StepChange Debt Charity response to APPG on Poverty Inquiry into Poverty Premium

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Introduction

StepChange Debt Charity welcomes the opportunity to respond to the APPG on Poverty Inquiry into the Poverty Premium. StepChange Debt Charity is the largest specialist debt advice charity helping people across the UK. In 2017, we helped 620,000 people with their debts.[i]

We have kept our response concise, to fit within the word limit, but would be happy to provide further information on any points, or to provide oral evidence to the inquiry should this be helpful.

Question 1: How do you think the poverty premium affects low income families?

The poverty premium has a significant impact on low income families, and means they are less likely to have their needs met without having to pay an exorbitant cost. A recent study by the University of Bristol's found that the average cost of the poverty premium was £490 per household per year.[ii] This is a significant amount of money for households on low incomes. It puts pressure on already stretched budgets and can affect people's ability to cover everyday household essentials such as keeping their home warm or buying clothes for their children. This may also lead them to fall behind on bills: in 2017, two in five new StepChange clients were in arrears on at least one of their priority household expenditures, such as an energy bill.[iii]

The poverty premium can also leave people vulnerable to problem debt. Many people have to borrow money to cover essential goods and bills that are either more expensive due to the poverty premium (such as energy bills) or which they are struggling to afford due to their constrained budget. Using credit in this way can leave people at risk of falling into problem debt. Previous research by StepChange has found that people who rely on credit to keep up with their essential costs after an income shock are twenty times more likely to end up in problem debt than people who are able to rely solely on benefits or their own resources.[iv] As we will explain further in Question 2, families using high cost credit are therefore both paying the highest poverty premium and facing the greatest risk of falling into problem debt. There is a clear need for other alternatives for these families to avoid the harm that having to use high cost credit for essentials can cause (our recommendations for this are outlined in our response to Questions 4 and 5).

The poverty premium, when it leads to debt, can also leave low income families exposed to harm from egregious debt collection practices. For example, there is evidence of ongoing issues with bailiff's behaviour[v], and previous research revealed many rent-to-own borrowers had experienced poor treatment such as a lack of forbearance when struggling, or creditors constantly contacting consumers demanding repayment.[vi]

Finally, there is significant evidence that financial difficulties can have a detrimental effect on people's health, productivity and their ability to hold down a job, or find a new one.[vii] Research conducted in 2015 found that 47% of StepChange clients polled said they had visited their GP as a result of mental or physical health problems caused by their debts.[viii]

Question 2: What is the extent of the poverty premium, in which areas of service or goods provision does it exist, and why does it exist?

As mentioned in Question 1, the University of Bristol's recent study found that the average cost of the poverty premium was £490 per household per year.[ix] This was made up of several elements such as insurance, energy, credit and access to banking. In our response to this question we have focused on two areas of the poverty premium which particularly affect our clients – the credit market and the energy market.

Poverty premium in the credit market

Through our work, we see how credit costs can be a significant element of the poverty premium. This sees households having to turn to high cost credit to cover basic essentials, meaning they can end up paying very high rates of interest and charges reducing their already constrained budgets further. Our research found that an estimated 1.4 million people used high cost credit for everyday household costs in 2017, up from 1.1 million in 2016.[x]

The University of Bristol study found that households that used high cost credit were subject to the highest level of poverty premiums.[xi] Those using doorstep loans were paying an additional £540 per year on average, those with subprime loans were paying £520, those using rent-to-own stores paying £315, and those with payday loans £120.[xii]

Typically those turning to high cost credit feel they have no other options. Due to their low income and constrained budgets, they are unlikely to be able to pay upfront for essential household goods like washing machines or fridges.[xiii] They may also have limited access to mainstream credit, either due to financial exclusion or because they have a poor or no credit history. [xiv] This in turn leads to weak competitive pressure on prices and means these households face prices more than double those available through mainstream retail channels.[xv] Indeed, research from the End Child Poverty Coalition found that 10 common items for the home cost £9132 – three times (or more than £6000) more than purchasing a similar list of ten items up front from a high street online retailer.[xvi] This highlights just how significant the poverty premium can be.

Poverty premium in the energy market

Another area in which our clients experience a significant poverty premium is within the energy market. This is perhaps one of the most recognised elements of the poverty premium. Within the market, the cheapest tariffs are reserved for those on fixed-term tariffs (which requires people to switch regularly), whilst those on Standard Variable Tariffs (SVT) or prepayment meters (PPM) pay considerably more. Research by Ofgem found that around 62% of consumers are on a SVT, and the price difference between the SVTs from the six largest suppliers and the cheapest tariff in the market recently reached nearly £308.[xvii]

Evidence shows that lower-income households are less likely to switch, with reasons including risk aversion (particularly in relation to budgeting control), digital exclusion and lower levels of financial capability.[xviii] The University of Bristol found that three-quarters (73 per cent) of low-income households they surveyed had not switched fuel supplier in the last two years – costing them an estimated £233 a year on average.[xix] According to Ofgem, households with the lowest incomes spend 10% of their expenditure on energy – over three times more than the proportion spent by households with the highest incomes.[xx]

Those with prepayment meters (PPM) can also face more expensive costs than those on other tariffs. In 2016, 4.4 million customers paid for electricity using a PPM and 3.5 million prepaid for their gas.[xxi] There are a number of barriers to customers on PPMs switching to credit meters, where they may be able to benefit from greater choice of cheaper tariffs. This could be because the supplier refuses to let the customer switch, or sets a condition (such as a credit check or security deposit) that the customer does not meet.[xxii] In 2016, just 4% of PPM consumers changed to credit meters.[xxiii]

Question 3: What steps have been taken by national government, local authorities, public bodies, business or investors to mitigate the poverty premium and how successful or otherwise have these been?

With regards to the high cost credit element of the poverty premium, there has been some action in recent years to tackle the consumer detriment caused by such products. In 2015 the Financial Conduct Authority (FCA) introduced stricter rules on payday lending to help regulate the market. The new rules included:

- A price cap on high cost short-term credit (HCSTC)
- Limits on how many times a payday loan could roll over
- Stronger guidance on affordability checks and financial health warnings

Research conducted by StepChange after the introduction of the payday loan cap found that this regulation had made a difference– with the number of clients coming to us with debts of this type falling from 23% in 2013 to 16% in 2017.[xxiv] This suggests fewer people are getting these loans and less of those who take them out are struggling to repay. However, our research found there were still some issues with payday loans,[xxv] and we continue to see detriment caused by other high cost credit, such as rent-to-own.[xxvi]

Within the energy market, recent steps have been taken by Ofgem to try and limit the costs faced by those on prepayment meters (PPMs) and on Standard Variable Tariffs (SVTs). In April 2017, Ofgem implemented a cap on PPM tariffs, [xxvii] which has resulted in prices falling by around £60 for a typical dual fuel PPM consumer.[xxviii] However, some of the cheapest tariffs are no longer available, as some suppliers previously offering below the cap chose to raise their prices to meet it.[xxix]

In February 2018, the price cap was extended to customers on SVTs who receive the Warm Home Discount, and will be further extended for winter 2018-19 (with eligibility likely to be based on receipt of certain disability or income-related benefits[xxx]). At this stage, it is too early to say what the impact will be but Ofgem predicts this will help over 3 million vulnerable consumers in total. [xxxi]

Question 4: What else could be done by local authorities, national government or public bodies to mitigate the situation? [AND] Question 5: What else could be done by business and investors to mitigate the situation? [Answered together]

As outlined in our response Question 2, a poverty premium exists in the credit market, with lower income households often having to turn to very high cost credit to meet even their basic needs. To tackle this significant element of the poverty premium, **we are calling for clear and coordinated action from the Government and others to build more accessible and affordable credit alternatives for the most financially vulnerable**. This should include:

- A sustained and long-term programme to expand provision of community lending, such as credit unions and responsible finance providers.

- The Government acting to introduce or underwrite the development of a new scheme for no-interest loans to help those who struggle to safely access any form of commercial credit.

- Increased and more secure funding for local welfare provision, to provide access to emergency support for those in financial crisis.

All three of these will be needed if we are to truly support those households affected by the poverty premium. Lower income households are not one homogenous group – they have different financial situations and need to borrow money at different times, for varying needs. Using the Joseph Rowntree Foundation's Minimum Income Standard (MIS)[xxxii], StepChange conducted analysis of the need for affordable credit amongst lower income families.[xxxiii] The MIS is an income level based on items and services that the public think households need to be able to afford to reach a minimum acceptable standard of living. We used this to segment lower income households into three main groups: those living just below the MIS, those living on 75% of the MIS, and those on significantly low incomes and classed as being in 'destitution'[xxxiv]. Whilst existing sources of affordable credit such as credit unions or community lenders are likely to be suitable for the first of these groups, those on incomes of 75% of the MIS or less are unlikely to meet the affordability checks for these products, and may struggle to repay even a low interest loan.

This highlights the need for further action to improve access to very low-cost credit, that can be repaid over a longer term period, with built in flexibility, for those households living below the poverty line. **We therefore recommend that the UK, and devolved, Government should lead the development of no-interest loan provision, either by reshaping the Social Fund or by working with business partners to create a UK scheme similar to the Good Shepherd Microfinance scheme in Australia** (more information provided in Question 6 below). We believe this would help tackle the poverty premium by ensuring households can access credit to pay for essential goods such as fridges or washing machines, or deal with income shocks, without having to pay the premium that comes with high cost credit.

For those with the very lowest incomes, and for whom any sort of borrowing is likely to be inappropriate, access to grants and wider service provision is needed. This would require increased and more secure funding and the ring-fencing of local welfare provision to ensure those facing destitution have access to crisis grants.

Question 6: Please provide examples of good practice

As mentioned in our response to Question 5, there is an international example of where partnership between government, private sector and charity has helped tackle the poverty premium of high cost credit and expand the provision of affordable credit. In Australia, Good Shepherd microfinance provides a range of programmes for those on low incomes including a no-interest loans scheme (NILs).[xxxv] This started as a local scheme in 1981 and, following significant funding from the National Australia Bank and the Australian Government, has become a nationwide scheme that has helped over 205,000 people.[xxxvi]

The scheme provides loans up to $1500 for essential goods and services including white-goods, furniture and education expenses, to those on low incomes (they must earn under A$45,000 –

around £26,000). The repayment rate is on average 95%, suggesting that low income borrowers are not higher risk if the product has affordable, sustainable repayments built in.[xxxvii] Good Shepherd find that the relationship between local microfinance workers and borrowers and the principle of 'circular community credit', where funds are recycled back for future applicants in the community, ensures they have high repayment rates. It is also likely to be down to the manageable structure of repayments. Borrowers make repayments typically once a fortnight over a 12 to 18 month period, and if a repayment is missed there are no charges and a NILs worker will engage in a follow up procedure.[xxxviii] The evaluation of the scheme found that it had significant positive impact by improving the socio-economic outcomes of clients, increasing their savings levels, decreasing their stress and anxiety, as well as diverting them away from high cost credit products.[xxxix]

The NILs scheme has been imported to the UK, on a local basis with the Tenbury no-interest loans scheme launched in 2013.[xl] This allows borrowers facing financial difficulties to borrow up to £400 to buy essentials and make flexible repayments for up to two years.[xli] It is funded through a voluntary donation and the local council and has expanded to nearby Ludlow and Leominster. This is still a relatively small scale operation supported by local partnerships but indicates how this scheme could be implemented in the UK.

Question 7: Are there key sectors which leave low-income consumers with no alternative other than to use a premium-charging provider? If so, please say which sectors.

Please see our answer to Question 2.

Question 8: If you are a consumer on a low income, please describe any experience you have of paying a premium for goods and services.

As a debt charity, we regularly hear from consumers on low incomes about their experience of paying premiums for goods and services. In 2017, we conducted a small survey of 89 StepChange Debt Charity clients who have used rent-to-own to purchase household items. This provided us with qualitative insight into their experiences. The below quotes are taken from this survey, and appeared first in an End Child Poverty Coalition report on rent-to-own.[xlii]

- *"Very expensive and the end bill you pay is terrible. Could have brought the goods twice over if I'd had the cash up front."*

- *"I personally won't be borrowing anything from anyone again for household stuff like this. Just so damned expensive."*

- *“The interest is incredibly high and the full amount you end up paying back is unnecessary.”*

- *“We feel we have no choice but to sign contracts so we can have normal everyday household items like a fridge… If you do not pay on time, this can lead to not only financial problems in the family but health issues as well, depression and anxiety where the money is coming from to pay if the person is already struggling with other payments eg rent, council tax and other bills. You can get into a real mess.”*

On why they had to use rent-to-own providers:

- *“(Considered) buying from [high street retailer] but didn't have the money for it.”*

- *“I looked at getting them second hand but I still couldn't afford them.”*

- *“Saving money to buy the product was my first option but I could not save enough… because the time to wait until the saving going to be up to the amount I needed is too long… Badly need the product.”*

- *“I asked other retailers for credit but was unsuccessful.”*

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[i] See: https://www.stepchange.org/about-us.aspx
[iiii] University of Bristol (2016) *Paying to be poor: Uncovering the scale and nature of the poverty premium*
[iii] StepChange (2018) *Statistics Yearbook 2017*
[iv] StepChange Debt Charity (2015) *Navigating the New Normal: Why working families fall into problem debt and how we need to respond*
[v] See: Taking Control Campaign report: The need for fundamental bailiff reform, Available: https://www.bailiffreform.org/storage/app/media/Taking%20Control%20report%20March%202017.pdf
[vi] End Child Poverty Coalition (2017) *Feeling the pinch: Furnishing your home with rent-to-own*
[vii] See, for example: StepChange Debt Charity (2014) *Cutting the cost of problem debt;* Money and Mental Health Policy Institute (2018) https://www.moneyandmentalhealth.org/money-and-mental-health-facts/;
[viii] StepChange Debt Charity (2015) *Statistics Yearbook 2014*
[ix] University of Bristol (2016) *Paying to be poor: Uncovering the scale and nature of the poverty premium*
[x] StepChange Debt Charity (2018) *What sort of credit can help low income households? A segmentation of the need for affordable credit*
[xi] University of Bristol (2016) *Paying to be poor: Uncovering the scale and nature of the poverty premium*
[xii] Ibid
[xiii] All Party Parliamentary Group (APPG) on Debt and Personal Finance (2015) *Report from the inquiry into the Rent to Own sector*
[xiv] University of Bristol (2016) *Paying to be poor: Uncovering the scale and nature of the poverty premium;* Office of Fair Trading (2010) *Review of High Cost Credit,* page 5
[xv] All Party Parliamentary Group (APPG) on Debt and Personal Finance (2015) *Report from the inquiry into the Rent to Own sector*

[xvi] End Child Poverty Coalition (2017) *Feeling the pinch: Furnishing your home with rent-to-own;* online comparison made November 2017
[xvii] Ofgem (2017) *Providing financial protection to more vulnerable consumers*
[xviii] University of Bristol (2016) *Paying to be poor: Uncovering the scale and nature of the poverty premium.*
[xix] Ibid
[xx] Ofgem (2017) *State of the energy market 2017*
[xxi] Ibid
[xxii] Ibid
[xxiii] Ibid
[xxiv] StepChange (2018) *Statistics Yearbook 2017*
[xxv] StepChange (2016) *Payday loans: The next generation*
[xxvi] End Child Poverty Coalition (2017) *Feeling the pinch: Furnishing your home with rent-to-own*
[xxvii] For more information, see: https://www.ofgem.gov.uk/gas/retail-market/market-review-and-reform/implementation-cma-remedies/safeguard-tariff-or-price-cap
[xxviii] Ofgem (2017) *State of the energy market 2017*
[xxix] Ibid
[xxx] See Ofgem consultation website: https://www.ofgem.gov.uk/publications-and-updates/providing-financial-protection-more-vulnerable-consumers
[xxxi] 1 million consumers predicted to benefit from extension to Warm Home Discount customers, and 2 million from the further extension in winter 2018-19. Source: Ofgem (2017) *Providing financial protection to more vulnerable consumers*
[xxxii] For more information on the Minimum Income Standard, and the 2017 rates of this, please see here: https://www.jrf.org.uk/report/minimum-income-standard-uk-2017
[xxxiii] StepChange Debt Charity (2018) *What sort of credit can help low income households? A segmentation of the need for affordable credit*
[xxxiv] JRF defines people as destitute if they, or their children, have lacked two or more of these six essentials over the past month (shelter, food, heating, lighting, clothing and basic toiletries), because they cannot afford them. For more information, see: https://www.jrf.org.uk/report/destitution-uk
[xxxv] Good Shepherd microfinance no-interest loans scheme (NILs): Accessible: goodshepherdmicrofinance.org.au/services/no-interest-loan-scheme-nils/ (Accessed 20.3.2018)
[xxxvi] Ibid
[xxxvii] Good Shepherd microfinance (2016) *Celebrating 35 years of NILs: Annual Report*
[xxxviii] Good Shepherd microfinance (2014) *Life Changing Loans at No Interest*
[xxxix] Ibid
[xl] Tenbury NILs website: www.tenburynils.org.uk/home/4578809386
[xli] Accessible: www.independent.co.uk/money/loans-credit/simon-read-yes-no-interest-loans-do-exist-9643817.html (Accessed 20.3.2018)
[xlii] End Child Poverty Coalition (2017) *Feeling the pinch: Furnishing your home with rent-to-own*