Financial Exclusion and Over-indebtedness in Irish Households

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Financial exclusion and over-indebtedness are of increasing importance in Irish social policy, particularly now with the onset of the economic recession.

This study provides baseline information on the extent of financial exclusion in Ireland, covering bank current accounts, credit, savings and home insurance. It also details the extent of household over-indebtedness and the underlying risk factors.

The research was undertaken by the Economic and Social Research Institute (ESRI) and funded by the Department of Community, Equality and Gaeltacht Affairs. It is primarily based on the CSO Survey of Income and Living Conditions (SILC) 2008.

The full report *Financial Exclusion and Over-indebtedness in Irish Households* and an Irish version of the research briefing can be accessed at http://www.pobail.ie/en/SocialInclusionDivision/

Main Findings

* Twenty per cent of Irish households do not have a bank current account, the main indicator of financial exclusion. Households most likely not to have a bank current account include older people, people not in employment, lone parents, social housing tenants and those on low incomes.

* The figures for other indicators of financial exclusion are:

  - half of households are unable to save:
  - a quarter of households do not have home insurance:
  - a tenth of households do not have access to credit.

* Across all indicators, there is a clear pattern of higher levels of financial exclusion among vulnerable groups, in particular those on low income.

* Irish people are up to three times more likely not to have a bank current account than the EU norm.

* Five per cent of households are over-indebted, while eight per cent have persistent arrears for utility bills, housing payments and personal loans. More recent data suggest these problems are worsening.

* Low income, rather than high consumption, is the main factor in over-indebtedness. A sudden income drop is a key trigger for over-indebtedness.

* Policy responses to these issues should combine broad anti-poverty initiatives and focused strategies, in particular access to basic banking services and targeted supports for those with high housing costs.

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Introduction

Financial exclusion and over-indebtedness are of major importance in Ireland and in Europe. The growing interest amongst the relevant stake-holders in Ireland is reflected in the formation of the number of high level policy groups. This list includes the Expert Group on Mortgage Arrears which published its final report in November 2010, the Steering Group on Financial Exclusion established in September 2010, and the National Steering Group on Financial Education established in 2006. There have also been several important publications by national agencies such as the Law Reform Commission reports on personal debt management and debt enforcement (LRC 2009, 2010a,b) and the Free Legal Aid Centres report on debtors' experiences in the Irish legal system (FLAC, 2009). Additionally, the Government's *National Payment Strategy* is promoting a shift away from cash to electronic payments of benefits.[1] This policy is closely linked to the issue of banking access among recipients of social transfers.

The growing interest in over-indebtedness is in part a response to the upsurge in personal debt and the concern that the combination of rising unemployment, falling household income and the collapse of the housing bubble, could lead to an increasing number of Irish households being unable to repay their debts. The growth of household debt during the boom years is reflected in Central Bank figures which show that credit card debt per capita increased sevenfold between 1996 and 2008, while mortgage lending increased tenfold between 1995 and 2008. Central Bank figures on mortgage arrears are only available since September 2009; they show that in the nine months up to June 2010, the number of households in arrears increased by 28%. This growth needs to be seen in the context of households in mortgage arrears representing 2.5% of Irish households at that time. While these figures show that access to credit increased during the boom period, there is little evidence on how this access was distributed across different types of households, or on the trend in access to other financial services, such as bank current accounts.

This study draws on the Survey of Income and Living Conditions (SILC) special module on over-indebtedness and financial exclusion, which was carried out by the Central Statistics Office in 2008. The module provides much needed empirical evidence on these issues in Ireland, and because it is a harmonised survey, comparison across EU countries is possible. The micro-data upon which this analysis is based relates to 2008 and are the most recent data available for examining financial exclusion and over-indebtedness.[2] The survey contains information on 5,208 households in Ireland and is representative of the national population. The survey was taken at the beginning of the financial crisis and it is very likely that the level of over-indebtedness has increased since then. Nevertheless, the study can provide insight into the nature of indebtedness experienced by Irish households and highlight the underlying risk factors and triggers for over-indebtedness.

Financial Exclusion

According to the European Commission (2008), financial exclusion is:

A process whereby people encounter difficulties accessing and/or using financial services and products in the mainstream market that are appropriate to their needs and enable them to lead a normal social life in the society in which they belong.

The concept of financial exclusion covers demand side factors (such as exclusion due to cost, geographical or physical access, eligibility requirements, and technological exclusion) and supply side factors, also referred to as self-exclusion. The literature identifies a number of factors which lead to individuals refusing to use financial services including: coming from a cash-only generation, fear of losing control over one's finances, low financial capability and poor financial literacy.

While there was a significant expansion in credit and in financial services during the boom period, the analysis below shows that at the end of the boom in 2008, many Irish households did not possess mainstream financial services. Moreover, a number of commentators have argued that the increase in the number and complexity of financial products and providers may have increased confusion and therefore make it more difficult for some people to engage with financial services (Kempson et al 2000; European Commission 2008).

This study examines financial exclusion for each of the four mainstream financial products that have been identified in the literature as being central to financial exclusion. These are:

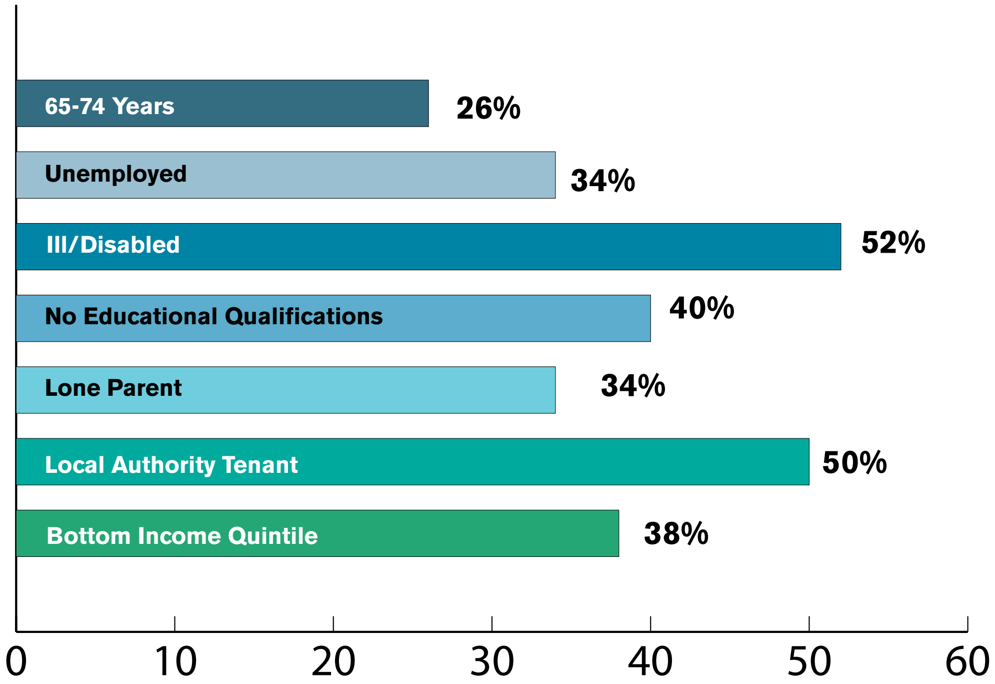
* **Banking exclusion (bank current account)**
* **Credit exclusion**
* **Savings exclusion**
* **Insurance exclusion.**

It is important to note that the SILC special module measures access to services but does not address the broader issues of how these services are used. While respondents may have access to a service, it may not be appropriate to their needs or they may be using it ineffectively. This should be borne in mind by the reader when interpreting the findings of this study. For each of these four services, the relationship between access and specific socio-demographic characteristics of the household are explored.

Banking Exclusion

Banking exclusion i.e. no bank current account, is considered the most critical aspect of financial exclusion because of its impact on access to other financial services and more broadly, its consequences for social exclusion. The survey showed that 20% of Irish households in 2008 did not have a bank current account.[3] The groups most likely to be in this category are shown in Figure 1 overleaf.

Figure 1: Households most likely not to have a bank current account



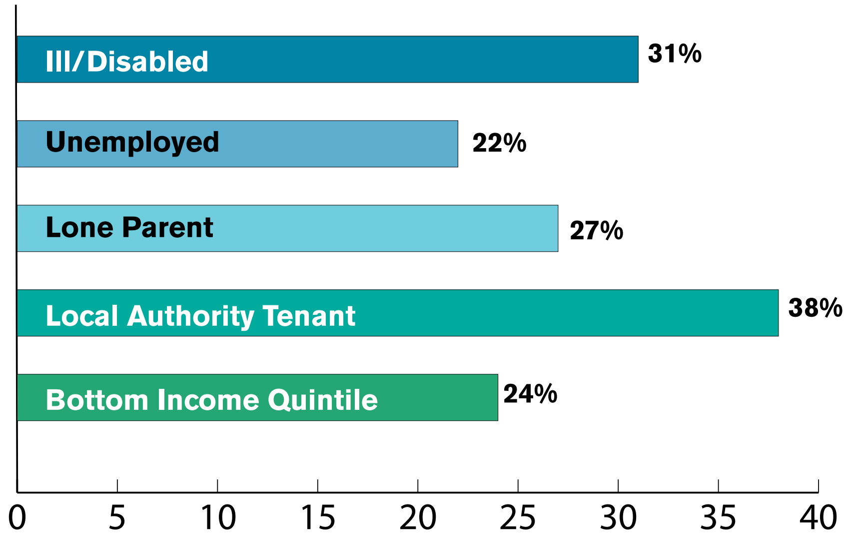
An examination of the relationship between banking exclusion and poverty showed that a high proportion of households 'at risk of poverty' did not have a bank current account (36%). This figure rose to 60% for 'consistently poor' households.[4] Just over a half of those without a bank current account expressed a preference for dealing with cash (54%). While this response can be classified as "self-exclusion", it is strongly influenced by socio-economic position. Specifically, the preference for dealing in cash was particularly common among those in the older age group, those with no educational qualifications and those in the bottom income quintile. Statistical analysis, using logistic regression techniques, highlighted the importance of low income and low education level as strong contributing factors to banking exclusion generally. Employment status and housing tenure were found to be weaker influences. It should be noted that this is an imperfect measure of banking exclusion as defined by the EU (European Commission 2008), as it does not capture those experiencing difficulties using the service.

Credit Exclusion

An examination of credit exclusion in 2008 showed that 71% of households did not have credit/loans, 65% did not have overdraft facilities (some because they did not have a bank current account in the first place) and 49% did not have a credit card/store card. Combining these three types of credit, the study found that 31% of households did not have any of these forms of credit. This group of respondents were asked why this was the case. Almost two thirds (63%) responded that they did not need to borrow, 22% said they did not have credit because they would be unable to repay the debt, 7% believed that they would not be given a loan, and 7% said they did not need commercial credit because they borrowed from family/friends. We define households as being credit excluded if they lack all three forms of credit (credit/loans; overdraft facilities and credit/store cards) for reasons other than 'not needing to borrow'. Using this definition, 10% of Irish households were classified as being credit excluded in 2008.

Those with the highest level of credit exclusion are shown in Figure 2. The logistic regressions showed that credit exclusion is even more strongly associated with low income and low educational qualifications than is banking exclusion. Principal economic status and lone parenthood status did not play such an important role in credit exclusion. Age was not a significant predictor of credit exclusion when other factors such as income position, and employment status, were taken into account.

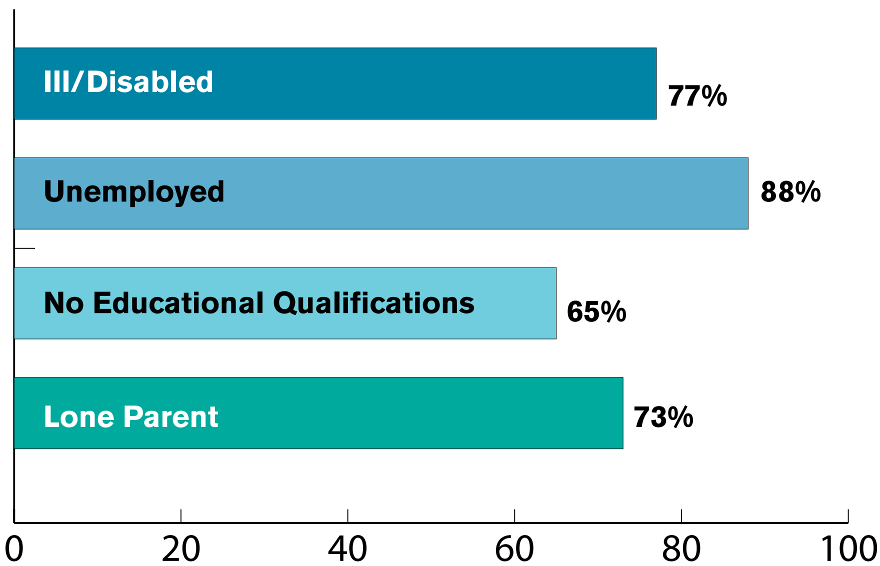
Figure 2: Households most likely to be credit excluded



Savings Exclusion

Savings exclusion was measured by the answer to a subjective question about the household's financial capacity to save regularly. It showed that 51% of households were unable to save. Overall there was little variation across the various groups of households analysed. There were no differences across gender and age groups for example. Nevertheless higher risks of savings exclusion did exist among some groups, as shown in Figure 3 below. Again, income level was the strongest predictor of savings exclusion and unsurprisingly a strong link was found between inability to save and poverty status.

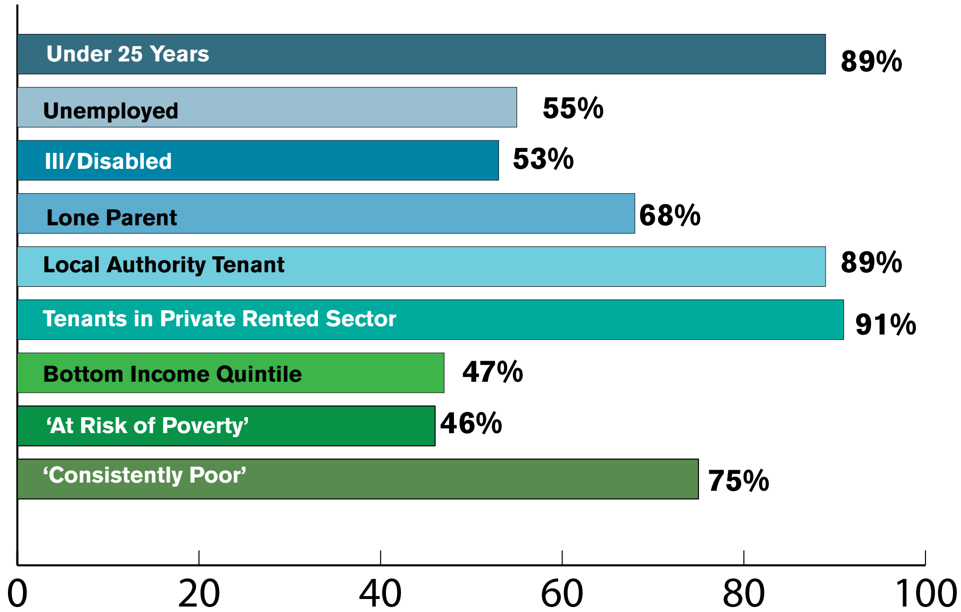
Figure 3: Households most likely to be savings excluded



Insurance Exclusion

Only a narrow measure of insurance exclusion can be derived from the survey, namely, whether or not the household has insurance for the structure and/or the contents of the dwelling. With this crude measure, 27% of households were found not to have insurance cover. Groups most likely to be without home insurance are shown in Figure 4. Overall, on each of the domains of financial exclusion analysed, the study found a clear pattern of higher exclusion among the more vulnerable groups in society. Further, low income levels were consistently found to be one of the strongest contributing factors.

Figure 4: Households most likely to be without home insurance



European Comparisions

Comparisons with European countries do not put Ireland into a favourable position with regard to access to a bank current account. Statistics drawn from the EU SILC 2008 (looking at individuals, rather than households) showed that 17% of Irish respondents did not have a bank current account compared to an average of 6% in the EU15 and an average of 12% for EU27.[5] The Scandinavian countries had the highest levels of banking inclusion, with all households having bank current accounts. The highest levels of banking exclusion were observed in Bulgaria and Romania, where 83% and 75% respectively of individuals did not have bank current accounts.

Variation across countries in access to credit/loans was much narrower. On this measure the proportion of individuals without access was lower in Ireland (67%) than the EU15 and NMS12 average (which both stood at 72%).

The final European comparison concerns access to credit cards/store cards. There was much wider dispersion in access to credit cards/store cards across countries. In Ireland, 44% of individuals did not have access to credit cards which was below the EU15 average of 49%. The disparity between the old and new member states is particularly wide on this measure. The relatively high level of inclusion for Ireland on this financial service reflects the fast growth in these products during the recent economic boom.

Over-indebtedness

Over-indebtedness has been defined in the following way by Stamp (2009):

People are over-indebted if their net resources (income and realisable assets) render them persistently unable to meet essential living expenses and debt repayments as they fall due.

Over–indebtedness should be distinguished from indebtedness which refers to the use of credit, which is a central and increasingly widely used element of modern financial systems. The Law Reform Commission's (2009: 10) *Consultation Paper* has offered the following definition of indebtedness*:*

Indebtedness can be said to refer to a commitment to repay moneys which a debtor has borrowed and used. In this regard, indebtedness can be seen as a necessary and healthy consequence of the provision of credit which is beneficial to society as a whole and to individuals. The majority of credit agreements are repaid without difficulty and result in benefits for all parties to the agreement.

While indebtedness in itself is not problematic, the unprecedented growth in personal debt in Ireland in recent years is a cause for concern, since it is now coupled with severe economic recession, high levels of job loss and significant cuts in household income.

Over-indebtedness has been defined and measured in a wide variety of ways across the EU and elsewhere, and this lack of consensus has made comparison between countries difficult. However, there has been a recent effort to develop a harmonised measure that could be applied across the EU (Davydoff et al, 2008). The special module of the EU-SILC is an important step in improving cross European measurement of this concept.

Arrears

Persistent arrears is one of the key dimensions of the EU measure of over-indebtedness. As Table 1 below shows, during 2008 the most common forms of arrears were on utility bills (7.5%), followed by arrears on rent or mortgage payments (4.8%). Less than 3% of Irish households were in arrears on personal loans/hire purchase agreements, or in arrears on other bills. Just under 8% of households had persistent arrears (i.e., had missed more than one payment in the preceding 12 months) on at least one of these items. Additionally, 4.9% of households were currently overdrawn on a bank account due to financial difficulties and 9% of households had outstanding balances on their credit card that they had been unable to pay in the previous 3 months.

In comparative terms, Ireland in 2008 had one of the highest levels of mortgage or rent arrears across the EU27 - second only to France. The level of utility arrears and arrears in hire purchase/loans in Ireland was also higher than the average for the EU15 countries. Taking all three forms of arrears together (i.e. the proportion of respondents with arrears on any of the three items), Ireland had a rate of 11% compared to 9% in the EU15.

Credit card debt and overdraft debt were found to differ qualitatively from arrears. While arrears were found to increase as household income declined this was not the case for outstanding credit card balances or overdraft debt. Clearly, accumulating such debt is predicated on having access to these credit services in the first place. The analysis of financial exclusion showed that lower income groups and other disadvantaged groups were less likely to have credit cards or overdraft facilities.

Table 1: Proportion of Households with Arrears or Other Outstanding Debts

	% households
Arrears in Utility Payments	7.5
Arrears in Rent or Mortgage Payments	4.8
Arrears in Personal loans/Hire purchase	2.4
Arrears in Other Bills	2.5
Persistent arrears on any one of the above	7.6
Overdrawn due to financial difficulty	4.9
Unable to pay credit card balance	9.0

Over-indebted Households

Following the recommendations from the EU report "*Towards a Common Operational European Definition of Over-Indebtedness*" (Davydoff et al, 2008), the study adopts a composite measure of over-indebtedness. The measure is based on persistent arrears, a heavy payment burden and an inability to access money to pay for unexpected expenses. On this basis, we estimated that 5.4% of Irish households were over-indebted in 2008.

The analysis shows that there is a strong connection between low income and over-indebtedness and its sub-elements: arrears, illiquidity and heavy payment burden. Households that are over-indebted are more likely to be income poor and in consistent poverty. Over-indebted households also have a higher rate of basic deprivation (which includes a lack of basic consumption items such as clothes, food and heating as well as social participation), secondary deprivation (which includes a lack of household durables, car, ability to take a week's holidays away from home), environmental deprivation (which includes pollution, crime) and health deprivation (which includes limited activities due to health problems). These results suggest that income inadequacy rather than a high level of personal consumption is a key factor in over-indebtedness in Ireland.

The risk groups identified, such as lone parent households, the unemployed and the ill/disabled, also highlight the role of a persistent lack of resources in over-indebtedness. The results also show the importance of income shocks as a trigger to over-indebtedness. More than 40% of over-indebted households had experienced a major drop in income over the previous 12 months, with unemployment and pay cuts being commonly cited factors. Households without access to savings or other ways of raising resources (illiquidity) were pushed into over-indebtedness by such shocks.

The year of the survey, 2008, marked the onset of the economic recession in Ireland. The rise in arrears was already noticeable in 2008. Figures published recently by the CSO for 2009, show that the situation continued to worsen for Irish households (with the proportion of households experiencing arrears on utility bills rising from 7.5% to 9.6%. The proportion of households experiencing rent/ mortgage arrears increased marginally.

Policy Implications

As poverty and lack of resources play a key role in over-indebtedness, and are also strongly correlated with financial exclusion, solutions to these problems include the broader anti-poverty measures (such as social welfare supports, employment support, and direct service provision) as well as more focused strategies that aim to deal with more specific causes or consequences of over-indebtedness and financial exclusion.

Policies to Support Financial Inclusion

In the light of the statistical evidence arising from the analysis of the EU-SILC 2008 and based on previous research (Corr, 2006; EC 2008), a number of policy measures has been identified that would support processes of financial inclusion. The first step forward would be to give more attention to financial exclusion in the overall strategy to tackle poverty and social exclusion. The most recent program (NAPinclusion 2007-2016) deals with financial exclusion in a limited manner, with an emphasis on financial education rather than on access to services.

Access to a bank current account is a key element in the process of financial inclusion. Legislative measures and action from the financial sector to support the creation of low cost or free basic banking services,[6] enabling all households to access a minimum level of financial services would have a significant impact on social inclusion and would be consistent with government and banking policies of moving toward a cashless society. Without further action to include currently excluded groups (through provision of appropriate services, education and technological inclusion), policies to minimise the use of cash will further disadvantage the financially excluded. As part of the recapitalisation of the Irish banks in 2008, the banks were asked by the Department of Finance to provide basic bank accounts as well as promoting them to "socio-economic groups where the holding of bank accounts is less prevalent and to those who find that a current account does not suit their basic banking needs" (Department of Finance, 21/12/2008). There is little evidence of progress on this commitment to date, indeed the increases in bank charges for domestic customers would seem to be a move in the opposite direction.

Financial education policies, which have been found to lead to more effective use of financial services in other countries (OECD 2005, 2008; EC 2008; EC 2009), are relatively undeveloped in Ireland. The Money Advice and Budgeting Service provides their client group with support to improve financial literacy and capability, but there are few financial education initiatives at the wider community level (see Report of the National Steering Group on Financial Education, 2009 for an overview of current provision and recommendations for future development).

Policies to Reduce Over-indebtedness

The study suggests that lack of resources is the main factor behind over-indebtedness. Consequently, policies to tackle poverty are likely to be most effective in addressing over-indebtedness. Strategies that focus on over-borrowing, protecting consumers through regulation or increasing the financial capabilities of the population, are likely to play a smaller role in preventing over-indebtedness. Nevertheless, these strategies have been identified as important in a Europe-wide investigation of over-indebtedness (Davydoff et al, 2008). The collapse in the banking sector in Ireland has focused attention on poor lending practices and weak regulation, and current efforts to restore this sector should place consumer protection as a primary objective alongside issues of financial stability. Financial education could have a more indirect effect on over-indebtedness by increasing financial inclusion. The analysis found that households without access to bank accounts were more likely to be over-indebted.

The main policy intervention in this area is the Money Advice and Budgeting Service, which provides supports and services to over-indebted households. This includes negotiating with creditors on behalf of clients and setting up special budget accounts (to pay creditors) and savings accounts in partnership with Credit Unions. The EU Working Group on Over-indebtedness identified debt advice as one of the essential building blocks in tackling over-indebtedness (Davydoff et al, 2008).

Policy measures to tackle the problem of mortgage arrears have been considered by the Expert Group on Mortgage Arrears. Their recommendations include: the deferment of interest payment for five years, stopping penalty interest or arrears charges for borrowers who are part of the Mortgage Arrears Resolution Process, and the introduction of new bankruptcy laws and mechanisms to allow repossessed borrowers to stay in their homes for a time.

Since the majority of over-indebted households identified in this report are not home-owners but are located in local authority housing or the private rented sector, supports for tenants are likely to be very pertinent. Possible support could include greater involvement of the State in negotiating rent reductions for households in receipt of Rent Supplement. The high risk of over-indebtedness among local authority tenants suggests that there is a need to reassess means and to review differential rents for those household who are persistently unable to meet housing costs and meet other basic needs and commitments (such as utilities).

It would be useful to examine the reach and effectiveness of each of these interventions in order to establish the extent to which the relevant groups are included and to investigate the (short and longer term) outcomes for those who receive the service or support as well as the economy-wide implications of such interventions. Work at the EU level to define and measure over-indebtedness lays the ground for improved policy analysis. Davydoff et al (2008) suggest that the development of the harmonised definitions of over-indebtedness "will enable the empirical analysis of policy measures and their effectiveness".

The EU-SILC special module provides an important resource for further research. Comparative European research using EU-SILC which examines over-indebtedness in different policy settings would make an important contribution to this debate. Given the deteriorating economic situation in Ireland between 2008 and 2010, it would also be important to continue to collect data and conduct research on this topic. This report highlights a number of additions and improvements in data collection which would facilitate a more accurate and comprehensive measurement of financial exclusion and over-indebtedness. While the EU-SILC special module is not yet scheduled to be repeated (up to 2014), key questions could be included in the Irish SILC questionnaire in the meantime. Given the rise in arrears levels and the growing policy concern with over-indebtedness and financial exclusion, it is increasingly important to have a firm evidence base for future policy developments.

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Footnotes

1 See Chapter 2 of *Financial Exclusion and Over-indebtedness in Irish Households* for further details.

2 The 2009 survey contains a limited set of questions on arrears and indebtedness. Initial figures have been published by the CSO (Nov. 2010) and these are reported in Chapter 5. The micro-data were not available at the time of publication.

3 The SILC questionnaire specifies that the standard services offered by a bank current account include a cheque book, electronic transfers and a debit (Laser) card. Building society, Credit Union and post office accounts are not included as they do not provide this full range of services in Ireland.

4 'At risk of poverty' means households that have incomes less than 60% of median household income. Consistently poor households fall below this poverty line and lack two items on the basic deprivation scale. These definitions are used in the National Action Plan for Social Inclusion.

5 The European-wide statistics are reported as a percentage of individuals whereas the figures for Ireland in this report, other than those discussed in the European comparisons, refer to percentages of households. This accounts for differences in the figures.

6 Including access to electronic services, such as payment/debit cards, electronic transfers etc.

References are contained in the full report.

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