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Developing a Financial Rule of thumb to support young people using credit

Summary Report

the Money Advice Service

The Money Advice Service (UK)
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Background and objectives

Background

1. Previous MAS research shows using credit is the topic young adults most wished they had learned more about at school

2. Improving young adults' ability to successfully use credit supports the Financial Capability Strategy call to action on credit – *'9 million adults often borrow to buy food or pay bills. We want to see a fall in the number of people relying on credit for everyday essentials.'*

3. The aim of the project was to develop a rule of thumb for young adults (18 to 24 year olds) to successfully use credit, by gaining insight/hindsight from 24-34 year olds

Objectives

Deliver robust, actionable insights on the specific lessons young adults wish they'd known when first using credit, as the basis for developing a rule of thumb

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Develop a proposed rule of thumb based on these insights by facilitating a workshop with policy stakeholders

The project was conducted by PwC Research

Headlines

1. There are many facets to managing credit use, within the areas of, reducing use, selecting the right product, and managing and reviewing credit use: **it is not straightforward to cover these three areas in a single rule of thumb**

2. **Reducing credit use is the most popular action to base a Rule of Thumb on:** particularly for Struggling and Squeezed who rely on credit to get through to the end of the month

3. **Reducing use needs careful framing to work as a rule of thumb:** to be specific, positive and empowering, but not obvious or daunting

4. **It also needs to be simple and not assume any background knowledge of credit products:** for example, a rule of thumb telling 18 to 24 year olds to avoid credit products with high interest rates won't work with those who have no idea what percentage would be high

5. Because it is not straightforward to cover all three areas in a single rule of thumb **additional tips or supporting information should be considered**

6. **There are three potential Rules of Thumb on reducing use, based on the suggestions from the fieldwork based :** these may prompt people to pause and think about the need or affordability before using credit, these should be copy edited and communications tested for the next stage of development

Methodology: a three stage, iterative process working with MAS, consumers and industry experts

	Struggling	Squeezed	Cushioned
Segment profile	Less likely to be working. Depend on benefits and alt. credit.	Working, mostly full time. Dependent on credit.	In full time employment. Some reliance on credit.
	Household income av: £16k - £23k	Household income av: £22k - £33k	Household income av: £30k – £54k
	Credit/store card use: 30% – 40%	Credit/store card use: 41% – 58%	Credit/store card use: 45% – 78%
	Median savings: £50 - £60	Median savings: £550 - £700	Median savings: £1k - £5.5k
Children	2	4	2
No children	5	9	4
Total	7	13	6
26 participants all aged 24-34			

- Representatives from 15 different organisations: youth/student support, further education, housing associations and financial institutions
- Half day session looking at the findings and consumer suggestions from the online forum

- Initial audience testing of the Rules of Thumb developed in the co-development workshop
- RoTs pitched to four consumers aged 18-24
- Spontaneous feedback to inform further development

Credit perceptions and use: Segment summary

	Struggling	Squeezed	Cushioned
PERCEPTIONS OF CREDIT	• Too readily available • Keeping up repayments can be stressful	• Love/hate relationship • Feel more confident managing credit, well aware of the consequences of managing credit badly	• Confident using credit and managing repayments
POSITIVES	• Good for use in emergencies • Vital for larger purchases	• Helpful for getting through to the end of the month • Useful for making large purchases you can pay off over several months	• Good for spreading the cost of large purchases • Helpful for building a good credit score
NEGATIVES	• Tempting to buy things you want rather than need • Bad when you take a short term view and don't think about the repayments	• Bad for small day to day purchases as it can lead to unnecessary spending	• Bad for unnecessary purchases that could build up debt • High interest rates and credit limits means that some products offer a bad deal
MANAGEMENT	• Often used to buy food, petrol etc. across the month • Can often only make the minimum payment	• Used for food and fuel towards the end of the month and for big purchases such as laptops, cars etc. • Try to use only when needed, making and monitoring repayments	• Often clear credit card balances each month (whenever possible)
VERBATIM	*“Credit can be a terrible idea when you only see the short term solution, or think that you can somehow avoid paying it back”*	*“Credit is bad for day to day things like food shopping and clothes. It can lead to living outside your means, and easily spiral into unnecessary spending. It is bad if you are using it constantly i.e. taking out multiple cards to rely on or buying spontaneous items”*	*“Credit is good for people who need to get a better credit record and also for when you want to purchase something but spread the payments"*

Participants recognised a number of common mistakes they made when they started out using credit

- **Overstretching limits**
  - Taking out an unmanageable number of credit products
  - Spending more than can be paid back
- **Burying head in the sand**
  - Allowing the balance to become higher than expected
  - Not facing up to the reality/responsibility of repayments
- **Lack of knowledge of products**
  - Facing unexpected fees and charges
  - Not understanding implications of certain products
- **Lack of alternative resources**
  - Using additional credit to pay off other debt
  - Lack of savings or means of making large repayments

"There was a time when I had many creditors (roughly around 20) that's many different products more than one for cards etc. and the total amount I was paying each month was more than I could afford so I ended up falling behind on phone bills, car insurance."

Female, 24, no children, Squeezed, Leeds

"The most difficult thing was attempting to resolve this myself by applying for yet more credit and ultimately got into more debt and ruined my credit score."

Female, 29, no children, Squeezed, London

When considering past behaviour and experiences across the credit journey, three broad themes of advice emerge

1. REDUCE YOUR USE

Use credit less often and always consider other options, for example using money from current account, savings, or saving up before buying

AIM

Encouraging consumers to honestly question their need for the credit they are thinking of using, their **ability to manage/budget for it,** and whether they have other options

2. SELECT THE RIGHT PRODUCT

Choose the right category, for example loans, credit cards, interest free credit from retailers, store cards, authorised overdrafts and actively choose the best individual product – not just taking what is offered

AIM

Inspiring consumers to make appropriate **credit decisions for themselves** – not for others or for the benefit of their creditors, to educate themselves on the best options for their time in life i.e. just starting out using credit

3. MANAGE AND REVIEW YOUR USE

Managing credit use to both get the most benefit from it now, and maximise opportunities for better/the best credit deals in the future

AIM

Inspiring consumers to consider how credit can help them reach their aspirations and benefit them **over the long term**. Challenging them to always reconsider and review products they have, to question limits and to think about how to build their credit score in order to access better deals in the future

Theme 1 – ‘Reduce your use’ by challenging need for credit

DO YOU ACTUALLY NEED CREDIT?

Challenge consumers to really think about their need for credit. ***Consider the purpose*** *(need vs. want),* ***the urgency*** *(i.e. can they wait and save instead) and if there are* ***other options available*** *(parents etc.).*

HOW EASILY CAN YOU PAY IT BACK?

Prompt them to consider their circumstances and be realistic about not overstretching themselves. *Encourage them to* ***be fully aware of*** *their* ***income and outgoings so*** *that they can assess their ability to cover repayments and manage their borrowing.*

THINK ABOUT YOUR LONGER TERM FUTURE

Encourage them to think carefully about the longer term cost and impact of borrowing and how their life could change over the next few years (i.e. jobs, relationships, children) so they’re not tied down too heavily or for too long as their outgoings increase. ***Weigh up immediate benefits vs. longer term impact.***

" If you don’t need it, don’t use it - from experience that's an age group [18-24] that won't always be able to differentiate between ‘want’ and ‘need’ when it comes to making purchases, and with credit the temptation is to think well I want it and I can get it"

Male, 29, no children, Cushioned, Scotland

" If you don’t want to tell your mum and dad what you’ve used credit for, then you probably shouldn’t have used it for that purpose"

Female, 24, children, Squeezed, Scotland

Theme 2 – 'Select the right product' by being an active not a passive consumer

PLAN YOUR BORROWING

Mistakes are common and often result from failing to actively plan borrowing. It's important to ***avoid making assumptions*** about individual products, to avoid following others, and to do your own research.

> *"Research credit before making any decisions. Use the internet or family and friends"*

Male, 24, no children, Struggling, London

CHOOSE THE RIGHT PRODUCTS

Stress the importance of choosing the right type of borrowing; work out what type of credit will suit you best, and then within that seek out the ***best individual products to meet your needs***.

> *" There was a time when I had that many creditors (roughly around 20) that many different products, that the total amount I was paying each month was more than I could afford, so I ended up falling behind on phone bills, car insurance – basically all priority bills. "*

Female, 24, no children, Squeezed, Leeds

THE ONUS IS ON YOU TO TAKE CONTROL

Take a good look at any credit you're offered, remembering that creditors are in business to make a profit. ***It's ok to turn down credit*** if you don't need or can't afford it, and to decide for yourself what credit limit you're comfortable with.

> *"Make sure you have enough left your account to at least pay the minimum payment each month. Always budget your money; if you struggle to budget don't get credit"*

Female, 34,no children, Struggling, Northern Ireland

IT'S NOT FREE MONEY

Remind people that the low interest rates on student loans and overdrafts are not the same as most credit products; ***interest soon mounts up if you make minimum payments*** or don't pay borrowing off as quickly as you intended to. Always keep in mind the longer term cost not just month to month.

> *" Pay back or pay big"*

Male, 32, children, Cushioned, Leeds

Theme 3 – ‘Manage and review credit use to your advantage’

Start off well

- Managing credit is a skill. Encourage 18-24 year olds to ***start ‘slow and steady’*** and learn how to successfully manage a limited number of products

Use it to your advantage

- Inspiring them to consider how credit can be good i.e. helps build credit rating. Encourage consumers to ***understand the benefits and use them to their advantage, for now and for the future***

Be proactive, stay in control

- Promoting and normalising reviewing behaviour – i.e. reducing credit limits, questioning need pre-purchase
- Highlighting how often credit use and debt can spiral
- ***Encouraging good credit behaviours*** – i.e. paying off more than the minimum, consolidating, setting up payment logs, saving whenever possible so credit isn’t the only option

“Having good credit can ensure you will have a helping hand to pay for things in the future, such as a mortgage”

Male, 29,no children, Squeezed, London

“Credit lenders seem to like people who have a good history so it makes sense to start building this history as soon as possible, but in a way that is affordable”

Male, 27, no children, Squeezed, Northern Ireland

Any Rule of Thumb will most likely focus on only one area and reducing use is the priority

	Positives	Implications
Reduce your use	• Identified as priority theme by the Struggling and Squeezed segments – particularly for the Squeezed segment • Ability to target everyone – in particular those most in need	• Positioning will be important – must be specific, practical and empowering, not theoretical and condescending • Some question if reducing use is unrealistic • Consumers will still use credit, so it must prompt them to pause and think before taking out or spending credit
Select the right product	• Clearer actions for people to take – more suited to a Rule of Thumb • Acknowledges that some people will use credit even when encouraged to reduce their use	• Not identified as a key area of focus by segments – cannot assume that people have the knowledge and skills to select without further help
Manage and review your use	• More easily action focused so works as a RoT • Identified as a priority theme by the Cushioned segment and some Squeezed	• Would provide some benefit to only a minority, mainly those not in most need • Cannot assume people have the knowledge and skills to use effectively without further help

‘Reducing your use’ is the most popular action for a Rule of Thumb

- We asked the forum participants which area to prioritise and over half voted for ‘Reducing your use’ – this was particularly popular from the Struggling and Squeezed segments
- We also asked the co-development workshop to vote for one of the three areas of action, again ‘Reducing your use’ was the most popular though they did not agree on any individual rules of thumb
- Drawing on the forum results and their own expertise, the co-development workshop recommended a rule of thumb to encourage budgeting or taking control of your finances, while budgeting is important to know if you can afford credit, this is already covered by another rule of thumb in development

‘Dragon’s Den’ 18 to 24 year old panel reactions

- A panel of 4 18 to 24 year olds were presented with potential rules of thumb, developed by the project team and based on the views of the co-development workshop
- The panel suggested using messages that credit can be managed without being scary, to start slowly and build confidence and that using credit well now will give you freedom later on (and to use some humour)
- They emphasised that any rule of thumb must be use positive language and feel easy to do with out needing much background knowledge
- The had mixed reactions to potential rules of thumb in the following areas of action:
  - Reducing use - seen as obvious or daunting and would need support to do it
  - Select the right product – might be onerous and need support (checklist etc) to do it
  - Manage and review your use – should be done but probably won’t

Summary and conclusions

- It is not straightforward to cover all aspects of successfully managing credit in a single rule of thumb, a rule for 1 aspect should be selected and considered for use alongside additional tips and guidance
- Reducing use of credit is the most popular area of action for a rule of thumb, but it needs careful framing to work as a rule of thumb: to be specific, positive and empowering, but not obvious or daunting
- A rule of thumb to reduce use may work by prompting the individual to pause and think about the need or affordability
- These forum suggestions should be considered for further development:
  - *Before taking out credit think about the length of the credit term and only sign up to a repayment amount you can consistently afford, even if you are having a bad month*
  - *If you wouldn't buy it with cash, don't buy it with credit*
  - *If you wouldn't tell your parents about what you are using the credit for you probably shouldn't be getting it*
- To be effective, the rule of thumb will need to be supported by close collaboration between MAS and partners to support successful adoption by young adults