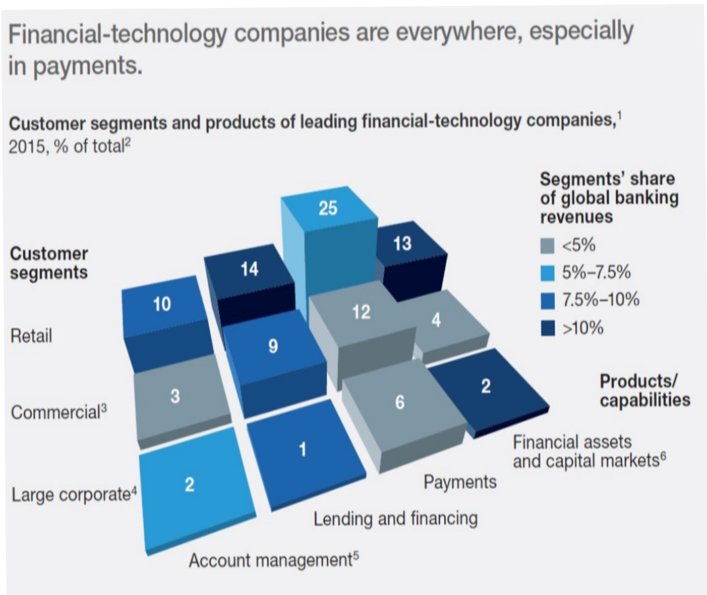
ECRI NEWS

Understanding Credit Markets for Europe

BIG CHANGES AHEAD FOR RETAIL FINANCIAL SERVICES

Editorial by Sylvain Bouyon, CEPS Research Fellow, Head of the European Credit Research Institute

As revealed by several studies (notably by McKinsey in 2015), products of leading financial-technology companies primarily focus on the retail segments of financial organisations, especially payments and household lending. In that context, ECRI is placing much emphasis on the apparent technological breakthrough in retail financial services, by organising specific events and conducting consistent research.



Source: McKinsey & Company (2015)

First of all, CEPS-ECRI is leading a study commissioned by the European Commission on "digitalisation, retail financial services and single market", with two organisations specialised in the analysis of financial innovations: the University College Cork and the Luxembourg Institute of Science and Technology. Specific interviews and focus groups are conducted with market players in order to better appreciate the potential technological developments in the forthcoming years and how they could contribute to the reinforcement of the single market for retail financial services.

In parallel, CEPS-ECRI organised in cooperation with Visa a successful conference on "How strong should customer authentication be?". While a new regulatory framework is emerging at European level, regulators, consumer protection associations and businesses gathered on 10 February to discuss how a new balance between security and risks could be determined, and how to ensure that the new rules remain consistent for all payment providers and users.

On the non-technological agenda of retail financial services, CEPS-ECRI organised on 26 January a large conference on "Over-indebtedness of European households: myths and realities". Admittedly, household over-indebtedness is tending to decrease as a consequence of the current gradual recovery; however, the levels remain relatively high, especially in peripheral economies of the euro area, and might result in some persistent impediments to future economic growth.

In addition, beyond the typical economic impact, persistent financial difficulties are also likely to have social consequences, notably by heightening social stratification. Against this background, the main objective of the conference was to emphasise the need for "shared responsibility" between regulators, lenders and consumers, to understand and curb the phenomenon of over-indebtedness. Therefore, the conference placed the focus on the main drivers behind over-indebtedness, the main effects on borrowers and lenders, and some innovative tools to tackle and/or prevent over-indebtedness.

The discussions on the drivers highlighted the key impact of income shocks and life change events on the development of over-indebtedness. The role of lending practices was also questioned somewhat. The session on the effects of over-indebtedness adopted a multidisciplinary approach and covered the macroeconomic and social impact, as well as the effect in terms of financial inclusion, informal debts and mental health. Finally, the discussions on the tools to curb the phenomenon resulted in several suggestions: policies to reduce the non-take-up of social benefits, improvement in debt advice systems across Europe and increasing use of data in order to prevent over-indebtedness (It is worth mentioning that some elements of this last dimension overlap somewhat with the technological agenda).

The main purpose of the present Newsletter is to present different points discussed during the conference on over-indebtedness.

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OBSERVATIONS ON "OVER-INDEBTEDNESS OF EUROPEAN HOUSEHOLDS: MYTHS AND REALITIES"

By David Rees, Chairman, Law Committee, Consumer Credit Association

The recent CEPS-ECRI Conference on debt highlighted some new policy analysis points.

Most striking, perhaps, was the emphasis on financial shock. A number of speakers (on both sides of the debate) implicated such shocks as a main cause of debt problems. Unexpected life events mainly cause these shocks. Events include job loss, divorce, accidents and sickness. They can hit any person or household at any time.

Shocks cause income to collapse, quickly disrupting even the most organised household budgets.

It is pretty well impossible to predict these events. But when they occur, they can – at a stroke – make affordable credit unaffordable. All the calculations the firm (and the customer) made when the credit was taken out cease to apply.

In the past, critics would sometimes infer that every debt problem could be traced back to poor lending practice. This is evidently not the case. Indeed, the CEPS-ECRI event data suggested the opposite was true and that, overwhelmingly, unexpected life events seem to cause most debt problems.

This all underscores that some types of policy response are unlikely to have much effect. Based on the data, it seems likely that consumers derive greater benefits from systems that seek to resolve debt problems than from initiatives that try to prevent problems from occurring in the first place.

Appropriately, the CEPS-ECRI event looked at some of the existing debt resolution systems, including the Bank of France's Commission de Surendettement scheme, the German CAWIN debt-counselling software system and the Dutch Vroeg Europaf initiative in Amsterdam.

There are many more of these schemes throughout the EU. Some focus on high throughput, high efficiency, ultra-low cost-per-case. Others have concluded that, for some consumers, an intensive face-to-face service is much more beneficial. Some of the ideas that have been considered (including the possibility of online, automated psychiatric counselling) are truly extraordinary.

Of note is the growing recognition that lenders and debt advisers must trust and cooperate with each other so as to produce the greatest benefits for consumers.

It is perhaps worth reflecting that these debt resolution systems have emerged as local solutions to local problems. This might therefore be seen as subsidiarity at work, producing optimal outcomes for consumers.

On a slightly different note, the CEPS-ECRI event considered informal lending and the positives and negatives of these systems. One important point, not part of the presentations, is the de facto blurring between 'informal' lending and illegal lending.

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ECRI PUBLICATIONS

Relaunching the European Retail Finance Market: Comments on the Commission's Green Paper

Sylvain Bouyon and Karel Lannoo, 15 December 2015

https://www.ceps.eu/publications/relaunching-european-retail-finance-market-comments-commissions-green-paper

Household Final Consumption in the EU: The key driver for a sustainable recovery?

Sylvain Bouyon, 4 December 2015

https://www.ceps.eu/publications/household-final-consumption-eu-key-driver-sustainable-recovery

What drives household consumption in the EU-28?

Sylvain Bouyon, 4 December 2015

https://www.ceps.eu/publications/what-drives-household-consumption-eu-28

A Convergence Process in Household Credit in Central and Eastern Europe

Robin Sainsot, 30 October 2015

https://www.ceps.eu/publications/convergence-process-household-credit-central-and-eastern-europe

ECRI STATISTICAL PACKAGE 2015

For the first time, detailed data on several "emerging economies"

WHAT IS THE ECRI STATISTICAL PACKAGE?

Since 2003, the European Credit Research Institute (ECRI) has published a highly authoritative, widely cited and complete set of statistics on consumer credit in Europe. This valuable research tool allows users to make meaningful comparisons between all 28 EU member states as well as with a number of selected non-EU countries, including the US and Canada.

WHAT IS COVERED?

Two Statistical Packages are on offer. The more comprehensive product "Lending to Households (1995-2014)" contains valuable data on consumer credit, housing loans, other loans, total household loans, loans to non-financial corporations as well as total credit to the non-financial business and household sector. The 'standard' "Consumer Credit in Europe (1995-2014)" exclusively covers consumer credit data.

The 2 Packages in Fact & Figures:

• 40 Countries: EU 28, Turkey, Rep. of Macedonia, Iceland, Norway, Switzerland, Liechtenstein, Australia, Canada, Japan, the United States, India and Russia.

• 20 years data series: 1995-2014

• National accounts: GDP, final consumption expenditure and gross disposable income of households, inflation and exchange rates.

• 150 (67) tables: present time series data in nominal and real terms, and per capita, as well as breakdowns by lender, type, currency and maturity are also available for selected countries.

• 27 (13) figures: highlight credit trends in a way that allows user to make meaningful comparisons of the retail credit markets across countries.

FACTSCHEETS

The European Credit Research Institute (ECRI) provides indepth analysis and insight into the structure, evolution and regulation of retail financial services markets in Europe. Through its research activities, publications and conferences, ECRI keeps its members and the wider public up-to-date on a variety of topics, such as retail financial services, credit reporting and consumer protection at the European level.

ECRI is an independent, non-profit research institute whose interdisciplinary team of researchers and academic cooperation partners has developed a specialised body of knowledge on retail financial markets. It was founded in 1999 by a consortium of European banking and financial institutions. ECRI's operations and staff are managed by the Centre for European Policy Studies (CEPS) in Brussels.

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ADDRESSING HOUSEHOLD OVER-INDEBTEDNESS: FINDING COMMON GROUND

By Hans Dubois, Research Manager Eurofound

Over-indebted persons, creditors and governments have different views on what, if anything, should be done at the EU level to address over-indebtedness beyond the important preventive measures already in place (Consumer Credit and Mortgage Directives). There may be some common ground for action, though. Here, two examples are presented which are worth exploring.

1) Addressing the non-take-up of social benefits

FAWOS, a Vienna-based organisation, receives referrals from the courts of households at risk of eviction. Vroeg Eropaf, an Amsterdam-based organisation, receives referrals from utility companies, tax authorities, healthcare insurers and social housing associations when people run into payment problems. Both FAWOS and Vroeg Eropaf report that they quickly resolve the situation of approximately 40% of their clients. How? Simply by helping them to claim the social benefits they are legally entitled.

Recent research by Eurofound shows that these two examples are no exceptions. Macro-level estimates show that many people across the EU do not receive the social benefits they are entitled to, often because people do not know the benefit exists or that they are entitled to it, or do not find their way through complex application procedures.

At first sight it may seem good for governments that people do not claim the benefits they are entitled to, as it saves public expenditure. However, governments implement these benefits with specific aims, such as addressing (child) poverty, preventing greater long-run public costs by enabling people to access basic services and goods and by stimulating social inclusion, activating people economically, or contributing to automatic stabilisation of the economy. These aims are not reached if people do not receive benefits they are entitled to.

The EU may not be in a position to set social benefits, but it may be able to hold Member States accountable for running efficient and effective benefit systems designed by the Member States themselves. This would contribute to preventing defaults, disconnections, evictions and over-indebtedness. It also prevents greater costs to society in the longer run, including loss of production and public service provision to address long-term impacts of non-take-up and over-indebtedness. Supporting European citizens in exercising the rights established by their governments further prevents costs which in the short run are 'non-monetary': reduced quality of life, trust in governments and financial institutions, and social cohesion.

2) Improving consumer insolvency laws

When going through an insolvency procedure, whether in or out of court, people with debt problems usually need to hand over all income above a certain minimum to creditors during a set period. As a consequence, during this procedure they have little financial incentive to earn more income. Sometimes there are incentives in terms of shorter insolvency periods (Austria, Germany), but they usually only kick-in after a number of years, and the benefit of increasing income is rather limited and felt by the debtor with a delay.

Such lack of incentives to maximise income is bad for debtors, creditors and governments alike. Debtors not only have little chance of increased living standards in the short run, their access to future jobs is also reduced if they are not incentivised to advance in their job search or careers. Creditors are harmed because they miss-out on potentially higher repayments, and governments lose-out owing to decreased loss of productive capacity and the negative consequences of a poor quality of life for its citizens.

Second, it has already been recognised across the EU that insolvency procedures should be available and accessible. Several countries have reduced the length of these procedures, which is one (among many) important dimension of accessibility. For example, Ireland reduced the number of years from 12 to three (in December 2013) and Germany from six to five, or even three if the cost of proceedings and 35% of creditor claims have been covered (July 2014).

However, procedures should also not be too speedy, as that may trigger adverse incentives. For example, as it may increase the likelihood of default, creditors could charge higher risk premiums, making loans unaffordable for people who may depend on them for investing in their future. There is an EU dimension to this. An example can be found in the UK, where people from other Member States have relocated to use its one-year bankruptcy procedure. Free movement of people allows for relocation to other EU Member States and make use of their bankruptcy laws. EU insolvency regulation subsequently guarantees that debtors availing of bankruptcy in one Member State gain the same protection against creditors in other Member States.

In short, the EU could contribute by setting certain standards for insolvency procedures, for example in terms of minimum and maximum durations, and requiring built-in incentives for debtors to maximise their incomes.

These two examples leave many problems unaddressed. For example, if people are subject to an insolvency procedure, they may still be ‘remembered’ in registries, leading to lasting financial exclusion. They may even be left with debts, including informal ones. From the creditor’s point of view, many of the repayments may further be absorbed by the cost of administrative procedures rather than by repayments. And with regard toaddressing non-take-up of social benefits, the procedure does not address challenges of sustainable public finances and of finding longer-term solutions, for example by making it easier for people to find well-paying jobs. However, these may be two more steps in the direction of addressing the complex, heterogeneous problem of over-indebtedness.

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EARLY DETECTION OF LATE PAYMENT - PROBLEMS IN AMSTERDAM: VROEG EROPAF

By Jan Siebols, Project Manager, Vroeg Eropaf Amsterdam

In the Netherlands, the debt-solution chain consisted for years of two main approaches: preventive activities and problem-solving activities. Nibud (National Institute for Family Finance Information) is an independent foundation that is very active in preventive activities and information.

The municipalities are in charge of problem-solving activities, which have two possible paths: the cordial way and the legal way. The city of Amsterdam has created a programme between debt prevention and resolution: an early-detection project for financial difficulties called Vroeg Eropaf.

Why Vroeg Eropaf?

More than 50% of the people in financial distress do not seek help in time. They optimistically think that they can manage the problems themselves. Another reason can be that they are uninformed about their debt-advice options. They may also be too ashamed (or too proud) to ask for help.

Debt advisors often ask their clients, “Why did you wait so long to come see us?”

They also often say, “Only when the client comes spontaneously to us is he sufficiently motivated.” Which is an outdated attitude!

For a long time, creditors and debt advisors did not work together constructively. In the last decade, however, we saw a changing attitude, towards a more social approach, exemplified by Amsterdam’s housing corporation’s management of their 200,000 rental houses across the city.

In 2006, some Amsterdam debt-advice organisations started small-format collaborations with local housing corporations which would informed the debt advisors of the most serious defaulters in rent-paying. If a person was not already known as having a debtproblem, the debt advise organisation visited him at home within a few days’ time.

An evaluation proved that this approach was profitable for both debtor and creditor. Therefore, in 2008, the city of Amsterdam launched Vroeg Eropaf, a large-scale late payment and early warning project, based on early detection and pre-emptive outreach.

Demanding

Vroeg Eropaf is rather demanding on all of its players. The debt-advice organisations must make first contact within a few days, form a complete analysis of the financial problem, and create an appropriate action plan within four weeks. The creditors must then accept the subsequent payment proposals.

The payment from the city of Amsterdam for the work of the debt-advice organisation is based on “no cure, no pay”. In practice, this means that no personal contact means no benefits, despite the provided efforts. This can force the advisors to visit the debtors at inconvenient times, including in the evening or during the weekend.

Conditions

The information from the housing corporations is highly private. That is why this information goes directly from the creditor to the debt-advice organisation (and not to the municipality).

Creditors and debt advisors are not natural allies, so they have to work towards building a good relationship. Establishing this trust can take some time, but the effort is well worth the result.

Results

In 2015, Vroeg Eropaf received 3,000 signals from the Amsterdam housing corporations, 2,000 from energy providers and 4,300 from health insurance companies.

Approximately 70% of the people visited under Vroeg Eropaf had no prior contact with a debt advisor or a social worker, while 47% of the visited debtors needed long-term debt advice.

In 2014, a social cost-benefit analysis by the Ministry of Social Affairs declared that Vroeg Eropaf had a clear and strong positive rate of return: every euro invested in the project by the city of Amsterdam generated a profit of €2.22.

On 25 November 2015, all partners signed a new contract to continue Vroeg Eropaf till 2019.

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ARREARS AND DEBT MANAGEMENT:LOOKING FOR AN EFFICIENT METHOD!

By Olivier Jerusalmy, Chairman of EFIN (European Financial Inclusion Network) & Senior Research Analyst at Réseau Financité

Confronted with "client financial difficulties" management in their daily activities, stakeholders such as companies, credit providers, building societies, social services, debt advisers and public authorities should look for approaches leading to better results to manage these difficulties and to limit over-indebtedness of their clients. But do they?

Starting points: three findings

a) Over-indebtedness is hard to overcome and expensive: it's very costly for every stakeholder and Society[1]. Moreover, recovery is aleatory and relapses arenumerous.

b) Too much time is dedicated to interpersonal negotiation. This is so because of the lack of a general agreement between stakeholders on a method to assess the needed living costs (to the amount should guarantee an adequate standard of living) and the amounts to dedicate to creditors.

c) Over-indebtedness treatments differ and are partially inefficient when used in situations of poverty.

These three findings show that time is wasted instead of focussing on action.

Tracks for improvement: food for thoughts

1. The early detection of financial difficulties is a technique that identifies individuals who are prone to, but have yet to encounter, severe financial difficulties.

This approach allows for adequate adjustments in product design and use, marketing options and budget advice that impacts positively the client's budget management capacity. This approach reduces the risk of companies defaulting and is also an appropriate way of dealing with the reality faced by debt advisers all over Europe: when people seek support, their situation has already deteriorated, the remedy is long-term and recovery uncertain – a situation best prevented by detecting the danger before it happens.

2. A constructive approach for people in financial difficulty.

The idea is to explore methods that will notexacerbate an already weak financial situation via financial sanctions, extra costs or penalties when arrears occur. This constructive approach is appropriate for situations where clients are willing to pay their debts. However, their income is really restricted and their budget objectively unbalanced. The "treatment" includes advice, action and projects that positively impact the debtor's budget balance: How to increase income and limit unnecessary costly expenditures. It is mainly provided by professionals working for public authorities and/or non-for-profit organisations.

3. Some ideas to gain time...and money?

We like to improve the way negotiations take place between each debtor and his creditors. A method that assesses the portion of income dedicated to the household and the portion dedicated to creditors should be more easily, objectively, and fairly determined, which will save time in the negotiation period. To reach this objective, a common method elaborated by a balanced committee (with creditors, debtors, public authorities, NGOs representatives) should be developed. The tool should process the budget data of the debtor (rent, charges, ...) to fairly determines the amount required to the cover the irreducible expenditures of the households (to guarantee human dignity standard) and the remaining amount available for creditors.

4. Processing the personal information of debtors using a common method could be done by professional debt counsellors working for a non-profit institution.

This should be done in order to externalise the task for the creditor, which is relevant not only when a situation includes different creditors, but also for purposes of professionalism. Organisation on a non-profit base should reduce costs.

5. These non-profit organisations should cover their costs via a percentage calculated on recovered amounts of money: this is certainly a fair way to share costs among all beneficiaries.

While the above is not to be considered the all-encompassing solution, it does provide food for thought and suggests real potential for efficiency improvement

1 R. Alström, January 2015, "Over-indebtedness and effects on health – What are the costs to society?", a macro health-economical analysis, Faculty of Health and Society, University of Malmö, Sweden – Presentation available : http://www.ecri.eu/new/system/files/RA%20CEPS-ECRI%20Brussels%20jan%202016%20Ahlstr%C3%B6m.ppt

for every stakeholder who is open to exploring an innovative and pragmatic approach. To know more about experiences, practices, assessments, etc., we invite you to contact EFIN. Members will be willing to share their knowledge and experience.

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CAWIN – UNDERSTANDING INSOLVENCY USING DEBT ADVICE DATA

by Udo Reifner, Director of the Independent Institute for Financial Services (iff) and Visiting Professor at the University of Trento

The financial and social cost of over-indebtedness is immense. In 2014 approximately 115,000 Germans went bankrupt. First and foremost, this leads to the social disintegration of consumers' lives, frequently leading to social alienation as insolvency is still considered a personal failure. Furthermore, the credit system is inundated with circulating bad debt and the official welfare system replaces productive labour.

Thus preventing over-indebtedness becomes imperative. Since debt and over-indebtedness have little to do with each other we must learn more about products, services, incentives, suppliers and intermediaries as well as the social factors and consumer capabilities which cause such problems. To do so, we need solid and representative data. Surprisingly, official statistics confound debt or credit with over-indebtedness and are often of little help. However, data that is already being collected in the process of debt advice might be a solution. For Germany, the Institute for Financial Services (IFF) provides its CAWIN software – which boasts a 60% market share – to 500 of the 1,150 debt advice institutions. Furthermore, CAWIN is used in all 16 German states. Providing data on 70,000 bankruptcies each year, it is a unique source of data worldwide. Its database includes information on the causes of bankruptcy and the bankrupt person's training,education, occupational background and financial situation.

For the past 10 years iff, working with the coop bank foundation "Deutschland im Plus", has used such information to publish its annual over-indebtedness report. The report features data related to the 'Big Six': the six most important triggers of bankruptcy, whose ranking varies according to age group. For young people between the ages of 18 and 25, for example, unemployment is the major bankruptcy trigger, accounting for a third of all cases, followed by behaviour (14%) and income reduction (8%), divorce, illness, and failed business (between 2-3% each). This is quite different for other age brackets. Meanwhile, report data reveal that the true damage to the economy occurs during the 14-year duration of the time between default and removal from the bankruptcy files, during which economic activity is limited. The next steps will include to identify suppliers and products which are especially prone to over indebtedness taking into regard their specific target groups and client selection.

The software is particularly useful because it helps debt advisors properly prepare the legal procedure, organise their communication and represent their work to their employers. Data collection by highly skilled interviewers is virtually automatic during this process.

Empirical research on over-indebtedness will soon be further improved using CAWIN data. Firstly, the system is being upgraded so that it can be used in other languages, which is crucial to collecting standardised multinational data for research on national legislation on over-indebtedness. Secondly, merging CAWIN data with other existing data sets, e.g. the German Schufa database, helps identify the influence of individual factors more clearly.

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OVER-INDEBTEDNESS AND EFFECTS ON HEALTH AND WORKING ABILITY: WHAT ARE THE COSTS TO SOCIETY? A MICRO HEALTH-ECONOMICAL ANALYSIS

by Richard Ahlström, Faculty of Health and Society, University of Malmö

In the aftermath of the crisis of the 1990s many people in Sweden were caught in the debt trap. With indebtedness in the country increasing, the risk of over-indebtedness is also rising. Over-indebtedness causes major personal suffering and considerable costs to society. The longer an individual is in debt, the more difficult the path out of it. Measures aimed at preventing over-indebtedness and quickly rehabilitating heavily indebted individuals are therefore of great importance – from the perspective of both individuals and the national economy, as it inflicts not only great personal suffering, but also a great national financial cost.

In a new study funded by the Swedish National Audit Office (NAO), which is a governmental body, we noted that many of the long-time problems of the debt restructuring system still remained despite attempts to solve them. Increased indebtedness entails an increased risk of over-indebtedness, which in turn has major consequences both for the individual and for society. In the study we dealt with the following issue:

How much does over-indebtedness cost in terms of ill health and absence from the labour market?

There is a major lack of reference data for calculating the costs to society of over-indebtedness. Consequently, the Swedish National Audit Office (NAO) commissioned a report to the present author in order to obtain reference data and thereafter carry out a tentative calculation of the costs to society of over-indebtedness in the form of loss of production and costs within the social insurance systems and medical care services. This report was based on a recent cross-sectional health survey measuring mental and physical health in a target group of 725 heavily over-indebted Swedes (Ahlström & Edström, 2014). All participants were considered eligible for legal debt restructuring. Compared to the overall population of Sweden, the target group was found to be suffering from an attenuated level of ill-health, both mental and physical. Also, when considering specific medical diagnoses (e.g. clinical depression, diabetes and myocardial infarction) prevalent in the target group, a ninefold increase was reported when compared to the general population. Another striking aspect of illness in the target group is a pronounced pattern of comorbidity, i.e. illnesses existing simultaneously with, and usually independently of, another medical condition (in the same individual).

The calculation of the annual costs of over-indebtedness per person is a way of illustrating the degree of seriousness of the problem by measuring its cost to society. By using a commonly accepted health-economic device in Sweden called KKP (Swedish Association of Local Authorities and Regions) based on ICD-10, i.e. the tenth revision of the list published by the World Health Organization (WHO), we could estimate an annual cost per over-indebted person as follows: The cost of medical care is estimated to be €13,500, loss of production €62,000, and payments within the social insurance systems and unemployment insurance €16,000 – or a total of €91,500. This does not include the municipalities' costs for income support and any loss of tax revenue.

The differences are also due to the NAO's figures being based on actual differences in health status between the group of over-indebted individuals and the population as a whole. In summary, the NAO notes that the macroeconomic and fiscal costs of over-indebtedness – including loss of production, medical care and social insurance system costs – conservatively estimated, probably far exceed the costs of public measures to deal with the problem. However, more data and further research are necessary to provide a more comprehensive and robust picture of the costs of over-indebtedness.

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