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CfRC

Centre for Responsible Credit, 3rd Floor, Inclusion, 89 Albert Embankment, London SE1 7TP
Tel: + 44 (0) 207 582 7221 Fax: + 44 (0) 207 582 6391
Email: admin@responsible-credit.org.uk

New government's key challenge: get credit working

Damon Gibbons, Chief Executive, CfRC

INTRODUCTION

The new Conservative-Liberal Democrat Coalition Government has set out its agreed programme and the first Queen's Speech of the administration has been delivered. The core themes for the Government are 'freedom, fairness, and responsibility' and at the heart of the programme are ambitious plans to reform banking services and improve consumer protection.

The Coalition Programme for the new Government (p.9) spells out that:

"In recent years, we have seen a massive financial meltdown due to over-lending, over-borrowing and poor regulation. The Government believes that the current system of financial regulation is fundamentally flawed and needs to be replaced with a framework that promotes responsible and sustainable banking, where regulators have greater powers to curb unsustainable lending practices and we take action to promote more competition in the banking sector."

It is unsurprising that Government wishes to prevent a reoccurrence of the reckless lending which presaged the collapse of the financial system and ushered in the most severe recession since the 1930's. However, as this article seeks to explain, not all credit is harmful, and with the public finances under severe pressure, restoring confidence in credit markets, including lending to households, as quickly as possible is now critical for our future growth prospects.

That does not mean a return to 'business as usual' but instead requires Government to develop a new regulatory framework that helps households to use credit in ways which return long term benefits and so improves overall productivity.

DEBT FUELLED CONSUMPTION TO REPAYMENT BUST

The Government is correct to point out that the financial crisis was preceded by a significant increase in household consumption expenditure relative to income, underpinned by a spectacular rise in debt levels. This is not the first time that this has happened.

Aggregate household consumption expenditure has exceeded total gross household disposable income three times since the end of the Second World War.

- Between 1955 and 1959, expenditure fluctuated between 100% and 103% of disposable income.
- In the third quarter of 1987 household consumption expenditure again passed 100% of gross disposable income, peaking at 102.5% in 1988 Q3 and not returning to below 100% until a year later.
- Consumption expenditure reached 100% of income in the third quarter of 2006, and peaked at 104.3% in the first quarter of 2008. It then contracted sharply following the credit crunch in the latter part of that year.

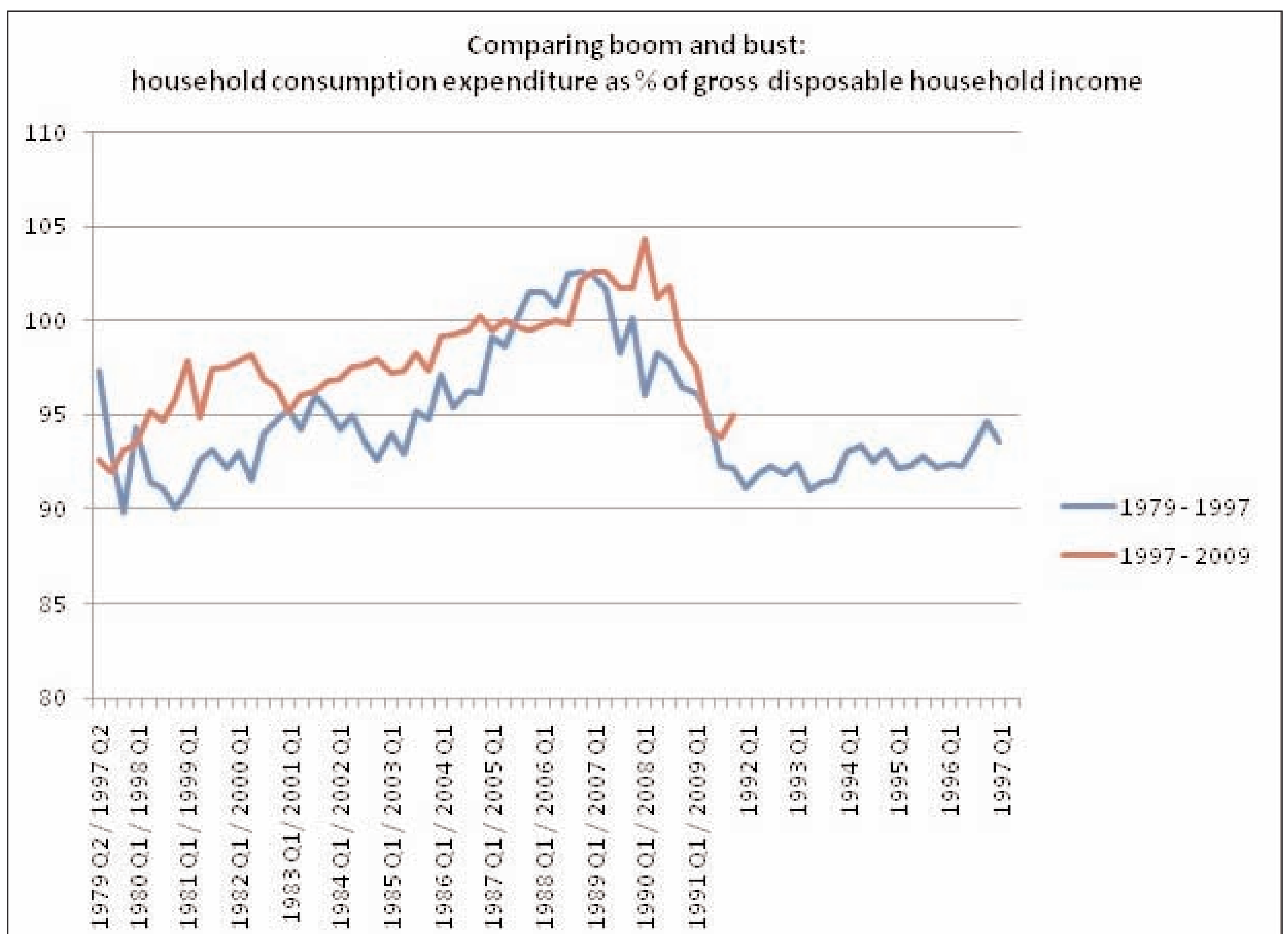
Ease of access to credit played a key role in all of three of these boom periods but there are important distinctions, with house prices in particular playing a greater role than spending on goods in the recent crisis and in the 1980's:

- The consumer boom of the 1950's was fuelled in part by the development of consumer credit (personal loan) products by banks and facilitated by a relaxation in Treasury rules to allow their expansion.

- In the 1980's, the removal of controls over hire purchase lending, breaking of the bank monopoly on personal credit, and de-regulation of the mortgage market combined with 'Right to Buy' legislation led to a surge in credit use both for mortgage and consumer credit purposes. However as interest rates rose to counteract inflation this led to record levels of mortgage repossessions in 1990 and 1991 and a sharp contraction in household spending which contributed to persistently high levels of unemployment.
- The rise in debt levels between 2006 and 2008 was primarily driven by rising house prices and the mortgage market, including buy to let and sub-prime mortgages. A significant level of equity withdrawal took place which was then used for consumption purposes. Repossession levels have been restrained by pressure on lenders to exercise forebearance and by slashing base rates, although these have not been passed on to borrowers in full.

Chart 1, below, shows that the general pattern of the two most recent booms is similar despite emerging under different political administrations. The blue line shows the quarterly trend for the Conservative administrations in power from 1979 through to 1997. Overlaid on this is the red line showing the record under the Blair and Brown Governments for the period 1997 through to the third quarter in 2009. Both demonstrate a rise in household consumption to beyond 100% of gross disposable household income approximately eight years into each administration followed by a severe contraction.

These contractions in household consumption are important, as household spending contributes significantly to the overall demand for goods and, by extension, to economic growth. When households have to repay debt, then this dampens economic activity. As Andrew Haldane, Executive Director for Financial Stability at the Bank of England put it recently:



"Debt operates rather like a tax. Debt servicing costs, like a tax, reduce the disposable income of the borrower. Too much debt means a higher debt "tax" and a greater drag on activity - lower lending by banks and spending by households and companies. Debt and taxes also affect incentives. Set too high, they may dissuade people from working and investing."

A long debt hangover would significantly restrain economic growth prospects, lengthen periods of high unemployment, and with it depress the tax revenues needed by Government to reduce the deficit. In short, we could be in for a protracted period of 'jobless recovery' which results in continued and increasing pressure on the public finances.

We consider that the Government should adopt two key objectives to guide its response:

- Firstly, a clear objective to protect against the future unsustainable expansion of household consumption fuelled by credit, and
- Secondly, to provide assistance to households to use credit in ways that help support sustainable economic growth moving forwards.

As a first step,Government should explicitly recognise the role of credit markets in the UK's economic cycle and immediately set a target to maintain responsible levels of household consumption expenditure relative to disposable income.The Bank of England should have regard to this target when exercising its proposed macro-prudential obligations.

The question that arises is whether we have a regulatory framework in place which is capable ensuring that any targets in this respect can be met? We need to develop tools that can limit credit expansion when the household consumption is in danger of exceeding the target and which encourage households to spend when the target is being under-shot.

We consider that changes are required to both the regulatory structures that exist and to the tools at the regulators' disposal.

As regards structures, the Coalition Programme correctly identifies the need for the Bank of England to be provided with a general macro-prudential obligation and with oversight of bank supervision (although the actual function of this will remain with the FSA). However, the role of consumer credit is largely ignored, and it is not clear what the relationship between the Bank of England and the Office of Fair Trading will be in this respect.

We would prefer to see the consumer credit licensing and regulatory functions of the Office of Fair Trading (OFT) now moved into the FSA to enable them to supervise the conduct of all lending. As banks and mortgage lenders are also often involved in consumer credit lending, we also think that there would be savings to be made by streamlining licensing and monitoring processes.

Secondly, the tool box provided to the regulators needs to be improved in three ways:

- Housing equity withdrawal should be more tightly controlled, particularly if there is evidence that a rise in property prices is temporary and unlikely to be sustained over the long term
- Debt to income, debt to value, and debt servicing to income ratios should be published in order to guide lending decisions based on interest rate and house price forecasts. The FSA should then monitor the main lenders as to their actual lending patterns against these guides.
- The purpose for which credit is being advanced should be taken into account when determining capital requirements for lenders (see box below).

HELPING HOUSEHOLDS

However, there remains an urgent need to help those households that are currently in difficulty and to reduce the impact of credit defaults, repossessions and insolvencies. These are particularly damaging as they affect the ability of households to access credit in the future, and drive forwards the process of credit market segmentation (with fewer and fewer people able to access 'prime' or mainstream products, and increasing numbers of people reliant on sub-prime lenders).

Productive uses of credit and the Green agenda

There are legitimate objections to the use of credit for consumption purposes from a Green perspective. Credit is essentially a transfer of potential future income to the present for which a price (interest) is paid. Using credit can be beneficial to households if the benefit they receive from the use of the credit outweighs the price that they pay for it.

However, whilst this may be beneficial for individual households it may not be in the long term interests of society as a whole, as it may accelerate the use of the planet's resources to an unsustainable level. This is because lots of households simultaneously choosing to spend tomorrow's income on consumer goods also means that they are bringing forwards the use of resources necessary to produce those goods. As a result the earth's resources can be utilised faster than they can be replenished.

Greater control over the purpose to which credit is put, and the encouragement of the use of credit for measures which in the longer term increase the use of renewable resources or help conserve energy are therefore to be particularly welcomed. The use of credit markets for these purposes should form part of the Government's overall energy and climate change strategy.

There are also other ways in which credit can be used productively as a means of raising capital for investment rather than to bring forward consumption. These include:

- Investing in education and skills
- Starting and expanding businesses
- Funding items which expand job opportunities, including paying up-front for transport costs or essential equipment

There are also a myriad of ways in which credit can be used to make investments now that will cut future levels of household expenditure. For people on low incomes, the use of credit to purchase better quality items which last longer may be productive, as would enabling them to make their homes more energy efficient, or providing access to the internet. Whilst it would be unwise to be overly prescriptive, lenders and borrowers could be encouraged to think through how credit can be used to either build future earnings capacity or reduce future costs as part of a credit application and decision process. Incentives for lenders to make credit available for these purposes could then be provided by loosening capital requirements.

The wide variation in the prices of credit, and the amounts of credit, available to people at different ends of the income spectrum and between the mainstream and sub-prime sectors also impact on wealth inequalities. For people on high incomes, easy access to large amounts of credit at cheap rates allows them to invest in asset building and increases overall wealth. For those on lower incomes, the types of investment that they can make are riskier (usually the lower end of the housing market) or the rates charged are so high that they cannot make a return in excess of the cost of the credit. This depresses disposable incomes further and can lead to a lifelong entanglement in debt.

Although insolvency procedures are designed to help people escape from debt, credit scoring and risk based pricing mechanisms used by lenders means that there is in reality no fresh start. Government should therefore look at how it can improve the rehabilitation of debtors back to mainstream credit markets, for example by ensuring that insolvency procedures and credit scoring and pricing mechanisms are more forgiving during periods following a general economic downturn.

Efforts also need to be stepped up to ensure that base rate cuts and other forms of assistance are passed onto those most in need of assistance. Mortgage spreads remain particularly high for those with little or no equity in their homes, and the FSA

should review whether or not it can force a reduction in spreads under its existing powers, and if not should seek stronger powers from Government in this respect.

The Government has stated that it will require lenders to prove to a court that repossession is a last resort. This is welcome. However, the Government could also provide stronger guidance to the courts concerning the types of measures that they should require lenders to put in place as alternatives to repossession, including taking up Shelter's suggestion that lenders swap part of the mortgage debt for a share of the future value of the home.

CONCLUSION

However, it now needs to develop a detailed strategy and provide a clear vision for the way in which it intends to regulate credit markets which balances action to prevent irresponsible lending levels with encouragement for productive credit use. With the public finances under immense pressure the latter is now critical. Government should therefore task regulators with ensuring that lenders and borrowers are encouraged to use credit effectively including by providing incentives to lenders for this to be achieved, whilst also setting an explicit target to control future levels of aggregate household consumption relative to disposable income.

Government also needs to set out how it will deal with the fall-out from the recession and ensure that opportunities exist for people who have defaulted on credit agreements to be rehabilitated to mainstream provision in the near future. Finally, if mortgage repossession is to really be a last resort then the Government should now seek to ensure that reductions in base rates are passed onto borrowers in most need of assistance and that creative solutions to mortgage debt are pursued by lenders.

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Will the Coalition deliver fair and inclusive financial services?

The Better Banking Campaign, which is seeking the introduction of a UK version of the Community Reinvestment Act and caps on extortionate credit, has the support of five hundred civil society organisations and forty MP's. The CfRC's Damon Gibbons, and Better Banking Campaign Co-ordinator Lucy Marples, review the Coalition's Programme for Government against the campaign's aims and indicate areas where further clarification from government is now required.

INTRODUCTION

Households with the lowest incomes pay a high price for credit. Around 3 million people use the very high cost door to door or home credit lending market which charges £82 in interest and collection charges for every £100 lent. Other forms of high cost lending, such as Payday loans, and Rent to Own are also expanding rapidly. There is evidence that the prices charged are not subject to normal competitive pressures both as a result of near monopoly positions of large lenders and because low income borrowers are not price sensitive .

Poorer households also often experience financial emergencies. This causes competition for their business to take place on the speed of the loan offer rather than on price terms.

The charging of very high prices to the lowest income households leads to greater wealth inequality, greater levels of child poverty, and constrains efforts to regenerate deprived communities:

- The National Equality Panel reports that the poorest 3% of the population now have 'negative wealth' and the distribution of financial wealth is extremely unequal . The variation in the price of credit charged to different income groups is one of the drivers behind this.
- The high costs of credit have to be repaid from future income and out of fixed budgets. The poorest households spend 17% of their gross incomes on unsecured debt repayments compared to just 5% for higher income groups.
- This level of debt repayment significantly reduces their ability to pay for ongoing essential expenditure and affects the quality of life for these households. The results are poorer diets, colder homes, rent, council tax and utility arrears, depression (which impacts on job seeking behaviour) and poor health, all of which present wider economic costs which have to be met locally and create pressure on public services.

The Coalition has not yet indicated its position on measures announced in the last Labour Budget to introduce a right to a basic bank account and to increase the contribution made by banks to the community lending sector. As the Coalition Government's stated priority is deficit reduction, tackling the failure of credit markets to meet the needs of low income groups and communities for affordable financial services should be high on their agenda. However, whilst the Coalition's programme is clear about its intention to improve credit provision to Small and Medium Enterprises (SMEs), provide more consumer protection powers to regulators, and take action to ensure greater financial stability, it remains uncertain about this wider financial inclusion agenda.

THE COALITION PROGRAMME

Levies on the financial sector

The first section of the coalition agreement, on banking, includes proposals to address both 'over-lending' and 'over-borrowing' and the stability of the

financial system. It presents a proposal to place a levy on the financial sector in order to pay for future crises. The final form of this levy will be influenced by discussions at the G20 in October. However, a second levy is also mentioned. This is presented as a 'social responsibility levy' on the financial services sector, which will be used to fund 'Britain's first free national finance service'.

It is, as yet, unclear as to whether or not this will simply be a means through which Government offloads the costs of the national money guidance service, Moneymadeclear, that now falls under the remit of the Consumer Financial Education Body, onto the industry or whether this is intended to go further – for example by providing funds to support debt advice. Local authorities have limited obligations to support advice provision, and the scale of savings being sought from local Government is substantial. Ensuring that the social responsibility levy is used to contribute towards the funding of debt advice as well as financial education would therefore be welcome.

However, there are dangers in using levies of this kind as these could simply result in the costs being passed onto consumers in the form of higher prices, particularly in areas of the market which are not price competitive. Care will therefore need to be taken in the construction of the levy and its effects monitored.

SME and community sector lending

The Coalition intends to 'ensure the flow of credit to viable SMEs', either by establishing net lending targets for nationalised banks and/or by creating a major loan guarantee scheme. However, it has now announced that it has scrapped plans to create a small business credit adjudicator.

For the community sector, the coalition proposes to create a 'Big Society Bank' using funds from dormant bank accounts. This follows the recommendations of the Social Investment Task Force and is to be welcomed.

Financial Inclusion

However, the Coalition's Programme is less well developed in respect of financial inclusion for low income households. Only two commitments stand out:

- To ensure that Post Offices are allowed to offer a wide range of services in order to sustain the network and to look at the case for developing new sources of revenue such as the creation of a Post Office Bank, and
- To provide Post Office Card account holders with the chance to benefit from direct debit discounts and ensure that social tariffs (for energy use) offer access to the best prices available.

However, as yet there has been no indication from Government as to its position on measures announced in the previous Government's 2010 budget to introduce a right to open a basic bank account and to increase the contribution made by banks to the community lending sector. The second of these included a commitment to consult on options to make sure banks make an appropriate contribution to community lenders, including Credit Unions, through regulatory action or a new community levy to be funded by retail banks, and was to be supported by efforts to ensure that banks disclosed information on their financial services provision at a local level.

Direct spending to support financial inclusion may well now also be in jeopardy. The March 2010 budget announced the previous Government's intention to mainstream financial inclusion activity into departmental budgets from April 2011, including Growth Fund support for Credit Union and Community Development Finance Institutions from the Department for Work and Pensions. Protecting activities to support financial inclusion will be difficult in the current climate, although the Coalition has pledged to protect those on low incomes from the negative impact of spending cuts, and confirmed its commitment to end child poverty in the UK by 2020. In view of this, it becomes more pressing to clarify the obligations of

the financial services sector itself, and to continue to press Government to introduce a UK version of the Community Reinvestment Act used within the U.S to ensure that banks play a full role in supporting the development of affordable credit provision in deprived communities.

Consumer Protection

The Coalition's Programme sets out welcome proposals to:

- Tackle unfair bank charges
- Provide more protection against aggressive bailiffs and unreasonable charging orders, ensure that courts have the power to insist that repossession is always a last resort, and ban orders for sale on unsecured debts of less than £25,000
- Give regulators new powers to define and ban excessive interest rates on credit and store cards; and introduce a seven-day cooling off period for store cards

However, it is unclear as to why the proposed new powers for the regulators to ban excessive interest rates are to be restricted to the credit and store card markets only when the rates charged to lower income consumers by home credit or door to door moneylenders and other 'alternative' credit providers are much higher, and there is evidence of a lack of effective price competition in those markets. The debate on this issue is certain to continue with the publication of the Office of Fair Trading's report on High Cost Credit due shortly and a major EU Commission study of the economic and social impact of interest rate ceilings scheduled to report in October.

CONCLUSION

Although these are still early days the Coalition does not appear to have a developed policy on financial inclusion or to have fully considered the problems faced by low income consumers in the credit market. There is an economic imperative for it to work up further details as a matter of urgency, as the negative impacts of high cost credit and financial exclusion more generally on the public purse are likely to be considerable. With public spending so constrained, there is now a clear rationale for clarifying the obligations of the financial services sector itself to expand access to affordable provision and putting in place a framework for monitoring its performance in this respect.

The Better Banking Campaign is therefore calling for Government to:

- Require banks to publicly disclose where they are lending and providing services – how much and to whom – including in respect of small businesses
- Provide incentives and obligations for banks to meet their social responsibilities, along the lines of the US Community Reinvestment Act
- Provide a power for regulators to cap the amount that can be legally charged for credit
- Secure the reinvestment of 1% of bank profits for public benefit

Further details about the campaign can be found at: http://betterbanking.org.uk/

Consumer Financial Education Body launched

Colin Kinloch, External Affairs and Consumer Policy Associate, CFEB

The Consumer Financial Education Body (CFEB) was set up by the Financial Services Authority (FSA on 26 April 2010.

The path to CFEB began in 2005 when the FSA created the National Strategy for Financial Capability. The numerous projects developed as part of that strategy have reached such a scale that the Treasury decided last year to transfer the consumer education objective of the FSA to a new, operationally independent body – CFEB.

Tony Hobman, currently the chief executive of the Pension Regulator, has been appointed as the Chief Executive of CFEB and recruitment is underway for a Chair and Non-Executive Directors

The primary remit of CFEB will be to enhance the public's understanding and knowledge of financial matters (including the UK financial system), and improve their ability to manage their financial affairs. Deeper understanding and improved money management skills lead to better financial decision making, which is vital to reducing personal indebtedness.

WHY DOES IT MATTER?

We know that being financially capable has wide social benefits. Recent FSA research found that improving an individual's financial capability leads to an improvement in their psychological well-being, and it increases life satisfaction twelve times more than earning an extra £1,000 a year.*

In fact, from the same research we know that moving from low to average levels of financial capability improves psychological wellbeing by 5.6% and life satisfaction by 2.4% and reduces likelihood of anxiety or depression by 15%.

CFEB will deliver its programmes on a universal basis with a focus on ensuring that everyone can reap the benefits of enhanced financial capability both in terms of better decision making and improved well-being.

BUILDING ON A STRONG START

The success to date of the FSA's financial capability programmes has rested largely on a partnership approach. There has always been an acceptance that, although the issue of low financial capability is population-wide, it does affect some groups of people in particular ways, for whom there are already avenues through which they can access help.

CFEB will build on the FSA's work in partnership with local and national organisations including government departments, the third sector, the financial services industry and academics.

Our work is UK wide. CFEB projects reach consumers across the devolved nations through schools, colleges, Jobcentre Plus offices, advice centres and in the workplace.

Some of the most recent additions to our portfolio of projects include a website for those facing divorce or separation, a Redundancy Handbook available to employees via their employer, a Guide to Retirement available via employers and pension trustee organisations, and the Moneymadeclear money guidance service.

The Moneymadeclear service, which has cross-party political support, was piloted in the North East and North West of England and a nationwide rollout programme is underway. Anyone can access the website or call our 'phone line and the free, impartial, face-to-face money guidance sessions are being phased in across the rest of the country, beginning with priority areas in each of the four nations.

Moneymadeclear can help people to:

- cope with changing circumstances, like a sudden drop in income;
- get the most out of a budget;
- save for a special event, or just a rainy day;
- understand different credit options enabling them to borrow wisely;
- plan for retirement;
- understand tax and welfare benefits; and
- explain financial jargon.

And when Moneymadeclear doesn't have the answers, it will help people to find them elsewhere. This includes signposting to specialist advice on debt or pensions, or to regulated financial advice.

EXCITING MILESTONES TO DATE

- Money Guidance reached over 500,000 people in the NE and NW during the Pathfinder phase of the project.
- The Parents Guide to Money (which features a useful table comparing the costs of different types of borrowing) has been distributed to over 1.3 million expectant parents through midwives and children's centres.
- The Moneymadeclear website had nearly 3.5 million user sessions during 2009 and has an average of 300,000 user sessions per month.

These figures only reflect the numbers of people reached of course. The impact made and benefits reaped vary widely, but are often impressive. One man in his 20's living in Manchester reported that:

"I had a consultation with a money guidance adviser. In the hour I spent with them it has really helped me to manage and plan my finances. They gave me some fantastic advice about budgeting my money for the month with guidelines and some resources helping me plan on minimum and maximum amounts that need to be set aside for certain things such as food, clothing, savings and emergencies."

At a pathfinder roadshow in Newcastle, a single mum was almost at the point of tears when she spoke with the Money Guide. She was really struggling on her own and the Money Guide informed her that she wasn't applying for the correct benefits and was entitled to more money.

Of course these are some of the cases where there was a tangible impact – there are many more where callers and users of the face-to-face service have finished a call or left a money guidance session with that small but powerful feeling of having taken control. Evaluation of the pathfinder found that use of the face-to-face service has built steadily and is reaching users with the highest levels of potential vulnerability.

The Moneymadeclear service is available:

- online at www.moneymadeclear.fsa.gov.uk, where there are step-by-step guides, interactive tools and impartial product comparison tables;
- over the telephone on 0300 500 5000 where people can speak to a trained money guide (calls cost no more than 01 or 02 UK-wide calls and are included in inclusive mobile and landline minutes); and
- face to face.

As well as across the North East and North West, the face-to-face sessions are currently available in priority areas in London, South Wales, Glasgow and Northern Ireland. The trained Money Guides are working in these areas with local trusted intermediary organisations such as local authorities, jobcentres, domestic violence centres, children's centres, advice agencies, housing associations, and credit unions.

For more information about CFEB visit www.cfebuk.org.uks

* FSA Consumer Research: Financial Capability and Wellbeing May 2009

Responsible Credit UK Convention

Marble Arch London
19th - 20th October 2010

Credit matters. With the public finances under pressure, getting our credit markets working again is critical to Britain's prospects for economic recovery. But restoring confidence in our credit markets does not mean returning to 'business as usual'. We need to find ways of helping households and businesses use credit more effectively as well as dealing with the debt problems created by the recession and the high levels of financial exclusion in some of our communities.

New partnerships need to be forged and an agenda for change developed with the involvement of all key stakeholders. This year's Responsible Credit UK Convention will bring together 300 delegates from financial services providers, regulators, debt advice agencies, financial education providers, academics, and partners involved in the design and delivery of financial inclusion activity at both the national and local levels. The Convention provides a forum for constructive discussion between stakeholders concerning the role of credit in society, future regulatory and policy options, and provides a platform to showcase best practice.

Supported by the Money Advice Trust, Community Development Finance Association, and Transact – the national forum for financial inclusion, the themes for this year's Convention are:

- From boom to bust: lessons of the crisis for credit regulation, tackling over-indebtedness and dealing with debt.
- Perspectives and best practice in financial education.
- Crediting local communities: what's working, how can we improve?

We will shortly be making a call for expressions of interest in presenting sessions against these themes. If you are interested, then please make sure we have your contact details by e-mailing us at: admin@responsible-credit.org.uk.

Who should attend?

The Convention is for all those involved in the design and delivery of services responding to debt problems and financial exclusion at the national and local levels. It will be of particular interest to:

- The credit industry, including social lenders - Credit Unions and Community Development Finance Institutions.
- Local authority staff, particularly those responsible for the commissioning and delivery of advice and economic development services.
- Money advice and welfare rights services.
- Agencies involved in the design and delivery of financial education provision.
- Social housing providers, welfare to work agencies, local community organisations and agencies involved in the delivery of services to disadvantaged communities and financially excluded groups.

Bookings, sponsorship and exhibitions

Early bird prices start at just £129, inclusive of VAT, and CfRC subscribers are also entitled to a 10% discount. We are also pleased to announce that members of Transact are entitled to a 5% discount on all bookings.

The conference is priced £217 for the public sector, and £258 for private sector organisations.

To book online, please click here.

We also have a range of sponsorship and exhibition opportunities on offer. For further details please click here.

Irresponsible Lending: the OFT's guidance

Ray Watson, Director
Consumer Credit Group, Office of Fair Trading

PURPOSE OF THE GUIDANCE

Section 25 of the Act provides that, in considering fitness to hold a consumer credit licence, the Office of Fair Trading ('the OFT') shall have regard to any matters which appear to it to be relevant, including any evidence tending to show that an applicant, licensee, or its employees, agents or associates, past or present, have engaged in business practices appearing to the OFT to be deceitful, oppressive or otherwise unfair or improper, whether unlawful or not.

Amongst the reforms introduced by the Consumer Credit Act 2006 was the inclusion of new provision section 25 (2B) of the Act which makes it explicit that amongst the business practices which the OFT may consider to be deceitful or oppressive or otherwise unfair or improper are practices in the carrying on of a consumer credit business that appear to the OFT to involve irresponsible lending.

The OFT is under a legal duty to prepare and publish guidance in relation to how it determines whether persons are fit to hold a consumer credit licence. The OFT must have regard to its guidance in carrying out its functions under the Consumer Credit Act 1974 ('the Act'). The primary focus of our irresponsible lending guidance is to provide greater clarity for businesses and consumer representatives as to the business practices that we consider may constitute irresponsible lending practices for the purposes of section 25(2B) of the Act. The guidance is not specifically intended to identify practices which, if conducted in isolation, might call into question the validity of individual agreements.

In determining whether a person is fit to hold a licence to operate a consumer credit business, the OFT also must have regard to the skills, knowledge and experience in relation to consumer credit businesses of that person and other persons who will participate in any business carried on by him under a licence and any practices and procedures to be implemented in connection with any such business. The guidance, therefore, also provides a basis against which the OFT and its enforcement partners in Local Authority Trading Standards Services can undertake assessments of whether creditors are 'competent' to be licensed by the OFT to operate a consumer credit business.

THE CONSULTATION PROCESS

We launched a consultation on the content of the draft guidance on 30 July 2009. We received a total of 79 formal responses to our consultation from a range of stakeholders. All of the comments received were taken into consideration in formulating the guidance which was published on 31 March 2010. We would expect consumer credit businesses to have regard to the content of the guidance from the date of publication.

SCOPE OF THE GUIDANCE

The guidance covers each stage of the lending process from the pre-contractual stage of advertising and marketing through to a consideration of issues such as the handling of arrears and default. In the OFT's view, whether or not a particular prac-

tice might be considered to constitute an irresponsible lending practice may depend, in part, on the context in which the practice is engaged in, taking into account other related or linked practices. Some business models might incorporate irresponsible lending practices that do not lend themselves to being simply 'segmented' into constituent elements but might rather form parts of a continuum of improper practice. Consequently, the extent to which we may consider certain practices to constitute irresponsible lending practices will depend, to some degree, on individual circumstances and/or individual business models.

GENERAL PRINCIPLES

In the OFT's view there are a number of overarching principles of consumer protection and fair business practice which apply to all consumer credit lending.

In general terms, creditors should:

- *Not use misleading or oppressive behaviour when advertising, selling, or seeking to enforce a credit agreement* – this would include such matters as employing the use of advertising, and/or other promotional material, and/or other oral or written representations, which suggest, either expressly or by implication, that credit is available regardless of the borrower's financial circumstances.
- *Make a reasonable assessment of whether a borrower can afford to meet repayments in a sustainable manner* – in the OFT's view, all assessments of 'affordability' should involve a consideration of the potential for the credit commitment to adversely impact on the borrower's financial situation, taking account of information that the creditor is aware of at the time the credit is granted. Whatever means and sources of information creditors employ as part of such an assessment of affordability should be sufficient to make an assessment of the risk of the credit sought being unsustainable for the borrower in question. In our view, this is likely to involve more than solely assessing the likelihood of the borrower being able to repay the credit in question. We consider that before granting credit, significantly increasing the amount of credit, or significantly increasing the credit limit under an agreement for running account credit, creditors should take reasonable steps to assess a borrower's likely ability to be able to meet repayments under the credit agreement in a sustainable manner.
- *Explain the key features of the credit agreement to enable the borrower to make an informed choice* – the OFT expects creditors to adopt a proportionate approach to the provision of explanations of credit products to borrowers. Nevertheless, the law requires that the explanation provided should be adequate to place the borrower in a position enabling him to assess whether the agreement is adapted to his needs and his financial situation.
- *Monitor the borrower's repayment record during the course of the agreement, offering assistance where borrowers appear to be experiencing difficulty* – the OFT considers that creditors should take appropriate action, including notifying the borrower of the potential risk of an escalating debt, and signposting the borrower to not-for-profit providers of free independent debt advice, when/if there are signs of apparent/possible repayment difficulties – for example, a borrower failing to make minimum required payments or making a number of consecutive small/minimum repayments or a borrower seeking to make repayments on a credit card account using another credit card. This is particularly important in the case of borrowers who it is known, or it is reasonably believed, may lack the mental capacity to make financial decisions about repayments at the time the repayments are due, especially under circumstances in which the borrower or his representatives have specifically requested that this should be done.
- *Treat borrowers fairly and with forbearance if they experience difficulties* – the OFT would not expect

a creditor to take disproportionate action against borrowers in respect of arrears or default. This would include such matters as applying to the court for an order for sale or for the borrower to be made bankrupt, without having explored other alternative, more proportionate options for recouping arrears. We consider that other possible options for dealing with the problem should be explored prior to resorting to taking steps to repossess the borrower's property and that proper consideration should be given to any reasonable offer by the borrower to pay by instalments.

When formulating their business practices and procedures, in order to facilitate the avoidance of engaging in irresponsible lending practices, we would expect creditors to have regard to the above general principles and to give effect to their practices and procedures in such a way as to facilitate these general principles being followed in practice. In line with our established policy, we will undertake a review to assess business adherence to, and the effectiveness of, the guidance, once it has been in place for a sufficient period to allow for such an assessment to reasonably be undertaken.

OFT AND ENFORCEMENT

The OFT is committed to fair, effective and proportionate enforcement. In practice this means that where we identify non-compliance with the law and/or businesses failing to have regard to relevant OFT guidance, we will decide on the appropriate regulatory response in the light of the facts and circumstances of the individual case.

The type of OFT action taken will be guided by the level of actual or potential harm to borrowers and by the scale or frequency of identified misconduct. For example, we can impose 'requirements' on a business where we are dissatisfied with any matter in connection with the operation of the licensed business. Failure to comply with such a requirement can lead to the imposition of a financial penalty of up to £50,000 per instance of non-compliance. We may also compulsorily vary a licence, for instance to limit the activities for which a trader is licensed, or limit the life of the licence. In serious cases, where there is evidence tending to show that a person is unfit to hold a consumer credit licence, the OFT can take action with a view to refusing or revoking the credit licence of the person concerned. Engaging in irresponsible lending practices would constitute grounds for the OFT to consider fitness to hold a licence.

THE ROLE OF BORROWERS

Borrowers also have a part to play in helping to better create an environment of sustainable credit provision. For example, where creditors' assessments of affordability rely, in part, on information provided by borrowers, it is important that such information is accurate and up to date and the borrower should advise the creditor in a timely manner of any relevant change of circumstances that is likely to significantly impact on any such assessment. Creditors would not be considered culpable by the OFT for placing reliance on information provided by borrowers, at least in part to inform such assessments, which was subsequently found to have been substantively inaccurate or untrue at the time that it was provided, where the creditor had no reason to suspect that this was the case.

Perspectives on Social Fund Reform

INTRODUCTION

In March the Department for Work and Pensions (DWP) initiated a consultation on the future of the Social Fund, in order to examine ways in which the fund could better link to the financial inclusion agenda, and improve support for people currently reliant on very high cost credit.

In the Green Paper, DWP highlighted that the although elements of the Fund provided an important source of support for people on low incomes, it was too focused on the short-term needs of the customer and there was evidence that some people became frequent users without it addressing their underlying financial needs or problems, or helping improve their financial capability.

Criticisms were also made that the scheme was overly complex and that customers found it hard to understand eligibility and to know which element of the scheme they should apply for.

Although the Government has changed, the consultation on the future of the Social Fund remains open until 7th June, and DWP has indicated that it remains its intention to publish a response to comments received. As a result, the consultation provides an early opportunity to raise concerns about financial exclusion with the new Government. Responses should be sent to social.fund@dwp.gsi.gov.uk

We asked Sophia Parker from the Resolution Foundation and Rhian Beynon from Family Action for their views on what now needs to be done.

Sophia Parker, Acting Director, Resolution Foundation

We at the Resolution Foundation welcome the publication of the Social Fund consultation. It rightly makes the case for simplifying the current arrangements around accessing loans, and emphasises the need to strengthen the connections between the Social Fund and financial advice and education. This is certainly the right direction of travel – although as ever, the devil will be in the detail when it comes to making these connections. As a minimum we hope to see some joined up government in action through ensuring that these reforms to the Social Fund are properly connected to the roll out of Money Guidance, a national generic financial advice service, this year.

In addition, we would argue that any conditional financial education must focus on building assets and long-term planning as well as budget management, which is often something low income households are expert at. More could be done to connect the Social Fund with existing asset-building initiatives such as the Savings Gateway. The Resolution Foundation has recommended previously that people reaching the end of a loan repayment could instead start paying into a matched savings account, for example.

Finally, while the Social Fund plays an absolutely crucial role in preventing crisis in vulnerable households, we believe there is a much wider debate that must continue about how to support those households who are in work, but who still struggle to ac-

cess fair and affordable credit. There are 9.4 million 'low earners' in the UK, people who are in work, but living below median income, and our analysis shows that many of these people are struggling in today's circumstances to access the credit they need from mainstream lenders and banks. So our view is that any reforms to the Social Fund take place alongside further detailed work on the wider issue of the access low income households have to fair credit.

Rhian Beynon, Head of Policy and Campaigns, Family Action

Family Action has been helping families overcome disadvantage since 1869. The main way we do this is through professional support to vulnerable adults, such as those with mental health problems, with parenting their children and running their households. Grant-giving to help people with both immediate financial needs and their long-term education and training is also an important part of our business.

In 2008/9, Family Action gave 2071 grants totalling over £366,000 to families and individuals in need. Many of these families were ineligible to apply for, or had been refused by, the Social Fund. It is the experiences of both supporting families at the grass roots and distributing grants that inform our interest in the reform of the Social Fund.

The current proposals for reform are encouraging in recognising the relationship between a continuing need for a Social Fund grants and loans; and the dearth of affordable savings and credit for families on very low incomes. We know from our experience of working with disadvantaged families that their only alternative to the Social Fund or a grant from us would be to incur a debt to a high cost home credit lender or increase their existing debt. While the home credit lenders do at least make legal loans available to families, and help cut out the loan sharks, nevertheless the high interest rates demand disproportionate amounts of poor people's incomes, and detract from the cross-party target of abolishing child poverty in the UK by 2020.

Some of the fine-tuning of the Social Fund proposed is positive: for example the idea of making Budgeting Loans accessible to people as soon as they become unemployed so as to prevent a spiral of debt. However, the proposed attachment of more stringent conditions and support to repeat Crisis Loans risks ignoring the obvious: in the absence of other zero interest, or reasonably priced credit to those on very low incomes, repeat applications for Crisis Loans are arguably a sign of rational consumer choice rather than just a sign of inability to manage money that will be mitigated by support.

We know from our experience of giving family support that there are indeed some very vulnerable individuals who need support with money management. However, in many cases where families repeatedly rely on small loans from the Crisis Fund or elsewhere, the main problem is that their incomes are just not high enough in the first place. The answer to this lies not so much in reform of the Social Fund but in a commitment by the next Government to invest in the incomes of the disadvantaged and vulnerable.

The End Child Poverty Campaign proposals for this include increasing and more widely enforcing the minimum wage, investing in increases to benefits and tax credits and an income disregard to enable parents to work in mini jobs. We also need continuing investment in professional family support services which can help empower poor, vulnerable parents to manage family life, including finances, in the home.

Very rightly the Social Fund proposals do take a big picture view – but it could be bigger still.

Out of work, out of money

Unemployment has long been recognised as one of the main triggers of debt problems, with people unable to maintain contractual payments on their credit commitments due to the drop in income that results. However, the relationship is multi-faceted. The extent of debt problems is in part determined by the degree of credit use prior to the loss of work but living on a low income for lengthy periods can itself give rise to debt problems. The long term unemployed in particular are likely to face an additional 'poverty premium' caused by their exclusion from mainstream and affordable financial services.

In February, Inclusion and the Centre for Responsible Credit (CfRC) were jointly commissioned by Manchester City Council, acting on behalf of the wider Manchester City Strategy Partnership, to determine how financial problems affect jobseeking behavior and the ability of unemployed people to undertake job search/secure a job and sustain employment.

The study identifies that money problems impact on jobseeking behavior in four ways, by:

- distracting people from job search;
- constraining job search activity;
- creating disincentives to work, and
- reducing the chances of people sustaining their employment.

It indicates that it would be counter-productive for Government to reduce benefit levels for the unemployed and that more needs to be done to reduce the financial burdens on unemployed people and to join up debt advice, financial education, affordable credit, basic banking, and welfare to work services at the local level. It therefore recommends that action in these areas be incorporated into Work and Skills Plans. The study also found that debt recovery policies and some insolvency procedures could affect job seeking behavior and the final report sets out a series of recommendations to be taken forwards at both the national and local levels.

ABOUT THE STUDY

The study comprised focus groups and telephone interviews with 45 unemployed people identified by welfare to work providers in the Greater Manchester area. Participants were predominantly male (80%), single (71%) and White (93%) and the median age group was 35-44. Just over half of the participants were long term unemployed and had been out of work for over 12 months, and 29 participants reported debt problems, including arrears with household bills as well as credit commitments.

Couple households where one partner was still working reported a higher incidence of credit debts than other household types, although 55% of all participants had credit debts, primarily obtained through credit cards and bank overdrafts. Housing debt was much less common, with just under a quarter of participants reporting mortgage or rent arrears. Long term unemployed people had a higher incidence of utility debt, Council tax arrears, and were also more likely to borrow from family and friends and the Social Fund. The only instances of high cost credit debt from moneylenders was also found amongst this group.

The amount of debt also varied significantly according to the length of time out of work. The mean level of debt for participants with debt problems was just over £6,200. However, this was skewed by the inclusion of four 'heavy' debtors who owed in excess of £12,500. The largest amount of debt reported was £30,000 and the second largest £26,000 and in three cases participants had either been made insolvent or were going through insolvency procedures at the time of the study.

The majority of participants had much lower debt levels, with 62% owing less than £3,500 and 87% of long term unemployed debtors owing less than £500.

Although the level of debts was often quite small, the impact of debt and financial problems associated with living on a low income nevertheless constituted a significant barrier to work for the following reasons.

The daily struggle of living on a low income distracts people from job search by:

- increasing travel times and the time required to undertake household chores;
- contributing to feelings of depression, anxiety and loss of self confidence;
- for those with debts, requiring additional time to deal with creditor demands, seek advice and comply with requests for information about their financial position on a regular basis

Having money problems constrains certain job search activities by:

- making it difficult to find extra money to attend interviews either due to transport costs or clothing needs;
- affecting the ability of people to make plans to return to work, for example, limiting the ability to maintain a car to widen job search;
- limiting options for employment as some employers use credit scoring to reject applicants for certain types of job.

Debt problems, and how they are sometimes dealt with, create disincentives to work:

- increasing the level of wages that people feel they need to earn before they are better off in work;
- insolvency procedures, notably Debt Relief Orders, create financial disincentives for people to return to work for 12 months as having more than £50 per month in disposable income entitles creditors to recover a greater level of debt.

Debt problems can reduce the chances of work being sustained because:

- some struggle to obtain credit during the transition period back to work and cannot cover additional work related expenditures;
- some do not feel better off in work once debt repayments are taken into account;
- debt problems can encourage people to take on too many additional hours of work in order to increase their income: this can have longer term health consequences;
- some may have to take time off work to deal with debt problems or their productivity at work may be affected.

Not all unemployed people experience these problems equally. We found that the impacts differ for the newly unemployed and long term unemployed groups. In particular:

- More recently unemployed people face greater distractions from job search because of the need to gain access to advice to help them deal with immediate debt problems that arise when a job is lost, and because they receive regular demands for payment from creditors. This group may also be less able to meet the additional costs connected with job search as much of the support with interview costs and other discretionary help is only available to longer term unemployed people.
- Longer term unemployed people often incur higher costs for basic services and have exhausted prior savings. They therefore have to spend more time managing their income carefully and have less money for transport costs. Basic household chores take longer leaving them less time available for job search. This group is also more likely to experience health problems and may have more difficulty in the transition back to work because they have problems obtaining bank accounts and lack any affordable credit options to cover additional work related expenditure during this period.

USE OF FINANCIAL SERVICES

The study also explored how unemployment affected the use of financial services. We found that:

- savings were used up quickly and accounts closed
- people often incurred bank charges, causing them to stop using their accounts and use Post Office Card Accounts in their place

- people had problems maintaining insurance payments, including for home contents

The closure of bank accounts affected the transition back to work as some of the participants found it difficult to obtain another account for the receipt of wages, and the absence of savings meant that it was difficult to cover additional work related expenses pending receipt of first wages. Many participants had to borrow from family and friends as a result but where this was not possible then it caused real difficulties, leading to benefit fraud in one case. These problems were exacerbated by delays in the administration of benefit payments designed to help with the transition to work and the low level of financial support available.

CONCLUSIONS AND RECOMMENDATIONS

The low level of benefits paid to unemployed people gives rise to a wide range of problems that affect their ability to maintain a focus on, and pursue job seeking activities. Reducing benefit levels has sometimes been justified on the grounds that this increases the incentive for people to find work. However, further reductions could be counter-productive as they would exacerbate the problems identified in this study. Instead, more should be done to reduce the financial burdens associated with unemployment and to address the impacts of money and debt problems on job seeking behavior.

A number of actions could be taken at the local level to help improve service provision, and we set out further details of these in the table on the following page. These need to be supported at the national level. Indeed, some issues identified in this report can only be addressed nationally, including lender practices, insolvency rules, and the use of credit scoring in recruitment processes. The report provides a detailed set of 12 recommendations to be taken forwards by national and local government and its agencies, the financial services industry, including credit unions and Community Development Financial Institutions, welfare to work providers, and debt advice agencies. A summary of the recommendations are set out below.

Finally, we have also developed a resource guide for welfare to work providers that includes details of services which can be delivered in employment settings (see across). The full report and the guide are available on the CfRC website at www.responsible-credit.org.uk/projects/financial-inclusion-and-worklessness

SUMMARY OF RECOMMENDATIONS

Recommendation 1: A clear process to screen Jobseekers Allowance (JSA) claimants for money and debt problems, and direct them to sources of assistance, should be put in place

Recommendation 2: Local partnerships should ensure their Work and Skills plans reduce the financial burdens on unemployed people and provide them with access to advice:

- Local authorities, together with their wider employment partnerships, should review the availability of debt advice as part of their local economic assessment and set out how they will ensure that unemployed people have access to advice services in their Work and Skills Plans;
- Work and Skills Plans should also set out how local partnerships will reduce the financial burdens on the unemployed, for example, by ensuring help is given with transport costs and job search related expenditures, and how they will provide access to small sum affordable credit to cover work-related costs during the transition to employment;
- DWP should continue to support the expansion of third sector lending and should ensure that its future commissioning of these services links with local partnership proposals as set out in their Work and Skills Plans.

Recommendation 3: DWP, Jobcentre Plus, and representatives from the debt advice agencies and financial services industry should convene a task and

KEY FEATURES OF A HIGH QUALITY SERVICE TO ADDRESS MONEY PROBLEMS IN WELFARE TO WORK SETTINGS

Systematic screening for, and rapid assistance with, money and debt problems

Welfare to work services should screen claimants for debt problems:

- at day one of a claim a basic screening should take place by Jobcentre Plus and, where problems are identified, Jobcentre Plus should signpost people to sources of assistance;
- at later stages in a claim Jobcentre Plus Support Contractors and flexible New Deal providers should check for both money and debt problems and enter into formal partnerships with debt advice agencies to refer people with the greatest problems for assistance within a rapid (contractually agreed) time period.

Where formal agreements have been entered into then these should provide for the sharing of information about the extent of money and debt problems and the steps being taken to address these should be incorporated within an individual's back to work plan.

Improved partnership working to provide tailored support packages to assist the return to work

Welfare to work providers, debt advice agencies, and providers of financial education services should design money management sessions suitable for delivery in welfare to work settings. These could, for example, cover:

- how to maximise income and reduce expenditure, for example, by giving advice on energy efficiency grants and other entitlements;
- dealing with debts, including advice on negotiating with creditors;
- managing the transition to employment, including help with drawing up an in-work budget and debt repayment plan supported by a Better Off Calculation.

Formal partnerships should be put in place between welfare to work services and financial services providers, including credit unions and CDFIs, to ensure that people have access to banking facilities and affordable credit, with rapid access to bank accounts guaranteed when someone obtains a new job.

Work and Skills Plans should be used to set out how local partners will reduce the financial burdens on the unemployed and improve levels of support (see Recommendation 2, below).

Better in-work support

In-work support programmes organised by welfare to work providers need to follow through on known money and debt issues by tracking progress on debt repayment agreements and providing support where necessary.

Employers, particularly those signed up to Local Employment Partnerships and the National Employment Partnership, should be encouraged to:

- provide information about debt advice services;
- encourage savings (for example, providing information on the Savings Gateway and offering salary deduction services into credit union accounts);
- participate in financial education programmes;
- work with trades unions to ensure that financial problems are recognised within health and safety policies as potential contributors to staff absenteeism and ill health.

finish group to develop proposals to improve the administration of unemployment insurance policies by reducing the need for claimants to respond to multiple requests for the same information.

Recommendation 4: Greater protection against debt recovery should be provided for people that have recently lost their jobs, or have just started work and need time to re-negotiate repayment levels.

Recommendation 5: DWP, BIS and the Insolvency Service should establish a joint working group to review the rules for all forms of insolvency to ensure that these procedures do not create disincentives to work.

Recommendation 6: DWP and the Insolvency Service should undertake research into the impact of debt and different insolvency procedures on future employment opportunities and prospects.

Recommendation 7: DWP, BIS, credit reference agencies, and employer and trades union representatives should develop guidelines concerning the use of credit reports in recruitment processes.

Recommendation 8: Welfare to work providers and debt advice agencies, with support from the new Consumer Financial Education Body and the Financial Services Authority, should enter into formal partnerships with financial services providers, including credit unions and Community Development Finance Institutions as well as the private sector, to:

- develop tailored financial education sessions and materials that are relevant to unemployed people and can be delivered in welfare to work settings;
- deliver rapid access to bank accounts for people returning to work;
- provide small sum, affordable credit for people moving into employment to cover the transition period;
- provide deferred payment products to replace existing small sum debts where these constitute a disproportionate barrier to employment. Welfare to work providers should ensure that access to these products is contingent on the claimant following their back to work plan.

Recommendation 9: Best practice on dealing with money problems should be shared as part of existing learning networks, including through the National Worklessness Learning Forum

Recommendation 10: The Social Fund needs to be more responsive and repayments deferred where these are impacting on the ability of people to undertake job search

Recommendation 11: Jobcentre Plus should take account of outstanding debts and the likely level of repayments required of someone moving into work when conducting Better Off Calculations (BOCs) and a basic calculator should be developed in order to help Jobcentre Plus provide this information to claimants as part of their BOC.

Recommendation 12: In work support should be improved:

DWP and Jobcentre Plus should lead a programme of work with employers to:

- ensure that information about debt and money problems is made available in workplaces;
- promote credit unions and the Savings Gateway to employees;
- build actions to identify and address debt and financial problems into health and safety policies.

Fit for Work Service Pilots should also be encouraged to test out ways of delivering advice and assistance on debt and financial matters in the workplace and evaluate the impact of these on job retention rates.

CfRC interactive map of local debt indicators

The impacts of the financial crisis and the subsequent recession vary significantly at the local level, and it is local partnerships and services that are in the front-line of dealing with the debt problems, mortgage repossessions and insolvencies that have resulted. Despite this, there are few tools available to local partners to assist them in planning provision and assessing their performance relative to other areas.

As a first step towards addressing this we have developed an interactive map on our website (www.responsible-credit.org.uk), which provides users with all publicly available data in an easy to use format. The map enables debt hotspots to be identified and provides information on trends at the local authority level over time.

The maps currently provide debt indicators down to a local authority level in England and Wales, including mortgage possession claims, mortgage possession orders, and insolvencies broken down into bankruptcy orders and IVA's.

A screen grab from the site is shown below.

The site also provides a time series graph in the bottom right hand corner and allows authorities to be sorted and ranked.

To provide context for the information on debt problems, we are also mapping worklessness data on the site. We are now investigating the availability of datasets for Scotland and Northern Ireland and hope to be able to improve the site further as more data becomes available. In the meantime we look forward to receiving any feedback you have about the maps, which should be sent to: info@responsible-credit.org.uk