

# Stuck in the red

StepChange Debt Charity client stories of persistent overdraft debt



# Summary

Overdrafts are one of the most widely used credit products. The Financial Conduct Authority (FCA) found that nearly 13 million people in the UK have been overdrawn in the last 12 months.<sup>1</sup> Overdrafts are so commonly used that some people do not even see them as a debt.<sup>2</sup> They allow those with personal current accounts to go up to an agreed borrowing limit (arranged overdraft) or in some cases over this limit (unarranged overdraft).

Overdrafts are designed for short-term borrowing. However, people who are frequently overdrawn and regularly going over their overdraft limit can find themselves in a cycle of borrowing that is very difficult to escape from. Where overdraft balances swallow up monthly wages and other income this can leave little left over for essentials such as food. This means that month by month households that are struggling to manage can be pushed further into their overdraft to cover these household expenses. This cycle of borrowing, along with additional charges and interest, leads to the build-up of persistent unmanageable debt.

At StepChange Debt Charity, we see first-hand the impact persistent overdraft debt can have. Just under half (49.8%) of our clients have overdraft debt and they are the second most common type of debt we see (after credit cards). The average overdraft debt among these clients is £1,722.

Struggling with overdrafts and regularly having to use them is not just an issue for our clients, it is a widespread problem. Our analysis of FCA data found that around 2.1 million people were constantly overdrawn, going into their overdraft in every month of 2016.<sup>3</sup>

Our previous research found that 8.8 million people turned to credit to pay for their everyday household expenses in 2016.<sup>4</sup> Of those using credit for essentials, 2.8 million were using overdrafts.<sup>5</sup> In order to understand more about overdraft usage and how this can lead to persistent debt problems, we undertook research among our clients with overdraft debts. This client survey found significant issues related to regular overdraft use, including:

## Using overdrafts to pay for essentials:

The vast majority (79%) of clients told us about having to use their overdraft to cover the costs of everyday essentials including paying for basics such as food, utility bills, housing costs and transport. For many clients, this was a reality of living life on a persistently low income. These circumstances and reliance on overdrafts often resulted from an income shock, such as losing their job, or a change in circumstances such as a long-term illness, divorce or separation. The regular use of credit such as an overdraft to pay for essentials and cover shortfalls in household budgets can lead to a cycle of borrowing and the build-up of persistent, problem debt.<sup>6</sup>

## A vicious cycle: the struggle to get out of the red

Many clients described a vicious cycle, where the money that went into their account from their wages and other income was immediately reduced to repay their overdraft and associated interest and charges. Then in order to cover their household bills and other essential expenses for the month

they were tipped back into overdraft. When they were next paid the whole cycle would repeat itself, pushing them further into the red and leading to the build-up of persistent debt. Facing regular bank charges, in particular the high costs of unarranged overdrafts also exacerbated these financial problems. Some clients were also turning to other credit products to cover their overdraft and juggling multiple financial commitments. Many clients described the negative impact of struggling with overdraft debt not just on their finances but also on their mental health and well-being.

## Banks' interaction with customers in persistent overdraft debt

There were issues raised by our clients around their initial interaction with their bank about their overdraft. Some described being given large overdraft limits in comparison to their income level, and this made it very difficult for them to repay once they got stuck in overdraft. This suggests there can be issues with unaffordable lending in the overdraft market.

Those clients who engaged with, or were approached by their bank when they were struggling had mixed experiences. The most common experience was that the banks were not helpful: clients described how they were not offered a suitable solution or interest and charges continuing to be added to their debt. Nonetheless some clients did have positive experiences with their bank as they were offered a range of options to help them out of their financial difficulties. These included a freezing of interest and charges, giving them an affordable way to repay their debt and signposting to free debt advice where appropriate. This indicates there is good practice in the industry that could be built on.

### Research methods

We conducted a mainly qualitative survey of StepChange Debt Charity clients who had overdraft debts to understand more about their overdraft usage when getting into financial difficulties and what they were using their overdraft for. The survey also explored why regular use of overdrafts can lead to persistent debt problems and what experiences our clients had with their bank when they started to struggle with their overdraft. We had 465 respondents to the survey in June 2017.

We also reviewed the data on overdraft use from the CMA retail banking market investigation and from the FCA review of high cost credit and overdrafts. We undertook some analysis of the FCA data to establish an estimate of the number of people regularly using overdrafts.

# Key recommendations

The nature and extent of persistent overdraft debt means that action needs to be taken by both the FCA and the banks themselves to remedy the problems it can cause. The FCA have acknowledged this and are planning to consult on proposals concerning overdrafts in Spring 2018.

In light of the evidence detailed in this briefing, our key recommendations for action to tackle persistent overdraft debt focus on three main areas:

## 1. Affordable lending:

- The FCA should investigate unaffordable lending in the overdraft market as part of their consultation on overdrafts.
- Ahead of this, action should be taken to provide a clear definition of a reasonable period for repaying overdraft lending to prevent unsustainable balances.

## 2. Unarranged overdrafts:

- The banks should stop (and where appropriate refund) unarranged overdraft charges where a consumer is identified as being in persistent overdraft debt, broader financial difficulties or in a vulnerable situation that the charges may make worse.
- The banks (that have not done so) should review their overdraft charges, remove additional charges for unarranged overdrafts and ensure their charging structures are clear and transparent for consumers.
- If there is no significant change by the conclusion of the FCA consultation then the FCA should take action and abolish outdated and costly unarranged overdraft charges.

## 3. Tackling persistent arranged overdraft debt:

- The banks should work with the FCA to find triggers and more proactively identify customers who are in or at risk of persistent overdraft debt.
- When a consumer is identified as struggling, the bank should offer them support that could include helping them reduce their overdraft balance by reducing or freezing interest and charges.
- It should also include separating the overdraft debt from transactional banking facilities by offering those in persistent overdraft debt a basic bank account and an affordable way to repay their debt separately.

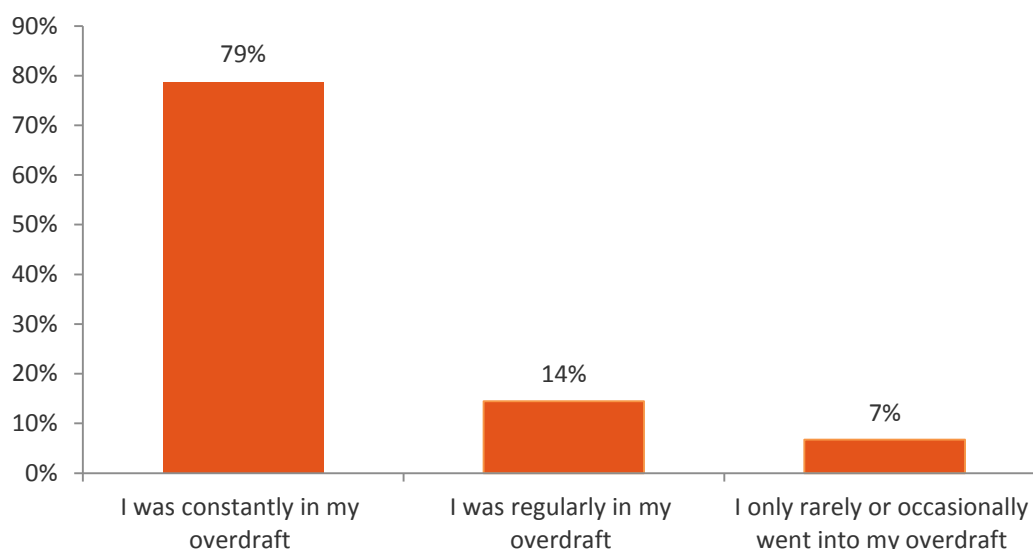
# Stuck in the red: use of overdraft

There is a large section of the UK population who use their overdrafts. The FCA Financial Lives survey found that a quarter of UK adults, 12.9 million individuals, have been overdrawn in the past year.<sup>7</sup>

There are also some who are frequently, almost constantly, in the red. Separate data analysis by the FCA found that 5% of individuals with a current account were overdrawn every month of 2016.<sup>8</sup> Based on this, we estimated 2.1 million people were constantly in their overdraft in 2016.<sup>9</sup>

Regular and particularly constant use of overdrafts is likely to lead to the build-up of persistent overdraft debt and can lead to financial difficulties. Over three quarters (79%) of clients in the survey were constantly in their overdrafts in the 12 months before they come to StepChange for debt advice. This echoes our previous research findings from 2016 that our clients with overdraft debt were on average in their arranged overdraft in 11 out of the previous 12 months.<sup>10</sup>

**In the 12 months before you came to StepChange for debt advice, how would you describe your use of your overdraft on your main bank account?**

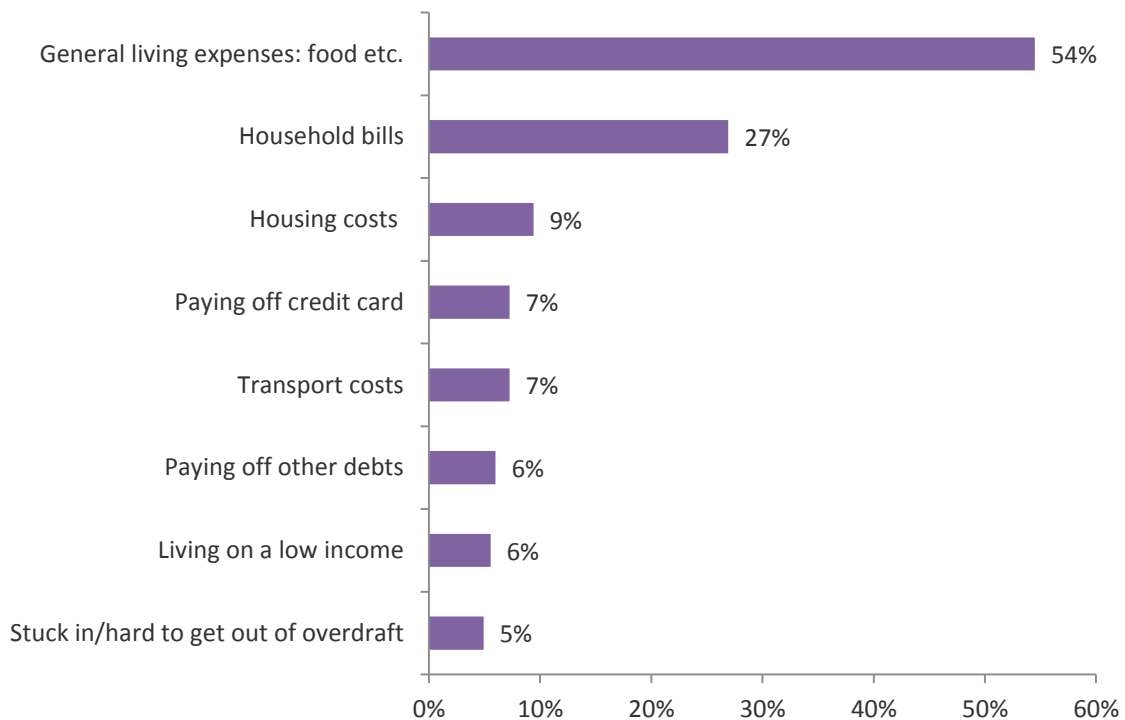


## Why some households are regularly turning to their overdraft to get by:

Households that are struggling to manage will turn to credit products like overdrafts to cover the costs of everyday essentials, for example, to get their washing machine fixed or even to just put food on the table. Our previous research found an estimated 8.8 million people turned to credit to pay for their everyday household expenses in 2016.<sup>11</sup> Of these, 2.8 million were using overdrafts to get by.<sup>12</sup>

In our client survey, the vast majority described having to use their overdraft for everyday essentials such as food, to cover household bills, housing costs and transport costs. In particular, over half (54%) of all those that responded mentioned having to use their overdraft for food and other general living costs and nearly a third (27%) said they used it cover household bills.

Please describe the reasons why you had to go into your overdraft?<sup>13</sup>



This suggests that regular overdraft users are likely to be using their overdraft facility to cover a shortfall in their household finances. These are examples where clients described using their overdraft for:

*Food, fuel to get to work, activities with children*

*Apart from regular food and energy, I had to extend my overdraft to cover bill payments.*

*To pay for just the basic necessities like food, and bills, rent, etc.*

*General day to day expenses when money ran out. Usually after a large unexpected bill*

## 'Robbing Peter to pay Paul'

Some clients were also juggling their overdraft with various other credit products. Another reason our clients gave for using their overdraft was to pay off other credit commitments (6%), in particular credit cards (7%):

*Was using it (overdraft) to pay the minimum balance on my credit cards.*

*Paying for my monthly outgoings as was always in it - payday loans took up the most of it*

*I kept topping my overdraft up to pay my credit cards, if I had been turned down I think I would have asked for help much earlier*

*I used my overdraft to keep up minimum payments for a short while, not realising the implications of my increasing debt*

Other clients borrowed from other sources of credit to try and manage their overdraft:

*At the worst period I always kept my overdraft within the limit, but I used other credit facilities to do this, I was always playing catch up, playing for time.*

*For a long time I did the 'Borrow off Peter to pay Paul'.*

*Once in pattern of using overdraft I could not get out so began using small loans to cover me like an overdraft extension*

*They dropped the limit and gave me 1mth to pay it I had to borrow money to pay it back*

*To avoid going into the overdraft limit, I would then have to take out money from credit cards to try to clear overdraft debt but it becomes a spiral with a no end situation.*

*I was always near my overdraft limit therefore sought other finance options to fund every living expenses and unforeseen costs. This caused my debt to spiral out of control as I was paying off debt with debt.*

*I borrowed to clear the overdraft on multiple occasions, but found I couldn't reduce my overdraft limit so easily.*

Overdrafts are often not used in isolation, as these quotes suggest. The juggling of overdrafts with other credit products to manage financial difficulties can mask the problem and lead to spiralling, unmanageable levels of debt. This reiterates the importance of lenders undertaking thorough affordability assessments to ensure the potential borrower is not already over-burdened and can afford to repay any new credit commitments (see section below on unaffordable overdraft lending).

## Living on a low income:

For many, being on a low income and struggling with the high cost of living were major reasons why they had to use overdrafts to cover everyday household costs. Families on tight budgets can find they have to make the difficult choice between going further into their overdraft and facing the associated costs, or going without essentials. Then once they are significantly in their overdraft, their low income can mean it is very difficult to get out.

Clients told us about how their low income impacted on their overdraft use:

*All my salary paid for my outgoings. My overdraft was what I used to live on. Once I had gone into it, it was hard to get out!*

*High rent, cost of food for my wife and son, sometimes no food for me... I was in a position in 2008, of being 3 pay checks away from being homeless*

*To live! I used it for living expenses - bills, food, travel costs, everything really. Once you're into your overdraft and on a relatively low wage it's really hard to get out of it unless you get a lump sum of money to clear it and start again.*

*Over 80% of my income was used for bills*

Those on low wages can find that they regularly do not have any of their earnings left to cover their basic living essentials at the end of the month. Therefore they have to regularly use their overdraft to cover these costs:

*I would go into my overdraft 4 days before getting paid and would need it often for diesel or food shopping*

*My overdraft limit was the same as my salary so whenever I got paid it just paid my overdraft*

*You were always getting paid then going straight into your overdraft. It was disheartening*

*Those on low incomes can also face 'expenses shocks' where they struggle to pay for larger essential purchases or unexpected costs. Examples of those on low incomes describing why having to use their overdraft for one-off costs were:*

*Low salary, expensive living cost and unexpected bills e.g car, vets etc.*

*When you live on a very tight budget every little thing that goes wrong tips you into overdraft.*

*A combination of unexpected bills which then I couldn't seem to put the money back*

## Growing reliance on overdraft:

Others described their journey into having to rely on their overdraft to cover essentials. This included 'income shocks' and changes in circumstances that can significantly undermine a household's finances such as job loss or relationship breakdown. Some clients had to use their overdraft due to their changing employment status, either they had lost their job, were in insecure/temporary employment, or had a reduction or interruption in income:

*I went into my overdraft after my change of job made my living expenses go beyond my means.*

*I was in temporary insecure work and needed extra money.*

*I was made redundant and didn't get any compensation and found it very hard to get a job*

*I am unemployed and am always in my overdraft,*

*Because my partner had no work we had to pay the bills*

*I was a student and work a zero hour contract.*

### **Case study: 51 year old man living in the South East:**

A StepChange client based in a town in the South East of England took on several months' part-time lecturing work in the South West. The high cost of commuting there led to the client becoming heavily overdrawn and getting into considerable credit card debt. The client was glad for the work and the experience but described this as a 'financial disaster' for them.



**Case study: 25 year old woman living in Yorkshire and the Humber:**

A StepChange client initially got an interest-free overdraft as a student. But when she graduated she was on Jobseekers Allowance for a year and found it hard to pay off her overdraft as it became a normal interest-bearing overdraft. Then when she did get a job, she still struggled to get out of her overdraft and couldn't keep up with monthly payments. She then lost that job and was at her overdraft limit of £1600. By the time she contacted StepChange it had gone up to £2100 due to bank charges and she was regularly being contacted by a debt collector.

Other clients had to rely on their overdraft after they had a change in circumstances due to physical or mental health problems or disability:

*I was off sick from work for over 6 months and the overdraft allowed payment of bills and living expenses.*

*I was off work sick and had to pay for therapies a while back, and also transport to stay with friends to recuperate.*

*In my case I was unable to work due to health issues, the overdraft took the place of my wage to pay direct debits.*

*Just for everyday living expenses...my husband is disabled and my income dropped off.*

**Case study: 41 year old man living in London:**

A StepChange client had an interest-free overdraft with his student account. After he graduated he became ill, was hospitalised for mental health issues and became homeless. He then was on benefits for over four years and was not able to get out of his overdraft from month to month and was regularly using his overdraft to cover daily living costs.

For others it was a different change in circumstances and they had to regularly use their overdraft after a relationship breakdown:

*Separated from my husband and left to pay everything*

*For daily living, due to divorce*

*My divorce costs, food, general... as a single parent.*

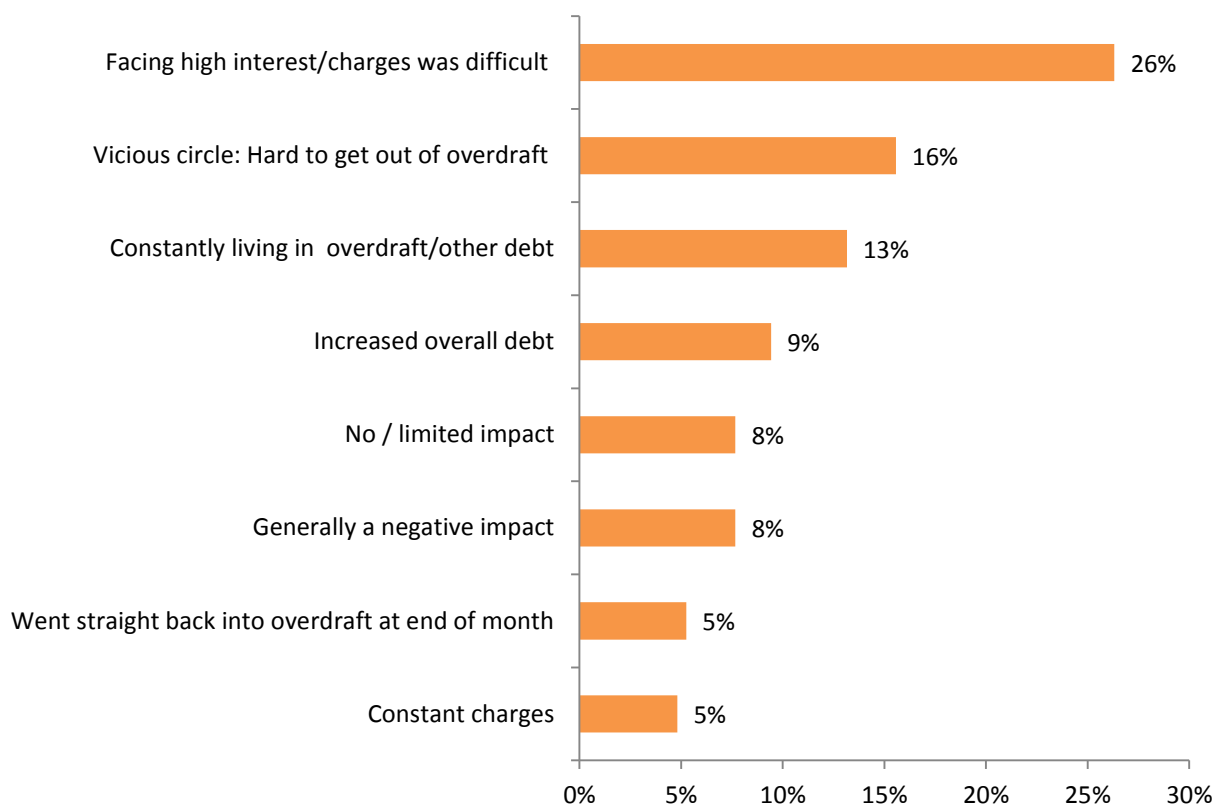
Therefore income shocks or life events such as job loss, relationship breakdown and health problems can all lead to tighter household budgets and in some cases higher outgoings. Those without sufficient savings, welfare or family safety nets to turn to then have to rely on available credit, including overdrafts, to keep up with everyday living costs and essential one-offs. This can then build up from short-term borrowing and quickly turn into longer-term persistent debt problems.

## The impact of the build-up of overdraft debt

Regularly having to go overdrawn or over an overdraft limit can lead to and exacerbate financial difficulties for many financially vulnerable households. These households can struggle to get out of their overdraft as fees and interest on arranged overdrafts can build up over a long period of time making it increasingly difficult to get out of the red. They are also more likely to be at the edge of their overdraft limit and if they go over they face the more substantial charges typical of unarranged borrowing that push them into further difficulties.

We asked clients what impact the build-up of overdraft debt had on their financial problems to explore how overdrafts can lead to and accelerate financial difficulties.

**Please describe how the build-up of your overdraft debt had an impact on your financial problems?<sup>14</sup>**



### Facing bank charges made financial problems worse

Bank charges and additional interest was the most common response to describe how overdraft debt impacted on our clients' financial problems. Over a quarter (26%) described how facing high interest and charges was difficult with some 5% saying they were constantly charged. Clients facing regular, in some cases constant, overdraft charges found that as they built up, they exacerbated their financial difficulties.

*As my financial situation got worse, the charges that were applied each month would constantly sting me even more.*

### *Charges each month crippled me*

*Constantly being charged to be in my agreed overdraft by the bank meant I was losing money every month and then further going into my overdraft more and more to assist my parents so they don't lose their home (and my home in the meantime)*

*Charges are too high and constant unwillingness of banks to drop fees to stop as income isn't great*

## Unarranged overdraft charges

Significant numbers of people face these charges each year. The FCA found that 3.1 million people in the UK have gone into unarranged overdraft in the last 12 months.<sup>15</sup> Being charged for being in unarranged overdraft is a particular issue raised by our clients. Our research from 2016 found that our clients go into unarranged overdraft in five months in a year on average, and are hit by charges of £45 each time.<sup>16</sup>

Frequently going over overdraft limits is not uncommon among the broader population with the FCA also finding that one in six (17%) of those who have been overdrawn in the last 12 months have exceeded their agreed limit some or all of the time.<sup>17</sup> The FCA also found that that a quarter of people that used unarranged overdrafts used them in four or more months during 2016 and nearly 10% used them for 10 or more months.<sup>18</sup> They stated their concern that those repeatedly using unarranged overdrafts were “being given access to a service that seems unsuitable for them, and which may be contributing to potential financial distress.”<sup>19</sup>

Some of our clients described why regularly facing high unarranged overdraft charges can cause financial problems:

*I struggled to pay direct debits. Then there were bank charges that took me over my limit, which then gave me more charges.*

*A big surprise bill would push me past the OD limit and then the bank would charge £30 odd quid every time they refused a standing order or DD.*

*The charges were huge each month and if I went over my overdraft they were crippling*

*Constant charges for direct debits and going over made it really hard to get back on track as I was always short the next month*

These charges had a significant impact on their finances and could lead to having to borrow from other sources:

*Charges applied when going over limit of overdraft were very high, some months I paid over £100 just in fees, I got stung nearly every month as needed money to pay bills, get food etc. and was desperate*

*Had to go without food shopping sometimes or resort to credit cards to buy food for family or petrol to get kids to school because of bank charges*

*Been charged for being overdrawn has forced me to borrow money off friends.*

## A vicious cycle

Many of the clients described the problem of persistent arranged and unarranged overdraft charges as a 'vicious cycle' that is hard to escape. A unique feature of overdrafts as a credit product is that balances are effectively entirely or partly paid off on a monthly basis by wages or other income. Only one month payday loans have a similar repayment structure, with the amount taken out expected to be repaid in full typically within a 30 day period.<sup>20</sup> With overdrafts, this lump of capital paid down can mean that the financially struggling, such as our clients, find their monthly wages are swallowed by their overdraft. Therefore in order to cover their essentials such as household bills and food, they have to go further into their overdraft the next month. This cycle of borrowing is difficult to escape:

*Once my overdraft was up to £1250 I could never clear it. My wages went in and took the account to 0 and then all my monthly spends such as bills petrol food etc. were taken from my overdraft. I could never pay it off.*

*All my money I had coming in went to pay the bills and money for food. There was no money left to pay the overdraft with.*

*As soon as I get paid the overdraft gets paid off but then I go into it again straight away to cover bills, it just gets deeper and deeper.*

*It meant that we were in a never ending cycle of debt, we'd be out of the overdraft for the first 2/3 days of the month then straight back in it as soon as bills started coming out. Very demoralising!*

*I was given a £2500 overdraft as a student which I used for essential living costs. Every month when my wages were paid in the overdraft instantly consumed my entire wage, forcing me to once again use my overdraft in full. This was a monthly cycle.*

*General living expenses, overdraft would be cleared each month, but then I would be straight back into it.*

This cycle of borrowing can be exacerbated by regularly facing added interest and charges for both arranged overdrafts and going into unarranged overdraft:

*I could never pay off capital due to paying overdraft interest, which is quite high*

*Always started the month down as overdraft fees were added causing me to have to reuse my overdraft whatever balance was available in my account was gone.*

*They just became worse. The charges were astronomical at nearly a hundred pounds a month.*

*There was no way to get out as the overdraft just built and built due to charges.*

*Kept getting charged for going overdrawn which in turn would then go even more overdrawn the following month*

*I would be charged monthly fees of £150, just because I was overdrawn. I often didn't have the funds, which meant I would go over my overdraft, and charged more fees.*

## Human impact of overdraft debt

The impact of being in persistent overdraft debt is not just financial. Many clients described the consequences of being regularly hit by overdraft charges and being stuck in overdraft debt had on them, particularly on their mental health:

*Constantly worried about being in debt and not being able to clear the overdraft due to being on a minimum wage.*

*I ended up with chronic anxiety which meant I was ill a lot and off my work, I became a recluse and couldn't open any mail*

*I stressed about it all the time.*

*Made it hard to live a healthy life*

*The charges are astronomical and impacted everyday living in the end I was being charged absolutely ridiculous amounts and it really affected my mental health*

*It was really destroying my life slowly to the extent that I wanted to give up life, because I just couldn't take it after being out of work for years due to unsuccessful surgery*

*Lead to a breakdown.*

*This debt caused myself and wife to become very depressed, and was prescribed medication which we still take*

Therefore the build-up of interest and charges from being stuck in arranged overdraft debt or for going over an overdraft limit can lead to a vicious cycle that has significant both financial and emotional consequences. This persistent debt can also in some cases lead to further borrowing in the struggle to juggle financial commitments. This all suggests there is a clear case for banks to intervene early where customers are showing signs of struggling with their overdraft debt. This could include providing appropriate support such as offering to freeze interest and charges, providing an affordable way to repay their debt, offering a basic bank account without an overdraft facility and signposting to free debt advice where suitable.

## Banks interaction customers on overdraft

In order to establish the current ways banks tackle persistent overdraft debt, our survey explored our clients' interactions with their banks during their journey into financial difficulties. This covered both the point when the customer is given an overdraft or when it is extended and how the banks engage with those who are struggling with their overdraft and in financial difficulties.

### Unaffordable overdraft lending

Consumers are significantly more likely to get into financial difficulties if the credit they are able to access is unaffordable from the outset. In overdrafts this can occur where consumers are given a large overdraft balance attached to their bank account that their current income levels suggest they will struggle to repay. This issue was raised by the clients in our survey:

*My bank offered me a £2,250 overdraft, even though I work part time. I only receive £200 a month wage; and the rest I rely on universal credit.*

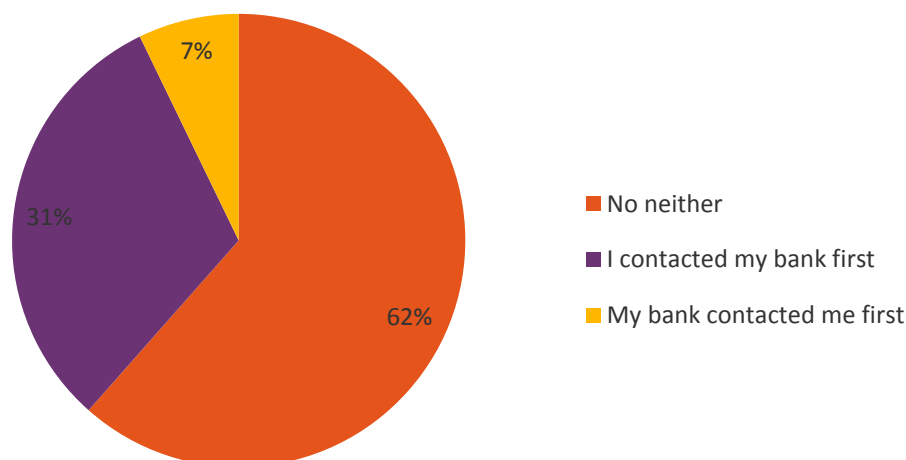
*I had no extra money. For anything. I was struggling to meet my financial commitment and couldn't get a loan. However my bank gave me a £5000 overdraft despite my credit score and my existing debts*

*My bank 'helped' by increasing my overdraft but then that just made things worse in the long term.*

### Banks' treatment of customers in persistent overdraft debt:

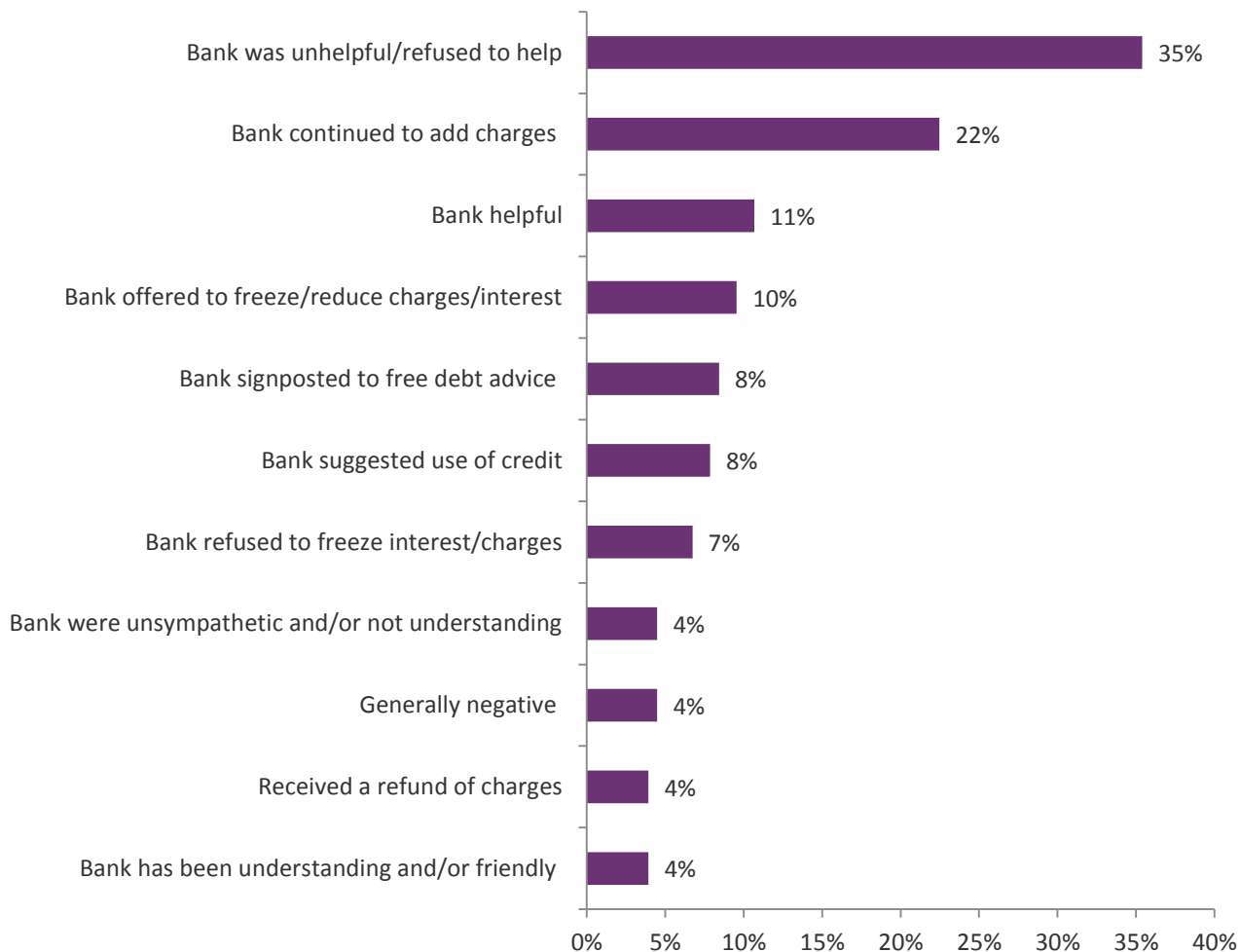
When a consumer is struggling to repay their overdraft and falling into financial difficulties, the interaction with their bank is key. Nonetheless engagement, both from the banks to their customers and from customers with banks, is clearly an issue. Nearly two thirds of clients (62%) stated that when they were in overdraft debt, the bank did not contact them and they did not contact their bank. This suggests that banks are not always identifying where people are struggling financially early enough and consumers do not always recognise or don't seek help when they are in difficulty.

**If you were worried about your overdraft debt, did your bank initially speak to you about this or did you contact the bank first?**



Of those who did have contact with their bank about their overdraft debt, we asked them whether this contact had an impact on their financial problems, either positively or negatively. Although the most commonly stated experience was that the bank was unhelpful or continued to add interest and charges, there were also examples where banks were helpful.

**Please describe how contact with your bank about your overdraft (either positively or negatively) had an impact on your financial problems.<sup>21</sup>**



As stated above, many did not have positive experiences and found that the bank was unhelpful or refused to help (35%):

*I contacted my bank on several occasions before approaching StepChange; and they couldn't help me in any way.*

*For the first six months they didn't help at all then they changed my account so I didn't get charges but it was too late by this point*

*It didn't help in the slightest. Once I made the decision to seek help with StepChange and made a move to switch banks - they cancelled my overdraft after my wage went in, leaving me with no money for the whole month for any bills, food, transport costs - nothing! This happened on the Friday so I had to go in on the next Monday and beg to be reinstated so that I could afford to live! Which to be*

*fair they did, and allowed to withdraw my overdraft funds, but at no point have they ever spoken to me about paying the overdraft off.*

*I cannot say it was a positive experience as it was hard to get the help I required.*

*They didn't want to know. They said because I had payday loans I was not eligible for any help?*

## What banks offered their customers in financial difficulty:

Some banks were not offering clients a solution to their overdraft debt problems even when they were directly asked by many clients for a loan to consolidate their debts:

*The bank was happy to keep increasing my overdraft but when I asked for help with a consolidation loan, they refused to help me.*

*No they did not. They looked into giving me a loan, however this was not a viable option as I am on benefits and it was not guaranteed that I'd be able to commit to the monthly repayments including the interest. I left being advised to just keep trying to pay as best as I could.*

*The charges are a disgrace. I asked for help by way of a loan and the bank refused saying I wasn't eligible. I had payday loans and high interest loans and couldn't meet them. Despite declining a loan the bank gave me a £5k overdraft with much higher interest*

*The bank suggested taking out a loan instead but then turned my loan down due to my credit history!*

*They looked into myself getting a loan to pay off the overdraft but I was refused and no further help was offered.*

Many were refused a loan to consolidate their debts as they did not meet the creditworthiness criteria. Extending further credit to those already in difficulties is not usually the answer as they are likely to struggle to repay. Offering a loan can mean that the consumer gets further into debt since they are using both the loan and the overdraft:

*Initially offered me a loan for a larger sum to clear the overdraft however subsequently through the additional monthly payment (for the loan) I had to use it once again. Ultimately the bank offered me a bigger and bigger loan to consolidate but when I couldn't afford to pay for it offered me no further assistance. I requested a meeting with them and even though I could show that I couldn't afford to live and pay back my debts to them, they offered no solutions.*

However, it is unclear whether other options were considered in these cases that may have been more appropriate for those in financial difficulties. For example, freezing interest and charges and offering a more affordable way to reduce the overdraft, such as offering a lower interest loan that would be affordable to repay.

Another particular issue for some clients (22% of respondents mentioned) was that interest and charges were added to their debt even when they had told their bank they were in financial difficulty. As outlined above, the build-up of interest and charges can exacerbate consumers' entrapment in a cycle of overdraft debt. These clients told us their bank continued to add on charges when they knew they were struggling:



*My bank offered little compassion and when I complained about charges etc. they sent me patronising literature on managing your money better and refused to refund charges initially. It was only until I filled out many expenditure forms and talked at length, that they agreed to refund some charges as a 'one off'.*

*My bank were not helpful at all, they are very aware of my financial problems and can see I don't have enough to get by. They offered me a solution of setting a cap of maximum £30 charges a month, by having a different account, but I already get charged that so it is of no use. They also won't refund any charges as a gesture of goodwill even though I have asked a handful of times. I have been to the financial ombudsman regarding the charges and they say the bank is not breaking the agreement by taking these charges.*

*Bank were really unhelpful, wouldn't stop the interest or charges being added. Did a budget plan with them, and they could see the financial situation I was in, but still wouldn't help.*

*I contacted them when new charges were applied and was told there was no alternative. As I had an overdraft they told me it would not be possible to get an account elsewhere.*

*My money was never my own. 60pound charges a month which was another debt I had to pay but couldn't get out of it to stop the charges. I even wrote a letter to my bank asking them to stop the charges so I could pay the 60 pound a month towards repaying it. They refused.*

In other cases, banks took the approach of encouraging clients to use other credit to cover their overdraft debt. This can lead to the situation outlined earlier where financially vulnerable households are juggling several credit products, which placed a significant strain on their already limited budgets. These are examples where other credit was suggested as a solution to overdraft debt problems:

*No offers of help, made an appointment to discuss my worries but told because I was making regular payments then they were not concerned. Fees added every month taking me over me overdraft every month leaving me with more fees to pay every month...constant cycle. Was also told to get a loan to pay off overdraft.*

*Previously excellent customer rarely used my overdraft due to a family financial situation I lost track of my own finances but once noticed I asked for a larger loan to consolidate my debts at which I was told they can't help me only assist me regarding my credit card which in the same month increased my APR meaning I was going to be higher in debt and kept in debt rather than allowing me to have 1 loan to cover everything they left me to deal with situation at which I called step change*

*The bank refused to give me a larger overdraft but said why not use credit cards for day to day things  
Told me to use my credit cards!*

## Positive experiences with their bank:

Some clients did have positive experiences and found their bank helped them (11%), offered to freeze interest and charges on their overdraft (10%) or signposted them to free debt advice (8%). Examples of those that found their bank helpful were:

*The bank to be fair, was incredibly helpful and let me keep it, noting my long history with them (25 years).*

*Because of my mental state and put me in touch with specialist teams.*

*The bank were very helpful. If I'd know 12 months before how flexible and reasonable the bank could be I would probably of been in a better position than I currently are*

*They helped by moving me to another account*

*The bank were always extremely understanding and more than helpful*

Some clients specified that the bank froze interest and charges on their account or offered to refund charges:

*Bank was very helpful, they offered to freeze charges for 6 months*

*The bank helped by waving charges and freezing my account but it's still there on my online banking reminding me I will have to pay at some point*

*Banks helped me set up a payment plan and froze interest and fees, some reduced contact*

*When I contacted the bank I found them very good putting me on reduced rates and accepting an offer that I was willing to pay*

*I contacted my bank when I started my DMP with StepChange. (The bank) were very understanding, immediately halting interest and charges.*

*It was helpful. They stopped additional charges. Downgraded my account*

*They froze the interest and no more additional fees have been added*

Overall, our clients' experiences present evidence of banks sometimes not engaging with the customers' financial difficulties and not offering solutions that could help them. In other cases, the bank took action that could exacerbate the existing financial problems such as suggesting the client used other forms of credit or adding significant charges and interest to the existing debt.

Nonetheless, there were other examples of banks proactively helping the client by freezing interest and charges, setting up an affordable repayment plan for the debt or offering specialist support for vulnerable clients. This all suggests that there is good practice in the industry and that this should provide a platform for the FCA and the banks themselves to build on.

# Policy change: what should be done to tackle persistent overdraft debt?

The evidence presented in this briefing highlights a clear problem with the level of persistent overdraft debt and as illustrated by our clients' experiences. Those in difficulty can be hit by recurring charges and see their debts mounting up to unmanageable levels. There is clearly a strong case for action to tackle persistent overdraft debt. The FCA in their review of high cost credit and overdrafts outlined that they have concerns that long-term use of arranged overdrafts can be persistent and unsustainable, and that unarranged overdraft charges are high cost and potentially harmful.<sup>22</sup> The FCA plan to consult on proposals on overdrafts in Spring 2018.

Ahead of this consultation, and based on the experiences of our clients, we are outlining the key measures we think should be taken urgently to tackle persistent overdraft debt across three areas.

## 1. Affordable lending

There is a case for banks and the FCA to do more to ensure overdraft lending is affordable to prevent the build-up of persistent debt. The FCA has recently consulted on creditworthiness assessments but it is disappointing that this did not include action on overdraft lending. As part of their other forthcoming consultation paper on overdrafts due in Spring 2018, the FCA should investigate unaffordable lending in the overdraft market.

Ahead of this, one element of the creditworthiness consultation proposals could be looked at further as the FCA state their rules require firms to consider the ability of the customer to make repayments within a reasonable period for running-account credit, such as overdrafts and credit cards. However, there is a lack of clarity around what constitutes a 'reasonable period' for repaying an arranged overdraft. In contrast the FCA has been clearer on definitions of short-term credit in other areas e.g. high-cost short-term credit is defined as within 1 year and persistent credit card debt is defined as 18 months. Setting a clearer definition of a reasonable period would mean that banks would have to assess whether consumers could affordably repay their arranged overdraft limit within that timeframe. This could also involve looking at how the size of an overdraft limit relates to level of the consumer's income. This would all go some way to preventing consumers being lent large overdraft balances that would be difficult if not impossible for them to repay, even over a number of years. The FCA should be more specific in the definition of a reasonable period for consumers to repay their overdraft.

The creditworthiness consultation also highlights that unarranged overdrafts are not currently subject to creditworthiness assessments in line with the Consumer Credit Directive.<sup>23</sup> This is concerning because regularly being hit by costly unarranged overdraft charges can exacerbate financial difficulties, as outlined by our clients above. Banks are required to do a creditworthiness assessment on arranged overdrafts and if this assessment is effective then consumers should not be regularly falling into unarranged overdraft. However, as FCA data shows nearly 10% of people that used unarranged overdrafts have used them for 10 months or more. As we outline below banks should be taking action to remove unarranged overdraft charges, particularly for those that are at risk of or already in financial difficulties.

## 2. Unarranged overdrafts

The high cost of unarranged overdrafts was an issue raised by many of our clients as they can exacerbate debt problems. Research from Which? has shown that unarranged overdrafts can be more expensive than payday loans.<sup>24</sup> The CMA's retail banking market investigation aimed to constrain the cost of these charges by getting the banks to set a maximum monthly charge (MMC) covering all unarranged overdraft charges.<sup>25</sup> However, the banks set high MMCs with most major banks charging between £75 and £95 a month.<sup>26</sup> StepChange and others called for the FCA to set an independent, regulated cap on the MMC in order to ensure the charges for unarranged overdrafts are significantly reduced.<sup>27</sup>

However, even with a price cap consumers could still be hit by charges on a regular basis and further action would be necessary to prevent the charges building up into unmanageable debt. The FCA review of high cost credit and overdrafts stated there is a case to consider "fundamental reform of unarranged overdrafts and whether they should have a place in any modern banking market".<sup>28</sup> They found that there did not appear to be justifiable reasons for these charges with technological developments in the modern banking system.<sup>29</sup> Moreover, some major banks have already reformed and restructured their overdraft charging structures, with one bank abolishing unarranged overdraft charges.

This regulatory approach, the change in banking practices and the experiences of our clients highlight the vital need for change to address the consumer detriment unarranged overdraft charges can cause. In the first instance protection should be given to the most financially vulnerable customers. In order to achieve this, banks should stop (and where appropriate refund) unarranged overdraft charges where a consumer is identified as being in persistent overdraft debt or broader financial difficulties. Further action should then be taken to examine overdraft charges as a whole. The banks (that have not done so) should also review their overdraft charges, remove additional charges for unarranged overdrafts and ensure their charging structures are clear and transparent for consumers. If banks do not make significant changes in a timely manner, the FCA should take decisive action and abolish outdated and costly unarranged overdraft charges.

## 3. Persistent overdraft debt: Earlier identification and more support

Our client survey illustrates how the build-up of arranged (and unarranged) overdraft charges can lead to the accumulation of persistent debt. The FCA has acknowledged that this is similar to the harm caused to consumers that they identified in the Credit Card Market Study.

The FCA should explore what more could be done by lenders to support people who are trapped in an overdraft cycle and give them better and more affordable ways of paying down their debts. Firstly this should involve the banks working with the FCA to find triggers and more proactively identify customers who are in or at risk of persistent overdraft debt (i.e. those that are struggling to get out of their arranged overdraft over a long period of time). The CMA identified 'heavy overdraft users' as those that were in their overdraft for nine months out of a year. The FCA would need to work with banks to establish a range of triggers based on the financial circumstances of customers.

Secondly, once a consumer is identified as struggling with their overdraft or in persistent overdraft debt the bank should offer them support rather than continuing to hit them with charges. Examples, of the additional support banks could provide include giving customers a way to reduce their overdraft balance by reducing or freezing interest and charges, and setting up an affordable repayment plan for the debt. A key element of this would involve banks separating the overdraft debt from transactional banking facilities by offering those in persistent overdraft debt a basic bank account (or another suitable account) and an affordable way to repay their debt separately. This more affordable way to repay could be a lower cost personal loan. This would bring vital stability to household finances and provide a sustainable and affordable way of repaying their debt balance.

If these options are unsuitable or not appropriate, banks should be offering specialist support for vulnerable clients and where appropriate signposting customers to free debt advice. These measures would ensure those in crisis and the most vulnerable get the external support they need.

### Urgent action needed on the overdraft debt cycle:

It is essential that action is taken to prevent unaffordable overdraft lending happening in the first instance and for sufficient support and interventions to be taken when it does occur. Only then will we see a significant reduction in the numbers of those struggling and trapped in a cycle of overdraft borrowing. This would prevent the devastating and costly impact this can have on financially vulnerable households as described by this client:

*I felt depressed all the time about always being in some form of debt... the cycle of added interest and charges every month just adds to the hole you are in.*

# References:

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- <sup>1</sup> Financial Conduct Authority [FCA] (2017) Understanding the financial lives of UK adults: Findings from the FCA's Financial Lives Survey 2017
- <sup>2</sup> FCA (2015) Consumer credit insights: Overdrafts
- <sup>3</sup> FCA analysis found (from figure 4.3 in FCA (2017) High-cost credit: Feedback Statement) 5% of individuals with a current account were in any overdraft every month in 2016 and there were 42 million individuals with a current account in 2016. Calculation undertaken by StepChange Debt Charity based on these FCA figures found 2.1 million individuals were in any overdraft for every month in 2016.
- <sup>4</sup> StepChange Debt Charity (2017) The high cost of credit: A discussion paper on affordable credit alternatives
- <sup>5</sup> This figure is from YouGov Plc polling. Total sample size was 3,204 adults. Fieldwork was undertaken between 15th-19th December 2016. The survey was carried out online. The figures have been weighted and are representative of all GB adults (aged 18+). Figures have been grossed up, using the ONS 2015 Mid Year estimates of adults in Great Britain: 49,921,573. Calculations have been undertaken by StepChange Debt Charity based on YouGov figures.
- <sup>6</sup> StepChange Debt Charity (2016) The credit safety net: How unsustainable credit can lead to problem debt and what can be done about it
- <sup>7</sup> FCA (2017) Understanding the financial lives of UK adults
- <sup>8</sup> FCA (2017) High-cost credit including review of the high-cost short-term credit price cap: Feedback Statement (FS17/2), figure 4.3
- <sup>9</sup> FCA analysis found (from figure 4.3 in FCA (2017) High-cost credit: Feedback Statement) 5% of individuals with a current account were in any overdraft every month in 2016 and there were 42 million individuals with a current account in 2016. Calculation undertaken by StepChange Debt Charity based on these FCA figures found 2.1 million individuals were in any overdraft for every month in 2016.
- <sup>10</sup> StepChange Debt Charity (2016) Falling into the red: How overdrafts can lead to problem debt
- <sup>11</sup> StepChange Debt Charity (2017) The high cost of credit: A discussion paper on affordable credit alternatives
- <sup>12</sup> This figure is from YouGov Plc polling. Total sample size was 3,204 adults. Fieldwork was undertaken between 15th-19th December 2016. The survey was carried out online. The figures have been weighted and are representative of all GB adults (aged 18+). Figures have been grossed up, using the ONS 2015 Mid Year estimates of adults in Great Britain: 49,921,573. Calculations have been undertaken by StepChange Debt Charity based on YouGov figures.
- <sup>13</sup> Only included responses said by 5% or more of clients
- <sup>14</sup> Only included responses said by 5% or more of clients
- <sup>15</sup> FCA (2017) Understanding the financial lives of UK adults
- <sup>16</sup> StepChange Debt Charity (2016) Falling into the red
- <sup>17</sup> FCA (2017) Understanding the financial lives of UK adults
- <sup>18</sup> FCA (2017) High-cost credit: Feedback Statement, paragraph 4.50
- <sup>19</sup> Ibid
- <sup>20</sup> Since the introduction of the price cap, the payday loan market has in a large part moved away from 30 day loans to an instalment loan structure where loans are repaid in instalments over a 3-6 month period
- <sup>21</sup> Only includes responses said by 4% or more of clients
- <sup>22</sup> FCA (2017) High-cost credit: Feedback Statement
- <sup>23</sup> Consumer Credit Directive (2008/48/EC)
- <sup>24</sup> Accessible: [press.which.co.uk/whichpressreleases/overdraft-charges-more-expensive-than-payday-loans/](http://press.which.co.uk/whichpressreleases/overdraft-charges-more-expensive-than-payday-loans/) (accessed 11.10.2017)
- <sup>25</sup> Competition Markets Authority (2016) Retail banking market investigation: Final report
- <sup>26</sup> Some banks charge £32 or £50 but the rest charge between £75-£95 from accessible: [www.lovemoney.com/news/66461/unarranged-overdrafts-monthly-maximum-charge-fee-cap](http://www.lovemoney.com/news/66461/unarranged-overdrafts-monthly-maximum-charge-fee-cap) (accessed 11.10.2017)
- <sup>27</sup> StepChange Debt Charity (2016) Falling into the red: How overdrafts can lead to problem debt
- <sup>28</sup> FCA (2017) High-cost credit: Feedback Statement
- <sup>29</sup> Ibid

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