Consultation response

Treasury Select Committee - Household finances: income, saving and debt inquiry

Response from the Money Advice Service

December 2017

1. About us

1.1. The Money Advice Service (MAS) is a UK-wide, independent service set up by Government to improve people's ability to manage their financial affairs. Our free and impartial money advice is available online and by phone or webchat.

1.2. As the statutory body for financial capability, MAS has led work with financial services firms, the third sector, government and regulators to develop the Financial Capability Strategy for the UK[1]. This 10-year strategy aims to give people the ability, motivation and opportunity to make the most of their money.

1.3. We have a statutory function to assist members of the public with the management of debt. Our latest data shows that 8.3 million adults in the UK are over-indebted[2].

1.4. We are funded by a statutory levy on the financial services industry, raised by the Financial Conduct Authority (FCA).

1.5. The *Financial Guidance and Claims Bill 2017*, which makes provisions to establish a new financial guidance body was introduced in the House of Lords on 22 June 2017.

[1] Money Advice Service, *Financial Capability Strategy for the UK*, (October 2015)

[2] Money Advice Service, *Press release: 'One in six people in the UK burdened with financial difficulties'*, (19 September 2017)

2. Executive summary

2.1. Too many people in the UK are in debt. Our modelling shows that 8.3m people in the UK feel their debts are a heavy burden or have missed three or more payments on bills and credit commitments in the last six months, an increase of over 300,000 on the previous year.

2.2. And there are many more people who are just one financial shock away from problems because they have no meaningful savings buffer. Our research indicates that 10.6 million working-age adults have no savings whatsoever to absorb economic shocks, whilst a further 11.8 million have less than £1,000 saved.

2.3. This situation is only likely to be exacerbated in the coming years. Household finances are likely to come under increasing pressure due to prevailing uncertainty impacting on the economic environment, and as such the subject of the enquiry is both timely and relevant.

2.4. We believe that there is an urgent need to help people build up savings buffers that provide financial resilience. This should sit alongside focused attempts to tackle the challenge of problem debt, and meeting the needs of those who can't be expected to save their way out of financial insecurity, persistent low income and reliance on benefits.

2.5. This is not an easy thing to achieve – we believe we need to develop - and then robustly evaluate - innovative ideas which can then be rolled out at scale.

2.6. So, our strategy is based on trialling different approaches to see what is effective and what works. We do this through a number of initiatives, including:

- a partnership with the NEST Insight Unit to see whether we can encourage people to build up short term savings buffers alongside their pensions;
- our Fincap Lab which has tested innovative ideas around encouraging people to save at the supermarket checkout;
- the What Works Fund programme which is testing different approaches to developing savings habits; and
- our work to widen and improve financial education, since we know that attitudes to money develop at a young age.

3. Response

What is the "right" level of saving for households and the UK economy more widely, in view of prevailing and potential future economic conditions?

3.1 Our research shows that nearly three-quarters of households receive an unexpected bill every year, but 26% of working-age adults have no savings to fall back on and a further 29% have less than £1,000 saved, meaning their capacity to absorb unforeseen bills is limited[3].

3.2 The overall average yearly cost of unexpected bills is just over £1,500. These unexpected expenses include car repairs or the breakdown of technology, washing machines or boilers[4].

3.3 However, there are a couple of much larger expenses that bump up that cost, for example, lending to family and friends and car replacement. If those are taken out of the equation most individual unexpected bills are around £300-£500. This figure might therefore be a level of savings that feels more achievable to a larger number of households.

3.4 MAS has blended our data on financial capability with consumer data to group the UK adult population into segments defined by financial resilience. The segmentation comprises three macro-segments, and fifteen sub-segments. The macro-segments have been labelled as follows:

- **The struggling.** They struggle to keep up with bills and payments and to build any form of savings buffer. They are the least financially resilient and the most likely to be over-indebted.
- **The squeezed**. Working-age consumers with significant financial commitments but relatively little provision for coping with income shocks. They are digitally savvy and have high media consumption but this is more for entertainment than financial information.

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[3] *2015 Financial Capability Survey,* Money Advice Service, 2015.

[4] "*Closing the Savings Gap*", Money Advice Service, September 2016.

- **The cushioned.** the most financially resilient group with the highest levels of income and savings and the lowest proportion of over-indebted. They are the most highly engaged with their finances.

We have made the following observations on each of these segments in relation to savings:

- **Struggling** (11.6m people, 22.7% of the population) – Median savings value of £50. 28% have 1+ months income in savings and 19% have 3+ months income in savings.
- **Squeezed** (12.7m people, 24.9% of the population) – Median savings value of £580. 40% have 1+ months income in savings and 25% have 3+ months income.
- **Cushioned** (24.5m people, 48.2% of the population) – Median savings value of £5.5k. 60% have 1+ months income in savings and 47% have 3+ months income.

3.5 The 2015 Financial Capability Survey shows that while household income is a key driver for saving frequency, a variety of savings behaviours are exhibited across the income spectrum. More frequent saving is associated with:

- future-focused attitudes;
- having goals and plans; and
- identifying specific reasons for saving, especially where these are near-term and positive.

3.6 People in the struggling segment understand the importance of precautionary savings better than rest of population. The reasons for this could include people in the segment's limited access to mainstream sources of credit. However, this segment is also the most likely to save only for a specific purpose and they have the lowest level of self-efficacy. The Financial Capability Survey 2015 evidence on attitudes and mind-set suggests that **information and awareness about the benefits of savings are insufficient to change behaviour, and that combining goal-based, habit-forming features may be effective elements in combination to help people to save**.

3.7 Given the variety of savings behaviours exhibited across the income spectrum there is a risk in actively promoting a bald cash figure that may feel unobtainable or irrelevant. In their research, StepChange Debt Charity has shown that if every household in Great Britain had at least £1,000 saved it would reduce the number in problem debt by 500,000[5].

3.8 However, there is increasing recognition that there are some groups within the struggling segment – typically heavily dependent on benefits, most likely to be over-indebted and on low incomes - for whom building any sort of meaningful buffer is an unrealistic expectation. To ensure they are not catapulted into debt if an income shock occurs, this group is likely to require greater support from government and organisations they owe money to, potentially through flexible repayment arrangements, providing grants and assistance or through timely access to low or no interest loans[6].

3.9 As part of our contribution to the Financial Advice Market Review, MAS sponsored a review of personal finance rules of thumb. There is also an industry rule of thumb that says that three months of expenditure is the optimum level of short term savings. In our guidance we draw on that industry rule of thumb because it would be sufficient to cover a number of key unexpected financial shocks and some unplanned for life events. The other side of the optimum savings question is access to affordable credit, which can minimise problematic over-indebtedness following an unexpected expense. The key, though, is regular saving and individual consumers can choose which measure – three months of expenditure, £300 or £1,000 – is most appropriate for their circumstances.

What policies could support households in achieving appropriate levels of saving? Are current policy interventions (e.g. ISAs) well targeted?

3.10 We welcome Help to Save, which recognises the need for more targeted incentives to promote saving among particular groups, in this case low-income families. There is a lack of evidence that policy interventions aimed at encouraging saving behaviour manage to get consumers who weren't previously saving to start - it may be that they are simply

[5] *Keeping Families Out of Debt,* StepChange, (2015). https://www.stepchange.org/Portals/0/documents/Reports/BecominganationofsaversStepChangeDebtCharityreport.pdf)

[6] *An example of such support is a small pilot the Money Advice Service is funding and evaluating through its What Works Fund. Known as rentflex and delivered by the National Learning and Work Institute, this provides additional assistance to some social housing tenants in the form of an offer to schedule rent payments in accordance with predicted fluctuations in income and expenditure over the course of a year alongside specific financial capability interventions.*

encouraging existing savers to switch to new schemes to maximise their returns, rather than encouraging an increase in saving behaviour[7]. Explicitly targeting groups that are known to have issues with saving is one potential way in which to address this[8].

3.11 Re-focusing incentives towards lower-income saving could have a positive effect. This might include considering widening eligibility for Help to Save, pending learning from roll out and evaluation, extending the scope of pension auto-enrolment to cover currently excluded groups and/or piloting new hybrid savings products for households that promote simultaneous short-term and long-term saving. It is also worth noting that in an era of historically low interest rates, high interest current accounts may be a more appropriate saving mechanisms for the struggling and squeezed, than, say, an ISA – particularly given the tax emption for the first £1,000 of savings. Our Financial Capability lab work, carried out in partnership with the Behavioural Insights Team, suggested potential innovations that providers may wish to investigate further. Again, we are happy to provide the Committee with additional information on this research.

3.12 However, any action that is taken to support household savings also needs to address people's mind-set and attitudes - while a lot of the barriers to saving concern the fact that people don't have the financial headroom to save, attitudinal issues are also important. Our evidence suggests that some non-savers don't believe that saving small amounts of money is worthwhile and have unrealistic expectations about how much they would need to save to make a difference, when even relatively smaller amounts of savings could their boost financial resilience[9].

3.13 As a small savings experiment, MAS carried out a "Savings Challenge" – challenging 24 non-savers to save £100 a month for three months. It indicated that by building confidence, overcoming inertia and creating financial goals, non-savers could be converted to monthly savers[10].

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[7] *Raising Household Saving,* T. F. Crossley C. Emmerson & A. Leicester, (2012), https://www.britac.ac.uk/sites/default/files/BRI1089_household_saving_report_02.12_WEB_FINAL.pdf

[8] *Savings Evidence Review*, Money Advice Service, (July 2017) https://masassets.blob.core.windows.net/cms/files/000/000/795/original/Savings_review_FINAL.pdf

[9] *"Financial Scarcity and Financial Decision Making"* Mechele Dickerson Arizona Law Review 58:137 (2016) http://arizonalawreview.org/pdf/58-1/58arizlrev137.pdf;

[10] *Closing the Savings Gap,* Money Advice Service, (2016). https://masassets.blob.core.windows.net/cms/files/000/000/548/original/MAS_Savings_Report_Sept_2016_FINAL.pdf

3.14 One hybrid approach MAS is investigating alongside NEST is "sidecar savings", which has the potential to be an effective vehicle for low-income households. A "sidecar" account would allow individuals to save into their pension and into a linked savings account at the same time, taking advantage of the same principles of inertia and our tendency towards loss aversion.

What actions can government take to improve levels of financial awareness and education, and what lessons can be learned in designing the successor to the Money Advice Service?

3.15 Financial capability in the UK is persistently low. People need to have a combination of knowledge, the right attitudes and motivations and access to appropriate financial advice and services in order to be financially capable. Poor financial capability results in detriment to consumers, undermines the impact of broader government policy, and can inhibit competition in the financial services market. The remit of the Single Financial Guidance Body (SFGB) as set out in the Financial Guidance and Claims Bill will make it easier for consumers to access the guidance and information they need to make effective financial decisions and take control of their money. With its new statutory duties and functions the SFGB will be able to consider and act on the full picture of consumer needs and help co-ordinate a system of effective guidance across all life stages.

3.16 This is important, because as the savings landscape shows, choices that consumers face are complex, and financial education, guidance and advice has to help people put together the different elements of their financial lives and engage with the trade-offs that may involve. For example, many working-age adults in our squeezed segment are in young families with children at home and may face a trade-off between saving for short-term goals, paying down a mortgage and other debts and saving for retirement.

3.17 MAS's own work has shown the current landscape for financial guidance can be confusing for consumers and this can lead to unproductive duplication or consumers not accessing the guidance they need. The SFGB will have the remit and role to develop a coherent, whole-life strategy, informed by robust evidence about what actually works to improve consumers' ability to make the financial decisions that are right for them.

3.18 MAS has demonstrated that how adults behave with money is in part a direct consequence of what is seen, experienced, and learned during childhood and adolescence, and that it will not be possible to achieve the goals of the UK Financial Capability Strategy unless children and young people receive effective financial education at home, at school, and in the wider community. Our previous research reports have helped build the case for this; for example, Habit Formation in Young Children showed the vital importance of parents' habits and behaviours, and found that by the age of 7 many children have key money habits in place, such as understanding the value of money, planning ahead, and prioritising needs over wants.

3.19 Last year, our ground-breaking nationally representative survey of 5,000 4-17 year olds and their parents proved the importance of starting financial education young, showing for example that 4-6 year olds who already identified as 'savers' rather than 'spenders', and those who were involved in decisions about money at home, already did better when it came to recognising and picking 'needs' over 'wants'.

3.20 The case for an early start and support throughout childhood and adolescence is clear. Survey results showed definitively that many young people aged 16/17 and approaching financial independence lack the vital skills, knowledge, and experience they'll need to manage money well – almost one in five had no bank account, and six in ten couldn't read a payslip properly.

3.21 However, there are large gaps in provision. Parents, who are the critical influencers of children's developing financial capability receive little support; most children still say they don't get financial education in school despite it being on the curriculum; and particularly vulnerable children and young people who are likely to face greater challenges ahead struggle to get the support they need. Few interventions start at a young age, and there is not enough practical, real-life learning taking place.

3.22 There are also large gaps in evidence. Funders and commissioners do not have the evidence they need to target their funding; the business case for new funders and providers (such as schools) to invest and deliver financial education has not been made, and delivery organisations do not have sufficient evaluation findings to understand whether their interventions work, in what ways, and to whom.

3.23 MAS's work on financial education is aimed at addressing these gaps. We are working to build the evidence base and get a robust understanding of needs, provision and what works; to coordinate the financial education sector; and to share our insights in ways the influence funding and commissioning, delivery and policy, based on evidence. Our insights will feed into a Commissioning Plan by Autumn 2018, setting out how we believe resource and activity can best be targeted to ensure all children and young people get the financial education they need, and that works, by 2025. The Financial Guidance and Claims Bill requires the new SFGB that will replace MAS, TPAS and Pensionwise to work with the financial services industry, the devolved authorities, and the public and voluntary sectors to support the co-ordination and development of a national strategy that will improve people's financial capability and debt management skills, and improve the provision of financial education for children and young people.

3.24 Government policy has a role to play in supporting improved financial education and awareness in childhood and adolescence though several routes:

- Providing a clear strategic steer about the importance of financial education as early as possible continuing throughout childhood and adolescence, for example by ensuring financial education is on the primary school curriculum, strengthening its delivery by including in teacher training, and as a subject specifically reviewed by inspectorates and monitoring bodies
- Considering the role of financial education and financial capability in wider government policy, such as embedding financial capability in support for 'troubled families', parenting, and social mobility programmes like the Department of Education Opportunity Areas, as well as sharing good practice and ensuring its inclusion as a topic on guidance around local government's role in supporting vulnerable children and young people, such as corporate parenting responsibilities.
- Continuing to support, incentivise and, where there is a clear gap, fund the development and delivery of well-evidenced programmes and interventions that succeed in achieving positive long-term impacts on financial capability.

Are retiring households receiving adequate and appropriate financial advice following the implementation of pension freedoms?

3.25 The recent FCA Retirement Outcomes Review[11] provided some evidence which showed that consumers have a disconnection with their pension savings and often revert to the 'default' position of sticking with their own provider as the easier option or removing their pension savings altogether to place in more familiar deposit based savings. However, these actions don't follow either an advice or guidance session, but appear to be acting on instinct, out of panic, or out of distrust.

3.26 There are mechanisms in place which should direct individuals towards a guidance session with PensionWise, but these could be made more effective in building engagement. Those consumers who do choose to take the guidance session by and large find it informative and useful.

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[11] "*Retirement Outcomes Review: Interim Report*", Financial Conduct Authority, (September 2017). https://www.fca.org.uk/publication/market-studies/retirement-outcomes-review-interim-report.pdf

3.27 The issue is that too few people are choosing to take that guidance, therefore more needs to be done to ensure individuals access guidance as a first step before making a decision on how to draw down their pension benefits.

What is the scale of and trend in problematic debt? To what extent is unmanageable debt being manifest in non-credit defaults (e.g. on utilities bills or council tax)?

3.28 Recent evidence[12] shows that there are currently 8.3m people in the UK who feel their debts are a heavy burden or have missed three or more payments on bills or credit commitments in the last six months. This is a slight increase from the total of 7.9m people in 2016, potentially reflecting the impact of accelerating levels of inflation and stagnant income growth.

3.29 The profile of debts is also changing. StepChange has reported[13] that it is now seeing more clients with arrears on essential household bills such as council tax, rent and utilities (40% of clients in 2016, up from 25% in 2011). This change is attributed, in part at least, to stagnant wage growth and increasing costs, and it has been exacerbated by greater enforcement activity by local authorities following the localisation of council tax benefit.

Have household incomes become more variable as a result of more flexible labour markets and the "gig economy", and does this raise the need for new credit products?

3.30 There are currently 1.4 million employment contracts that do not guarantee a minimum number of hours[14], whilst there has been a 30% rise in agency work since 2011[15]. 4.8

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[12] *Over-indebtedness in the UK,* Money Advice Service, (2017) Statistics available at https://www.moneyadviceservice.org.uk/en/corporate/debt-publications

[13] *"Held back by debt: how Britain's lack of financial resilience is tipping people into a debt trap."* StepChange (2015) https://www.stepchange.org/policy-and-research/held-back-by-debt-financial-resilience-in-britain.aspx

[14] *Contracts with No Guaranteed Hours, Employee contracts that do not guarantee a minimum number of hours: 2017 update,* Office of National Statistics, (May 2017)

[15] *A tough gig? The nature of self-employment in 21st Century Britain and policy implications,* Resolution Foundation, (February 2017) http://www.resolutionfoundation.org/publications/a-tough-gig-the-nature-of-self-employment-in-21st-century-britain-and-policy-implications/

million people - 15% of workers - are now self-employed[16]. On 18th December 2017, MAS published a brand new, five-year strategy, which sets out our approach to commissioning free to client debt advice services across the UK17. It outlines a challenging but client focused plan to deliver better outcomes for the UK's over-indebted population. A key priority of the strategy is delivering to those who are most in need, focusing on three cross cutting characteristics shared by many people across the over-indebted population:

- having dependent children,
- having a low household income; and
- experiencing mental ill health.

3.31 Our aim is that the most financially vulnerable groups and those most under-served will be targeted more clearly, benefitting from easier access to services and support to build their financial resilience.

3.32 The strategy is built around six well considered and evidenced principles, based on client outcomes and supported by a phased plan for regional rollout across England to ensure continuous improvement. The strategy has been designed to be responsive to the challenges identified in the current debt advice marketplace, with a central focus on working supportively with the sector to improve the quality of debt advice across the services delivered.

3.33 As part of MAS's statutory obligation to improve the availability, quality and consistency of debt advice we conducted a review and consultation of the formal and informal courses of action available to people who have problem debt. The Debt Solutions review found the current options for repaying debt do not generally take into account the growth of flexible working as repayment plans are generally premised on someone having a regular, stable income. This presents problems for workers with fluctuating earnings, where the amount they can afford to repay may vary between months[18].

[16] *UK labour market*, Office for National Statistics, (December 2017). https://www.ons.gov.uk/releases/uklabourmarketstatisticsdec2017

[17] *"A Strategic approach to debt advice commissioning 2018-2023"*, Money Advice Service, (December 2017). https://www.moneyadviceservice.org.uk/en/corporate/a-strategic-approach-to-debt-advice-commissioning-2018-2023

[18] *Debt Solutions Review,* Money Advice Service, (2017) https://www.moneyadviceservice.org.uk/en/corporate/draft-opportunities-for-change-debt-solutions

3.34 Affordable credit products with low interest rates and flexible repayment terms, and genuinely accessible insurance would benefit low-income families and those in the gig economy. However, in addition to this, action is also required elsewhere. For example, the financial services sector could facilitate better third-party access to banking (for example for carers), improve digital comparison tools, and be more open about the use of credit referencing.

3.35 If new products are introduced it is vital that effective regulation is in place. We are supportive of the work the FCA does in ensuring innovation is encouraged with adequate monitoring and it is vital the regulator continues to act in this way. Regulation must be suitable across the consumer credit sector and for all types of consumers. New FCA rules on creditworthiness should be appropriate, making sure firms have a full view on potential customer situations when making lending decisions. In addition, regulatory rules regarding price caps, lead generation and unsolicited real-time promotion may need further thought.

What are financial regulators doing to monitor the issues of problematic debt?

3.36 We know that debt advice works: debt advice offers a range of positive outcomes[19] to those struggling with debt or wider financial difficulties. These include negotiating affordable and effective mechanisms of repayment with creditors, clearing or at least reducing debts even within a short period and improving financial capability for clients' long-term benefits. Outcomes extend to reductions in stress and sleeping difficulties, improved family relationships and emotional and mental wellbeing.

3.37 We have upcoming research[20]; The Economic Impact of Debt Advice, which shows that the benefits of debt advice extend to sectors beyond financial services. This research showed that debt advice has a direct, beneficial social impact on health through improving the state experienced by those suffering from health conditions and, in doing so, alleviating part of the service costs incurred by the health system. The financial benefits of heath improvements associated with receiving debt advice range from £50 to £93 million per annum. The research also showed that debt advice is making an indirect contribution to

[19] *2016 Outcome Evaluation of Debt Advice funded by Money Advice Service*, Money Advice Service, (Oct 2017) https://masassets.blob.core.windows.net/cms/files/000/000/823/original/Debt_Advice_Outcomes_2017.pdf

[20] Whilst this is not yet published, we would be happy to share this confidentially with the committee.

enhanced productivity by helping to resolve financial distress. The increase in productivity resulting from debt advice is estimated at £67-£137 million per annum.

3.38 The total social benefits across the UK that can be robustly quantified are estimated at £301-£568 million annually. This can be seen as a conservative estimate, in that there are many impacts of debt advice which this study considers well-proven but for which there is insufficient evidence to allow the monetary impact to be quantified robustly

Has the UK financial services market been effective in providing suitable credit products for low income households?

3.39 Positive engagement with the credit market is a two-way street. While MAS works with consumers to help them navigate credit markets, we also believe firms need to do more to ensure the products they offer are effectively assessed for affordability and when consumers are detected to be in trouble, they are offered adequate help.

3.40 Poor creditworthiness assessments can contribute to low levels of financial capability by resulting in both immediate detriment but also longer-term disengagement. They can result in people being:

1. Provided with credit they cannot manage, in the near term pushing them into persistent debt and in the longer-term leading to distrust of credit markets.

2. Denied credit they could manage, causing them to turn to higher-cost forms of borrowing, exacerbating immediate problems (one in six people with consumer credit debt suffer moderate to severe 'financial distress'[21]). Again, over an extended time-frame this can lead to disengagement from the credit market.

3.41 Both problems can be compounded by poor communication about lending decisions. Positive customer interaction with credit markets also represents an opportunity for firms to identify those at risk, and provide or signpost to appropriate help. Effective early intervention measures are crucial in this area.

[21] *Occasional Paper No. 28: Preventing financial distress by predicting unaffordable consumer credit agreements: An applied framework,* Financial Conduct Authority,. (July 2017) https://www.fca.org.uk/publications/occasional-papers/occasional-paper-no-28-preventing-financial-distress-predicting

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What interventions can the Government make, including "breathing space" schemes?

3.42 It is positive to see "breathing space" being given such a priority in the Financial Guidance and Claims Bill.[22]

3.43 We recognise that such a scheme offers the opportunity to provide a degree of protection that over-indebted people in Scotland already have via the Debt Arrangement Scheme[23].

3.44 We know that debt advice can be effective for people who use it. As the proposals are developed, we need to focus on developing a scheme that will encourage more people to seek advice, or seek it earlier than they would otherwise have done – part of this may result from an environment in which there were greater incentives for them to do so.

3.45 There is currently an independent review of Debt Funding underway by Peter Wyman. The review has been established in response to a challenging and complex debt advice funding landscape, which includes an increasing need for advice, growing consumer debt and challenges to sufficient funding for free advice. The review will look at issues affecting some of the most vulnerable people in society who are struggling with money worries.

3.46 Finally, we would ask that the Government continues to encourage good creditor practice in its own collection activities, as well as setting a good example for creditors in other sectors. To that end we would encourage the adoption of our Creditor Toolkit, which was created with Debt Advice Agencies. It encourages creditors to examine their debt collection strategies and collaborate with the debt advice sector to better support customers in financial difficulty[24].

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[22] https://publications.parliament.uk/pa/bills/lbill/2017-2019/0070/18070-DPMsupplementary3.pdf

[23] https://www.aib.gov.uk/debt-arrangement-scheme

[24] Please see this link for further details: https://www.moneyadviceservice.org.uk/en/corporate/press-release-ground-breaking-toolkit-helps-creditors-to-support-people-who-fall-behind-on-payments