Money, votes and warm coats

How current turmoil is impacting consumer debt

Storm clouds on the horizon?

We are in a well publicised cost of living crisis, complemented with political turmoil seen throughout the summer and autumn, and war in Europe contributing to chaos in energy markets. At TDX Group we are asking how do these events change the debt landscape, how will these anticipated changes be impacted by society, and what as an industry can we do to help.

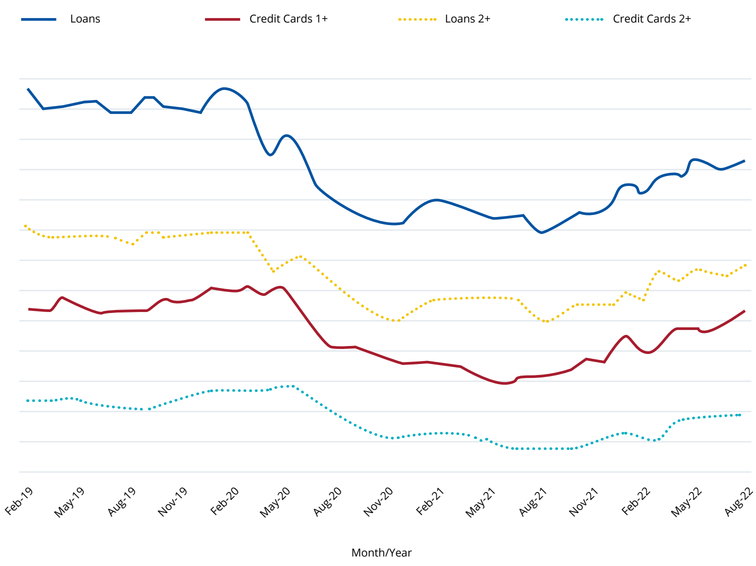
As consumers we have become used to low borrowing costs that spanned the entire 2010s decade. As the global financial crisis (GFC) passed, and especially in the last 5 years, we have seen delinquency and default rates being fairly steady and ultimately relatively low over that period.

Since 2009, over 9 million people have reached adulthood and subsequently able to access credit products, only ever knowing an environment of ultra-low interest rates.

This prolonged period of low cost of funds and low bad debt has created an environment that has allowed the birth of new financial products such as buy-now-pay-later, becoming hugely popular. From borrowing costs increasing significantly and defaults inevitably set to grow, can this relatively new form of credit survive? The debt sale market has seen very strong pricing in recent times, is that sustainable?

More generally in bureau data, we can see that consumers are already showing signs of financial stress, particularly in utility portfolios, as you might expect given the huge increase in typical energy costs, even with government support.

Delinquency: 1+ Arrears and 2+ Arreas (%)



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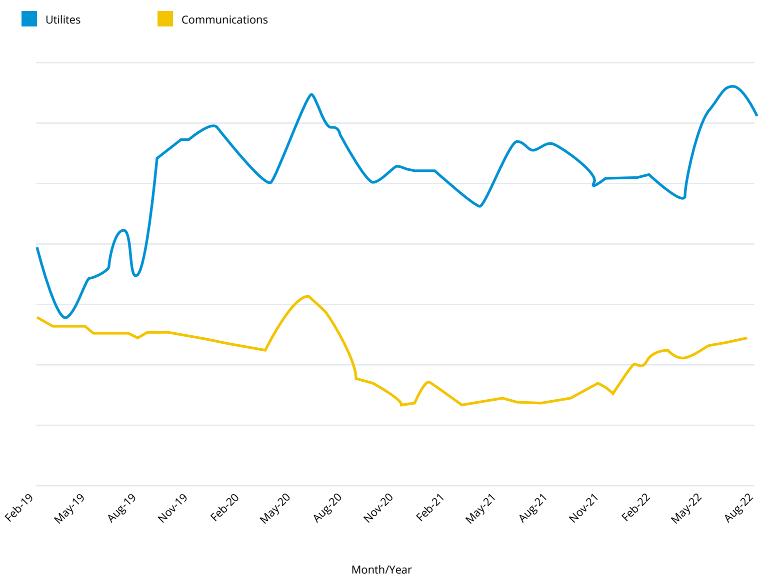


According to research from the Money and Pensions Service (MaPS) nearly half of adults don't feel confident in managing their money day-to-day, and FCA research highlighted that **as of May 2022, 12.9 million UK adults (1 in 4) had low financial resilience,** an increase of over 20% compared to 2020. Given inflation has increased and continued to be stubbornly high since, it is likely this number will continued to grow.

With up to one in four people set to experience mental ill-health in the next year (MIND) and having a direct impact on ability to manage finances and 'life-admin' in turn increasing consumer vulnerability, it's no wonder such **a large number of people don't, and won't, feel equipped to tackle their money worries head-on.**

To date we've had a fast increase in essential spending, and the material increase in mortgage rates is likely to keep those outgoings under pressure as consumers exit fixed rate mortgage terms at historically low rates, and onto new terms potentially in the hundreds of pounds a month higher. This will play out over the next few years as consumers steadily roll off their current fixes, but may be softened somewhat if core inflation steadies out.

It certainly feels like those storm clouds are looming large.

How tight can the belt go?

Whilst arrears and delinquencies are starting to head upwards, for many credit types, they are still typically below pre-pandemic levels. So is it all a storm in a teacup for debt?

Equifax's Open Banking data has enabled us to observe some incredibly insightful trends as to consumer spending. It exposes that consumers are taking steps to manage their expenditure, to 'tighten their belts', in light of increased costs across the board. Changing their supermarket and cancelling streaming services being two simple to enact cost savings.

Disposable income dropped by 10% in Q2 2022...

+19% Essential spending

+27% Low income energy bills

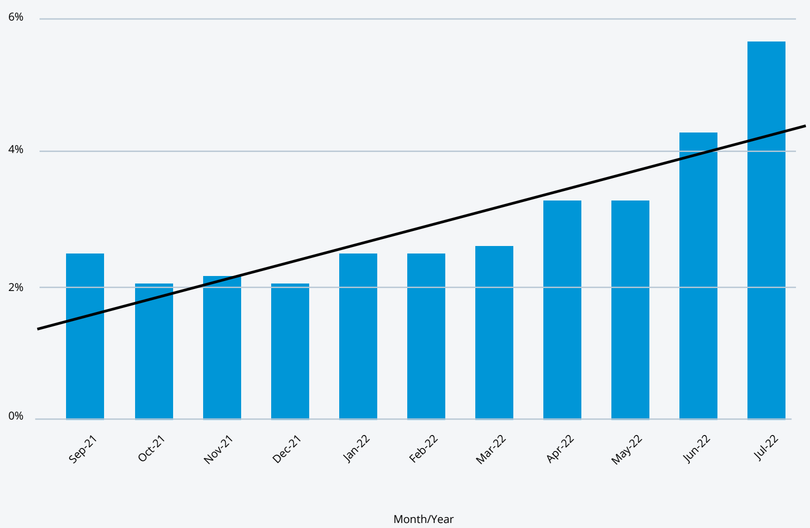
+16% Use budget supermarket

+46% Low income fuel spend

As consumers exhaust their ability to accommodate rising costs through cuts to discretionary spending, they may fall back on their savings - another reason why we're seeing muted levels of arrears.

A recent survey by the Building Societies Association (BSA) found **35%** of those questioned had stopped saving because of the rising cost of living. Meanwhile, **36%** of those asked said they were relying on their savings to get through a period of rising bills and prices.

% of customers with credits from HCST providers



Whilst consumers are adjusting their spending and utilising savings, a stark sign that some consumers are facing clear affordability challenges is the strong upward use of high cost short term credit. This could be indicating that some are starting to run out of holes on their belts, and we may soon start to see more customers falling into arrears.

The changing IVA consumer

	Pre-Pandemic (2019)	Current Characteristics 2022
	£140 disposable income	↓ **£125** disposable income
	£115 energy bill	↑ **£143** energy bill
	27p/£ dividend rate	↓ **25p/£** dividend rate
	£20,000 total debt	↓ **£18,000** total debt
	10% home-ownership rate	↓ **8%** home-ownership rate
	19% benefits share of income	↑ **26%** benefits share of income

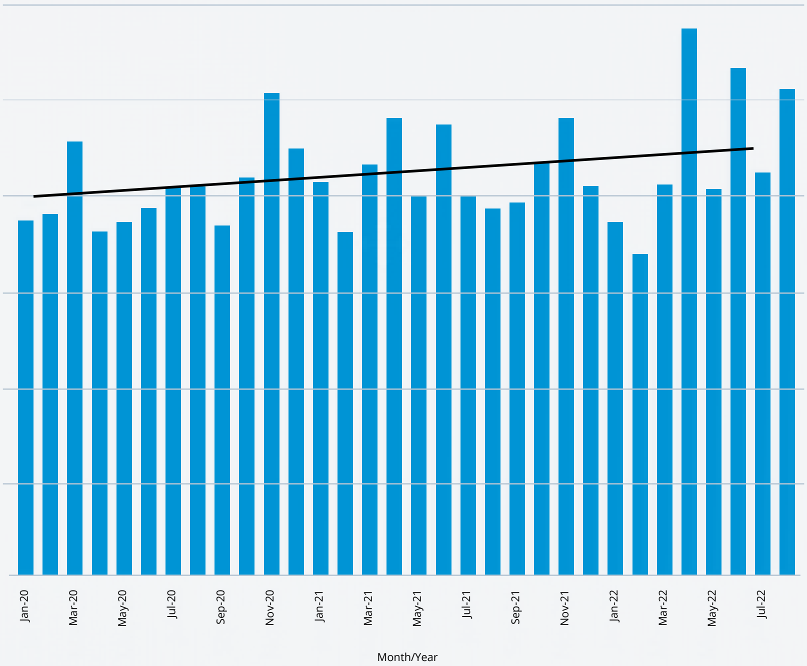
The profile of consumers entering into IVAs continues to evolve.

Total debt values are decreasing, but so too is the amount of disposable income available to pay into the IVA. Energy bills are a clear factor for this, but as the cost of living increases generally, **the amount consumers can contribute into their IVA will continue be under downward pressure.** And this of course also applies to consumers already in IVAs, who will need greater flexibility to ensure they can continue on their path to debt resolution.

Whilst homeownership is low in the IVA demographic, the effect of higher mortgage interest rates for landlords is likely to drive private rent increases. This level of increased expenditure is likely to support the heightened demand for insolvency solutions over the longer term - as consumers ensure they keep a roof over their head for some it will mean they cannot meet their credit commitments as a result.

Overall **we expect demand for IVAs to remain high for the foreseeable future,** with those consumers previously able to service their debt commitments or meet minimum repayments now falling into a situation where they need a formal debt solution.

TIX Variation Volumes



As a result of the changing environment, we have seen variation volumes increase this year, 12% of which have been for consumers in the first year of their IVA - reflecting the rapidly changing affordability situation.

So what do the next 12 months look like?

There are huge external factors that will influence the medium term outlook; political stability and policy approach, the conflict in Ukraine, China's COVID policy and impact on supply chains to name but a few.

Any forecast will have significant assumptions and a large margin of error. But with inflation expected to be well above the BOE's 2% forecast for the next 2 years, and the UK formally entering recession seemingly inevitable, we certainly expect to see:

- **More consumers in debt**, including those who have never been in a debt situation before
- **A lower ability to manage income shock** / unexpected bills
- Those **just about managing now likely to fall into arrears**
- **Increased levels of debt** likely to be particularly prevalent for energy debts
- **Decreased monthly debt repayments** to ensure future payments are affordable
- **Slower recovery;** more payment plans for lower amounts, stretching for longer
- **Debt prioritisation;** consumers making conscious decisions about which to pay

Across the debt lifecycle, it is more critical now than ever, for creditors to:

- **Tailor engagement to consumer circumstance** - one size does not fit all
- **Deploy the right tools for the job** - being able to handle each contact appropriately and effectively with the right capability and capacity - especially with inbound volume set to rise with consumers new to debt problems
- **Adapt, test and learn** - have the right MI to understand changes in consumer behaviour / circumstance, adapt to that change, and test and learn to ensure you are deploying the best approach.

Putting consumers first

Impact of Consumer Duty regulations

Since the pandemic, the FCA has been monitoring and gathering insight into how firms support borrowers in financial difficulty. As the cost of living crisis continues to take hold and consumers face into increasing financial challenges, the FCA has issued their latest guidance on how firms support those customers struggling financially. **(link here).**

Some key takeaways from the review include:

- Early engagement with customers who show signs of financial difficulty can help to set the right tone of support and alleviate customer anxiety and stress brought on by their financial circumstances
- Effective discussions being critical to understand the customers personal and financial circumstances, including characteristics of vulnerability. These discussion will drive the right support and forbearance options. Well trained staff are a key component in delivering this tailored support.
- Firms responsibility to help customers understand what type of debt or money advice is available to them. Signposting to appropriate sources of guidance is therefore a critical component of effective discussions and communications.
- Application of fair fee charging for those in arrears. Fee charging should be reflective of the associated costs and supported by considered rationale.

With the Consumer Duty implementation deadline of 31 July 2023 fast approaching, FCA regulated business should by now have agreed their implementation plans for meeting this timescale. A key element of the Consumer Duty is for firms to assess, test and evidence that their customers receive fair outcomes. Achievement of this will include regular reviewing of relevant sources of data to assess whether customer experiences are consistent with the Duty's principles, rules and outcomes. With this in mind, there is no better time to consider whether current practices deliver the positive customer experiences required under the Duty, whilst adapting where appropriate to do so, current service standards, operating models, communication strategies and even staff training in this fast evolving digital dependent environment.

We have already done a lot of work on how we focus on and engage with our consumers but we want to do more. We want to not only continue to improve our own standards but that of the industry.

Over the next three years we will partner with The Money Advice Trust to deliver vulnerability training to more than 3,000 people across our network. This will build the skills and knowledge to design and deliver an inclusive service for all.

Continuing our mission to make the debt industry better for everyone

The support and protection we provided to over 5 million consumers throughout 2020 and 2021, is still in effect as we speak. And it will be for some time to come. Right now, it's more important than ever that we continue to treat consumers in a fair and empathetic way, with the cost-of-living crisis forecast to cause further uncertainty for millions more across the country.

By continuing to work together with our clients and supply chain, consumers will continue to reside where they belong – at the heart of what we deliver.

We will continue monitoring our consumers and the impact future financial changes may have on them. Some key metrics we will be following include:

- Equifax Risk Navigator Scores
- Consumer experience through our CXF score
- Vulnerability volumes

How TDX Group can help

We listen, understand and care about reducing the impact of debt.

With fresh pressures likely to come from all quarters, our vision – to make the debt industry better, and to make it better for everyone – has never held such value.

As the UK's leading provider of data-powered debt resolutions services, we recover debt on behalf of our clients ethically, fairly and sustainably.

We intelligently harness insightful and unparalleled levels of data and analytics to power better informed decisions and maximise outcomes for both businesses, and consumers; continually seeking out new and innovative ways of making the debt resolution process as positive an experience as possible.

Our Advisory team are able to help Creditors benchmark their current capabilities across C&R. Highlighting areas of risk and opportunity, both short and long term to help ensure creditors are able to adapt to the challenges we're likely to see in the next 6-12 months.

Over the last couple of years, we've reflected on how we communicate with consumers and transformed our standards and processes to create an industry-leading debt management solution bespoke to all consumer debt types and segments.

Through our Insolvency Exchange (TIX), we provide a comprehensive managed service for personal insolvency which ensures creditors are represented and customers are treated fairly – as well as maximising collections potential.

So, while the debt industry will be facing often unprecedented challenges in the near future, our clients can rest assured that they have a team by their side who not only understand their challenges, but have their, and their customers' best interests at heart.

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