for example drugs/alcohol), family breakdown and a deterioration of mental health.

In contrast, results from the household interviews reveal that debt problems do have a significant impact on individuals' well-being, leading to mental health problems, a reduction in living standards and a deterioration of family relations. Many household interviewees indicated that financial difficulties negatively affected the household's

⁸⁹⁸ Brown, S., Taylor, K., and Wheatley-Price, S., 'Debt and Distress: Evaluating the Psychological Cost of Credit,' *Journal of Economic Psychology*, Vol. 26, No. 5, pp. 642-633, 2005.; Bridges, S., and Disney, R., 'Debt and Depression,' *Journal of Health Economics*, Vol. 29, No. 3, pp. 388-403, 2010; Gathergood, J., 'Debt and Depression: Causal Links and Social Norms Effects,' *The Economic Journal*, Vol. 122, No. 563, pp. 1094-1114, 2012; Talor, M., Jenkins, S., and Sacker, A., *Financial Capability and Well-being: Evidence from the BHPS*, Occasional Paper Series 39, 2009, United Kingdom: Financial Services Authority.

⁸⁹⁹ Boenheim, R., & Taylor, M., 2000; Helen, R., Maitre, B., and Donnelly, N., *Financial Exclusion and Over-indebtedness in Irish Households*, Social Inclusion Research Report, 2011, Dublin: ESRI.

⁹⁰⁰ For implications for legislative frameworks see for instance: Niemi-Kiesilainen, J., 'Overindebted Household and Law: Prevention and Rehabilitation in Europe,' in *Consumer Credit, Debt & Bankruptcy. Comparative and International Perspectives*, edited by Johanna Niemi, Iain Ramsay, and William Whitford, 2009, Oregon: Hart Publishing; Niemi-Kiesilainen, J., 'Consumer Bankruptcy in Comparison: Do We Cure a Market Failure or a Social Problem?' *Osgoode Hall Law Journal*, Vol. 37, Nos. 1-2, pp. 473-503, 1999. For implications concerning the health sector see for instance: Emami, S., *Consumer Over-indebtedness and Health Care Costs: How to Approach the Question from a Global Perspective*, World Health Report, Background paper 3, 2010, World Health Organisation.

⁹⁰¹ For instance, Hira found that in Japan, twenty years ago, the consequences of bankruptcy were extremely severe including family breakdown and mental health problems, often resulting in suicide or running away from home. See Hira, T.K., 'Causes and Effects of Consumer Bankruptcies: a Cross-cultural Comparison,' *Journal of Consumer Studies and Home Economics*, Vol. 16, Nos. 229-243, 1992.

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well-being. For instance, an interviewee reported having suffered from sleeplessness and that it would be "better to be in jail" because that would not be so costly. Another household interviewee, who started taking anti-depressants when severe financial difficulties arose, stated that the impact was "catastrophic".

Overall, the testimonies of both stakeholders and households show that over-indebtedness affects several areas of individuals' lives and that the consequences are intertwined. So, while stakeholders recognise home repossession as a direct consequence of not paying the mortgage, mental health problems and family breakdown – as reported by households – may also be caused by the stress and stigma of not keeping up with debt repayments.

The impact of debt problems on individuals has recently been a matter of strong political debate in Spain. Data from the General Council of the Judiciary (Consejo General del Poder Judicial) shows in fact that since the beginning of 2008 around 400,000 homeowners have faced foreclosure (see Annex B). Moreover, from 2008 until the second half of 2012 around 203,000 properties were repossessed. The scale of these events and the reported impact on individuals' economic and psychological well-being have prompted both ruling and opposition parties to agree on new legislation to protect vulnerable segments of society.

25.4.2 Consequences of over-indebtedness for the financial services industry

The cost of defaulted credits was rated most highly by the interviewed stakeholders, in terms of consequences for the financial services industry. Lower demand for credit arising from higher risk premiums and increased costs for financial services providers, as a result of stricter credit regulation, were also rated highly.

25.4.3 Economic and social consequences of over-indebtedness for society

The European Commission stated recently in a report that consumer confidence, together with an increase in real incomes and employment rates, is a key element in restoring private consumption to pre-crisis levels. It is therefore an important driver of economic growth. Lack of consumer confidence may contract private sector demand and decelerate growth.⁹⁰² Indeed, loss of consumer confidence in the financial services industry was rated highly by stakeholder interviewees when asked about the economic consequences of over-indebtedness for society.

According to an independent expert, the current economic situation makes individuals inclined to pay off their debts using savings. This may lead to a decrease in private consumption, income and employment. Debt to income ratios therefore may not decrease.⁹⁰³ The European Commission 2012 forecasts further indicate that

⁹⁰² European Commission, *European Economic Forecast – Spring 2012*, European Economic 1/2012, Commission Staff Working Document, 2012, Brussels: DG Economic and Financial Affairs.

⁹⁰³ For more information, see forthcoming *The Burden of Debt* by Oscar Dejuán, London: Routledge.

Spain's economy will be negatively affected by weak domestic demand. In other words, high unemployment rates, large household debt and credit constraints, together with lower household disposable income and savings, are expected to restrict private consumption growth and, as a consequence, general economic growth.⁹⁰⁴

Reduced productivity at work was also rated highly by stakeholder interviewees. According to some studies published in the US,⁹⁰⁵ financial stress reduces employees' productivity at work, producing substantial costs for the employer.

25.4.4 Debt collection practices

Spain does not have any regulations that deal with extra-judicial debt collection practices. This has led many debt collection firms to proliferate. Private companies rely on these firms – which sometimes act aggressively – to collect their debts. Half of the interviewed stakeholders noted an increase in aggressive debt collection practices during the past five years.

According to some stakeholders, service providers and banks have also become more aggressive. A civil society stakeholder illustrated the situation as follows:

As a consequence of the economic and financial crisis, many businesses ... have relied on debt collection agencies to put pressure on debtors, harassing clients with multiple phone calls, at any time of the day, almost to the limit of legality by contacting neighbours, family members or employers to inform [them] about the client's situation.

In 2009 a proposal was put forward by a Catalan political party (Convergència i Unió; CiU) to develop a legal framework to tackle debt collection practices and protect consumers against unlawful and abusive practices.⁹⁰⁶ However, these proposals have not yet been made into laws.

⁹⁰⁴ European Commission, 2012.

⁹⁰⁵ Kim, J., and Garman, E.T., 'Financial Stress and Absenteeism: An Empirically Derived Research Model,' *Financial Counselling and Planning*, Vol. 14, No. 1, pp. 1-13, 2003; Garman, E.T., Leech, I., and Grable, J., 'The Negative Impact of Employees Poor Personal Financial Behaviours on Employers,' *Financial Counselling and Planning*, Vol. 7, pp. 157-168, 1996.

⁹⁰⁶ For the original proposals in Spanish see: http://www.congreso.es/public_oficiales/L9/CONG/BOCG/D/D_072.PDF and http://www.congreso.es/public_oficiales/L9/CONG/BOCG/D/D_167.PDF

25.5 MEASURES IN FORCE TO ALLEVIATE THE IMPACT OF OVER-INDEBTEDNESS

25.5.1 Early identification of households at risk

Formal mechanisms for the identification of households at risk of over-indebtedness do not exist in Spain. Stakeholders reported that lenders (i.e. banks, credit agencies) regularly monitor the financial situation of households to identify loan payments arrears. Furthermore, the Centre for Risk Information of the Bank of Spain (Central de Información de Riesgos del Banco de España; CIRBE) maintains a database with all clients' paid and unpaid debts and loans. The purpose is to evaluate the level of risk that individuals or businesses are taking and assess their level of indebtedness. Nevertheless, none of these measures are specifically aimed at identifying households at risk of over-indebtedness.⁹⁰⁷

25.5.2 Advice offered to over-indebted households

In contrast to some other European countries, where specialised (often formally recognised) agencies provide advice and help in cases of over-indebtedness, in Spain consumer and financial organisations are expected to provide advice to problematic debtors. Some of them, particularly financial organisations' customer services, may not offer impartial advice. In the past few years, several initiatives have been undertaken at a regional level (for example in the region of Castilla La Mancha) and within civil society to increase awareness about households' over-indebtedness and to promote websites that offer consumer advice.⁹⁰⁸ However, the weak institutional interest in household over-indebtedness – and consequent lack of regulation and public funding – resulted in a lack of specific public initiatives to tackle this phenomenon in the years preceding the crisis, according to several interviewed stakeholders and a report published by the University of Castilla la Mancha.⁹⁰⁹

The weak visibility of these initiatives is somewhat reflected in the comments of interviewed stakeholders. Interviewees were asked about the types of advice offered (i.e. face-to-face, telephone, email/online chat, web-based tools and printed information) in Spain to over-indebted households and to assess their availability, costs, demand and effectiveness. The vast majority of stakeholder interviewees did not know or did not answer these questions (less than 5 responses to most questions). The few interviewees who answered these questions did not agree on the types of advice offered. Overall, results from stakeholder interviews suggest that most

⁹⁰⁷ For more information see: <http://www.bde.es/clientebanca/cirbe/cirbe.htm>

⁹⁰⁸ Trujillo Diez, I., *El Sobreendeudamiento de los Consumidores*, n.d., Universidad de Castilla la Mancha. For more information see: <http://www.ecri.eu/new/system/files/13+Sobreendeudamiento-spanish-Trujillo.pdf>

⁹⁰⁹ Ibid.

types of debt advice are not effective, though given the low response rates these results cannot be conclusive.

25.5.3 Key measures in place to alleviate the impact of over-indebtedness

Stakeholders were also asked to assess the availability and effectiveness of key measures⁹¹⁰ aimed at alleviating the impact of over-indebtedness in Spain. Again, at least half of respondents did not know or did not answer the question, which may indicate a lack of awareness or knowledge of existing policy, financial or legislative measures.

Availability and costs

Many independent websites illustrate the options available for the rescheduling and discharge of debts in Spain. For instance, as part of a financial education programme the website of Women's World Banking (El Banco de la Mujer), a civil society organisation which aims to improve women's labour market participation and empowerment in society, provides an overview of formal and informal measures to alleviate debt problems, such as debt rescheduling, consolidation and management plans, repossession, embargo and insolvency.⁹¹¹ The pros and cons of each procedure are also discussed. For instance, while debt consolidation helps reduce monthly payment quotas at lower interest rates, it is thought that in the long-run individuals would pay larger sums of money and the cost of cancelling existing debts and requesting a new one would be substantial. Debt consolidation is therefore only suggested as a temporary measure to alleviate households' financial burden. Legal procedures (for example consumer insolvency proceedings)⁹¹² are considered by experts as very slow, inefficient and very costly. Judicial costs may range from 10,000 to 12,000 Euro and individuals cannot apply for court-appointed lawyers.⁹¹³

Stakeholders identified informally brokered arrangements between the debtor and creditors, such as a repayment plan, a debt management plan, a debt write-off brokered by a debt counsellor and legal procedures that take place in court (such as consumer insolvency proceedings), as the most widely available measures in place to alleviate the impact of over-indebtedness. These are followed by formal procedures for debt settlement that do not take place in court. Financial support for households

⁹¹⁰ These key measures include: informally brokered arrangements between the debtor and creditors such as a repayment plan, a debt management plan or a debt write-off that may be brokered by a debt counsellor; legal procedures that take place in court (e.g. consumer insolvency proceedings); formal procedures for debt settlement that do not take place in court; financial support for households to repay debts/arrears (e.g. public fund).

⁹¹¹ <http://www.educacionfinanciera.es/>

⁹¹² Consumer insolvency proceedings are articulated under the Law 22/2003 of 9 July. This law, which was previously conceived to allow businesses to declare themselves insolvent, was extended to individuals in 2003. The main aim is to allow both lenders and borrowers to agree on a debt repayment plan before the business or individual is declared bankrupt. During the financial crisis this law was further modified by Law 38/2011 of 10 October with the aim of simplifying insolvency proceedings.

⁹¹³ For more information (in Spanish) see: http://www.educacionfinanciera.es/t_dinsolv.asp

to repay debts/arrears (e.g. public funding) was not deemed to be available. Informally brokered arrangements are thought to be free of charge by most interviewed stakeholder, while legal procedures and formal procedures for debt settlement, as mentioned previously, are paid services.

Effectiveness as assessed by stakeholders

The effectiveness of the measures is hard to assess, as stakeholders did not reach a consensus in most cases. They did, however, express strong opinions about informally brokered arrangements, as most respondents indicated that they are fairly effective, and for legal procedures, which most respondents considered to be hardly effective. According to an interviewed civil society stakeholder, legal procedures are very costly and not very accessible. The same interviewee stated that legal procedures should be improved to increase accessibility to highly indebted families.

25.5.4 Changes in response to over-indebtedness

In the past five years, legislative changes have been made by the Spanish government to alleviate households' debt problems. These include measures to alleviate debt repayments in case of unemployment (RDL 1975/2008),⁹¹⁴ to encourage debt rescheduling in cases where there is a risk of social exclusion (RDL 6/2012),⁹¹⁵ and to promote responsible lending (Law 2/2011 and Orden EHA/2899/2011).⁹¹⁶ Additional laws were enforced to deal with debtors who lose their property and do not have enough resources to cover their debt (RDL 8/2011 of 1 July).⁹¹⁷ The amount exempt from seizure was also increased to 150% of the official minimum wage plus an additional 30% for each member of the household not receiving income above the minimum wage.

More recently, the previously described dramatic events have prompted the Spanish government to urgently modify the law to account for the high number of foreclosures and home repossessions produced by the economic crisis. With the

⁹¹⁴ Under the terms of this regulation, unemployed individuals can ask for financial support for the repayment of mortgage instalments. The support received would cover 50% of the monthly quota up to 500 Euro per month, provided that the total mortgage is less than 170,000 Euro and had been contracted before 2008. For more information see: http://noticias.juridicas.com/base_datos/Admin/rd1975-2008.html

⁹¹⁵ This decree-law establishes diverse mechanisms for the restructuring of the mortgage debt of 'at risk of social exclusion' individuals. This law is therefore applied to individuals who cannot service their mortgage payments and who cannot provide for their basic subsistence needs. The law is also sensitive to the economic situation of other members in the household. For more information see: <http://www.boe.es/boe/dias/2012/03/10/pdfs/BOE-A-2012-3394.pdf>

⁹¹⁶ These laws establish protection mechanisms for consumers with the aim of promoting responsible lending. In fact, credit institutions will be required to undertake financial assessments (i.e. solvency assessments) of borrowers as well as provide more information about the financial products they offer. For more information see: <http://www.boe.es/boe/dias/2011/03/05/pdfs/BOE-A-2011-4117.pdf> and <http://www.boe.es/boe/dias/2011/10/29/pdfs/BOE-A-2011-17015.pdf>

⁹¹⁷ This decree-law establishes protective measures for mortgage borrowers on low incomes as well as regulating abusive practices during the debt settlement procedures. For more information see: <http://www.boe.es/boe/dias/2011/07/07/pdfs/BOE-A-2011-11641.pdf>

Royal Decree-Law 27/2012, the government enacted a two-year moratorium on foreclosures for vulnerable segments of society. The measure, which is defined as extraordinary and temporary, is not aimed at modifying foreclosure procedures. Given the exceptional economic circumstances, it is aimed at preventing new home repossessions and evictions while giving troubled homeowners the time to recover economically. To qualify, individuals need to meet certain 'vulnerability' requirements such as being lone parents with two children, having children under the age of three, being unemployed or being a victim of gender violence, among other criteria.⁹¹⁸

25.5.5 Types of households of over-indebted consumers not reached by current measures

Some stakeholders identified immigrants and recent homeowners as not being reached by current measures. According to a civil society stakeholder, the measures to alleviate debt repayments in case of unemployment (i.e. RDL 1975/2008) would not be of use to these groups as their homes were acquired during the housing boom, when properties and lands were overvalued. Most mortgages would therefore be above the 170,000 Euro threshold for financial support.

The recently enacted RDL 27/2012 is viewed as a development of the RDL 6/2012. However, it has been severely criticised by certain judicial sectors as it does not tackle the insufficiencies and pitfalls of previous laws and the restrictive accessibility requirements may mean that not all vulnerable groups in society are protected. For instance, lone parents with two children may apply but lone parents with one child are not eligible.

25.5.6 Best practices

Until the RDL 27/2012 was passed, the previously described Royal Decree-Law 6/2012 was mentioned in the stakeholder interviews as the best practice as it took into account individuals' circumstances and created a code of best practice for debt rescheduling which all financial entities could adhere to. However, this Decree-Law was considered by some other interviewees to be insufficient. One of the measures outlined by this decree-law is the so-called 'dación en pago' which allows individuals to legally discharge their debts if the keys of their properties are returned. Nevertheless, financial entities' adherence to this scheme is voluntary and accessibility requirements are described by the interviewees as 'too restrictive'

Alternative measures suggested by the interviewees to improve the situation include the cancellation of debt (i.e. fresh start) of households who have had their homes repossessed, allowing unemployed individuals to temporarily stop servicing debt, and improving transparency and financial literacy.

⁹¹⁸ For more information see: http://www.boe.es/diario_boe/txt.php?id=BOE-A-2012-14115

25.6 OUTLOOK

The current state of the Spanish economy, as it struggles to recover, raises questions as to how over-indebtedness levels may change over the next five years. Restrictive changes to the credit markets and lending practices should prevent indebtedness levels from increasing. However, stakeholders across the main groups included in the study (i.e. civil society, public sector, financial industry and independent experts), recognised that as unemployment rates soar and austerity measures take effect, households will be confronted with a substantial deterioration in their economic well-being. Over-indebtedness levels are therefore likely to increase, according to most interviewees, given that unemployment rates have not yet stagnated. Persistency in over-indebtedness and poverty caused by a lack of economic resources and access to new credit were considered to be future challenges.

In light of the economic climate, interviewed stakeholders considered that existing legislative measures should be reviewed to prevent households from relying heavily – and sometimes irresponsibly – on credit. In terms of credit and lending, consumer protection and the promotion of responsible lending and borrowing (e.g. financial education) were identified as priorities by the interviewees, particularly for EU policymakers, alongside the development of specific over-indebtedness legislation and financial regulation. At a national level, more transparency is required for the regulation of utilities and specific commercial practices of utility companies. With regards to housing, clearance of debt after repossession or a 'fresh start' is advised to aid over-indebted households.

At a macroeconomic level, policy responses should aim to promote measures that reduce unemployment and increase families' earning capacity, according to many interviewees. An interviewee working in the public sector added that fiscal and macroeconomic measures should be combined to "strengthen families' economic reactivation, to protect social networks and prevent social exclusion".

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ANNEX A: STATISTICAL DATA FROM EU SOURCES

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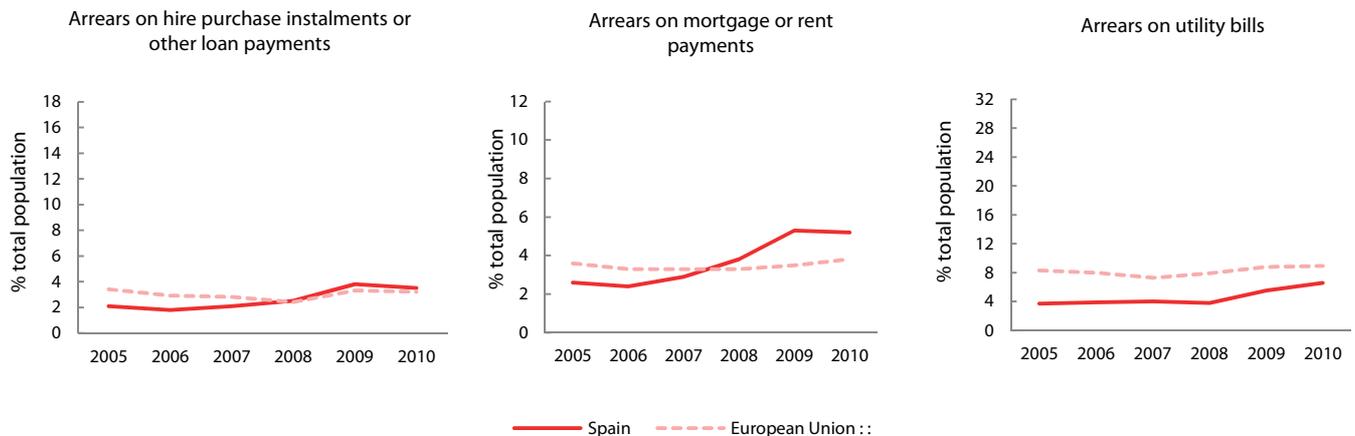
ANNEX 4: STATISTICAL DATA FROM EU SOURCES

Spain

I. Eurobarometer¹

	Spain	EU average	Lowest EU value	Highest EU value
<i>Households <u>at risk</u> of being over-indebted</i>				
Respondents feeling at risk of over-indebtedness in 2010	↘ 27%	25%	7%	52%
Respondents feeling at risk of over-indebtedness in 2009	↘ 49%	27%	9%	53%

II. EU SILC standard survey data²



III. EU SILC 2008 module: Over-indebtedness and financial exclusion³

	Spain	EU average	Lowest EU value	Highest EU value
<i>Proportion of people in households with <u>bank overdrafts, outstanding balances on credit cards or in arrears on other loans</u> of over 100% of household disposable income</i>				
Overdrawn bank account (% of people in households overdrawn)	↘ 0.3%	2.2%	0.0%	7.7%
Credit or store card (% of people in households with outstanding balances)	↘ 0.2%	1.1%	0.0%	8.6%
Other loan/credit payments (% of people in households in arrears)	↘ 0.1%	0.3%	0.0%	1.1%
<i>Proportion of people in households in <u>arrears in servicing housing-related loans and bills and in paying other bills</u> of over 100% of household disposable income</i>				
Housing bills (% of people in households in arrears)	↘ 0.2%	0.5%	0.0%	2.9%
Other payments (% of people in households in arrears)	↘ 0.1%	0.4%	0.0%	1.7%
<i>Households living with <u>outstanding debts and/or arrears</u> of over 100% of household disposable income</i>				
Total (% of households with outstanding debts/arrears)	↘ 1.1%	4.6%	0.0%	11.8%
Income above 60% median (% of households with outstanding debts/arrears)	↘ 0.6%	4.2%	0.0%	11.3%
Income below 60% median (% of households with outstanding debts/arrears)	↘ 3.1%	7.0%	0.2%	13.7%
Materially deprived (% of households with outstanding debts/arrears)	↘ 8.6%	9.0%	0.1%	27.4%
<i>Proportion of those in broad <u>age groups</u> with outstanding debts of over 100% of household disposable income</i>				
Households with all adults aged 25-39 (% of households with outstanding debts)	↘ 1.3%	6.3%	0.0%	17.2%
Households with all adults aged: 40-64 (% of households with outstanding debts)	↘ 1.3%	5.8%	0.0%	10.9%
Households with all adults aged: 65+ (% of households with outstanding debts)	↘ 0.1%	1.2%	0.0%	2.8%

Proportion of those in different types of household with outstanding debts of over 100% of household disposable income

Living alone (% of people in households with outstanding debts)	↘ 0.9%	4.3%	0.0%	8.2%
Single parent (% of people in households with outstanding debts)	↘ 7.6%	9.5%	0.0%	27.1%
Other (% of people in households with outstanding debts)	↘ 1.0%	4.8%	0.0%	12.1%

Proportion of those in households with outstanding debts of over 100% of household disposable income by marital status

Never married (% of people in households with outstanding debts)	↘ 0.9%	5.0%	0.0%	15.4%
Married (% of people in households with outstanding debts)	↘ 0.6%	4.1%	0.0%	9.7%
Separated/divorced (% of people in households with outstanding debts)	↘ 3.4%	7.5%	0.1%	13.9%
Widowed (% of people in households with outstanding debts)	↘ 0.8%	1.7%	0.0%	4.3%

Proportion of those in households with outstanding debts of over 100% of household disposable income by housing tenure

Owner occupied without mortgage (% of people in households with outst. debts)	↘ 0.3%	3.2%	0.0%	9.6%
Owner occupied with mortgage (% of people in households with outst. debts)	↘ 2.0%	6.3%	0.0%	16.1%
Market rent (% of people in households with outstanding debts)	↘ 2.3%	8.2%	0.0%	16.0%
Subsidised rent (% of people in households with outstanding debts)	↘ 1.4%	8.7%	0.0%	17.9%
Rent-free housing (% of people in households with outstanding debts)	↘ 0.8%	2.3%	0.0%	15.1%

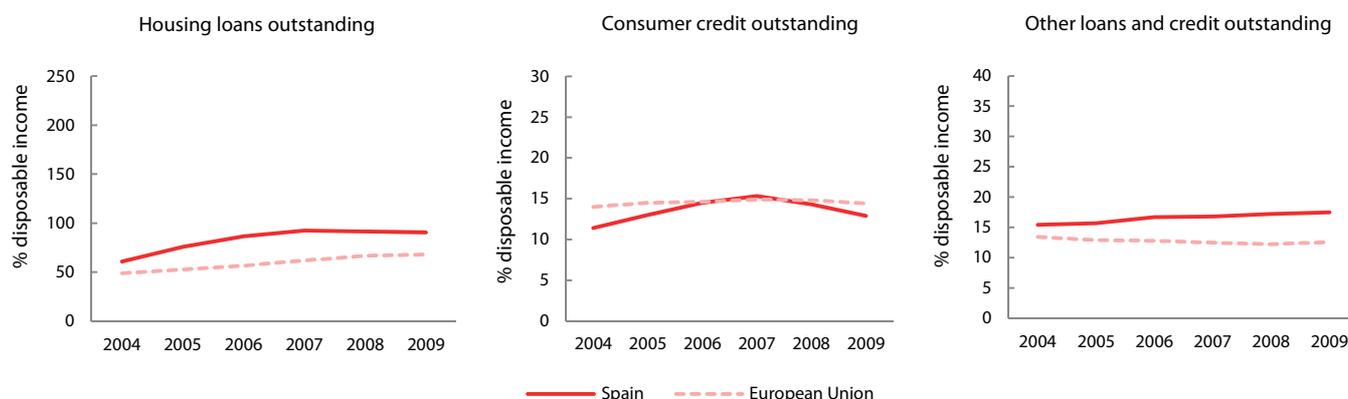
Proportion of those in households with outstanding debts of over 100% of disposable income by work intensity

Work intensity of 0 - 0.19 (% of people in households with outstanding debts)	↘ 1.5%	5.7%	0.0%	10.6%
Work intensity of 0.20 - 0.50 (% of people in households with outstanding debts)	↘ 2.3%	5.7%	0.0%	15.3%
Work intensity of 0.51 - 0.74 (% of people in households with outstanding debts)	↘ 0.5%	5.4%	0.0%	13.5%
Work intensity of 0.75 - 1.0 (% of people in households with outstanding debts)	↘ 0.8%	5.3%	0.0%	14.3%

Proportion of those in over-indebted households that experienced a major drop in income over the preceding year

Over-indebted (% of people in households that experienced drop in income)	↗ 77.6%	33.3%	0.0%	77.6%
Other (% of people in households that experienced drop in income)	↗ 25.9%	19.2%	5.9%	32.5%

IV. Loans and credit outstanding⁴



Notes:

(1) Eurobarometer 72.1 (2009) and Eurobarometer 74.1 (2010). Note: Those who answered 'very at risk' or 'fairly at risk' to the question 'Please tell me how much you feel at risk of being over-indebted'.

(2) Eurostat, SILC

(3) European Commission, Research Note 4/2010, Over-indebtedness new evidence from the EU-SILC special module.

(4) European Commission, Research Note 4/2010, Over-indebtedness new evidence from the EU-SILC special module. European Credit Research Institute (ECRI), Lending to households in Europe, 1995-2009 and Eurostat, National accounts.

ANNEX B: COMPLEMENTARY NATIONAL STATISTICAL DATA

Table 11. Fore-closures and repossessions

Source: General Council of the Judiciary (Consejo General del Poder Judicial). Note: (a) This refers to 'ejecucion hipotecaria' in Spanish legislation. According to the same source, there were 48,213 foreclosures in the first two quarters of 2012. (b) This refers to 'lanziamento' in Spanish legislation. Further 37,092 properties were repossessed in the first two quarters of 2012.

	2007	2008	2009	2010	2011
Number of foreclosures ^(a)	25,943	58,686	93,319	93,636	77,854
Number of repossessed properties ^(b)	n.d.	26,748	33,918	47,809	58,241

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26 SWEDEN

Document The over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact - Country report Sweden

Prepared by Annina H. Persson

Finalised on 20 December 2012

Final report

Over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact

26.1 DEFINITION OF OVER-INDEBTEDNESS

It was reported in the stakeholder interviews that different authorities and organisations define over-indebtedness in various ways and that there is no generally accepted definition in Sweden of what constitutes over-indebtedness.

A person is considered insolvent according to the Bankruptcy Act⁹¹⁹ when they are unable to settle their debts as they fall due for payment, assuming that this inability is more than temporary. In order to qualify for debt relief⁹²⁰ a person must be insolvent and so indebted that they cannot be presumed capable of paying off their debts within the foreseeable future (this is called the "qualified insolvency requirement").

In some research and policy reports, a broader definition of the concept has been used. A person would be considered over-indebted according to this definition if they have constantly recurring problems in terms of not being able to pay their debts.⁹²¹

The above definitions refer to individuals, not to households. However there are some organisations in Sweden which use a definition not restricted to individuals. For example, the Financial Supervisory Authority has discussed the risk of being over-indebted in relation to the situation of households.⁹²²

Several stakeholders indicated that there is a need for a better definition of over-indebtedness, for various reasons. Firstly, with a better definition it would be easier to discuss the problem from a common starting point. Secondly, with a clear definition one could better determine the debtor's debt level, which would facilitate the undertaking of measures to help the debtor. Thirdly, a common method of measurement is needed in order to draw statistically valid conclusions and to adopt measures to alleviate the consequences of over-indebtedness.

26.2 LEVEL OF OVER-INDEBTEDNESS

Households in Sweden have markedly increased their indebtedness since the 1990s.⁹²³ It has been relatively easy to borrow money, partly due to the deregulation of the credit market in Sweden in the 1990s. Household debts rose from 90% of

⁹¹⁹ 1987: 672; Chapter 1, Section 2.

⁹²⁰ See Debt Relief Act, SFS 2006:548, amended through 2011:472.

⁹²¹ See for example: Swedish Enforcement Authority, *Everyone wants to pay their fair share*, Report, 2008.

⁹²² Swedish Financial Authority, *One in five households have no financial buffer*, Press Release, 27th June, 2007.

⁹²³ See: Finocchiaro, D., & Nilsson, C., & Nyberg, D., & Sultanaeva, A., 'Hushållens skuldsättning, bostadspriserna och makroekonomin: en genomgång av litteraturen', *Penning och valutapolitik*, Sveriges Riksbank, 2011, p.1; Statens bostadskreditnämnd, *Hushållens skuldsättning i spåren av finanskrisen - en internationell jämförelse*. Report, February 2011; and Persson, M., *Household indebtedness in Sweden and implications for financial stability - the use of household-level data*, BIS Paper no 46, May 2009.

⁹²³ See Finansinspektionen, 'Beslutspromemoria', FI Dnr 10-1533, 2010-07-08, p. 4.

available income in the mid-1990s to 170% in 2010, mainly due to an increase in housing loans.⁹²⁴ Roughly 70% of Swedish households are home owners and home loans constitute 81% of household debts.⁹²⁵ Swedish law makes mortgage interest payments fully deductible, which in turn makes money relatively cheap to borrow.

Credit institute lending on the security of single-family dwellings and tenant-owner homes at the end of 2011 totalled 2,684 billion Swedish Krona.⁹²⁶ More than one in ten borrowers in the Swedish market (12%) have mortgaged their homes for over 90% of their value.⁹²⁷ As mortgage loans make up the bulk of total household debt, this increases the risk that individuals will be affected by excessive indebtedness and insolvency. Most borrowers in Sweden (88%) opt for a variable interest mortgage, which makes them vulnerable to increases in the interest rate.⁹²⁸

However, there has been no increase in the last five years in the percentage of the total population in arrears with their mortgage or rent payments. In fact the figure has marginally sunk, from 2.4% in 2007 to 2.2% in 2011. This is around half the figure for the EU as a whole (4% in 2011).⁹²⁹ The losses incurred by credit institutions on mortgage loans have stayed at a low level. 'Amortisation-free' loans used to be common practice, but during the past year banks have begun tightening up their amortisation requirements.

Furthermore, in 2010 only 7% of respondents in a Eurobarometer study (see Annex A) felt at risk of becoming over-indebted. This was far below the EU average of 25% and also marked a decline from 2009, when 10% of respondents in Sweden felt at risk of over-indebtedness.

Additionally, there has been little change in the percentage of the population with any arrears in the last five years (i.e. with mortgage or rent, utility bills, hire purchase or other loans). Although the figure rose slightly in the immediate aftermath of the financial crisis in 2008, over the period 2007 to 2011 it remained stable, increasing only slightly from 5.8% in 2007 to 5.9% in 2011. This was almost half the EU average for 2011 (11.4%).⁹³⁰

⁹²⁴ The following is based on Finocchiaro, D. & Nilsson, C. & Nyberg, D. & Soutanaeva, A., Hushållens skuldsättning, bostadspriserna och makroekonomin: en genomgång av litteraturen, Riksbanken, Penning och valutapolitik, 2011:1 and Statens bostadskreditnämnd, Hushållens skuldsättning i spåren av finanskrisen - en internationell jämförelse. Market report. February 2011, as well as Persson, M., Household indebtedness in Sweden and implications for financial stability - the use of household - level data, BIS Paper no 46, May 2009.

⁹²⁵ Svenska bankföreningen, Bolånemarknaden i Sverige, 2011, p. 6.

⁹²⁶ Svenska bankföreningen, Bank- och finansstatistik, 2010, August 2011.

⁹²⁷ See Beslutspromemoria, FI Dnr 10-1533, 2010-07-08, p. 4.

⁹²⁸ Svenska bankföreningen, Bolånemarknaden i Sverige, 2011, p. 10.

⁹²⁹ Eurostat, 'Arrears on mortgage or rent payments' (code: ilc_md06).

⁹³⁰ Eurostat, 'Arrears (mortgage or rent, utility bills or hire purchase)' (code: ilc_md05).

Final report

Over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact

Despite the increase in overall indebtedness since the 1990s, the percentage of the population with outstanding debt and/or arrears amounting to at least 100% of household disposable income is far below the EU average (0.6% in Sweden against 4.6% in the EU as a whole - see Annex A).

Nonetheless, the majority of stakeholders assessed that the number of over-indebted households had increased in the last five years.

26.3 NATURE AND DRIVERS OF OVER-INDEBTEDNESS

26.3.1 Most common types of households that are over-indebted

Problems with over-indebtedness are often faced by households with low income. Data from Eurostat shows that 2.3% of households with an income of less than 60% of the median (i.e. those at risk of poverty) had outstanding debts and/or arrears amounting to at least 100% of household disposable income, compared to 0.4% of households not at risk of poverty (see Annex A). Amongst materially deprived households this figure was even higher - 7.3%. Low income is a particular risk factor for households with dependents and high basic living costs, such as single parents. It has been shown by previous research that single parents with an income that is 30% lower than the income standard are at particular risk of suffering from over-indebtedness.⁹³¹

However, there was some disagreement among the stakeholders as to relationship of low income to over-indebtedness. While some stakeholders stressed the importance of low income or a drop in income (for example as the result of unemployment or illness), other stakeholders indicated that personal factors, such as a lack of money management skills, were more important.

In terms of age, stakeholders observed that households between the ages of 25 and 64 were most commonly affected by over-indebtedness, in particular those in the age group 40 to 64. This corresponds fairly well with data from Eurostat, which shows that 0.7% of households between the ages of 25 and 39 had outstanding debts amounting to 100% of household income, as did 0.6% of households between the ages of 40 and 64. By contrast, this was the case for only 0.1% of households aged 64 or above (see Annex A).

Nonetheless, a few stakeholders pointed to a change in the type of age groups most commonly affected by over-indebtedness. According to these stakeholders, an increasing number of households below the age of 25 and above the age of 64 were getting into dangerous levels of debt. In particular in relation to younger households,

⁹³¹ Rätts Barnen, *Barnfattigdomen i Sverige*, Årsrapport 2010, p. 15.

stakeholders indicated that this was related to the development of SMS loans and consumerism.

26.3.2 Causes of households' over-indebtedness

The causes of over-indebtedness are complex. As stakeholders pointed out, most over-indebted households have suffered an unexpected deterioration in their finances, for example as the result of unemployment or illness (although other personal circumstances such as divorce or death in the family are also of significance). Data from Eurostat shows that 43.2% of over-indebted households in Sweden had suffered a major drop in income in the preceding year, compared to only 12.2% of other households (see Annex A). On the other hand, many people lose their job or fall ill without becoming over-indebted. Whether an individual becomes over-indebted or not depends on that person's ability to deal with traumatic events, as well as the social network surrounding them. Lack of money management skills and/or incapacity to deal with financial products can also play a role, as pointed out by stakeholders.

Stakeholders also commented that macro-economic factors can be seen as relevant for the overall level of over-indebtedness, particularly the unemployment level. For example, one expert commented that

The extent to which personal circumstances cause over-indebtedness is also related to the economic situation, i.e. the higher the general level of unemployment, the greater the chance of personal circumstances causing over-indebtedness

In addition to the unemployment rate, a few stakeholders indicated that the social welfare level could be seen as a cause of over-indebtedness. One stakeholder commented that the reduction in the scope of the Swedish welfare state has made people more vulnerable to extraordinary circumstances such as unemployment or illness.

In terms of the type of loan/credit taken out, stakeholders most frequently referred to regulated consumer credit with high interest rates or specific practices/easy to obtain products in the financial services industry. In particular, they mentioned that problems had been caused by SMS loans. These are loans where the borrower can obtain a loan of between 1,000 and 3,000 Swedish Krona by sending an SMS to the credit provider. The credit can then be granted and delivered within 15 minutes to the consumer's account. These types of loans have caused some households major

difficulties with repayment and many young adults in particular have been registered at the Enforcement Authority after contracting such loans.⁹³²

There are several reasons why SMS loans have been a particular cause of repayment difficulties. For example, before the new Consumer Credit Act came into force, it was not necessary for the credit provider to carry out a credit assessment of the consumer beforehand. The credit provider is now obliged to carry out an assessment of the consumer when granting a consumer loan, but problems with this type of lending remain. The main reason for this is the very high interest rates that accompany them. An SMS loan to the amount 3,000 Swedish Krona, which is, for example, repayable within 30 days, might carry a charge of around 600 Swedish Krona, effectively meaning an annual interest rate of 792%.

Regarding other types of credit that cause over-indebtedness, just under half of stakeholders referred to mortgages or home loans. Certainly, these types of loans make up the bulk of indebtedness in Sweden. However, as explained above, the level of losses incurred by creditors on these types of loans has been low. Two stakeholders specified therefore that mortgages were not the major cause of over-indebtedness in Sweden, but rather high interest consumer credit (SMS loans).

Nonetheless, several stakeholders highlighted housing costs as an issue. The growth in mortgage debt is linked to an increase in house prices, which rose by 250% between the mid-1990s and 2010, i.e. a good deal faster than household incomes.⁹³³ In this way many property owners have been able to build up their wealth without their incomes really increasing, which has triggered an upturn in what are called senior loans.⁹³⁴ The rise in house prices is primarily a city phenomenon, but also affects other parts of the country, because rental accommodation is relatively hard to come by no matter where one lives. Consequently there is a big discrepancy between supply and demand where cheap rental housing is concerned and many people are forced to buy, which pushes up prices. High construction costs and other factors have also led to a relatively small output of new homes, thus compounding the rise in prices.

⁹³² The Enforcement Agency is a government body responsible for debt collection. It is empowered to deduct money directly from a debtor's bank account and keeps a register of debtors. It is also responsible for administering the procedure of formal debt settlement (akin to insolvency).

⁹³³ See Final Report – Part 1: General Report, Study on Equity Release Schemes, Project No. Markt/2007/23/H, submitted by Reifner, U. & Clerc-Renaud, S. & Perez-Carrillo, E. & Tiffe, A. & Knobloch, M., 2009, Institut für Finanzdienstleistungen ev., Hamburg, Germany, p. 1.

⁹³⁴ Senior loans are a form of credit for seniors (persons aged 58 or over), inviting them to release the in-built value of their house or tenant-owner flat without needing to sell it. The loan is disbursed to the borrower, but the latter need not pay any instalments or interest before selling the home, moving out of it or dying. See Persson A. H., Seniorlån - en skuldfälla eller ett sätt att få guldkant på tillvaron? Rätten i den ekonomiska krisen, (ed. Calleman), 2011, pp. 117.

26.3.3 Changes relevant to levels of over-indebtedness

Stakeholders pointed out that there have been several changes relevant for the levels of over-indebtedness in the last five years. They indicated that the financial crisis and changes in the welfare system, along with consumers increasingly using loans with high interest rates from unregulated lenders, had played a role in increasing the number of households and individuals that have difficulties meeting their financial commitments. In particular, they referred to an increase in the unemployment rate, which rose from 6.1% in 2007 to 7.5% in 2011.⁹³⁵ Stakeholders also observed that there had been changes in the regulatory environment. For example, several stakeholders referred to new legislation that imposed a maximum 85% loan to value ratio on real estate loans.

26.3.4 Cultural attitude towards debt and actual level of households' (over-) indebtedness

Stakeholders felt that there was a relationship between the cultural attitude to debt in Sweden and the actual level of household indebtedness. Several stakeholders referred to an increased level of consumption and a more relaxed attitude to credit than had existed in the past. While it used to be common in Sweden to save money before making large purchases, the reverse was now true. For example, one stakeholder commented:

If we go back to the 1960s or 1970s or further back, all families and individuals in Sweden were going to save money before buying for example a TV or a car or something like that. Then in the 80s and 90s this changed so that today you go and buy first and then you have this credit to pay off.

One stakeholder criticised the consumer society in general, for encouraging people to place too much importance on the products they bought: "The consumption society has made identity strongly associated with consumption - what clothes you wear, housing and so on".

26.4 CONSEQUENCES OF OVER-INDEBTEDNESS

26.4.1 Consequences for affected households

One of the issues rated most highly by stakeholders, in terms of the consequences of over-indebtedness for affected households, was reduced standard of living. This is partly because over-indebted households are frequently subject to distraint/seizure.⁹³⁶ In cases where a person does not repay his/her debts, the

⁹³⁵ Eurostat, 'Unemployment as a percentage of the labour force' (code: tsdec450).

⁹³⁶ Konsumentverket, PM 2003:04: Överskuldssättning - omfattning, orsaker och förslag till åtgärder; Kronofogden, Alla vill göra rätt för sig, Överskuldssättningens orsaker och konsekvenser, 2008.

Enforcement Authority can sell some of the indebted person's property, or take a portion of the debtor's monthly salary until the debt is paid. Furthermore, the debtor cannot prevent their home from being the object of an executive procedure.

Stakeholders also referred to reduced labour market activity and financial exclusion. A person who is unemployed and over-indebted may find it considerably more difficult than other people in getting a job. It can be difficult for someone with serious financial difficulties to get a lease for an apartment, get new credit, take out phone or Internet contracts, get pension insurance, and so on. For many over-indebted people, the burden of debt increases over time because of compound interest effects and various forms of penalties.

Research has shown that there is a clear link between poor physical/mental health and indebtedness.⁹³⁷ This was also observed by the stakeholders, who rated deteriorating well-being and mental health highly as consequences of over-indebtedness. One of the stakeholders pointed to people with financial problems who suffer from depression, stress related symptoms, suicidal thoughts, feelings of powerlessness, shame or the feeling of being second-class citizens.

26.4.2 Consequences of over-indebtedness for the financial services industry

Consequences of over-indebtedness for the financial services industry were rated less highly, in terms of the average score given by stakeholders. As stated above, credit losses incurred by credit institutes have stayed at a low level in Sweden. Therefore indebtedness has not been very much discussed by the industry.

26.4.3 Economic and social consequences of over-indebtedness for society

It is estimated⁹³⁸ that over-indebtedness costs society between 3 and 5 billion Euro annually as the result of reduced productivity, lower tax revenues and costs for providing housing for households affected by home repossession, among other things. As many over-indebted people suffer from poor health, there are also costs related to an increased use of health care services.

This assessment was supported by the comments made by stakeholders. Increased use of healthcare services, reduced productivity at work and other costs associated with over-indebtedness (costs for provision of debt advice, to help households repay arrears, legal costs) were all rated highly, in terms of the economic and social consequences of over-indebtedness for society.

⁹³⁷ Ahlström, R., *Ohälsa och marginalisering till följd av överskuldsetting, PM 2003:04*, 2003; Engström, J. & Josefsson, M.: & Ahlström, R., *Krisbetingande känslreaktioner hos överskuldsetta*, TemaNord 2004:513 s. 142 ff.

⁹³⁸ Kronofogden, *Alla vill göra rätt för sig, Överskuldsettingens orsaker och konsekvenser*, 2008.

26.4.4 Debt collection practices

On the whole, stakeholders tended to agree that there had been an increase in the use of aggressive debt collection practices in the last five years. According to one stakeholder, the number of debt collection agencies in Sweden has increased five times within the last seven years. It was indicated that they are applying at an earlier stage to the Enforcement Agency and that they are increasingly using aggressive collection practices. For example, stakeholders referred to phone calls late at night, threatening letters or the automatic deduction of money from people's salaries. Some debt collection agencies have been criticized for using imprecise information when collecting debts. This makes it difficult for the debtor to know what the claim is for and to be able to decide whether the claim is correct or not. Furthermore, many collection agencies use web services, where the debtor may see the debt, give notice to the debt collection company or request a postponement, etc. The Swedish Data Inspection Board has criticized several companies regarding how they ensure the identity of those who log on to their websites.⁹³⁹

26.5 MEASURES IN FORCE TO ALLEVIATE THE IMPACT OF OVER-INDEBTEDNESS

26.5.1 Early identification of households at risk

It is fairly easy for a credit provider to make a reasonably reliable assessment of the credit recipient in order to establish if the person is at risk of becoming over-indebted. Firstly, the debtor must state the household's monthly income and expenditure in their credit application, as well as its assets and liabilities. To facilitate the assessment, additional information is usually obtained from a specialised credit bureau, such as Upplysningscentralen.⁹⁴⁰

The information provided by the credit bureaus usually includes the following aspects: name, address, current residential locality, cohabitation (national registration number/s of the spouse or of children under 18 living with the person enquired after), marital status and year of immigration or emigration, income figures taken from the annual income tax assessment, whether the debtor is engaged in business activity, details concerning any ownership of real estate, and presentations of the balance of credits outstanding for which no security has been furnished or for which the only security consists in someone having provided surety-ship for the credit concerned. Finally, there are records of non-payment, i.e. failure to settle a debt in time.

⁹³⁹ Se www.datainspektionen.se, Datainspektionen riktar tydlig kritik mot otydliga inkassokrav, 25.11. 2010 and Säkrare identifiering krävs i inkassobolags webbtjänster, 15.9.2010.

⁹⁴⁰ Upplysningscentralen is Sweden's largest credit information bureau and is owned by the largest Swedish banks. See: <https://www.uc.se/uc-in-english/English-Start/about-uc/about-uc.html>.

26.5.2 Advice offered to over-indebted households

An over-indebted individual or family can seek advice from a budget and debt advisor. These advisors are located in all municipalities in Sweden and access to their services is guaranteed by law. The advisors can give advice on how to resolve an over-indebtedness situation, for example by helping to set up a household budget and assisting the debtor with a debt restructuring procedure. According to stakeholders, this type of personalised face-to-face advice is fairly well known and demand is high. One concern, however, is that the waiting time in some communities to meet such an advisor can be up to 78 weeks. On the other hand, the number of people without access to these advisors is reported to have decreased.⁹⁴¹

Municipal consumer advisors should also be mentioned in this connection.⁹⁴² They are tasked with providing information, particulars and guidance to individual consumers in specific matters.⁹⁴³ They can also mediate in disputes between a specific consumer and a specific trader. Consumer guidance is available in most municipalities, but around half of the population of Sweden does not know of its existence, even though a mere 6% of the country's inhabitants live in municipalities without consumer guidance officers of their own. During 2009 consumer guidance officers were consulted by consumers on some 142,000 occasions. According to an estimate by the Swedish Consumer Agency, mediation by consumer guidance officers leads to a settlement of about 95% of the disputes concerned.⁹⁴⁴

In terms of web-based tools targeted at over-indebted households, stakeholders indicated that these were rarely available. However, there are some websites which provide information on what a person should do if they are unable to pay their debts or help people to plan their budgets.

Funding of debt advice

Debt advice in Sweden is funded by the state. However, stakeholders pointed out that more funding was needed in order to meet demand and that the problem of over-indebtedness had not been given enough priority. As stated above, the waiting time to meet a budget and debt counsellor can be quite long. Several measures have been discussed in order to update the structure of support, for example more web-based information. One stakeholder suggested that creditors should be involved in the funding of debt advice.

⁹⁴¹ See SOU 2012:43 p. 126.

⁹⁴² See also Konsumentverkets rapport 2010:21. Kommunernas konsumentvägledning - bra men okänd. See the same report concerning the four "Consumer Bureaux", e.g. Konsumenternas Bank- och Finansbyrå, which provide information and guidance to private persons in their respective markets.

⁹⁴³ See, e.g., Proposition 1985/86:121.

⁹⁴⁴ See Bakardjieva Engelbrekt, A., Från materiella regler till genomföranderegler: en ny fas i det europeiska rättssamarbetet på konsumentskyddsområdet, Europarättslig tidskrift, 2007, pp. 588-589.

26.5.3 Key measures in place to alleviate the impact of over-indebtedness

Informally brokered arrangements between the debtor and creditor(s) such as a repayment plans, a debt management plan or a debt write off are widely or partly available, according to stakeholders. They are fairly effective in alleviating the impact of over-indebtedness, although one stakeholder commented that they tend only to be effective in the early stages of over-indebtedness.

Until 2007 it was a legal requirement that individuals applying for the formal debt settlement procedure first attempt to reach an agreement with their creditors, with the help of the municipal debt and budget counsellors. However, this legislation was repealed in 2007.⁹⁴⁵

However, there remain various requirements that must be fulfilled in order for an individual to apply for debt settlement. Debt relief can be granted to a person domiciled in Sweden if the person is insolvent and so indebted that he or she cannot be presumed capable of paying off their debts within the foreseeable future. An additional consideration is that – taking into account the debtor's personal and financial circumstances - it is "reasonable" that debt restructuring be granted. It has been discussed whether the criteria for someone to be granted debt relief are too strict.⁹⁴⁶ For example, one stakeholder commented

There are about 8,000 applications per year and only about 6,000 are approved. [It is estimated] that in fact insolvency should be declared for about 20,000 people per year.

If a debtor is successful in their application, they will be issued with a repayment plan by the Enforcement Agency. They are required to follow this plan for a period of five years, at the end of which they will be free from debt.

There has been discussion about the introduction of financial support for over-indebted households (e.g. from a public fund). One proposal has been to offer state loans to such households.⁹⁴⁷ Financial assistance may otherwise be granted by the state to those who live and reside in Sweden if they or their families cannot support themselves through other means.⁹⁴⁸ Over-indebted households may also seek financial assistance from religious organisations, various private and public funds and aid organisations.

⁹⁴⁵ Kilborn, J., 'Twenty-Five Years of Consumer Bankruptcy in Continental Europe: Internalizing Negative Externalities and Humanizing Justice in Denmark', 2009, p. 14.

⁹⁴⁶ See SOU 2008:82.

⁹⁴⁷ See SOU 2008:82 pp. 218. A social loan means that the debtor may borrow money from a social authority at a low interest rates or it can mean that a private or government owned foundation will act a guarantor for the debtor when he/she is taking a loan from a bank. This proposal is controversial.

⁹⁴⁸ See Chapter 3, Section 1, Social Services Act (2001:453).

Other measures to alleviate the impact of over-indebtedness are being explored by the Swedish government at the time of reporting. They are expected to be finalised in 2013. A number of new legislative changes have also been implemented, for example in the Debt Relief Act (see below).⁹⁴⁹ As stated above, the Swedish Financial Supervisory Authority has adopted a rule that new real estate loans must not exceed 85% of property market value.⁹⁵⁰

26.5.4 Changes in response to over-indebtedness

The problem of over-indebtedness has been increasingly recognised and several government investigations have been initiated to counter it. The Debt Relief Act was changed in 2011 with the aim of making it easier for a person to be granted debt relief. For example, one stakeholder pointed out that the requirement that the Enforcement Agency assess the age of the debt has been removed. Prior to this it was difficult for individuals whose debts were recent to apply for debt settlement. It is likely that the Debt Relief Act will be changed again in the near future.

26.5.5 Types of households of over-indebted consumers not reached by current measures

The majority of stakeholders indicated that there were types of over-indebted households not reached by current measures. For example, they referred to debtors who have been over-indebted for a long time and have been the object of a seizure or other form of debt recovery several times. These debtors do not tend to apply for debt relief, although they would be granted it if they applied. Stakeholders also referred to people running small businesses and people with informal loans (e.g. to their family or friends).

26.5.6 Best practices

Stakeholders had little to say about measures that could be considered best practice. However, there was reference to debt and budgeting advice, particularly at an early stage.

26.6 OUTLOOK

The majority of stakeholders assessed that the number of over-indebted households in Sweden would increase in the next five years. Some stakeholders indicated that this was due to the ongoing economic crisis. Although the Swedish economy is expected to grow by 1.3% in 2013 and 2.7% in 2014, unemployment remains an

⁹⁴⁹ See Consumer Credit Act (2010:1846) and Debt Restructuring Law (2006: 548, amended 2011:472) and Direktiv 2012:31. Strategi för att motverka överskuldssättning. See also Direktiv 2012:30 Skuldsanering för evighetsgäldenärer.

⁹⁵⁰ See Beslutspromemoria, FI Dnr 10-1533, 2010-07-08.

issue.⁹⁵¹ By 2012 it had risen to 8%.⁹⁵² Another issue identified by stakeholders was the risk of rising interest rates. As most mortgage holders in Sweden tend to take out their home loans with variable interest rates, they would be affected if interest rates were to rise. Finally, the overall level of lending in Sweden has not been reduced in the last five years, but is in fact continuing to grow. Mortgage lending grew by 10% annually in 2009 and 2010, and by 7% in 2011.⁹⁵³ This has led to criticism of lending practices in Sweden, which are seen by some as too lax.⁹⁵⁴

In particular, this rapid build-up of indebtedness has troubled the Swedish legislators, prompting them to appoint several government commissions to map the debt situation and to propose new measures for curbing over-indebtedness.

Various challenges were identified by the stakeholders who took part in interviews, including the need to make it easier for individuals to be granted debt relief as part of the formal debt settlement procedure. Stakeholders also called for more regulation of credit, in particular of SMS loans and debt collection. Attention was also called to the need for more financial education.

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⁹⁵¹ Eurostat, 'Real GDP growth rate - volume' (code: tec00115).

⁹⁵² Eurostat, 'Unemployment as a percentage of the labour force' (code: tsdec450).

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⁹⁵⁴ See for example SCB Finansmarknadsstatistik 2012, Dagens Industri, "Hushållen lånar mer", 2012-09-27, Jakobsson, Det är för billigt att låna, Svenska dagbladet, 2012-08-13..

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Over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact

ANNEX A: STATISTICAL DATA FROM EU SOURCES

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Over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact

Sweden

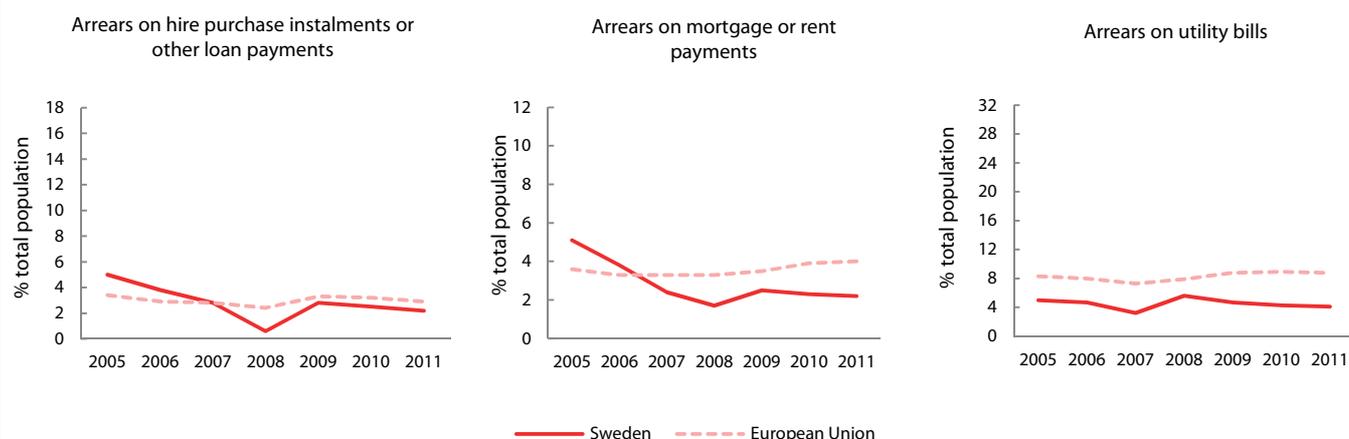
I. Eurobarometer¹

Sweden EU average Lowest EU value Highest EU value

Households *at risk* of being over-indebted

Respondents feeling at risk of over-indebtedness in 2010	7%	25%	7%	52%
Respondents feeling at risk of over-indebtedness in 2009	10%	27%	9%	53%

II. EU SILC standard survey data²



III. EU SILC 2008 module: Over-indebtedness and financial exclusion³

Sweden EU average Lowest EU value Highest EU value

Proportion of people in households with bank overdrafts, outstanding balances on credit cards or in arrears on other loans of over 100% of household disposable income

Overdrawn bank account (% of people in households overdrawn)	0.1%	2.2%	0.0%	7.7%
Credit or store card (% of people in households with outstanding balances)	0.2%	1.1%	0.0%	8.6%
Other loan/credit payments (% of people in households in arrears)	0.4%	0.3%	0.0%	1.1%

Proportion of people in households in arrears in servicing housing-related loans and bills and in paying other bills of over 100% of household disposable income

Housing bills (% of people in households in arrears)	0.2%	0.5%	0.0%	2.9%
Other payments (% of people in households in arrears)	0.1%	0.4%	0.0%	1.7%

Households living with outstanding debts and/or arrears of over 100% of household disposable income

Total (% of households with outstanding debts/arrears)	0.6%	4.6%	0.0%	11.8%
Income above 60% median (% of households with outstanding debts/arrears)	0.4%	4.2%	0.0%	11.3%
Income below 60% median (% of households with outstanding debts/arrears)	2.3%	7.0%	0.2%	13.7%
Materially deprived (% of households with outstanding debts/arrears)	7.3%	9.0%	0.1%	27.4%

Proportion of those in broad age groups with outstanding debts of over 100% of household disposable income

Households with all adults aged 25-39 (% of households with outstanding debts)	0.7%	6.3%	0.0%	17.2%
Households with all adults aged: 40-64 (% of households with outstanding debts)	0.6%	5.8%	0.0%	10.9%
Households with all adults aged: 65+ (% of households with outstanding debts)	0.1%	1.2%	0.0%	2.8%

Proportion of those in different types of household with outstanding debts of over 100% of household disposable income

Living alone (% of people in households with outstanding debts)	↘ 0.8%	4.3%	0.0%	8.2%
Single parent (% of people in households with outstanding debts)	↘ 2.1%	9.5%	0.0%	27.1%
Other (% of people in households with outstanding debts)	↘ 0.5%	4.8%	0.0%	12.1%

Proportion of those in households with outstanding debts of over 100% of household disposable income by marital status

Never married (% of people in households with outstanding debts)	↘ 0.5%	5.0%	0.0%	15.4%
Married (% of people in households with outstanding debts)	↘ 0.4%	4.1%	0.0%	9.7%
Separated/divorced (% of people in households with outstanding debts)	↘ 1.5%	7.5%	0.1%	13.9%
Widowed (% of people in households with outstanding debts)	↘ 0.0%	1.7%	0.0%	4.3%

Proportion of those in households with outstanding debts of over 100% of household disposable income by housing tenure

Owner occupied without mortgage (% of people in households with outst. debts)	↘ 0.4%	3.2%	0.0%	9.6%
Owner occupied with mortgage (% of people in households with outst. debts)	↘ 0.3%	6.3%	0.0%	16.1%
Market rent (% of people in households with outstanding debts)	↘ 1.2%	8.2%	0.0%	16.0%
Subsidised rent (% of people in households with outstanding debts)	↘ 3.1%	8.7%	0.0%	17.9%
Rent-free housing (% of people in households with outstanding debts)	:	2.3%	0.0%	15.1%

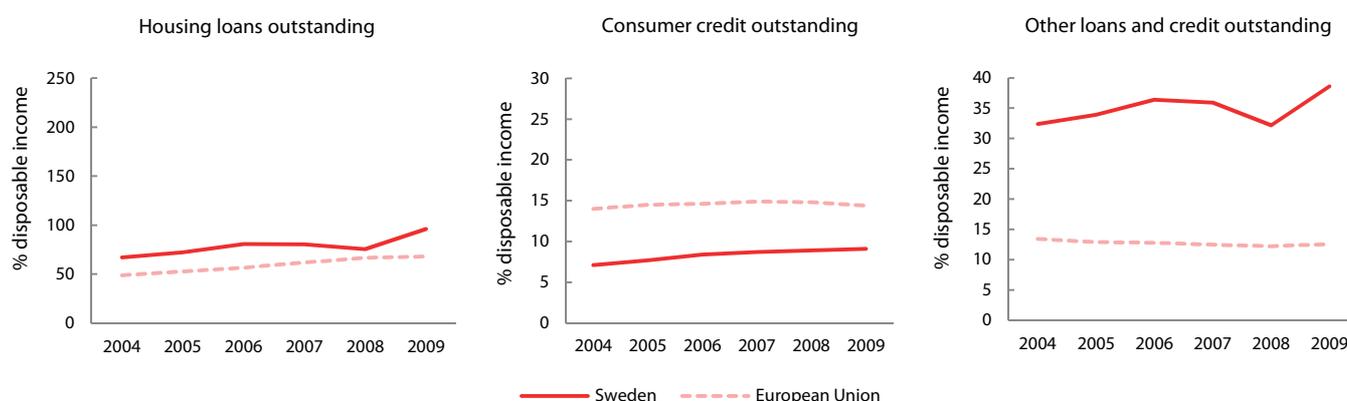
Proportion of those in households with outstanding debts of over 100% of disposable income by work intensity

Work intensity of 0 - 0.19 (% of people in households with outstanding debts)	↘ 2.3%	5.7%	0.0%	10.6%
Work intensity of 0.20 - 0.50 (% of people in households with outstanding debts)	↘ 1.4%	5.7%	0.0%	15.3%
Work intensity of 0.51 - 0.74 (% of people in households with outstanding debts)	↘ 0.1%	5.4%	0.0%	13.5%
Work intensity of 0.75 - 1.0 (% of people in households with outstanding debts)	↘ 0.6%	5.3%	0.0%	14.3%

Proportion of those in over-indebted households that experienced a major drop in income over the preceding year

Over-indebted (% of people in households that experienced drop in income)	↗ 43.2%	33.3%	0.0%	77.6%
Other (% of people in households that experienced drop in income)	↘ 12.2%	19.2%	5.9%	32.5%

IV. Loans and credit outstanding⁴



Notes:

(1) Eurobarometer 72.1 (2009) and Eurobarometer 74.1 (2010). Note: Those who answered 'very at risk' or 'fairly at risk' to the question 'Please tell me how much you feel at risk of being over-indebted'.

(2) Eurostat, SILC. Data as of December 2012.

(3) European Commission, Research Note 4/2010, Over-indebtedness new evidence from the EU-SILC special module.

(4) European Commission, Research Note 4/2010, Over-indebtedness new evidence from the EU-SILC special module. European Credit Research Institute (ECRI), Lending to households in Europe, 1995-2009 and Eurostat, National accounts.

27 UNITED KINGDOM

<i>Document</i>	The over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact - Country report United Kingdom
<i>Prepared by</i>	Sharon Collard, Andrea Finney, Personal Finance Research Centre, University of Bristol
<i>Finalised on</i>	27 December 2012

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Over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact

27.1 DEFINITION OF OVER-INDEBTEDNESS

There is no commonly used definition of over-indebtedness in the UK. Two interviewed stakeholders mentioned a range of different indicators that can be used in combination to define over-indebtedness. These mainly comprised objective measures such as the level of unsecured debt, the ratio of unsecured debt repayments to household income, and the level of secured debt. In addition, the financial regulator has a technical definition of mortgage arrears.

Only one stakeholder (from civil society) had a specific definition for being at risk of over-indebtedness. It related to people who currently meet their contractual payments but who experience significant stress in their household budgets which means that maintaining payments over the longer term is unlikely.

There was no consensus among UK stakeholders about the need for better definitions. An independent expert and a civil society stakeholder considered that any definition of over-indebtedness should incorporate measures of debt in relation to income. Some stakeholders expressed concern that standard definitions would be difficult to agree, did not take into account the circumstances of individuals or households and risked excluding individuals or households that needed support.

27.2 LEVEL OF OVER-INDEBTEDNESS

Eurobarometer data shows that 35% of UK respondents felt at risk of over-indebtedness in 2009 and 2010 (see Annex A). The 2008 EU-SILC module found that 12% of UK households had outstanding debts and/or arrears that totalled more than 100% of their disposable income. This proportion was higher for low-income households (14%) and materially deprived households (19%).

EU-SILC standard survey data shows that a minority of the UK population has experienced arrears on consumer credit or household bills within the last years. The proportion of the UK population that reported arrears on hire purchase instalments or other loan payments remained fairly steady between 2005 and 2007. Then it decreased slightly (to 1.5% in 2008), increased again to 2.6% in 2010 and finally decreased to 2% in 2011, all along being under the EU average.⁹⁵⁶ Self-reported arrears on utility bills have also been lower than the EU average and have stayed relatively constant over recent years, but an increase from 4.5% in 2007 to 5% in 2011 can be noted.⁹⁵⁷ There has been a good deal of fluctuation in self-reported arrears on mortgage or rent payments which have generally been above the EU average levels. These arrears fell sharply in the UK between 2007 (4.7%) and 2009 (2.15%) but have

⁹⁵⁶ Eurostat (code: ilc_mdcs08). Data for 2009 is not available.

⁹⁵⁷ Eurostat (code: ilc_mdcs07). Data for 2009 is not available.

risen steeply since that time and reached 4.9% in 2011 (compared to the EU average of 4%).

There is no single data source in the UK for over-indebtedness over the period 2008 to 2012. The data that exists refers to Britain (i.e. England, Wales and Scotland, excluding Northern Ireland). Since 2008/2009, the government has collected data through online surveys which comprise adults sampled at random from a panel of volunteers. The data from the online surveys conducted between 2008/2009 and 2011 show a downward trend in over-indebtedness across a number of different measures. For example, 10% of British households in 2011 were defined as being in financial difficulty (either involved in action to resolve debt problems or more than three months in arrears with payments), down from 12% in 2009/10.⁹⁵⁸ Individual insolvencies in England and Wales (bankruptcy orders, individual voluntary arrangements and debt relief orders) increased from 25,264 in Q1 2008 to 35,682 in Q1 2010. The number of individual insolvencies has since fallen but was still at 27,390 in Q2 2012.⁹⁵⁹

A similar rise and then drop in the levels of indebtedness through the past half a decade can be observed in the data on mortgage arrears and possessions in the UK that are collected by the industry trade association (Council of Mortgage Lenders). These data refer to mortgages, rather than individuals or households, and they relate to first charge mortgages only (i.e. they do not include additional lending secured on the property). In 2008, 1.57% of first charge mortgages were in arrears by 2.5% or more of the outstanding balance. By 2009, this had increased to 1.73%, before falling to 1.42% in 2011. (For comparison, the average for the eight year period 2000-2007 was 1.05%). A similar pattern is seen in relation to mortgage possessions. At the end of 2008, 0.19% of all outstanding mortgage loans were in possession (including voluntary possession). This fell to 0.14% in 2009 and seemed to stabilise at 0.12% in 2010 and 2011. This is possibly explained by forbearance measures introduced by the UK government. (For comparison, the average for the eight year period 2000-2007 was 0.05%).

27.3 NATURE AND DRIVERS OF OVER-INDEBTEDNESS

27.3.1 Most common types of households that are over-indebted

All other things being equal, households with no or low household savings have increased odds of financial difficulty. Other predictive factors are age; living in a rented home; job loss; annual household income of 25,000 Pound or less; having a

⁹⁵⁸ Department for Business, Innovation and Skills, *Credit, debt and financial difficulty in Britain, 2011*, Department for Business, Innovation and Skills, London, 2012, p. 7.

⁹⁵⁹ See 'Insolvency Service Official Statistics', at *The Insolvency Service*, www.bis.gov.uk/insolvency/About-us/our-performance-statistics/insolvency-statistics [accessed 24.08.12].

strong spending orientation; and low financial awareness.⁹⁶⁰ Multiple studies have revealed that the presence of children in a household increases the likelihood of financial difficulties, particularly for lone parent families.⁹⁶¹ The risk of over-indebtedness is higher in large families and those with younger children.⁹⁶²

Data for one debt advice charity shows a growth in clients aged under 25 and those aged 60 and over, as well as a steady increase in the proportion of renters seeking advice.⁹⁶³

27.3.2 Causes of households' over-indebtedness

Macro-economic factors

Stakeholders most frequently identified increased unemployment, wage stagnation and social welfare cuts as causes of household financial difficulties. Whereas exchange rate movements were not generally felt to be a cause of over-indebtedness, movements in interest rate were mentioned by some stakeholders. Some mortgage-holders have benefitted financially from historically low mortgage interest rates;⁹⁶⁴ others have not. Qualitative research found that some mortgage-holders relied on low mortgage interest rates to make ends meet.⁹⁶⁵ A future rise in interest rates (or the need to re-mortgage) may therefore have serious negative consequences for these households. In contrast, low interest rates have impacted adversely on people who rely on savings income, notably the elderly.

In the household interviews carried out for this study, unemployment level, wage level and social welfare level were all mentioned as causes of over-indebtedness. Four of the 20 interviewed households were affected by unemployment at the time of the interview, while others had been affected by unemployment at some point in the past. In terms of wage level, some interviewees indicated that they had not received a pay rise for a long time, although the costs of living continued to increase. With regard to social welfare level, the interviewed households mentioned both the low level of the social benefits they received, as well as their lack of eligibility for certain benefits.

⁹⁶⁰ Department for Business, Innovation and Skills, *Credit, debt and financial difficulty in Britain, 2009/2010*, Department for Business, Innovation and Skills, London, 2011.

⁹⁶¹ Berthoud, R. and Kempson, E., *Credit and debt: the PSI study* Policy Studies Institute, London, 1992. Kempson, E., McKay, S. and Willitts, M., *Characteristics of families in debt and the nature of indebtedness*, Research Report 211, Department for Work and Pensions, London, 2004. Department for Business, Innovation and Skills, 2011.

⁹⁶² Kempson et al, 2004.

⁹⁶³ Consumer Credit Counselling Service, *CCCS statistical yearbook 2011, 2012*.

⁹⁶⁴ CCCS, 2012.

⁹⁶⁵ Finney, A. and Davies, S., *Facing the squeeze 2011: A qualitative study of household finances and access to credit*, 2011.

Cost of living

In the first quarter of 2012, real household actual income per head fell to the lowest level since 2005. This was mainly due to prices going up at an increasing rate.⁹⁶⁶ Statistics for one debt advice charity indicate that problems with consumer credit debts fell between 2008 and the first quarter of 2012, while problems paying household bills increased.⁹⁶⁷

In the household interviews, almost half of the interviewees considered the general costs of living to be driver cause of their financial difficulties. In addition to everyday living costs such as food or transport, several interviewees specified utility and childcare or child related costs as an issue. For example, one interviewee described how she had to give up her job as she could not afford to pay for childcare.

Types of credit/loan taken out by households

Stakeholders considered that the growth in the UK of payday lending could aggravate households' debt problems.⁹⁶⁸ There has been a sharp increase in the number of debt advice clients that have payday loans.⁹⁶⁹ It is not clear whether payday loans caused over-indebtedness or whether people used payday loans when they were already in debt.

Penalty charges on credit cards and overdrafts were another possible cause of financial difficulty mentioned in the stakeholder interviews. Recent research has also highlighted long-term minimum repayment of credit cards to be a potential cause of financial difficulty.⁹⁷⁰

In the household interviews, the most common types of credit reported by the interviewees were credit cards, overdrafts and bank loans, as well as credit with shops/mail order catalogues. Two of the interviewed households had problems related to payday loans. In both cases the interviewees also had significant debt in terms of credit cards and bank loans, and one interviewee explained that he had initially started taking out payday loans in order to manage the payments on these.

Although more than half of the interviewed households lived in owner-occupied housing with mortgages, only one interviewee mentioned their mortgage as a cause

⁹⁶⁶ Barnard, A., 'The economic position of households, Q1 2012', *Office for National Statistics*, 2012.

⁹⁶⁷ Citizens Advice, 'Advice Trends 2012/13 Quarter 1', April-June 2012.

⁹⁶⁸ Payday loans are small-value cash loans with a typical loan term of around 30 days that are generally much more costly than other forms of credit.

⁹⁶⁹ CCCS, 2012. See also 'National Debtline takes 9,500 calls for help with payday loans in just six months', 25 July 2012, at Money Advice Trust, www.moneyadvicetrust.org/content.asp?ssid=169 and 'Citizens Advice welcomes report on payday lending regulation', 13 March 2012, at Citizens Advice Bureau, www.citizensadvice.co.uk/en/news/headlines/Citizens-Advice-welcomes-report-on-payday-lending-regulation/ [accessed 27.08.12].

⁹⁷⁰ Policis and Toynbee Hall, *The consumer dynamics of debt traps and debt spirals*, forthcoming 2012.

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of their financial difficulties. Some interviewees had renegotiated the terms of their mortgage in order to cope with their financial difficulties, for example by switching to interest-only payments, but only two of the interviewed households were actually in arrears with their mortgages at the time the interview took place.

Personal circumstances

Changes in personal circumstance are a major cause of over-indebtedness. This was reflected in the stakeholder and household interviews conducted for this study and reported in previous studies. Such changes include drops in income, for example due to a job loss or relationship breakdown; persistent low income (poverty); over-commitment; and, to a lesser extent, poor financial management.⁹⁷¹ One interviewed civil society stakeholder mentioned an increase in debt problems linked to gambling and other addictions.

In the household interviews carried out for this study, the cause of over-indebtedness most frequently mentioned, in terms of personal circumstances, appeared to be a drop in income as the result of unemployment or illness. A few households reported a drop in income due to other factors, such as divorce/separation, the death of a partner or having to give up work to look after children. In a few cases the interviewees explained that they had built up debt before their income was reduced, and that they were subsequently unable to meet the payments. However, a couple of households specified that they built up debt afterwards, to cover the difference between their living expenses and their new, reduced, income.

In some cases the interviewees also referred to low income, a lack of money management skills or behavioural biases. In most cases these were mentioned in combination with another factor, such as a drop in income. But in a few cases the interviewees placed the blame for their problems almost entirely on their own behaviour. For example, one interviewee explained that he had a problem with overspending and took out loans to go out and fund a lifestyle that he could not afford.

27.3.3 Changes relevant for levels of over-indebtedness

Increased unemployment, reduced incomes and credit constraint were felt by stakeholders to have increased over-indebtedness. Mitigating factors mentioned were low interest rates, quantitative easing and the increased use of personal insolvency and debt write-off.

The regulation of consumer credit and mortgages is the subject of major review in the UK. The new regulatory regimes are likely to have significant implications for

⁹⁷¹ European Commission, *Towards a common operational European definition of over-indebtedness*, 2008. Disney, R., Bridges, S. and Gathergood, J., *Drivers of over-indebtedness*, Department for Business, Enterprise and Regulatory Reform, London, 2008.

credit availability. Payday lenders and fee-charging debt management companies have become more prevalent and both have been the subject of government and regulatory scrutiny. Some stakeholders thought the UK public had become more credit averse, others doubted that this was the case. One stakeholder felt that people were now more willing to seek professional advice with debt problems than in the past. Stakeholders also reported that households were increasingly experiencing difficulties paying energy and water bills. Energy debt has always been a particular problem in Scotland due to colder weather.

27.3.4 Cultural attitude towards debt and actual level of households' (over-) indebtedness

Stakeholders generally agreed that there was a link between cultural attitudes to credit use and levels of over-indebtedness in the UK. Consumers took on more credit in the late 1990s and early 2000s, when credit was increasingly widely available and it became socially acceptable to borrow. This meant that UK consumers entered the recession with high levels of indebtedness. There is some evidence that since the financial crisis consumers have been paying down debts and are more cautious about taking on credit. There were mixed views among stakeholders about whether this was a short-term response to macro-economic conditions or signified a longer-term cultural shift in attitudes.

27.4 CONSEQUENCES OF OVER-INDEBTEDNESS

27.4.1 Consequences for affected households

The previously reported consequences of over-indebtedness for households are: stress/anxiety; lack of money; lower standard of living; relationship tensions; adverse impact on mental health; adverse impact on self-confidence.⁹⁷² Based on an average rating of consequences of over-indebtedness for households attributed by interviewed stakeholders, the consequences most highly rated by stakeholders were: deteriorating well-being, reduced standard of living, home repossession, family breakdown/divorce, deteriorating mental health, financial exclusion and homelessness. It was noted that some consequences were inter-linked. Home repossessions affect a relatively small proportion of households, but the consequences can be very serious, such as family break-up, social exclusion and homelessness.

In the household interviews, one of the consequences of financial difficulties most frequently mentioned was reduced standard of living. Several households reported

⁹⁷² Kempson 2002; Fitch, C., Jenkins, R., Hurlston, M., Hamilton, S., Davey, R. and Walker, F., 'Debt and mental health: an overview of selected evidence, key challenges, and available tools', *Mental Health Today*, September 2009. Collard, S., *Understanding financial difficulty: Exploring the opportunities for early intervention*. Barclays/Money Advice Trust, 2011. CCCS, 2012.

that they had cut back on all luxuries, such as eating out or going on holiday. In particular, several interviewees indicated that they could not buy things for their children or do things together with them, such as go to the cinema. Other issues that came up frequently were deteriorating well-being and mental health. More than half of interviewees mentioned suffering from stress, while five interviewees described themselves or other household members as suffering from depression. Around a third of interviewees mentioned that the stress of their financial situation had placed serious strain on their relationships with their partners.

Almost half of the interviewed households reported being excluded from credit as a result of their financial difficulties, but most of these did not consider this to be a problem.

27.4.2 Consequences of over-indebtedness for the financial services industry

The two most highly rated consequences that emerged from the stakeholder interviews were the costs of default/arrears and the agreed repayment/debt management plans for creditors. Over and above this, stakeholders had little to say on the issue. One stakeholder noted that the short-term costs borne by lenders because of over-indebtedness may have longer-term benefits, for example if stricter credit regulation as a result of over-indebtedness led to lower levels of default.

27.4.3 Economic and social consequences of over-indebtedness for society

The two most highly rated consequences from the stakeholder interviews were the loss in consumer confidence in the financial services industry and reduced productivity at work. Stakeholders generally felt it was difficult to say with any certainty that over-indebtedness (in its own right) caused specific economic and social consequences. It has been estimated that the average quantifiable cost to the Exchequer of a repossession of a vulnerable household is 16,000 Pound.⁹⁷³ The average cost per debt problem to the public and in lost economic output has been estimated to be over 1,000 Pound, with serious problems costing many times more.⁹⁷⁴

27.4.4 Debt collection practices

Of those who expressed a view, some stakeholders felt that debt collection practices had become more aggressive. Others felt that there had been a reduction in aggressive practices, partly due to government pressure on lenders to demonstrate forbearance. The Financial Ombudsman Service reported an increase of 12.5% in complaints about debt collection, from 512 complaints in the financial year 2011 to

⁹⁷³ Communities and Local Government, *Homeowners Support Package Impact Assessments*, 2008.

⁹⁷⁴ Pleasence, P., Buck, A., Balmer, N., Williams, K. A., *Helping Hand: The Impact of Debt advice on people's lives*, Legal Services Research Centre, 2007.

576 in the financial year 2012.⁹⁷⁵ However, there is no information about whether or not these complaints concerned aggressive practices.

27.5 MEASURES IN FORCE TO ALLEVIATE THE IMPACT OF OVER-INDEBTEDNESS

27.5.1 Early identification of households at risk

Lenders in the UK must assess affordability at the point of agreeing a credit contract. During the course of a credit contract, some lenders proactively try to identify people at risk of financial difficulty, but this is not common practice.⁹⁷⁶ Since 2010, credit and store card providers have contacted customers who have made minimum repayments for six months, to explain what they can do to improve their situation and provide details of independent advice. Following recent guidance from the regulator,⁹⁷⁷ the mortgage industry is considering the identification and analysis of potential impairment indicators. The Money Advice Service (a non-departmental public body) provides an online financial health check to help consumers understand whether they are at risk of financial difficulties (among other things).⁹⁷⁸

27.5.2 Advice offered to over-indebted households

Free-to-client debt advice is provided by a wide range of not-for-profit agencies. Some local authorities also employ debt advisers. These services generally provide debt advice face-to-face and by telephone, and their clients are typically on lower incomes. The funding for debt advice means that individuals above a certain level of income may only receive one-off advice or be given self-help materials.⁹⁷⁹

National Debtline provides free debt advice by telephone, email and self-help information packs to help people in England, Wales and Scotland negotiate with their creditors. Two national organisations (CCCS and Payplan) offer free of charge debt management plans (DMPs), i.e. informal means for people to repay their consumer credit debts in full in a structured way. Assistance is provided by telephone, email and online. It is funded by 'fair share' voluntary contributions from the credit industry. Both organisations also offer assistance with Individual Voluntary Arrangements and bankruptcy (see Section 1.5.3). Christians Against Poverty⁹⁸⁰ is a church-based

⁹⁷⁵ Financial Ombudsman Service, *Annual review of consumer complaints about insurance, credit, banking, savings, investments*, Financial year 2011/2012, 2012.

⁹⁷⁶ See for example Collard, 2011, for an analysis of the prearrears service at one of the major banks.

⁹⁷⁷ Financial Services Authority, *Forbearance and Impairment Provisions - Mortgages*, Finalised guidance, October 2011.

⁹⁷⁸ See 'Money health check', *Money Advice Service*, available at www.moneyadvice.service.org.uk/en/tools/health-check.

⁹⁷⁹ Collard, S., *An independent review of the fee-charging debt management industry*, Money Advice Trust, 2009.

⁹⁸⁰ See: <https://www.capuk.org/home/index.php>.

national debt charity which provides DMPs and other debt advice through its local centres.

CASHFlow is an assisted self-help resource that supports clients to make repayment offers directly to their creditors with assistance from a money advice agency.⁹⁸¹ Web-based tools that provide personalised advice include Debt Remedy operated by CCCS and My Money Steps operated by the Money Advice Trust. Some lenders have in-house teams of advisers that only deal with their own debts. These teams may signpost customers to services that can help them with all their debts. In parallel, there is a large fee-charging debt management industry in the UK and most companies offer DMPs, IVAs and bankruptcy advice. Printed materials that provide information about dealing with debt are available free of charge from a wide range of organisations.

Demand for debt advice as assessed by stakeholders

Stakeholders generally felt that demand had increased in the last five years, and that demand exceeded supply, particularly for face-to-face advice. At the same time, funding for face-to-face advice had been cut. Research shows that demand for debt advice rose between 2007 and 2009, then fell in 2010 before rising again in 2011. It is estimated that demand will increase during 2012 and remain high in 2013 and 2014.⁹⁸²

Effectiveness as assessed by stakeholders

Stakeholders had little to say about the effectiveness of debt advice. Previous research indicates that high quality debt advice reduced the cost of over-indebtedness to the public purse as well as helping households.⁹⁸³ Debt advice resulted in financial improvements for households because they owed less to creditors but also due to better budgeting and improved negotiations with creditors. It also led to health improvements.⁹⁸⁴

In the household interviews carried out for this study, just over half of interviewees had sought some type of personalised debt advice, mostly quite late in the process when they could not make the contractual payments anymore or when they were being threatened with debt collectors or bailiffs. Most of the interviewed households that made use of debt advice and/or other measures to alleviate their difficulties reported that this had led to positive outcomes for them. Several households indicated that they found it very helpful to have a personalised debt adviser who

⁹⁸¹ See 'About CASHflow', *Money Advice Trust*, at www.moneyadvice Trust.org/section.asp?sid=28 [accessed 28.08.12].

⁹⁸² Gathergood, J., *Demand, capacity and need for debt advice in the United Kingdom*, Money Advice Trust, 2012.

⁹⁸³ Financial Inclusion Taskforce, *Mainstreaming financial inclusion: Dealing with financial distress: access to debt advice*, 2010.

⁹⁸⁴ Pleasence et al, 2007.

explained to them their options and how they could best go about contacting their creditors to reach a solution (for example, by helping them draft letters and suggesting realistic amounts that they could offer to repay). A couple of interviewees mentioned that their creditors seemed more prepared to negotiate once they had the support of an external organisation.

In general, the interviewed households who had made use of debt advice or other measures reported feeling more in control of their financial situation as a result. Some indicated that they had developed better money management skills, while others had managed to arrange for a rescheduling or a reduction of their debt and were now able to keep up with their payments. The interviewees also frequently mentioned improved well-being or mental health.

Nonetheless, most households still thought they would need several years until they had fully recovered from their current difficulties. For example, some households who had negotiated debt rescheduling or reduction plans explained that this had allowed them to stabilise their situation, but that their standard of living was still very much reduced and that it would take them a long time to pay back their debts. Half of interviewees felt that they would need at least two years to recover from their difficulties, while many others could not say how long it would take. Most interviewees explained that an improvement in their financial situation would be dependent on some other factor, such as finding a job or returning to work after illness.

Funding of debt advice

Public funding for debt advice was felt to be insufficient, and further cuts in public funding are due. There was some support for greater creditor funding of debt advice, for example through the 'fair share' model.⁹⁸⁵

In 2011, the Money Advice Service published research which explored the development of a new model of funding for debt advice. Currently the Money Advice Service is funded through a levy on the financial services industry, collected through the Financial Services Authority. The research explored different options for setting the appropriate share of future fees in support of the debt advice activities of the Money Advice Service. These options attempted to develop a potentially fairer allocation of debt advice service costs across a wider spectrum of creditors. The research explored using either the Office of Fair Trading's Credit Register or the Financial Services Authority fee block system as a base for a levy aimed specifically at funding the Money Advice Service's debt advice activities. The research also looked at

⁹⁸⁵ Under a fair share model, "a debt advice agency receives a fee income from contributions from creditors to whom debt payments by clients are distributed" (see http://www.adviceuk.org.uk/projects-and-resources/money-advice/sustainable_debt_advice).

how creditors not registered in the OFT Credit Register or covered by the FSA funding blocks could be included.⁹⁸⁶

27.5.3 Key measures in place to alleviate the impact of over-indebtedness⁹⁸⁷

Informally brokered arrangements between the debtor and creditors such as a repayment plan, a debt management plan or debt write-off that may be brokered by a debt counsellor

(1) Debt management plans

Debt management plans (DMPs) are provided by creditor-funded free-to-client agencies, notably Payplan, StepChange Debt Charity and Christians Against Poverty, as well as fee-charging debt management companies. An affordable payment is calculated, based on an assessment of an individual's income and expenditure. The person in debt makes one monthly payment to a debt management provider, which is then distributed between their creditors on a pro rata basis

When setting up a debt management plan, creditors are not obliged to accept offers of reduced payment or to freeze the interest on the outstanding balance. The Office of Fair Trading (OFT) guidance on debt management states, however, that creditors must accept payments from any third party even in cases where the creditor has indicated that it will not negotiate with that third party.⁹⁸⁸ It could be argued therefore that once a payment has been made by a DMP provider to a creditor, a debt management plan is, *de facto*, in place. There is no time limit on payments, which means some could continue for years, unless the circumstances of the person in debt change.

(2) Pro rata or token payments

Offers of payment based on a pro rata distribution of available income are probably the most common remedy for credit debts provided by free-to-client advice providers such as CAB to people in debt, where a formal remedy is not appropriate. This means that creditors are offered a fair proportion of what the person in debt can afford to pay. Creditors are usually asked to freeze interest and other charges as well. There are no minimum or maximum levels of debt required to make pro rata offers. Creditors do not have to accept pro rata offers or requests to freeze interest and other charges and there is no time limit on payments. In contrast to DMP arrangements, the person in debt generally has to distribute the payments to individual creditors themselves.

⁹⁸⁶ London Economics, *Funding debt advice in the UK - a proposed model*, Money Advice Service/Department for Business, Innovation and Skills, 2011.

⁹⁸⁷ Unless otherwise indicated, the information in Section 1.5.3 is taken from Collard, 2009.

⁹⁸⁸ Office of Fair Trading, *Debt management (and credit repair services) guidance*, March 2012.

If a person in debt has little or no available income, they may not be in a position to offer any payment to their creditors, and therefore might request a moratorium (a period of time when the repayments do not have to be made and creditors agree not to take any further action). Alternatively, they may choose to offer token payments (typically one Pound per month) to their creditors. As creditors tend only to accept a moratorium or token payments for a limited period of time, they do not represent a long-term debt remedy.

(3) Full and final settlement of debts

If a person in debt has a lump sum available (e.g. through a windfall, sale of an asset or financial help from family or friends), they can offer their creditors a proportion of the outstanding balance owed in full and final settlement. In return for having a lump sum payment, the creditor agrees to write off the rest of the debt. If the lump sum payment has to be divided between several creditors, the usual way of doing this is to make pro rata offers.

A full and final settlement is generally only appropriate if the person in debt is in difficult circumstances that are unlikely to change for the better, and has no other assets or available income. Otherwise creditors are likely to reject an offer of lump sum payment in favour of further enforcement action. There are no minimum or maximum levels of debt required to make an offer of full and final settlement.

Creditors generally only consider writing off unsecured credit debts in exceptional circumstances, for example where the person in debt has no available income or assets and their circumstances are unlikely to improve, where it is uneconomic for the creditor to try and collect the debt, or where the person in debt has a long-term illness. Even if creditors do agree to write off debts, this agreement is not legally binding and there is no guarantee that the creditor will not take legal action in the future to recover the debt.

Formal procedures for debt settlement that do not take place in court

The main formal out-of-court debt settlement procedures are described below. In addition UK stakeholders reported that formal plans to deal with mortgage debt are widely available.

(1) Debt Relief Orders (England and Wales)

Introduced in England and Wales in April 2009, Debt Relief Orders (DROs) are aimed at debtors with little surplus income, few assets, and total debts of less than 15,000 Pound who are unable to repay their debts. Individuals meeting these conditions can apply for a DRO that results in their debts being discharged after one year and prevents creditors taking any further action to recover the debt in that time. There is a fee to apply for a DRO, which since April 2009 has been 90 Pound. Applications for a DRO can only be made online to the Official Receiver through an approved

intermediary, such as a licensed debt advisor. The same restrictions apply to individuals subject to a DRO as those that apply to bankrupts.

(2) Individual Voluntary Arrangements (England and Wales)

Individual Voluntary Arrangements (IVAs) were introduced as an alternative to bankruptcy in England and Wales under the Insolvency Act 1986. An IVA may constitute either a scheme of arrangement or a composition in satisfaction of debts, for example a person in debt may come to an agreement with their creditors to pay a certain percentage of what is owed with the remainder being written off. Although there is no statutory time limit for IVAs, they generally run over a five-year period. An IVA generally has to be set up through an insolvency practitioner, and the IVA proposal must be agreed by over 75 per cent of the voting creditors (by value of outstanding debt). If this criterion is met, all participating creditors are bound by the IVA. In addition, IVAs may include an 'equity clause' where the person in debt's property must be valued after a certain number of years and a portion of the equity released into the IVA for the benefit of creditors.

Details of current IVAs are included in the Individual Insolvency Register, and IVAs are also recorded on credit reference files. If an IVA fails, the creditors or the insolvency practitioner may apply to the court for the debtor to be made bankrupt. In January 2008, an IVA Protocol was introduced, which aimed to promote the efficient handling of straightforward consumer IVAs by standardising the process and thereby making it more transparent.

(3) Trust Deeds (Scotland)

Trust deeds are voluntary arrangements in Scotland. They fulfil much the same role as IVAs, but there are important differences in the way they are set up and administered. A trust deed is a formal agreement between a debtor and their creditors, by which the person in debt voluntarily transfers some or all of their assets to a trustee (who has to be a qualified insolvency practitioner) to administer on behalf of the creditors for the payment of debts. It usually includes a contribution from income for a specified period, typically three years, after which time the remaining debt is effectively written off. Once the trust deed is agreed by creditors, it is legally binding and no further interest or charges can be added to the debt. Creditors who do not agree to the trust deed can still take further action against the person in debt, however, including petitioning for sequestration (the equivalent to bankruptcy in Scotland).

Providing it meets certain conditions, a trust deed may be recorded in the Register of Insolvencies as a protected trust deed. The proposal for a trust deed to become protected is automatically agreed unless there are objections from a majority of the creditors (in number), or from creditors who hold no less than one third of the total debts. A protected trust deed involves the transfer of all assets to a trustee and is

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binding on all creditors. As long as the person in debt complies with the terms of the protected trust deed, creditors can take no further action to pursue the debt or to make the person in debt insolvent. It also prevents the person in debt from applying for their own sequestration or a debt payment programme under the Debt Arrangement Scheme (see below). Like sequestration, a protected trust deed is likely to affect a debtor's credit rating and may prevent them from being employed in certain jobs. If the person in debt does not co-operate with the trustee, the trustee can petition for their sequestration.

(4) Debt Arrangement Scheme (Scotland)

The Debt Arrangement Scheme (DAS) is a statutory scheme introduced in Scotland in 2004. The DAS administrator, who is part of the Office of the Accountant in Bankruptcy, manages the scheme. To be eligible to apply, debtors must live in Scotland, have more than one debt and have some money left over after essential expenditure. Applications to the scheme have to be made through an approved money adviser and are automatically accepted where all the creditors have consented to it. The application can still be approved even if some creditors do not consent to it, provided that the DAS administrator considers it fair and reasonable to do so. The DAS is normally free.

Under the DAS debt payment programme, the person in debt makes a single monthly payment to an approved payment distributor, who disburses the money to the creditors. As long as the agreed payments are made, creditors cannot take any enforcement action against the person in debt, such as sequestration (the equivalent to bankruptcy in Scotland) or taking deductions from earnings. Interest and other charges are suspended once the debt payment programme is approved. As long as the debtor fully completes the debt payment programme, the frozen interest, fees and charges are written off.

A debt payment programme can be revoked, the most likely causes being if the person in debt fails to meet the conditions of the programme, made untrue statements in their application, or misses three payments. Applications for a DAS are recorded on a DAS register, which is not available to the general public. Details of a debt payment programme may also be recorded on the person's credit file, which is likely to affect their ability to take out further credit.

Legal procedures that take place in court (e.g. consumer insolvency proceedings)

Individuals in England, Wales and Northern Ireland can become formally insolvent through bankruptcy. A person in debt can petition for their own bankruptcy, regardless of how much they owe, and the majority of bankruptcy petitions are from debtors. This costs around 500 Pound in total although there is scope for remission of the court fee element for certain low-income groups. Alternatively, a creditor can

petition the court to make an individual bankrupt if they are owed 750 Pound or more and can demonstrate that the individual is unable to pay their debts.

Under bankruptcy legislation, the assets and liabilities of the person in debt are dealt with by the Official Receiver or an insolvency practitioner as trustee of the bankrupt's estate. If the person in debt has any assets (such as a house with equity) these are usually sold to pay creditors, and they may be obliged to make a contribution towards their debts from any income earned for a period of up to three years; otherwise the individual is usually released from their bankruptcy debts when they are discharged. There are a number of restrictions on the activities of bankrupts (e.g. in relation to credit applications and running a business), and bankruptcy adversely affects an individual's credit rating for six years.

Bankruptcy details are usually published in a trade paper, The London Gazette, and may also appear in the classified section of a local paper. Details of bankruptcies that are current or have ended in the last three months are also publically available via the Individual Insolvency Register maintained by the Insolvency Service. Changes to bankruptcy legislation, which were introduced in 2004, mean that most bankruptcies are now discharged after twelve months, compared with two to three years previously. Restrictions (under a Bankruptcy Restrictions Order or Undertaking) can be imposed for up to fifteen years, however, if a debtor's behaviour is considered dishonest or blameworthy.

In Scotland, the equivalent process to bankruptcy is sequestration. Although Scotland operates a separate legal system, the process and conditions of sequestration are broadly similar to those for bankruptcy in the rest of the UK. A major change to the Scottish legislation was the introduction of a new route into sequestration for people with low income and low assets (LILA), which came into force from 1 April 2008. The main advantage of this scheme for the person in debt is that, unlike the usual sequestration process in Scotland, they can petition for sequestration without having a court ruling against them or needing to have a creditor who has agreed to the sequestration

Financial support for households to repay debts/arrears (e.g. by public fund)

Some energy and water companies have set up charitable trusts that help people pay off energy and water debts.⁹⁸⁹

Mortgagors who receive certain income-related social security benefits are able to get help towards interest payments on their mortgage or loans taken out for certain home repairs or home improvements, called Support for Mortgage Interest (SMI).⁹⁹⁰

⁹⁸⁹ See for example Auriga, *Information about Water and Energy Companies and the schemes or services they provide to help customers*, September 2012.

⁹⁹⁰ See 'Support for Mortgage Interest', at <https://www.gov.uk/support-for-mortgage-interest/overview>.

The government only provides help towards the interest payments, not the amount borrowed. SMI is normally paid direct to the lender after a waiting period, which is 13 weeks after the mortgagor has claimed benefit. The standard interest rate used to calculate SMI is currently 3.63%. This may be less than the mortgage interest rate charged by the lender.

For mortgagors in England who are at risk of becoming homeless because they cannot pay their mortgage, the government launched a Mortgage Rescue scheme⁹⁹¹ in January 2009. If they are eligible for help, mortgagors have two options. They can apply for an interest-only loan from a registered social landlord (which is an independent housing association) to help pay off some of the mortgage and reduce their mortgage payments to an affordable level. Alternatively, the registered social landlord buys the home for 90% of its market value. The mortgagor stays in the home and pays rent to the registered social landlord. The rent is 20% less than the market rate for the area.

Other measures

One stakeholder mentioned debt consolidation loans. The idea behind a loan for debt consolidation is that it allows a person in debt to repay their outstanding debts in full. They can then make one monthly loan payment rather than individual payments to multiple creditors. Unless they default on their consolidation loan, the individual's credit rating should not be affected.

Debt consolidation loans can only be an effective means for people to resolve their financial difficulties if all debts are consolidated and no further debt is built up and, crucially, they can afford the new loan repayments. The interest rate on the consolidation loan compared to the interest rate on the individual debts to be consolidated is also an important consideration, as is the length of the new loan term. A loan for debt consolidation can be secured on an individual's home, with the risk of repossession if the repayments are not maintained. People may use credit union loans to consolidate or pay off higher-cost debts.

Effectiveness as assessed by stakeholders

Stakeholders considered that debt management plans could be effective, but had concerns about poor practice by fee-charging companies. One of the solutions proposed by government to improve the fee-charging industry is a stronger industry code of practice, also called a 'debt management protocol'. No such protocol is in place at the time of writing. Other drawbacks were that creditors did not always freeze interest or charges, creditors could still take enforcement action and DMPs could last over 10 years.

⁹⁹¹ See 'Mortgage Rescue Scheme', at <https://www.gov.uk/mortgage-rescue-scheme/overview>.

Formal out-of-court procedures for debt settlement were considered effective because creditors generally cannot take further action; debts remaining at the end of the period are written off; the fees are either paid as part of the arrangement (in the case of IVAs) or are relatively affordable (in the case of DROs). Stakeholders also pointed out some downsides to IVAs and DROs, for example in both cases they are entered on a public register. Some interviewees mentioned that the strict criteria for DROs excluded many debtors from pursuing this option. The Debt Arrangement Scheme in Scotland was considered to be effective in helping many people.

With bankruptcy, debts are written off with certain exceptions and creditors cannot take any further action unless debts are secured on property. On the downside, bankruptcy is entered on a public register and advertised, any business will be closed down and employment may be affected. Bankruptcy fees are thought by some to be prohibitively high. With Administration Orders, the court deals with the creditors, interest and charges are stopped and there is no up-front fee. The effectiveness of financial support for households to repay debts is limited by funding constraints and/or eligibility criteria. Official statistics indicate that the Mortgage Rescue Scheme has helped 4,413 households remain in their homes since it began in 2009/2010.⁹⁹²

Debt consolidation loans can be effective if the new loan repayment is lower. However, there might be fees associated with arranging the loan, the interest rate could change, and people with poor credit histories may be offered poor terms and conditions.

27.5.4 Changes in response to over-indebtedness

(1) Formal responses

In England and Wales, the main change to formal responses to over-indebtedness was the introduction of Debt Relief Orders. Although the eligibility criteria for a DRO limit who can apply, it seemed to be viewed as a positive step in helping people on lower incomes and with few assets to manage debt problems. For one civil society stakeholder the year-on-year increase in demand was a sign of the effectiveness of the DRO.

Proposed changes in England and Wales included moves to take uncontested insolvency proceedings out of court.

An interviewee from a consumer organisation also mentioned government legislation in 2007 to introduce a suite of debt remedies in England and Wales, but noted that these changes have not actually been introduced. The interviewee felt this has resulted in a fragmented system of protection and debt relief that meant not all people in debt were able to access the help they needed. In contrast, the current

⁹⁹² See 'Mortgage Rescue', at *Homes & Communities Agency*, www.homesandcommunities.co.uk/mortgage_rescue_guidance [accessed 27 December 2012].

government was introducing measures to make it easier for creditors to enforce debts.

Changes in Scotland mentioned by stakeholders included legislative changes to allow people with low income and low assets to apply for bankruptcy. Debtors have also been given new protection under the Homeowner and Debtor Protection Act, especially in relation to homelessness. Less positively, bankruptcy fees in Scotland doubled to 200 Pound in June 2012, which was regarded as a barrier for people in debt to access help. In addition, during 2012 the Scottish Government had consulted on plans for significant reform to the system of statutory debt remedies; at the time of the stakeholder interviews, the outcome was still awaited.

(2) Other responses

Stakeholders were concerned that public funding for debt advice (for example by local authorities) has been reduced as a result of public spending cuts. Further cuts are due in 2013, when legal aid for most debt problems is abolished in England and Wales.

In 2012, the Money Advice Service took on responsibility for the co-ordination and funding of face-to-face debt advice services. Its work in this area includes developing quality standards for debt advice. There has been a government committee inquiry into the Money Advice Service in 2012 (covering its whole remit, not just debt advice), which is not yet completed at the time of writing.⁹⁹³ The inquiry has been highly critical of the Money Advice Service and this led to the resignation of the Chief Executive.

Some stakeholders also expressed concerns about the fee-charging debt management industry, and in particular the prevalence of dubious practices and companies. A government committee inquiry took place in 2012 to explore these issues.⁹⁹⁴

Following a feasibility study, the government has committed additional funding for the expansion and modernisation of the credit union movement in the UK.⁹⁹⁵ It is hoped that this will provide greater access to affordable loans.

(3) Mortgage debt

It was reported in the stakeholder interviews that the regulator (Financial Services Authority) has heightened its supervision of how mortgage lenders deal with

⁹⁹³ See 'Money Advice Service', at Common Select Committee, www.parliament.uk/business/committees/committees-a-z/commons-select/treasury-committee/inquiries1/parliament-2010/money-advice-service/.

⁹⁹⁴ See 'Debt management', at *Common Select Committee*, www.parliament.uk/business/committees/committees-a-z/commons-select/business-innovation-and-skills/inquiries/parliament-2010/debt-management/.

⁹⁹⁵ See 'Credit Union Expansion', at *Department for Work and Pensions*, <http://www.dwp.gov.uk/other-specialists/credit-union-expansion/>.

mortgagors in financial difficulty, for example by conducting more visits to lenders and taking enforcement action against firms that do not treat customers fairly. New regulations have also been introduced, for example mortgage lenders have to record all conversations with customers in payment difficulties.

As mentioned above, the Mortgage Rescue was launched by government in January 2009. An investigation into the scheme by the National Audit Office in 2011 found that it was not delivering value-for-money. As a result, changes were made to reduce the cost of the scheme to the taxpayer but which may also reduce local availability of the scheme.⁹⁹⁶

The rate at which Support for Mortgage Interest (SMI) is paid was cut from 6.08% to 3.63% in October 2010. Because it is paid at a flat rate, it will not necessarily cover all the interest that a mortgagor has to pay, according to one stakeholder.

(4) Consumer credit

Subsequent to the stakeholder interviews conducted for this study, there has been increasing concern in the UK about the activities of payday lenders. This has led to a number of actions including the introduction of a new customer charter for short-term credit customers. The Office of Fair Trading, that regulates consumer credit, conducted a compliance review of 240 payday lenders. It published a critical interim report in November 2012 and is taking action against non-compliant lenders.⁹⁹⁷ During 2012, the OFT also received new powers to suspend consumer credit licences with immediate effect in certain circumstances.

The final version of the Financial Services Bill, to be implemented in 2013, includes provisions for the new Financial Conduct Authority (FCA) to cap excessive interest rates or associated charges on borrowers. The Bill clarifies that the FCA would be able to specify the level of the cap in rules and also to define which charges, in addition to interest, should be captured.⁹⁹⁸

27.5.5 Types of households of over-indebted consumers not reached by current measures

The stakeholders mentioned possible cultural barriers for some ethnic groups; insolvency fees and lack of disposable income acting as barriers for some households; the reduction in access to Support for Mortgage Interest and the Mortgage Rescue

⁹⁹⁶ As reported on the National Audit Office website: "The Mortgage Rescue Scheme, launched in January 2009 by the Department for Communities and Local Government, achieved fewer than half of the rescues expected. The Department helped 2,600 households avoid repossession and homelessness at a cost of in excess of £240 million - but it originally expected to help 6,000 households for £205 million." See 'The mortgage rescue scheme', at *National Audit Office*, www.nao.org.uk/publications/1012/mortgage_rescue_scheme.aspx.

⁹⁹⁷ Office of Fair Trading, *Payday Lending Compliance Review, Interim Report*, November 2012.

⁹⁹⁸ See 'Lords final changes to Financial Services Bill', 6 December 2012, at www.parliament.uk/business/news/2012/december/lords-financial-services-bill-third-reading/.

Scheme for homeowners due to the above-mentioned recent changes; and the limited debt remedy options available to homeowners (they are not eligible for debt relief orders and can face severe penalties if they enter an IVA or bankruptcy).

27.5.6 Best practices

The stakeholders interviewed mentioned the CCCS-model of debt management plans to repay debts, as opposed to debt write-off or insolvency; free-to-client debt advice services as opposed to fee-charging services; and promoting credit unions and other social lenders to tackle the causes of over-indebtedness. For creditors, best practice involved making efforts to understand the customers' situation and the early identification of customers at risk of financial difficulty. The trade organisation for mortgage lenders has published good practice guidance for helping mortgage borrowers who are in financial difficulty. There is also guidance for creditors and debt collection agencies about dealing with people in financial difficulty who have mental health problems.⁹⁹⁹

27.6 OUTLOOK

If the current economic conditions¹⁰⁰⁰ continued, stakeholders who commented on the issue generally anticipated that levels of over-indebtedness would remain high or increase. Lender forbearance made it difficult to assess the true extent of mortgage arrears. An increase in interest rates would likely result in increased mortgage arrears.

Challenges identified in the stakeholder interviews included:

- ▶ Regulation of consumer credit under the new Financial Conduct Authority;
- ▶ Regulation of payday lending and other high-cost credit, in terms of the cost of credit but also marketing;
- ▶ The impact of welfare reform and reduction in social welfare levels;
- ▶ The development of a coherent set of debt remedies and the co-ordination of debt advice by the Money Advice Service;
- ▶ Higher interest rates;
- ▶ At firm level, the tension between financial conduct issues and prudential issues.

⁹⁹⁹ See Council of Mortgage Lenders, 'A practical guide to helping mortgage borrowers in financial difficulty' (available at: www.cml.org.uk/cml/filegrab/?ref=5985) and Money Advice Liaison Group 'Good Practice Awareness Guidelines for Consumers with Mental Health Problems and Debt', 2009 (available at:

<http://www.malg.org.uk/dmhddocuments/Mental%20Health%20Guidelines%20Ed%202%20Final%202009.pdf>)

¹⁰⁰⁰ This refers to the period when stakeholder interviews were conducted, i.e. summer and autumn of 2012.

Stakeholders also identified:

- ▶ A continued need to tackle unscrupulous practices among lenders generally;
- ▶ The need for greater support for social lenders such as credit unions;
- ▶ The need for a greater focus on debt prevention;
- ▶ The need for continued support for homeowners in financial difficulty.

In relation to utilities, stakeholders identified the lack of competition among utility providers as a major concern where further action was required in addition to proposed reforms. Better arrears data sharing by utility providers was also felt to be needed.

In relation to housing, stakeholders were particularly concerned about high levels of rent in the private rented sector and poor practices by private landlords. High private sector rents were closely linked to the lack of mortgage finance and the difficulties this created for first-buy buyers who wanted to move out of the private rented market.

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Over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact

ANNEX A: STATISTICAL DATA FROM EU SOURCES

Final report

Over-indebtedness of European households: updated mapping of the situation, nature and causes, effects and initiatives for alleviating its impact

United Kingdom

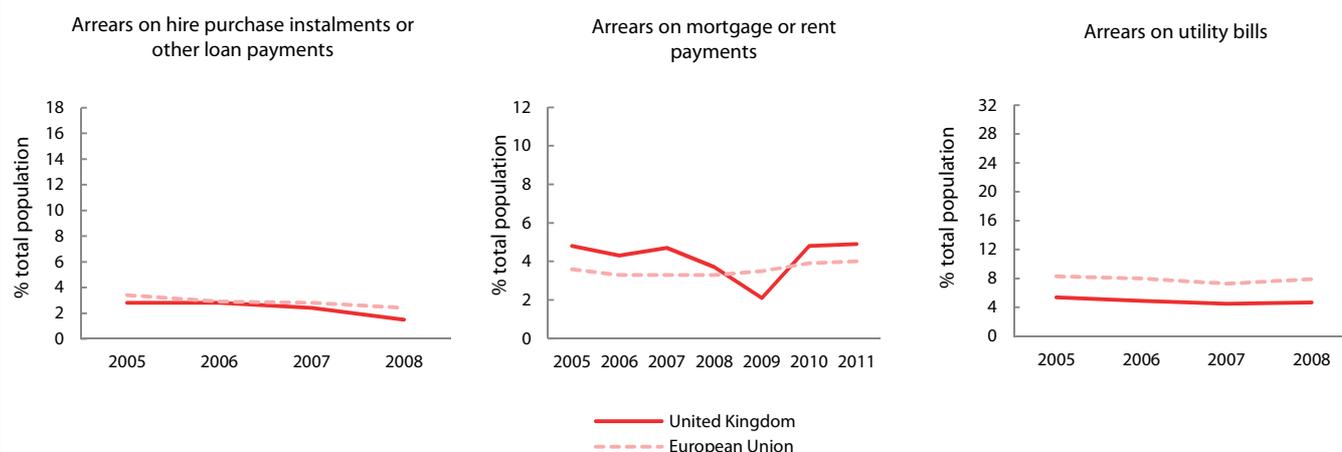
I. Eurobarometer¹

	United Kingdom	EU average	Lowest EU value	Highest EU value
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Households *at risk* of being over-indebted

Respondents feeling at risk of over-indebtedness in 2010	↗ 35%	25%	7%	52%
Respondents feeling at risk of over-indebtedness in 2009	↗ 35%	27%	9%	53%

II. EU SILC standard survey data²



III. EU SILC 2008 module: Over-indebtedness and financial exclusion³

	United Kingdom	EU average	Lowest EU value	Highest EU value
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Proportion of people in households with bank overdrafts, outstanding balances on credit cards or in arrears on other loans of over 100% of household disposable income

Overdrawn bank account (% of people in households overdrawn)	↘ 2.1%	2.2%	0.0%	7.7%
Credit or store card (% of people in households with outstanding balances)	↗ 8.6%	1.1%	0.0%	8.6%
Other loan/credit payments (% of people in households in arrears)	↗ 0.3%	0.3%	0.0%	1.1%

Proportion of people in households in arrears in servicing housing-related loans and bills and in paying other bills of over 100% of household disposable income

Housing bills (% of people in households in arrears)	↗ 0.9%	0.5%	0.0%	2.9%
Other payments (% of people in households in arrears)	↘ 0.0%	0.4%	0.0%	1.7%

Households living with outstanding debts and/or arrears of over 100% of household disposable income

Total (% of households with outstanding debts/arrears)	↗ 11.8%	4.6%	0.0%	11.8%
Income above 60% median (% of households with outstanding debts/arrears)	↗ 11.3%	4.2%	0.0%	11.3%
Income below 60% median (% of households with outstanding debts/arrears)	↗ 13.7%	7.0%	0.2%	13.7%
Materially deprived (% of households with outstanding debts/arrears)	↗ 19.1%	9.0%	0.1%	27.4%

Proportion of those in broad age groups with outstanding debts of over 100% of household disposable income

Households with all adults aged 25-39 (% of households with outstanding debts)	↗ 17.2%	6.3%	0.0%	17.2%
Households with all adults aged: 40-64 (% of households with outstanding debts)	↗ 10.5%	5.8%	0.0%	10.9%
Households with all adults aged: 65+ (% of households with outstanding debts)	↗ 1.7%	1.2%	0.0%	2.8%

Proportion of those in different types of household with outstanding debts of over 100% of household disposable income

Living alone (% of people in households with outstanding debts)	↗ 8.2%	4.3%	0.0%	8.2%
Single parent (% of people in households with outstanding debts)	↗ 15.0%	9.5%	0.0%	27.1%
Other (% of people in households with outstanding debts)	↗ 12.1%	4.8%	0.0%	12.1%

Proportion of those in households with outstanding debts of over 100% of household disposable income by marital status

Never married (% of people in households with outstanding debts)	↗ 15.4%	5.0%	0.0%	15.4%
Married (% of people in households with outstanding debts)	↗ 9.3%	4.1%	0.0%	9.7%
Separated/divorced (% of people in households with outstanding debts)	↗ 12.8%	7.5%	0.1%	13.9%
Widowed (% of people in households with outstanding debts)	↗ 3.2%	1.7%	0.0%	4.3%

Proportion of those in households with outstanding debts of over 100% of household disposable income by housing tenure

Owner occupied without mortgage (% of people in households with outst. debts)	➡ 3.2%	3.2%	0.0%	9.6%
Owner occupied with mortgage (% of people in households with outst. debts)	↗ 16.1%	6.3%	0.0%	16.1%
Market rent (% of people in households with outstanding debts)	↗ 16.0%	8.2%	0.0%	16.0%
Subsidised rent (% of people in households with outstanding debts)	↗ 11.6%	8.7%	0.0%	17.9%
Rent-free housing (% of people in households with outstanding debts)	↗ 15.1%	2.3%	0.0%	15.1%

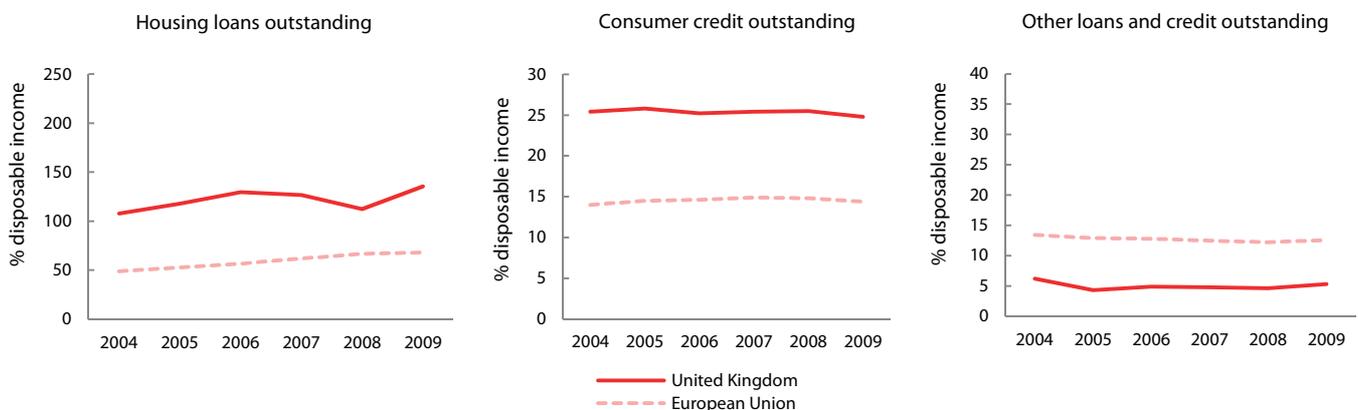
Proportion of those in households with outstanding debts of over 100% of disposable income by work intensity

Work intensity of 0 - 0.19 (% of people in households with outstanding debts)	↗ 10.6%	5.7%	0.0%	10.6%
Work intensity of 0.20 - 0.50 (% of people in households with outstanding debts)	↗ 15.3%	5.7%	0.0%	15.3%
Work intensity of 0.51 - 0.74 (% of people in households with outstanding debts)	↗ 12.3%	5.4%	0.0%	13.5%
Work intensity of 0.75 - 1.0 (% of people in households with outstanding debts)	↗ 14.3%	5.3%	0.0%	14.3%

Proportion of those in over-indebted households that experienced a major drop in income over the preceding year

Over-indebted (% of people in households that experienced drop in income)	↘ 33.0%	33.3%	0.0%	77.6%
Other (% of people in households that experienced drop in income)	↗ 21.4%	19.2%	5.9%	32.5%

IV. Loans and credit outstanding⁴



Notes:

- (1) Eurobarometer 72.1 (2009) and Eurobarometer 74.1 (2010). Note: Those who answered 'very at risk' or 'fairly at risk' to the question 'Please tell me how much you feel at risk of being over-indebted'.
- (2) Eurostat, SILC. Data as of December 2012.
- (3) European Commission, Research Note 4/2010, Over-indebtedness new evidence from the EU-SILC special module.
- (4) European Commission, Research Note 4/2010, Over-indebtedness new evidence from the EU-SILC special module. European Credit Research Institute (ECRI), Lending to households in Europe, 1995-2009 and Eurostat, National accounts.