DEBT BRITAIN 2018 UPDATE

Debt Britain - The Changing Landscape in 2018

SUMMER 2018

FOREWORD

Debt Britain 2016: The Big Picture: The Arrow Global Guide to Consumer Debt, was first published in 2016 and included for the first time, forecasts for debt defaults, mortgage possessions and personal insolvencies in the UK. It was designed to understand the role of debt in consumers' lives and in the nation's economy.

Following the latest forecast update from the Office for Budget Responsibility (OBR) published in March 2018, we have refreshed our forecast.

Debt Britain 2018: The Changing Landscape, provides a unique forecast of the future path of credit default. It shows that within the next two years the UK will start to see defaults rise significantly as debt levels build up. A sustained period of exceptionally low interest rates is also expected to end as signalled by the recent Bank of England rate rise to 0.75%, and the effects of Brexit remain uncertain for many. The forecast also looks at the impact on default levels if the Bank of England increases the bank base rate at a faster rate than currently projected. Every scenario requires preparation by those who work with indebted consumers, because although progress has been made in some areas since our 2016 report, there remains a significant proportion of the population that is likely to be exposed to financial difficulty over the next 3-4 years.

Credit plays an important societal role and fuels the economy by enabling people to buy houses, cars and make future plans. However, some debt defaults are inevitable as personal circumstances and macro-economic factors change. Often these factors are hard or impossible to plan for. When consumers are unable to meet repayments, it is vital they are provided with the right support and tools to help them get back on track. Getting problem debt under control is a significant achievement with major long-term benefits for the consumer.

It is important that consumers understand how to manage their finances and ensure that they don't take on more debt than they can afford to repay in the first place.

The debt management industry can help through better collaboration, whether this is through improved financial education, better use of data across the industry or working together to help consumers' rehabilitation and in turn, their access to more affordable mainstream financial products.

We are determined to play our part in this. We are committed to offering young people and adults the tools and knowledge to better manage their personal finances, as well as equipping them with the skills and confidence to take the first and next steps on their career journey. In addition to running our own financial education programmes, we also partner with organisations including Junior Achievement Europe, Citizens Advice, Christians Against Poverty, StepChange and Payplan to help them deliver crucial education, advice and support to young people and consumers in debt.

Equally, one of the most important aspects of our business is the significant data we hold. We will continue to share insights and feedback for the benefit of our customers and regulators in terms of depersonalised data and case studies (see p13). We will continue to contribute to consultations and proactively provide information to drive better regulation; we will play an active role in debt advice forums, fund charities and challenge the traditional 'us and them' attitudes for the benefit of our customers; and we will promote codes of conduct and best practice for our customers wherever we operate.

In 2016, we proposed the introduction of a 'traffic light system' to provide recognition for those who are making regular repayments to their outstanding debts. While the implementation of such a system is not easy, it is pleasing that the principle has prompted discussion across the sector.

One alternative to the traffic light concept could be greater usage of the 'debt balance trend' data already held by the credit reference agencies, which in simple terms looks to offer a consistent and clear recognition of the individual's efforts to make regular repayments. It will allow customers who are making consistent payments to access better tariffs on utilities and other products, and could also make renting a property more achievable. However, it will be necessary to introduce safeguards against unaffordable further borrowing, and take advantage of open banking data to enhance decision making. These topics will be the subject of further discussions with stakeholders.

We firmly believe financial problems should not hold people back from achieving their goals in life. We hope that Debt Britain 2018 provides useful insights into future trends in credit and indebtedness, so that we can continue to work with our customers and other trusted stakeholders to prepare them for the times ahead.

Lee Rochford,
Group Chief Executive Officer,
Arrow Global Group
Summer 2018

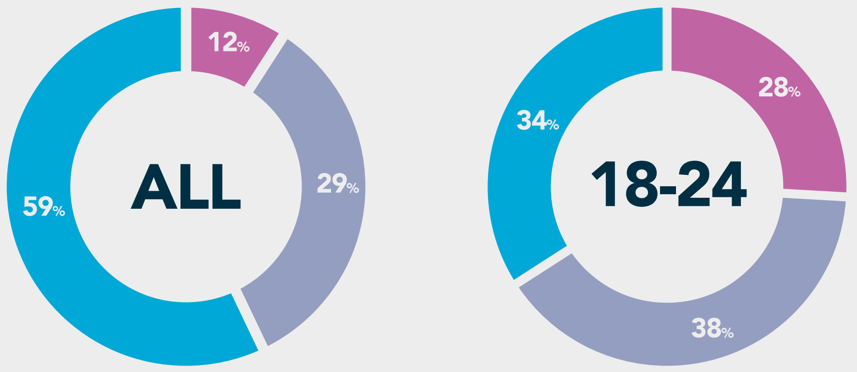
ARROW GLOBAL

ARROW
GLOBAL

DEBT BRITAIN 2018

The Changing Landscape

Knowledge of what APR means and views of its importance



% who do not know what APR means
% who see it as of little or no importance
% who see it as having fair or great importance

Source: Arrow Global research

Percentage of borrowers who do not know the interest rate they are being charged

19% MORTGAGES

43% BANK OVERDRAFT

31% UNPAID CREDIT CARDS

53% STUDENT LOANS

Source: Arrow Global research

The main types of loans that people struggle to pay back

60% OF BORROWERS
HAVE STRUGGLED TO CATCH UP ON REPAYMENTS IF THEY FALL BEHIND

51% CREDIT CARD NOT BEING PAID OFF IN FULL

18% UNSECURE LOANS

15% MAIL ORDER CREDIT

24% BANK OVERDRAFT

10% MORTGAGE

Source: Arrow Global research

Debt Britain 2016: The Big Picture: The Arrow Global Guide to Consumer Debt, was first published in 2016 and included for the first time, forecasts for debt defaults, mortgage possessions and personal insolvencies in the UK.

The report was designed to provide a comprehensive overview of the macro factors of consumer debt and investigate the issues affecting consumers.

Debt Britain 2018: The Changing Landscape, provides an updated forecast of the future path of credit default.

The majority of borrowers start defaulting through no fault of their own

ILL HEALTH 21%

LOSING JOB (COMPLETELY) 20%

POOR BUDGETING 32%

LOSS OF EARNINGS (OVERTIME OR SELF-EMPLOYED EARNINGS) 28%

I BORROWED TOO MUCH 22%

Source: Arrow Global research

The human impact of defaulting on debt

% TROUBLE SLEEPING
35% MALE
50% FEMALE

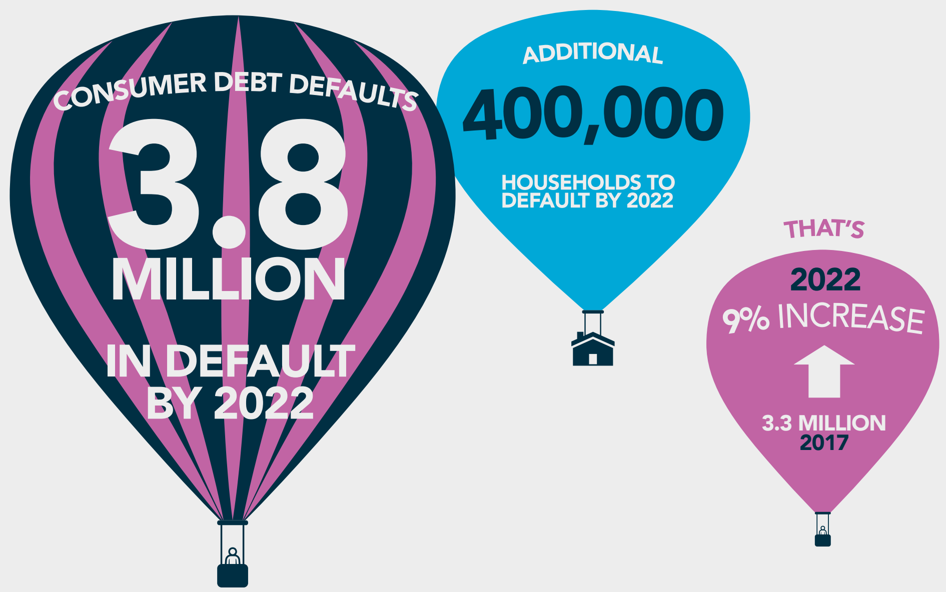
% MENTAL HEALTH PROBLEMS
20% MALE
17% FEMALE

% TROUBLE WITH PERSONAL RELATIONSHIPS
20% MALE
20% FEMALE

% REDUCED OUTPUT AT WORK
15% MALE
14% FEMALE

Source: Arrow Global research

Consumer debt defaults set to rise



Source: Arrow Global model based on statistics from the Office for Budget Responsibility.

UK CONSUMER PERSONAL INDEBTEDNESS FORECAST

SUMMER 2018

Debt Britain 2018: The Changing Landscape offers further insight into the UK's personal indebtedness. The main points are:

- Household defaults set to rise to 3.8 million by 2022. The number of households in default has been falling in recent years due to interest rates staying low for longer than expected, which has kept borrowing costs for millions of households at historically low levels . However, we expect defaults to rise quickly from 2020.
- The impact of bank base rate increases is significant. An additional 0.5% rise above the central forecast adds a further 250,000 households in default, taking the total to over 4 million.
- Mortgage possessions will rise. The main driver is rising interest rates, and by 2022 we expect possessions to be 17% above their 2017 level.
- The number of personal insolvencies will also increase, rising to 105,000 per annum by 2022. The level of personal insolvencies keeps exceeding projections, perhaps suggesting a change in consumers' attitudes toward debt. We therefore expect personal insolvencies to be 8-10% higher throughout the forecast period.
- Increased financial education is needed. There remain serious gaps in consumer knowledge around debt. For example, knowledge around APR is low, the impact of missed payments on an individuals' credit rating is misunderstood, and credit scores are still a mystery to many.
- The credit management industry can help, both by providing timely financial education and by setting achievable repayment arrangements for those in financial difficulty. We must also continue to work closely with the debt advice sector by signposting consumers to appropriate free debt advice.
- Successfully rehabilitating borrowers who have been unable to manage all their debts is paramount. Steps are being taken. Greater cooperation between credit management providers and the debt advice sector, with the hope of more efficient funding arrangements under the new Single Financial Guidance Body, give cause for optimism. However, progress on initiatives such as financial education and self-help is likely to be outstripped by the growing number of households needing help.

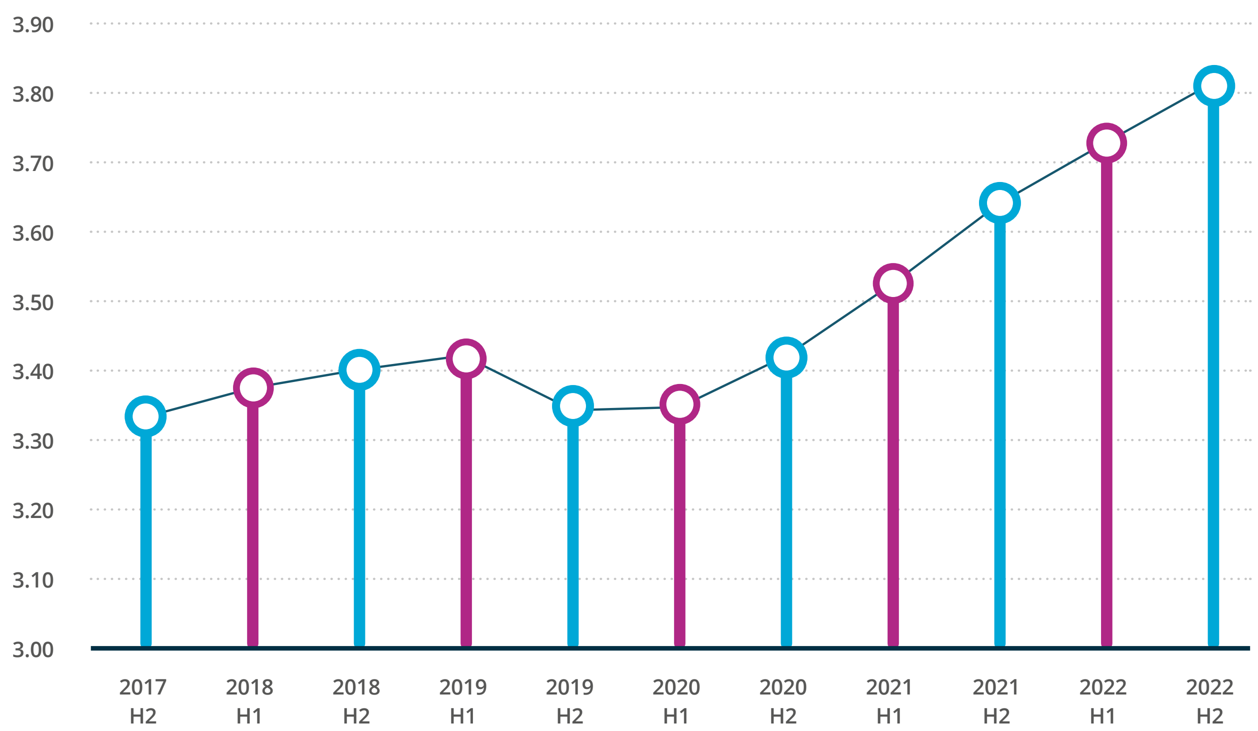
DEBT BRITAIN
– SUMMER 2018 UPDATE

FORECAST FOR THE NUMBER OF BRITISH HOUSEHOLDS IN DEFAULT

Putting the new forecast numbers into our econometric model of defaults, Chart 1 shows the updated forecast for the number of British households in default. The chart is based on OBR projections for interest rates, unemployment and consumer debt.

The number of households in default has been falling in recent years. However, we expect the number to rise from 3.33 million at the end of 2017 to 3.42 million by the middle of 2019, before dipping slightly in 2019 and 2020, due to the lagged effect of the post-Brexit interest rate cut. It will then resume its upward trajectory to reach 3.81 million by the end of 2022.

CHART 1: NUMBER OF HOUSEHOLDS IN DEFAULT (MILLIONS)



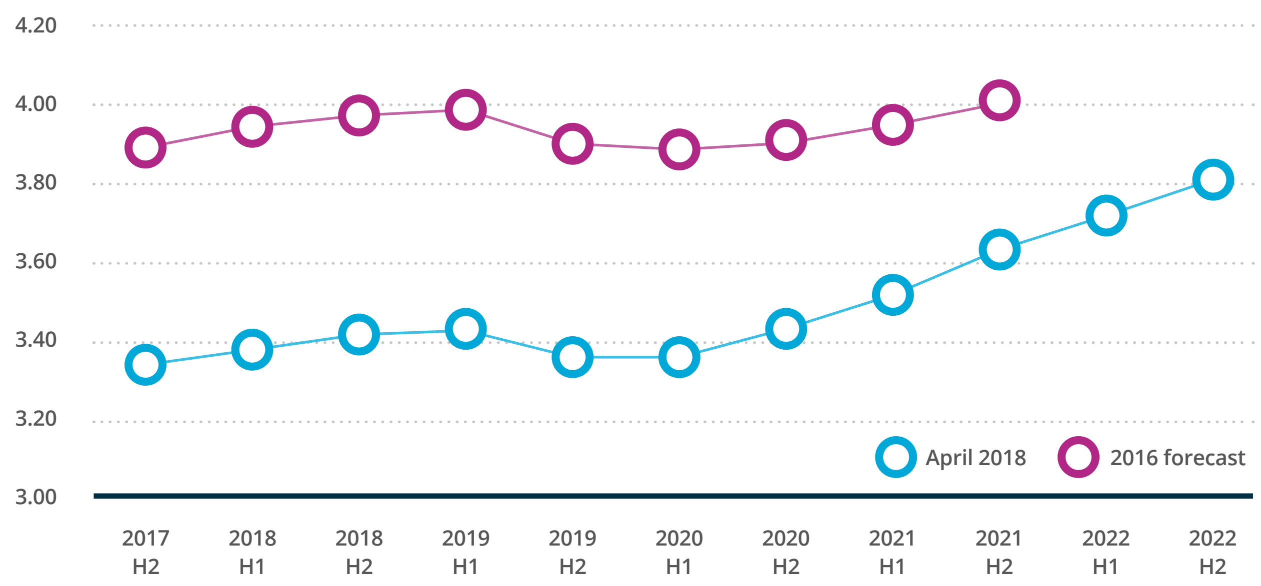
PREVIOUS FORECASTS WERE HIGHER

Chart 2 compares the new forecast with the one we produced in March 2016. We are now expecting defaults to be lower than we previous predicted, as the relatively benign low interest rate environment helped those in debt.

From 2020, defaults will rise quickly with an additional 400,000 households expected to have defaulted in the two years to the second half of 2022.

Moreover, according to recent data from StepChange, the debt charity, more households are now falling behind on priority debts such as rent and utilities, but there is a limit on how far household income can stretch, and it is likely that those who are just about managing (the so-called JAMs) will form a significant part of the increase in households in default.

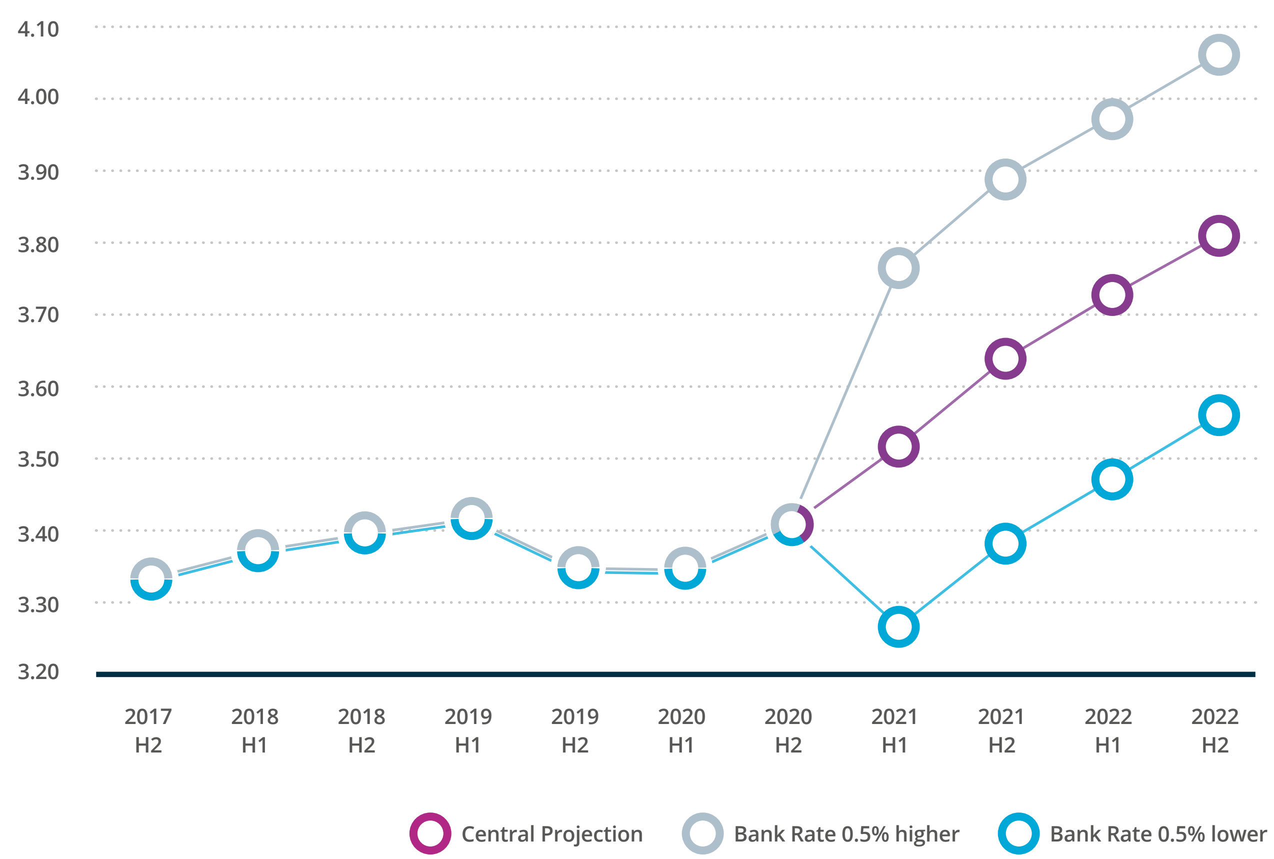
CHART 2: NUMBER OF HOUSEHOLDS IN DEFAULT (MILLIONS)



IMPACT OF INTEREST RATES

Chart 3 shows the impact on our forecast of a 0.5% increase and alternatively a 0.5% decrease in Bank of England bank rate. The impact of these interest rate changes occurs with a lag. By 2021 a 0.5% change in bank rate alters the number of defaults by some 7% either up or down. This would represent an additional 250,000 household defaults.

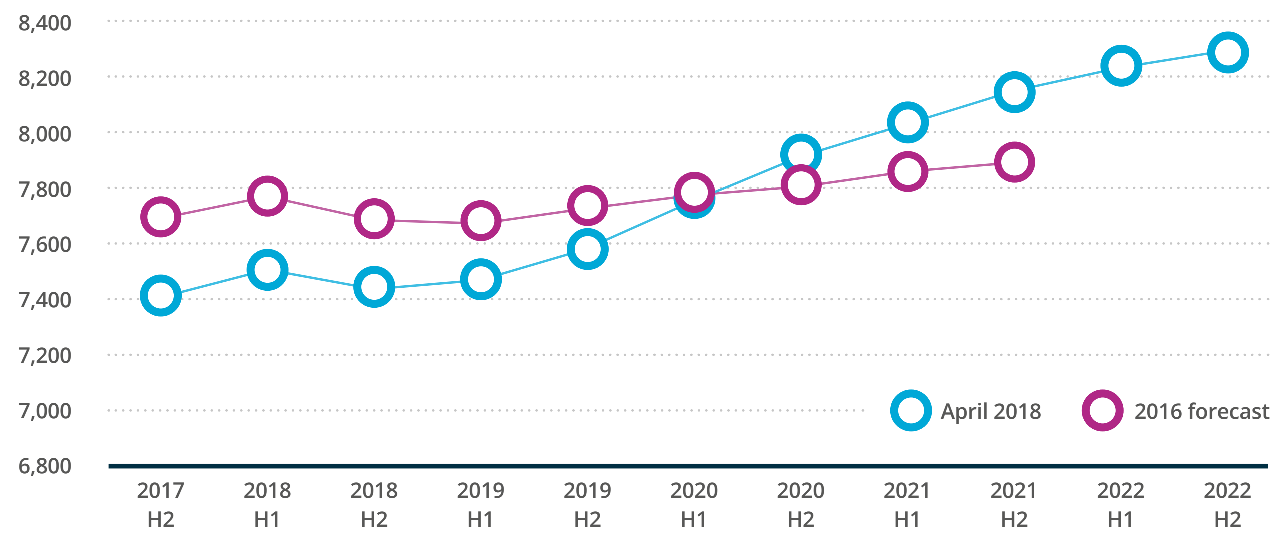
CHART 3: NUMBER OF HOUSEHOLDS IN DEFAULT (MILLIONS)



MORTGAGE POSSESSIONS SET TO INCREASE

Chart 4 shows the forecast for the number of mortgage possessions. In contrast to households in default, the mortgage possession forecast moves above the previous projection, albeit from a lower base initially. The key driver of higher expected possessions is rising interest rates. By 2022, we expect possessions to be 12% above their 2017 level.

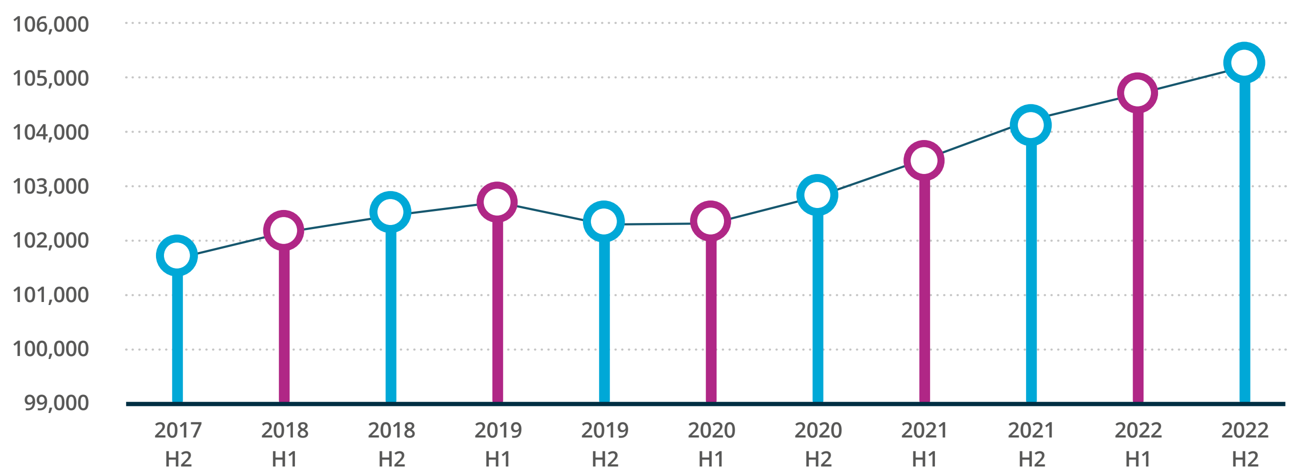
CHART 4: NUMBER OF MORTGAGE POSSESSIONS (ANNUAL RATE)



PERSONAL INSOLVENCIES TO HIT 105,000

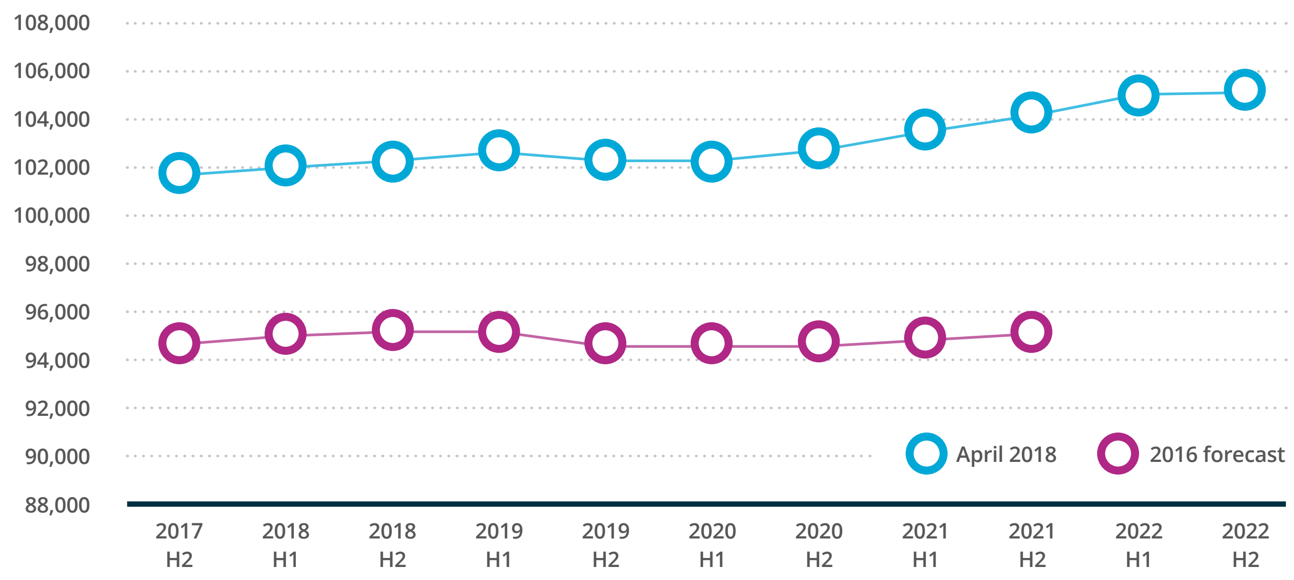
Chart 5 shows the number of personal insolvencies, which have been on an upward trend since 2015. We expect this trend to become more pronounced from 2021, when the lagged effect of interest rate increases will make themselves felt. On our estimate, personal insolvencies are set to reach 105,000 in 2022. This is the highest total since 2012, driven by both higher interest rates and higher levels of personal debt.

CHART 5: NUMBER OF PERSONAL INSOLVENCIES (ANNUAL RATE)



We have revised up our forecast for personal insolvencies as shown in Chart 6, as we did in our previous forecast. Personal insolvencies keep exceeding projections such as ours, which may point to the possibility that some consumers' attitudes to debt are changing. We now expect the number of personal insolvencies to be 8-10% higher throughout the forecast and 9,000 higher in 2021.

CHART 6: NUMBER OF PERSONAL INSOLVENCIES



CONSUMERS' ATTITUDE IS CHANGING

As part of the update to our Debt Britain programme, we have again canvassed more than 2,000 people to see if attitudes to debt have changed since 2016. Further details on this will be released in due course, but at a high level, it is evident that overall debt levels continue to rise and that a lack of awareness of some important consequences of being in debt remain worrying. Also, the impact of Brexit is uncertain for many and is expected to remain so for some considerable time.

CO-OPERATION BETWEEN THE CREDIT MANAGEMENT INDUSTRY AND OTHER STAKEHOLDERS IS KEY

While firms such as Arrow Global can play their part in helping consumers, there are times when it is equally important to involve other parties.

Arrow Global supports customers in financial difficulty by referring them to a wide range of free debt advice providers. These referrals include signposting and funding to StepChange, Payplan, Citizens Advice and Christians Against Poverty.

We are also pleased to be helping the industry improve how it works. For example, working with the Money Advice Service to launch a new toolkit to bring consistency to the way creditors work with debt advice agencies. *Working Collaboratively with Debt Advice Agencies,* this 'how-to' toolkit encourages creditors to examine their debt collection strategies and collaborate with the debt advice sector to better support customers in financial difficulty (see case study on page 13).

CONCLUSIONS: CALL TO ACTION

Recognising the efforts of the honest consumer as they rehabilitate their finances, giving access to better tariffs and interest rates, while avoiding offers of unaffordable credit, is our goal. We will continue to work with partners to find the most effective means of providing data to sit beside our customers' credit scores to achieve this goal.

Stakeholders including MAS, the FCA, trade bodies including UK Finance, FLA and CSA and the debt advice sector, will hopefully continue to work with Arrow Global and the credit reference agencies and creditors to put workable and realistic proposals forward, including the recognition of customers who have taken debt advice.

Over the next three years we want to:

- Improve financial education to prevent people incurring unaffordable debt in the first place;
- Ensure collaboration between the credit industry, debt advice sector and consumers to make the right advice available; and
- Give recognition to honest consumers who stay in touch with their creditors and consistently reduce their debts despite financial difficulty. We urge all stakeholders to look again at this, whether by means of the traffic light or balance trend systems mentioned earlier, and to work together to develop workable solutions.

Arrow Global Group
Summer 2018

CASE STUDIES:

1. Working with MAS to launch new creditor toolkit

Arrow Global worked with the Money Advice Service and other debt advice stakeholders to launch a new toolkit to bring consistency to the way creditors work with debt advice agencies.

Working Collaboratively with Debt Advice Agencies, a 'how-to' toolkit, encourages creditors to examine their debt collection strategies and collaborate with the debt advice sector to better support customers in financial difficulty.

This is the first time that all major debt advice agencies and creditors have worked together to raise standards of creditor practice by using a toolkit, benefiting both creditors and debt clients.

Leigh Berkley, Director of External Affairs at Arrow Global, worked with the Money Advice Service to provide best practice examples of how Arrow works. He commented: "Creditors working in partnership with the debt advice sector tend to achieve fairer outcomes, better customer engagement and sustainable repayments, which fits perfectly with our Group purpose of building better financial futures."

Currently, creditors have varying practices when it comes to recognising, assessing and reviewing people's ability to repay their debts. The toolkit will help provide flexibility to suit different types of creditors, presenting best practice processes and case studies from creditors that already have effective partnerships in place with the debt advice sector.

Leigh added: "We were delighted to collaborate with the Money Advice Service on this useful and pragmatic toolkit. Working closely with a range of free debt advice providers can be a real win-win for the consumer and the creditor alike.

"We are already an enthusiastic supporter of this initiative, and with our Debt Britain report forecasting further rises in unmanageable household debt by 2020, I hope the toolkit will enable creditors such as local and central government, utilities and landlords to fully embrace the benefits of working collaboratively with MAS and debt advice agencies."

2. The benefits of debt advice

Arrow Global recognises that every customer's situation is different and supports those in financial difficulty by referring them to a wide range of free debt advice providers. These referrals include signposting and funding to StepChange, Payplan, Citizens Advice and Christians Against Poverty.

We are also part of the creditor steering group helping Citizens Advice implement their new Debt Management Service, with a view to providing enhanced end-to-end services for its clients.

Arrow Global takes a multichannel approach, so that customers can be made aware of their debt advice choices at every stage: via our letters, emails and SMS messages, during calls with our people, and via our customer website and portal.

The results are clear: customers taking advice are more likely to have multiple debts and larger overall balances, but they are still able to start rehabilitating their finances more quickly than those not taking advice.

- Customers who had taken debt advice were on average able to make payments 20% higher than those in similar circumstances who had not sought advice
- Arrangements to pay were less likely to be broken, with only 8% of first monthly payments failing, and only 4% of payments missed in months 2-6. This provides good evidence of the sustainability of debt advice solutions
- Due to multiple debts, the length of payment plans are often longer for those who have taken debt advice, in fact it can take more than two years longer to settle on average, but the payments are more sustainable

Good quality free debt advice can assist consumers with many of the issues surrounding debt. Arrow Global hosted an industry round table in December 2016 to discuss how the industry can work better together. In 2018 and beyond, we hope to continue to drive discussions to find a workable means of recognising the honest consumer as they rehabilitate their finances, giving access to better tariffs and interest rates, while avoiding offers of unaffordable credit.

FORECAST METHODOLOGY

Our forecast for consumer debt defaults is based on an econometric model which uses two explanatory variables: bank rate and unemployment. The model measures the past relationship between these explanatory variables and the dependent variable (mortgage defaults) using data going back to 1982.

Having determined the past influence of bank rate and unemployment on mortgage arrears, we can estimate the future trend in the rate of mortgage arrears using forecasts for bank rate and unemployment from the OBR. We then overlay the projected arrears rate onto the OBR forecast for the volume of consumer debt. Using an assumption for the change in the size of the average debt we can then produce an estimate for the number of households in default.

The same explanatory variables are used in our forecasts for mortgage possessions and personal insolvencies. Again, we estimate the past relationship between the explanatory and dependent variables and using this statistical relationship we can show how future changes in bank rate and unemployment could affect possessions and insolvencies going forward.

As with any econometric model, our model cannot capture the full complexity of the real economy. A wide range of other variables can have an impact on defaults. But in the past bank rate and unemployment have been statistically the variables that best explain changes in mortgage arrears.

ARROW GLOBAL

For further information on the report or for a comment please contact:

Paul Fitzjohn
Corporate Communications Manager, Arrow Global
t 0161 242 1711
m 07715416020
e pfitzjohn@arrowglobal.net

Arrow Global
Intelligent analysis. Fair solutions.
Belvedere, 12 Booth Street
Manchester, M2 4AW
arrowglobal.net