ECRI Seminar

OVER-INDEBTEDNESS IN EUROPE: DEFINING MEASURES AND DESIGNING POLICY RESPONSES

Minutes

Monday, 15th September 2008, 8:45 – 12:00
Centre for European Policy Studies (CEPS) and European Credit Research Institute (ECRI)
1 Place du Congrès, 1000 Brussels

The provision of increasing amounts of new and innovative financial products as well as the expansion of access to credit and financial services is expected to prove beneficial to European consumers. However, the lack of financial education and literacy paired with insufficient information and advice may cause consumers to take unreasonable transaction decisions, potentially leading to financial difficulties and over-indebtedness. The European Commission is committed to identify the most appropriate and effective policy responses to the problem. Substantive analysis, however, is still hampered by the lack of a common operational definition of the phenomenon at the European level.

For that reason, the Commission issued the project "Towards a Common European Operational Definition of Over-Indebtedness" which was carried out the Centre for European Policy Studies (CEPS) together with the Personal Finance Research Centre (PFRC) and the European Savings Institute (OEE) as administrative leader. After the recent publication of the study, the forum is now open for discussion. At this half-day seminar, we will present insights from the survey and discuss with policy makers, industry officials and academics both the implications of building such a common understanding of over-indebtedness in Europe as well as the necessary policy actions to be taken in order to tackle the problem of over-indebtedness.

The study can be downloaded from: http://ec.europa.eu/employment_social/spsi/studies_en.htm

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The Chief Executive Officer of the Centre for European Policy Studies, **Karel Lannoo,** opened the event and welcomed all participants on behalf of CEPS and ECRI. **Mr Lannoo** introduced the contributing parties to the study "Towards a Common European Operational Definition of Over-Indebtedness" and outlined the importance of the topic in the light of the ongoing financial turmoil.

During the first panel, the report was presented by the drafting parties. **Marc Rothemund**, **Research Assistant at the European Credit Research Institute**, started off with an "Overview of Definitions and Measurements of Over-Indebtedness". According to the study, the existing definitions of over-indebtedness varied considerably among the surveyed 19 European countries,

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and also had different sources, ranging from governments, academics to consultancies. The concepts were typically rather broad and might include equally broad concepts, such as “standard of living”. The multi-dimensional nature of over-indebtedness complicated the search for statistics that could possibly serve as a measure that captures the wide scope of the phenomenon.

In general, several elements were common to the different existing concepts of over-indebtedness, including the household as the unit of measurement, some kind of contracted financial commitments, as well as references to a household’s payment capacity, a time dimension, the necessity of maintaining a certain standard of living and to illiquidity. **Mr Rothemund** pointed out that it was important to note that one single indicator for over-indebtedness might not be sufficient, as it may lead to wrong conclusions.

A look at various existing indicators on the national level showed that several hurdles were difficult to overcome, as the availability and coverage might greatly vary from one country to another. After the discussion of definitions, **Mr Rothemund** introduced the two main surveys at the European level which could potentially be used to help measure over-indebtedness: the Eurobarometer and the European Survey of Income and Living Standards (EU SILC). While the Eurobarometer primarily surveyed EU citizens’ attitude towards the European Institutions and the Common Market, the EU SILC was a annual panel survey with both factual and self-assessment questions, all related to social topics such as a household’s financial situation or unemployment. Moreover, a special once-off module on over-indebtedness and financial inclusion was introduced to the regular EU SILC survey in 2008, with the result expected to be available in 2009. The use of the EU SILC survey seemed to be more adequate for various reasons, among them the fact that the households can be tracked over time. In addition, a number of already existing questions covered a range of the previously introduced common elements of present definitions, such as questions on arrears on financial commitments, on a household’s payment capacity and liquidity. **Mr Rothemund** concluded by presenting the 5 indicators which the consortium proposed to be used to measure over-indebtedness: (a) comparably high payments on commitments that push the household below the poverty-threshold (defined as 60% of the median household disposable income), (b) structural arrears on at least one financial commitment, (c) perceived heavy burden of monthly payments on commitments, (d) payment capacity considered to be difficult and (e) inability to meet an unexpected expense.

Andrea Finney, Research Fellow at the Personal Finance Research Centre, addressed the issue of “Understanding and Tackling Over-indebtedness” with a presentation of findings from a study across 19 European countries. The statistics showed that in general households in northern European countries had less difficulty keeping up with their financial commitments, compared to the Eastern and Southern European countries, although there were exceptions to this. One important and often overlooked aspect of households’ over-indebtedness proved to be utility bills. The typical risk factors were: being young, having children, low income, changes in income and family circumstances, heavy credit use and poor budgeting skills; as such relating to the two primary routes into over-indebtedness: financial shocks and persistent low incomes.

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Ms Finney explained that the national recognition of the problem of over-indebted households varied across the EU countries: many of the northern and western European countries started debating about policy responses and building counseling networks following the 1990s recession, while some eastern European countries had only began recently to address the issue, if at all. **Ms Finney** concluded by discussing the six building blocks that the study set out to be essential for a comprehensive policy response. The first three aimed at preventing over-indebtedness: (a) responsible borrowing and money management, (b) responsible lending, (c) responsible arrears management; whereas the other three blocks sought to alleviate over-indebtedness: (d) debt advice, (e) holistic judicial processes and (f) non-judicial processes

In a brief discussion, **Rosa-Maria Gelpi, Vice-President of BNP Paribas Personal Finance,** stressed the importance of considering (variable) interest rates when speaking about income and expenditure shocks, because interest rates raises may have a great effect on the household budget. Responding to this comment, **Mr Lannoo** mentioned that over-indebtedness always depended on circumstances and therefore should be seen in a context of income, interest rates, housing prices, living expenditures, etc. **Javier Arias, Head of Representative Office to the EU from BBVA,** emphasized the importance of a proper credit risk assessment on the lender side, and the significance of the availability and sharing of data on a client's credit history in this context.

During the second session of the event, **Jennifer Robertson** from the **DG Internal Market & Services of the European Commission** discussed the importance of both responsible borrowing and lending and elaborated on policy responses by DG MARKT. In order to enable responsible borrowing behaviour on the consumer side, the client needed to be put into a position that allowed him to correctly determine whether he/she was able to afford the product. This evidently depended on the financial education of, as well as the information provided to the borrower.

Responsible lending is primarily based on the creditor's assessment of a potential client's creditworthiness, which in turn had both a prudential and a consumer protection perspective. Lenders, intermediaries or financial advisers could also give financial advice to borrowers. Amongst the policy actions by DG MARKT were an examination of the rules on the origination and (mis-)selling of mortgage credit, as well as a study on the costs and benefits of various policies options for mortgage credit. Furthermore, the European Commission has established an Expert Group on Credit Histories, in order to examine the barriers to the access to and exchange of credit data within the EU and to find solutions to overcome those obstacles.

The Commission has also published a Communication on financial education that set out principles for the provision of financial education including - amongst others - the following points: the promotion of financial education at all stages of life, integrating financial education to national curricula and ensuring it was targeted to consumer's specific needs. The Communication also announced a series of initiatives, such as the establishment of a European database for financial education.

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In the following presentation, **Antoine Saint-Denis** from **DG Employment & Social Polices of the European Commission** elaborated on the actions taken by DG EMPL regarding over-indebtedness in Europe. Fighting over-indebtedness implied fighting social exclusion, and the objective of social inclusion was part of the Lisbon agenda 2000 and the Social Policy Framework by the European Commission. More precisely, it was stated that (a) access for all to the resources, rights and services needed for participation was ensured, and (b) social inclusion policies involved all relevant actors and were mainstreamed into all relevant public policies, including economic, budgetary, education and training policies. The Social Policy Framework had an open method of coordination, where the member states agreed upon the common objectives and reported on their strategies to achieve those.

This was accompanied by several policies, inter alia a supporting programme for mutual learning among all actors. **Mr Saint-Denis** stressed the link between social and financial exclusion, where one can reinforce the other. Financial inclusion was affected by several dimensions, such as the problem of over-indebtedness, financial education and access to effective and affordable basic bank service. Regarding the follow-up of the study at hand, Mr Saint-Denis mentioned that the study would be submitted to the Social Protection Committee of EU SILC. Moreover, it would be included in assessing the above mentioned national strategies of social inclusion and also in mainstreaming the social objectives regarding over-indebtedness in EU policies.

In the final workshop discussion, **Ms Gelpi** mentioned the risk of the including lenders' advice into the concept of responsible lending, as advice given by lenders might induce consumers to seek less information and rely solely on the lender's judgment. Responding to this comment, **Ms Robertson** emphasized that there was not one precise definition of responsible lending, and lenders were not obliged to give advice. If advice was provided, the ultimate choice was evidently still to be left to the consumer. **Mr Arias** pointed at the difficulty to provide advice by the lender; given the variety of consumer finance products, it could be a very complex situation to provide a suitable recommendation to the borrower. Referring to a question on the long term objectives, **Ms Robertson** explained that the aim was to empower the consumer to take the right decisions one the one side, and to oblige lenders to assess the creditworthiness by all appropriate means. **Mr Saint-Denis** added the long-term objective to enable consumers to have access to new financial tools that may serve as positive support to their life. The workshop was concluded by **Mr Lannoo**, who thanked the participants for their contributions.

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