



# Towards a common operational European definition of over-indebtedness

## Handbook

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# Introduction

With the expansion of access to credit and the provision of new products in financial services, over-indebtedness of consumers is increasingly moving into the focus of the European public. In 2007, a consortium composed of the OEE (Observatoire de l'Épargne Européenne), the Centre for European Policy Studies and the Personal Finance Research Centre/Bristol University conducted a research project for the European Commission (Directorate-General for Employment, Social Affairs and Equal Opportunities) on the theme: “**Common Operational European Definition of Over-Indebtedness**”.

A conference was organised by the European Commission and the Consortium (OEE-CEPS-PFRC) in Brussels on 11th December 2007 with 250 European Experts to discuss the preliminary findings of this research.

The study lays the foundation for a common operational European definition of over-indebtedness that can be implemented in all European Member States. It covers three main areas:

- (1) Definitions and measurement of over-indebtedness;
- (2) Nature and causes of over-indebtedness; and
- (3) Policy initiatives and key organisations.

The **main output** from this project is:

- the **final report**,
- a **statistical database** with several indicators of over-indebtedness (mainly data on arrears, data on debt settlement, and assessment by households of their financial burden),
- an **institutional database** (with national institutions involved in the combat against over-indebtedness or in data gathering), and
- the present **handbook**.

The **main objective** of this handbook, that accompanies the Final report and the two databases, is to help policy makers **identify operational factors in order to implement an efficient policy to tackle over-indebtedness**.

The **first part** of the handbook reviews all statistics that are necessary to be collected in order to identify populations at risk and to target the policies to tackle over-indebtedness (data already available has been gathered in the database). The **second part** of the handbook focuses on the main tools available to public bodies, private institutions and non-for-profit sector so as to combat over-indebtedness. Lastly the **third part** briefly describes the types of institutions that are involved in the combat against over-indebtedness and their role in this combat (details about national institutions are available in the institutional database).

# I. Collecting data on over-indebtedness

Measuring over-indebtedness is a key element of policies tackling over-indebtedness:

(1) Reliable statistics help to define policies targeted at individuals who are the most at risk of falling into over-indebtedness.

(2) Reliable statistics help to evaluate the efficiency of public policies.

This part of the handbook deals with different types of indicators necessary

- to evaluate the number of over-indebted households in a country
- to define types of households at risk and the main causes of over-indebtedness

Available sources of information are described in the final section of this chapter.

## Elements of any operational definition of over-indebtedness

Compiling statistics first requires adopting an operational definition of over-indebtedness. The most important elements of definition are set out below:

**Household:** Households are the relevant unit of measurement. Households may be defined as small groups of persons (or one person) who share the same living accommodation, who pool some, or all, of their income and wealth.

**Contracted financial commitments:** All contract financial commitments are included, among them mortgage and consumer credit commitments, utility and telephone bills as well as rent payments (recurring expenses). Informal commitments entered into within families, for instance, are excluded as no data exists on them.

**Payment capacity:** The capability to meet the expenses associated with contracted financial commitments. Over-indebtedness implies inability to meet recurring expenses.

**Structural basis:** This is the time dimension, which holds that the definition must capture persistent and ongoing financial problems and exclude one-off occurrences that arise due to forgetfulness, for instance.

**Standard of living:** The household must be unable to meet contracted commitments without reducing its minimum standard of living expenses.

**Illiquidity:** The household is unable to remedy the situation by having recourse to (financial and non-financial) assets.



# Numbering over-indebted households

Four types of indicators of over-indebtedness have been identified:

- (1) Data on arrears (debt or bills owed by the household which have not been paid)
- (2) Data on debt settlement
- (3) Self-assessment by households of their financial burden
- (4) Other indicators

# (1) Data on arrears.

Statistics on arrears include a specific number of missed payments, where the number might vary from one missed payment to three consecutive ones. It may also be measured in terms of how many days a consumer is late in making a payment that is due (30-, 60-, 90-day periods for delinquencies) and where 120- or 180-day delays typically denote defaults.

## Categories of indicators in the database

- (1) Arrears on any financial commitments
- (2) Arrears on mortgages
- (3) Arrears on utility bills
- (4) Arrears on unsecured loans
- (5) Arrears on rents
- (6) Arrears on tax payments

## Examples

- Number of households more than 2 months in arrears on any credit commitment or household bill (indicator used in the UK)
- Number of arrears for low income households (indicator used in the Netherlands)
- Number of households that have been in arrears at any time in the last 12 months (EU-SILC survey)
  - Rent for accommodation or mortgage payments
  - Utility bills
  - Other loans
- Number of arrears on revolving/credit "facilities" (data available in Germany)
- Number of summonses for tax non-payment (indicator available in the UK)

## (2) Data on debt settlement

Statistics on debt settlement refer to either legal procedures such as regulated amicable debt settlement procedures, insolvencies, bankruptcies, sequestrations or summonses. This information is not available for all countries as not all have such procedures. In addition, even for those countries that do have such procedures, the process itself might vary widely from one country to another.

### **Categories of indicators in the database**

- (1) Court arranged solutions
- (2) People assisted with repayment plans by debt advice agencies or administrative bodies
- (3) Debt write-offs by creditors

### **Examples**

- Number of people admitted to the procedure for debt settlement
- Number of personal insolvencies
- Number of bankruptcies
- Number of repossessions
- Number of restructurings of debts
- Number of files received by debt settlement bodies
- Number of agreed repayment schedules
- Outstanding number of files in process by debt settlement bodies
- Number or value of debt write-offs
- Number or value of debt write-offs due to credit cards

# **(3) Assessment by households of their financial burden**

**Self-assessments by households include surveys on consumers/ households and their assessments of whether they feel over-committed.**

## **Categories of indicators in the database**

(1) Self-assessment by households of over-indebtedness

(2) Questions asking people to give facts about their financial situation

## **Examples**

- Number of households who consider that the repayment of debts is a heavy burden (EU-SILC survey)
- Percentages of adults having difficulties paying bills (the Eurobarometer survey)
- Number of households/individuals experiencing debt problems from ordinary living expenses (Indicator available in Ireland)
- Percentage of low income households that report they have to make debts (Indicator available in the Netherlands)
- Non-mortgage debts that are not repaid in full at the end of each month (indicator available in Ireland)
- Percentage of households with difficulties to make ends meet (indicator available in the Netherlands)

# (4) Other indicators

This category includes all the other measures such as borrowing to income ratio, debt-service burden, or the users of debt advice agencies. Often, the economic variables such as the household debt-service ratio, has to be combined with a specific threshold, any indebtedness higher than this threshold being defined as over-indebtedness.

## Categories of indicators in the database

- (1) Statistics concerning users of debt advice agencies
- (2) Borrowing to Income ratio
- (3) Debt-service burden
- (4) Number of credit commitments

## Examples

- Number and characteristics of persons using debt counselling
- Number of households with total debt repayments higher than 50% of gross income (indicator used in the UK)
- Number of households with debt repayments higher than x% of disposable income and an income inferior to a given level (indicator used in the Netherlands and in Belgium)

# Limits of single indicators

**Administrative indicators** should be analysed with caution:

- They should be used in a complementary way with other indicators. For example, a decrease in the number of mortgage credit arrears may be due to increased repossession by banks
- The legal framework may change over time and the access to administrative procedures may become more or less easy
- Administrative indicators measure the enforcement of public policies, more than over-indebtedness by itself.

**All indicators also capture a certain number of households who do not fall under the definition of over-indebtedness.** Although the existence of **arrears** is one of the best indicator of over-indebtedness, the comparison with other indicators reveals that it captures a certain number of households who are not over-indebted and on the contrary a certain number of over-indebted households are not covered by arrears. For example:

- A number of households with arrears have a debt service to income ratio inferior to 50% or even 30%
- A number of households with arrears and a number of households with a debt service to income ratio superior to 30% do not respond that they have serious difficulties to make end meets

# Composite indicators

None of the indicators usually used to measure the number of over-indebted households can capture the complex reality of the phenomenon. However **it is necessary to have an overall view on the level of over-indebtedness**. The Indicators' Sub-group of the Social Protection Committee have noted that **a basket of indicators might be the most beneficial approach**. Two approaches are possible for that purpose:

(1) A composite index can be calculated as **a combination of indicators**. However indicators should not be equally weighted in such a calculation: some are more important than others.

**An example of a composite index:** This index is an indicator for critical signs of private indebtedness (Privatverschuldungs-Index) and is based on credit reports held by Schufa Holding AG on the German population. For the index, Schufa combines a number of negative data entries on households that are weighted and a total value is calculated upon these features. The 'critical signs' are then marked ranging from 'low' to 'high' for risk classes. It has been calculated every year since its introduction in 2004, but for Germany only.

(2) Alternatively **households meeting a given number of indicators** can be considered as over-indebted.

**An example derived from the UK experience:** Five indicators are defined: Total debt repayments > 50% gross income, unsecured debt repayments > 25% gross income, households with more than 4 credit commitments, households more than 2 months in arrears on any credit commitment or household bill and payments considered by the household as heavy burden. Then a frequency table of criteria being met simultaneously is compiled.

Proportion of over-indebted indicators the households match in the UK

Number of indicators breached	% of households meeting that number of indicators	Cumulative %
None	75%	75%
One	15%	90%
Two	7%	97%
Three	2%	99%
Four	1%	99.8%
Five	<1%	100%

# Indicators Chosen

*The study “Common European operational definition of over-indebtedness”* considers that a household is over-indebted if it meets simultaneously the **following criteria**:

- (1) High commitment payments considered the income that pushes the household below the poverty-threshold
- (2) The household has been in structural arrears on at least one commitment
- (3) The burden of monthly payments (housing including rent or mortgage, other household bills, and credit) is considered by the concerned person to be a heavy burden
- (4) The payment capacity is considered by the concerned person to be ‘very difficult’ and/or ‘difficult;’
- (5) The household does not hold liquid assets enabling him to meet his commitments



# Defining populations at risk of falling into over-indebtedness

Specific surveys aimed at combining indicators about over-indebtedness with socio-demographic characteristics of households, so that populations at risk and other causes of over-indebtedness can be more readily identified.

# Characteristics of households being at risk of falling into over-indebtedness

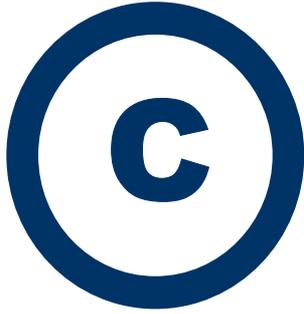
Identifying over-indebted households is not only necessary to number such households. It is also intended **to define the profile and to identify the main causes of over-indebtedness**. For that purpose, indicators of over-indebtedness should be combined with socio-demographic characteristics of concerned households.

**Characteristics most frequently associated to over-indebtedness** include:

- Age
- Employment status (employed/unemployed, retired)
- Marital status (single, married, divorced)
- Number of individuals that compose the household
- Number of children
- Housing tenure (owner or renter)
- Income
- Value of financial and non-financial assets

Surveys can also give information on the **main causes** of over-indebtedness and compare the hierarchy of these causes with other European countries. Most frequently reported causes of over-indebtedness are:

- Unemployment
- Low income
- Divorce
- Excessive expenses
- Difficulties with the bank
- Health problems



# Sources of information

Besides general information such as national accounts, two other main types of sources of data on over-indebtedness have been identified:

- Credit registers
- Specific surveys

Specific attention should be paid to pan-European surveys:

- The Eurobarometer survey
- The EU-SILC Survey

# Credit registers

Credit register files enable the compilation of **statistics on arrears** (negative files) and the **level of indebtedness** (positive files).

In several countries, the **quality** of data provided by credit registers is **excellent for two reasons**:

(1) **Financial institutions are encouraged to provide accurate information** as they use consolidated information of credit registers in their decision process for granting new credits.

(2) As information is very sensitive, debtors who are included in credit registers files are informed and can contest or correct that inclusion in several countries.

However data from credit registers has its **limits**:

(1) In some countries, **not all borrowers are included** in such credit registers.

(2) Many credit registers **only record a specific type of debts**: debts owed to financial institutions for example.

(3) Most credit registers record **maximum overdraft authorizations**, rather than the actual use of such overdrafts.

(4) The **primary mission** of credit registers **is not to compile statistics**. Hence they should be closely associated to policy makers in order to promote the publication of statistics which are relevant, of good quality, regularly updated and freely accessible.

(5) Most credit registers **do not include data on any characteristics of households** other than the one on indebtedness. But the level of indebtedness can only be qualified as excessive if it is related to the income of the considered household. Hence, credit register data has to be completed with surveys.

# Surveys

**Why should surveys be used** to measure the level of over-indebtedness ?

- (1) **In many countries**, surveys are the **only comprehensive source of information**. In particular, all European countries have run the EU-SILC survey since 2006.
- (2) They are a means of **measuring of over-indebtedness** by asking questions on how the people surveyed appreciate the situation they find themselves in.
- (3) Besides the number of over-indebted households, **combining indicators of over-indebtedness with socio-demographic or geographic characteristics** of concerned households helps to focus policies on target populations.

## USING EUROPEAN SURVEYS

**Two European surveys** provide information on over-indebtedness; they are the **Eurobarometer** survey and the “**European Statistics on Income and Living Conditions**” survey.

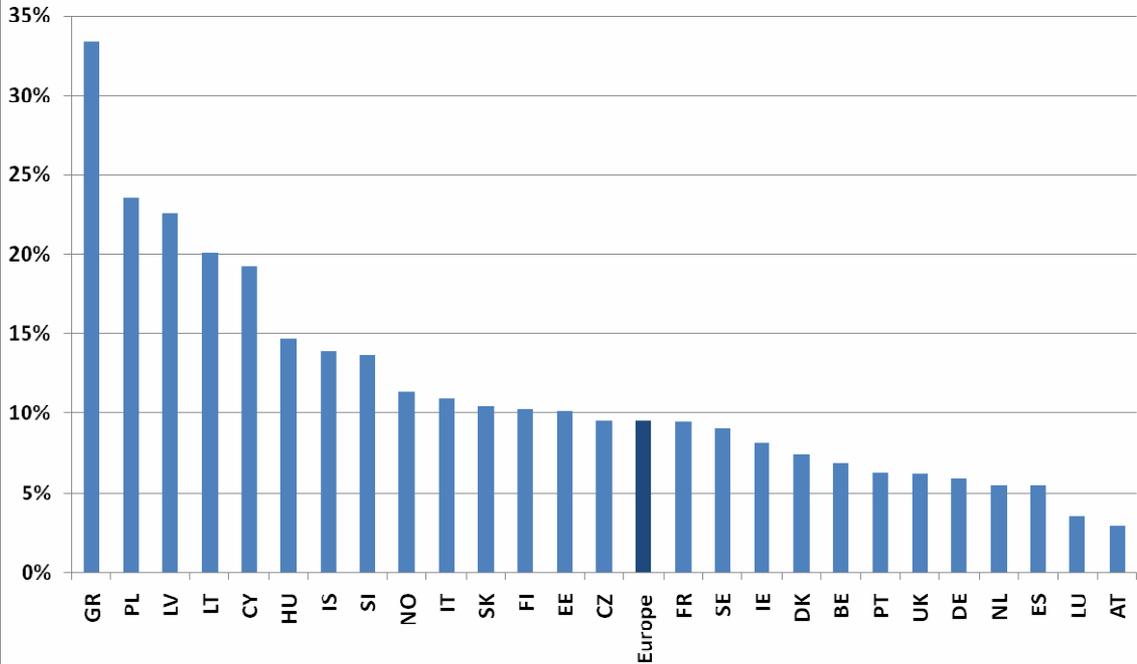
- The Eurobarometer survey includes one question on the difficulties of paying all the bills at the end of each month. However, the research entitled “Towards a common operational European definition of over-indebtedness” concluded that the EU-SILC survey was a better tool for measuring and analysing over-indebtedness.
- The EU-SILC is a **panel survey** which interviews the same households each year. This allows for analysis of the over-indebtedness histories of households and analysis of links with timing of key life events.
- The EU-SILC survey collects statistics concerning a **wide-range of other topics** (such as unemployment and financial exclusion) which enables an expansion of research.
- The EU-SILC survey’s questions **relate to households**, which is the most relevant unit for analysing over-indebtedness, while the Eurobarometer questions relate to individuals.
- **All Member States** have been implementing the EU-SILC survey since 2006.

# EU-SILC: relevant questions in the regular module

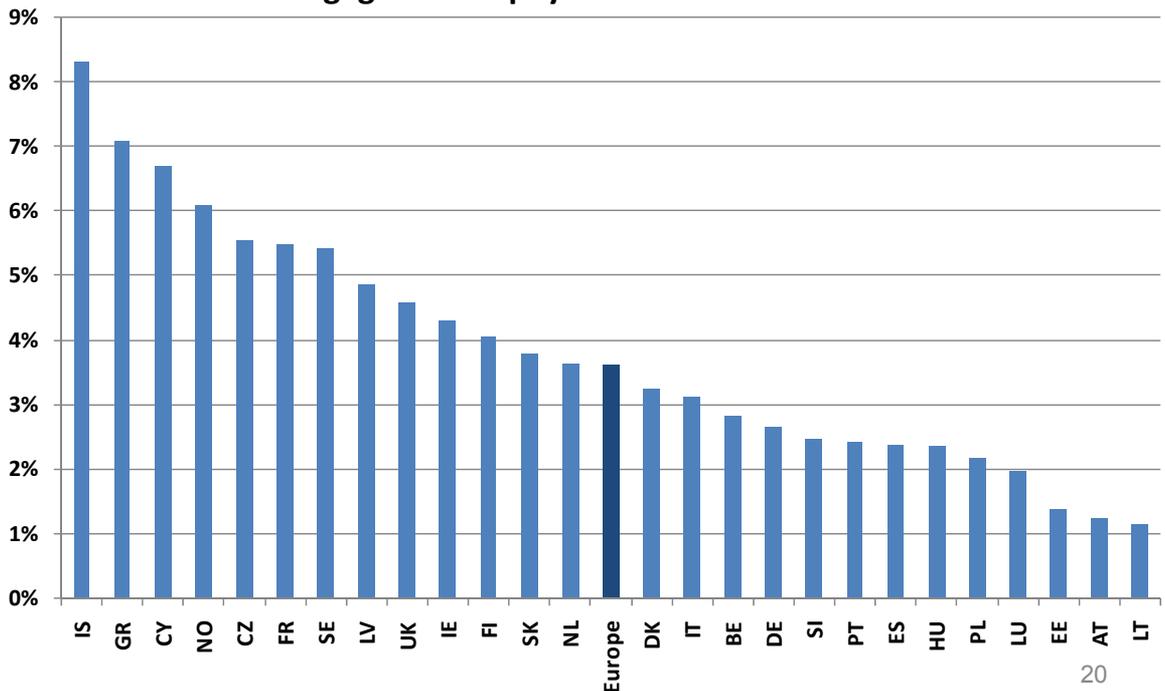
- **Arrears**
  - *Has the household been in arrears at any time in the last 12 months?*
    - (a) *Rent for accommodation or mortgage payments (HS010)*
    - (b) *Utility bills, such as electricity, water or gas (HS020)*
    - (c) *Hire-purchase or other loan payments (HS030)*
- *Questions asking people to give facts about their financial situation*
  - *Thinking of the household's total monthly income, with which level of difficulty is the household able to pay its usual expenses? (HS120)*
    - with great difficulty
    - with difficulty
    - with some difficulty
    - fairly easily
    - easily
    - very easily
  - *Capacity to face unexpected financial expenses (HS060)*
- *Self-assessment by households*
  - *How much of a financial burden is total housing cost? (HS140)*
    - Repayment is a heavy burden
    - Repayment is somewhat of a burden
    - Repayment is not a burden at all
    - Not applicable (No loans)
  - *How much of a financial burden is the repayment of debts from hire purchase or loans other than mortgage or loans connected with the house? (HS150)*
    - Repayment is a heavy burden
    - Repayment is somewhat of a burden
    - Repayment is not a burden at all
    - Not applicable (No loans)

# EU-SILC: Data on arrears (1)

Percentage of households that have been in arrears over the last 12 months

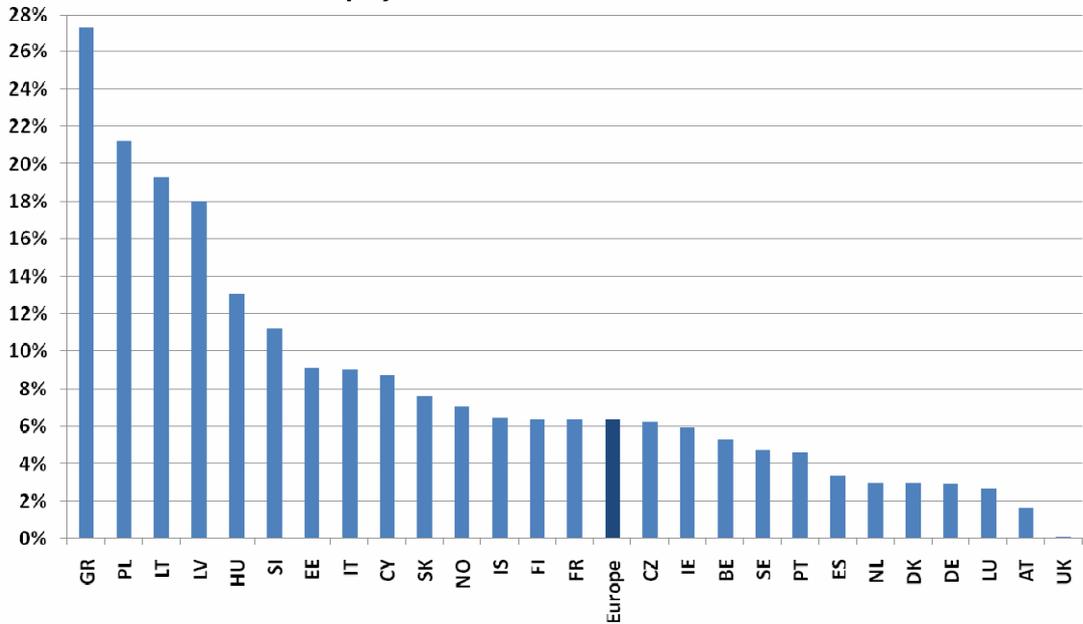


Percentage of households that have been in arrears on mortgage or rent payments in last 12 months

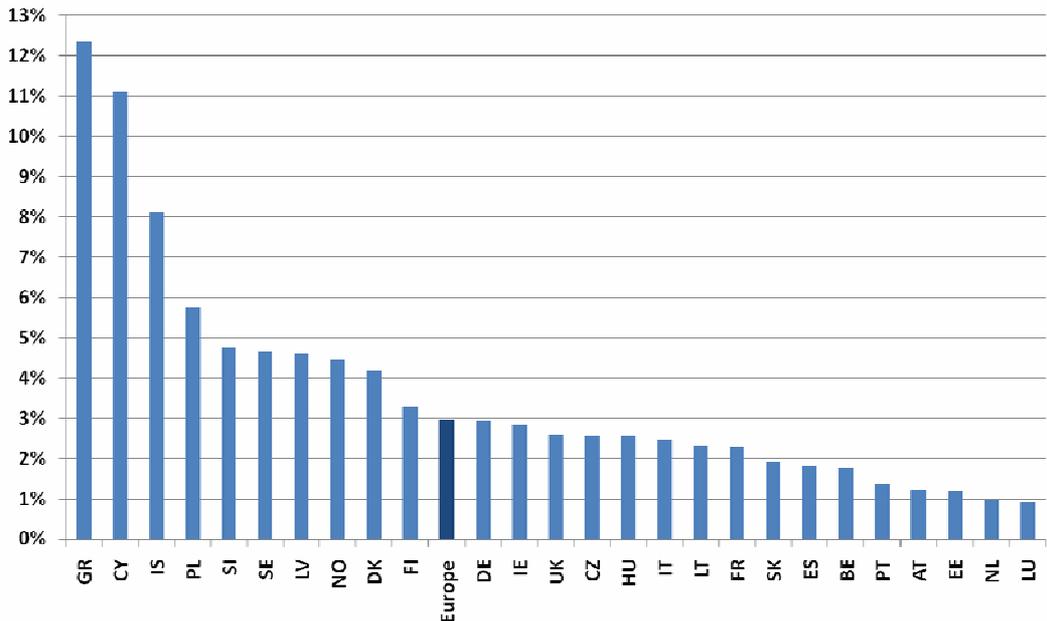


# EU-SILC: Data on arrears (2)

Percentage of households that have been in arrears on utility bills payments over the last 12 months

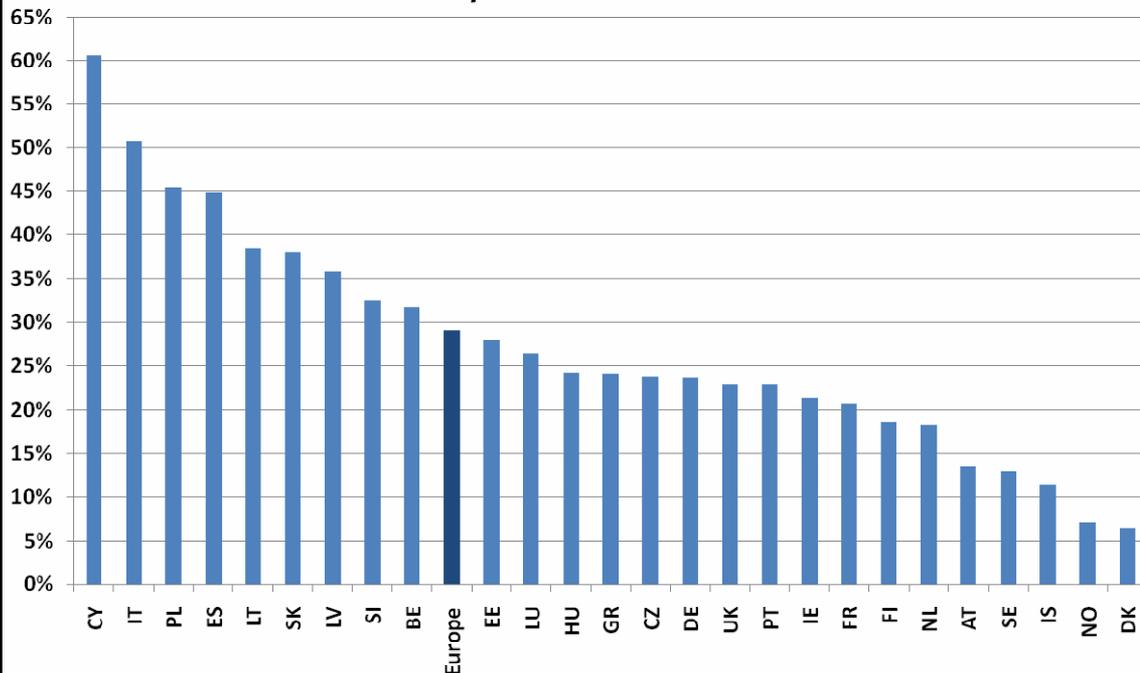


Percentage of households that have been in arrears on hire purchase instalments or other loan payments over the last 12 months

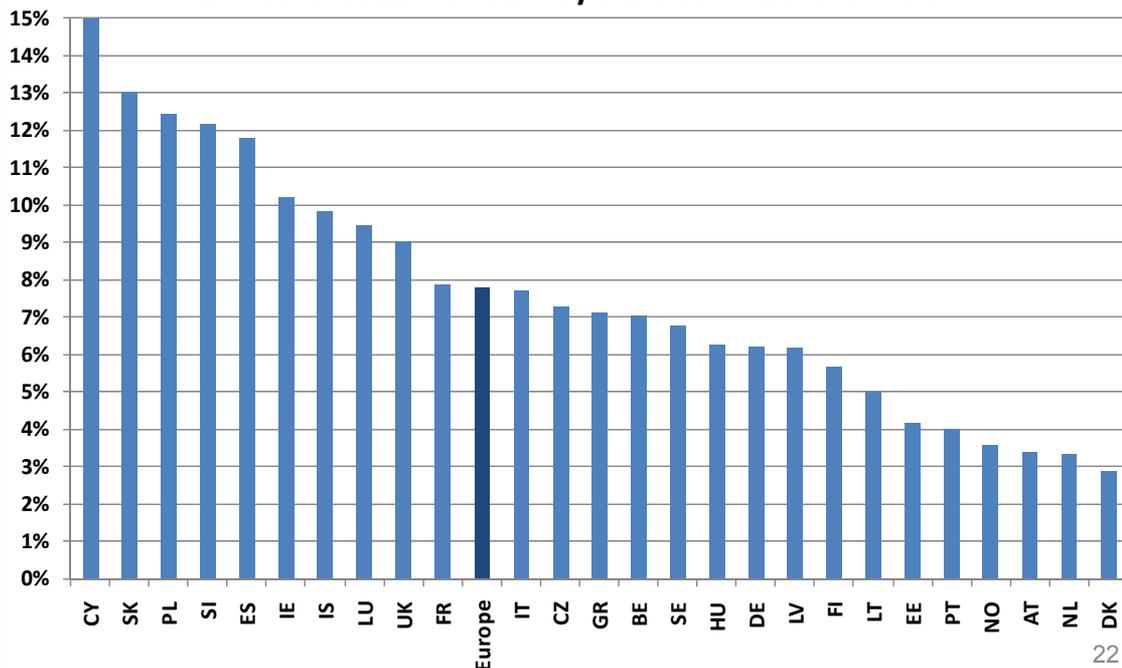


# EU-SILC: Self-assessment (1)

Percentage of households reporting that total housing costs are a heavy burden to the household



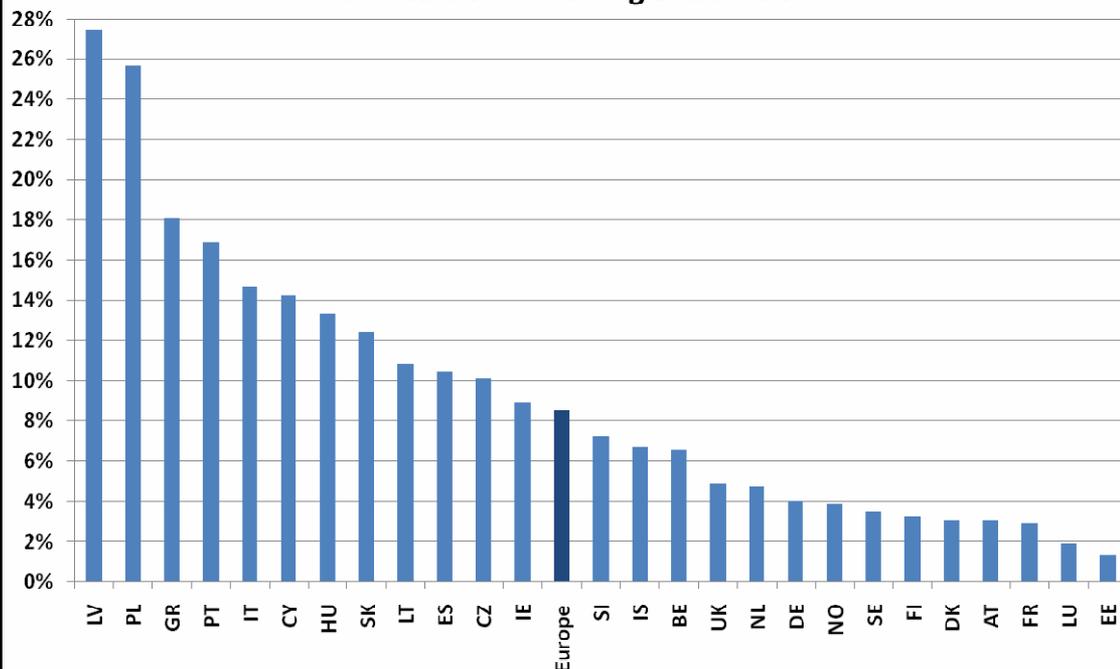
Percentage of households reporting that the repayment of unsecured loans\* is a heavy burden to the household



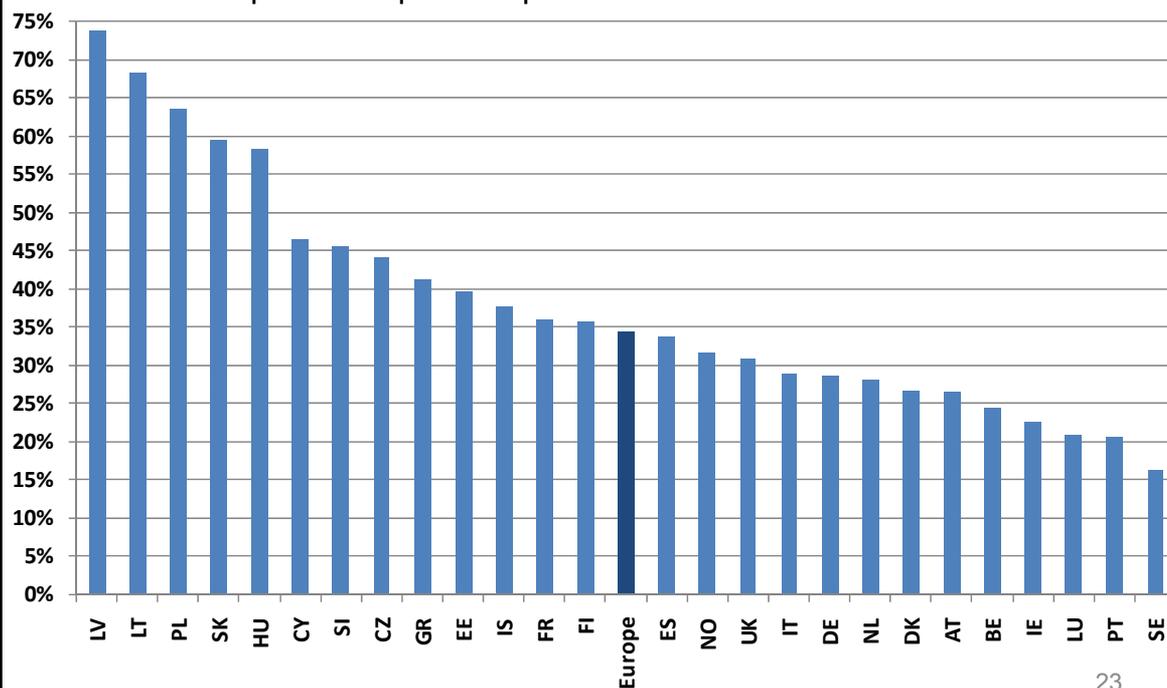
\* Debts from hire purchase or loans other than mortgages or loans connected with the house

# EU-SILC: Self-assessment (2)

Percentage of households reporting they have great difficulties in making ends meet



Percentage of households reporting they cannot afford an unexpected required expense of with their own resources



# The special EU-SILC survey module on over-indebtedness and financial exclusion

The regulation N° 215/2007 of 28 February 2007 established the list of “**secondary variables**” *that were to be introduced into a special module on over indebtedness and financial exclusion* of the EU-SILC survey. This module will only be used once in **2008**, but some of its questions could be introduced in the general module in 2011 if they appear as especially relevant.

Variables in this module relating to over-indebtedness are as follows:

## ***Unbalanced amounts on bank or credit card accounts***

M1025: Estimated total unbalanced amount on household's banks accounts.

M1045: Estimated total unbalanced amount at the last monthly statement on household credit/store cards.

Questions asking about the ***existence of different types of credit/loans*** the households have. A large number of credits can be considered as signaling over-indebtedness. Questions M1051 to M1058.

## ***Questions on arrears***

M1060: Arrears on other non-housing household bills.

M1065: Estimated total amount currently in arrears for other non-housing household bills.

M1075: Estimated total amount currently in arrears for household housing bills.

M1085: Estimated total amount currently in arrears for other household loans and credit repayments.

***Financial exclusion*** and over-indebtedness are interlinked phenomena. Hence it is useful to cross the answers to the above questions with answers to other questions. Following questions can contribute in defining the profile of over-indebted households:

Questions M1090 to M1095: are questions on the drop in household income and the main reason for the drop in income.

Question M1100: Expectations of the financial situation over the next 12 months.

Questions relating to the reasons why the household does not have commercial credit (especially question M124: Household used to have credit but the facility was withdrawn).

# II. Key elements of a policy to combat over-indebtedness

Measures to prevent over-indebtedness are needed in three broad areas:

- (1) Responsible lending;
- (2) Responsible borrowing and money management;
- (3) Responsible arrears management and debt recovery.

A comprehensive approach to tackling over-indebtedness also requires three groups of measures to assist people who are seriously over-indebted and to rehabilitate them:

- (1) Debt advice and counselling services;
- (2) Judicial processes, including bankruptcy;
- (3) Non-judicial (or amicable) procedures for debt settlement.

**In the following table, building blocks of policies to combat over-indebtedness are identified. Policy contents and examples of best practices are summarised.**

	<b>Building Blocks</b>	<b>Policy content</b>	<b>Best practices</b>
<b>Preventative policies</b>	<b>1. Responsible lending</b>	<ul style="list-style-type: none"> <li>- Credit reporting</li> <li>- Other responses (interest rate ceilings, affordable credit, tackling illegal lending)</li> <li>- Information</li> <li>- Advice</li> <li>- Education</li> </ul>	<ul style="list-style-type: none"> <li>- Efficient compliance monitoring</li> <li>- Sanctions</li> </ul>
	<b>2. Responsible borrowing</b>	<ul style="list-style-type: none"> <li>- Information</li> <li>- Advice</li> <li>- Education</li> </ul>	<ul style="list-style-type: none"> <li>- Young people still at school</li> <li>- The general population</li> <li>- Those in difficulties to prevent further problems</li> </ul>
	<b>3. Responsible arrears management</b>	<ul style="list-style-type: none"> <li>- Appropriate payment methods</li> <li>- Flexible procedures</li> <li>- Defaulters contacted at first sign of arrears</li> <li>- Negotiated repayment plans</li> </ul>	<ul style="list-style-type: none"> <li>- Enforceable provision with compliance monitored</li> <li>- Protection of dignity and minimum living standards</li> </ul>
	<b>4. Debts advice and counselling services</b>	<ul style="list-style-type: none"> <li>- Preventative work</li> <li>- Access to ancillary services</li> </ul>	<ul style="list-style-type: none"> <li>- Adequate funding</li> <li>- Quality ensured by certification/accreditation</li> </ul>
	<b>5. Judicial processes</b>	<ul style="list-style-type: none"> <li>- Holistic debt settlement</li> </ul>	<ul style="list-style-type: none"> <li>- Unrestricted access for most debtors</li> <li>- Compulsion on lenders to participate</li> <li>- Realistic payment levels and time limit on repayment schedules</li> <li>- Link to preventative measures for rehabilitation</li> <li>- No fault provision</li> </ul>
	<b>6. Non-judicial procedures</b>	<ul style="list-style-type: none"> <li>- Amicable debt settlement</li> </ul>	<ul style="list-style-type: none"> <li>- Unrestricted access for most debtors</li> <li>- Realistic payment levels and time limit on repayment schedules</li> <li>- Link to preventative measures for rehabilitation</li> <li>- Under-pinned by referral to judge if needed</li> </ul>
<b>Measures to alleviate over-indebtedness and rehabilitate debtors</b>			

# Responsible borrowing

**The goal** is to **help consumers to become sufficiently skilled** to act responsibly in their decisions to spend and borrow.

**Three target groups** have been identified: children and young people; adults in general; and adults in difficulty.

*On 18 December 2007, the European Commission adopted a communication on financial education. The Communication sets out some basic principles to guide providers of financial education, based on existing best practices. See: [http://ec.europa.eu/internal\\_market/finservices-retail/capability/index\\_en.htm](http://ec.europa.eu/internal_market/finservices-retail/capability/index_en.htm)*

## **Target group 1: children and young people**

School lessons can be organised:

- Either within the core curriculum: a compulsory program is to be included in an element that will be examined
- Or through external partners (such as private companies or not-for-profit organisations)

*Example of good practice: the SCHUFA programme in Germany*

*« SCHUFA macht schule ! » See: [www.SCHUFAmachtSchule.de](http://www.SCHUFAmachtSchule.de)*

### **Conditions for success:**

- Inform senior teachers by explaining to them why financial skills are important
- Train teachers
- Provide well designed resources

## **Target group 2: adults in general**

### **Main areas:**

- Budgeting
- How to put plans in place to protect the individual's financial security

### **Various channels:**

- Handbooks and seminars
- At the workplace
- At sales points (for specific product information)
- Interactive web pages. *Note that the **Dolceta** website, supported by the European Commission, developed on-line consumer tools for adults. It includes a "Financial services" module which has a specific focus on credit. See: <http://www.dolceta.eu/>*

## **Target group 3: adults in difficulty**

**Main areas:** Debt counselling and/or coaching on good budgeting and money management

### **Conditions for success:**

- Adequate funding
- Requiring debt counsellors to have a certified minimum level of training and skills, and offering them opportunities for further professional development
- Providing debt counsellors with the support of other professionals such as lawyers

*Example of good practice: the state-funded Money Advice and Budgeting Service in Ireland. See the synthesis report of the peer review, 2004.*

# Responsible lending

**The goal** is to **avoid irresponsible borrowing** in the interest of lender, borrower or society as a whole. It is therefore essential that there is some form of regulation to **protect vulnerable consumers from exploitative lending**.

All the countries covered by this study have transposed existing EU Directives into national law. Consequently, legislation regarding **disclosure prior to the credit agreement** is commonplace. Cost disclosure is an area of continuing debate and is being addressed further by the new directive that is going through the European Parliament at the time of writing.

**In addition to disclosure**, there is **a range of other measures**; some initiated by the credit industry itself, others by governments often in the form of legislation:

**Creditor initiatives:** Codes of practice which include provisions on responsible lending. Most effective when compliance is supervised by an independent body and sanctions can be taken when the code is broken.

*Example of good practice: the UK Banking code*

**Legislative requirements to check affordability** (including checking with credit reporting agencies and default registers)

Relatively uncommon but the proposed Consumer Credit Directive requires the affordability to be checked before the credit is granted.

*Example of good practice: Unsecured credit legislation in Belgium*

Legislation should allow **usurious and exploitative credit** agreements to be re-opened by the courts to make these agreements non-enforceable and the debt written-off.

The need for affordable credit for people the credit industry considers to be at high risk requires **public subsidy**.

# Responsible management of arrears

## ***Two general principles:***

- (1) Creditors should assume that ***non-payment arises due to difficulties*** paying rather than unwillingness
- (2) Creditors should seek to ***understand their customers' circumstances*** and needs

## ***Three levels of good practice:***

### ***Level 1: arrears avoidance***

- Utility customers should receive clear, regular and accurate statements listing both expenditures/outgoings and payments.
- Utility suppliers should regularly use actual readings (instead of estimated ones) and listings should be clear over when bills are based on estimates.

### ***Level 2: arrears handling***

- Creditors should initiate personalized contacts with the customer as soon as a payment is first missed.
- Creditors sharing payments should maintain the privacy of individuals by not contacting the individual at work nor making unsolicited contacts with defaulters' friends, family or work colleagues.
- Sheets sent to customers should include information on customers' rights and responsibilities and how to obtain independent debt advice.
- "Debt resting" (setting aside demands for payments for a period of time) is appropriate if a consumer has had a temporary shock on his financial situation.
- Creditors should accept any repayment plan devised by a debt advisor.
- Creditors might seek to waive or reduce penalty fees and interest surcharges in case of financial difficulties of the customer.

### ***Level 3: debt recovery***

- Creditors should take recovery actions only after they have exhausted all other avenues. They should make all reasonable efforts to re-schedule payment prior to instigating repossession proceedings.
- The creditor should protect the dignity of debtors.
- The creditors should protect the basic living standards of the individual. They should not cancel the contracts when this would jeopardize the basic needs of the debtor (utility contracts, renting contracts).

# Non-judicial procedures

Non-judicial procedures have **three major objectives**:

- 1) **Economic**: enabling over-indebted persons to remain or come back to normal economic life and employment.
- 2) **Social**: combating social exclusion.
- 3) **Regulatory**: encourage direct settlements between creditors and debtors without systematically going to Courts.

*From an operational viewpoint, policy makers will find practical recommendations in a peer review concerning The Netherlands: “Amnesty of debts: Amicable agreement and statutory solution”, 2006.*

Non-judicial procedures should be open to debtors and creditors who act **in good faith**

- **Incentives for creditors to participate**: supervision of debtors, realistic payment plans, no fees or lower fees than Court.
- **Incentive for debtor to participate**: time limits on the payment plans, partial debt write-off, advice and support on budgeting.

It is recommended that non-judicial procedures open the possibility of a **“clean slate” after a relatively short period of time** (two or three years). During this period debtors should be entitled to retain a minimum income and the surplus should go to pay off the creditors. Provided that debtors fulfil all their obligations under the debt rescheduling plan, they should be declared to have a “clean slate” after three years.

A sufficient number of **skilled, verified trustees** should be available to accompany the debtors. This will enhance the confidence of stakeholders in the procedure. A close cooperation with social services is a key element, for example when over-indebtedness goes with addiction or alcoholism. A holistic approach to consumer support (see above debt advice and counselling services) is to be recommended.

Finally it should be noted that **decentralized procedures** have proved to be the most efficient for dealing with amicable debt settlement.

# Judicial procedures, including bankruptcy

A **number of countries** have introduced holistic **judicial processes** to achieve debt settlement. Countries covered by this study where debt settlement procedures exist include: Austria, Belgium, Finland, France, Germany, the Netherlands, Norway, Sweden and the UK (where procedures are in the process of being revised). Similar procedures will be introduced in the Czech Republic in 2008. Where introduced, debt settlement procedures have played a major role in tackling over-indebtedness in a humane and efficient way, leading to their endorsement by the 2007 Council of Europe recommendation. **The main criticism is that they often do little to rehabilitate the debtor and prevent further financial difficulties in future.** Where countries lack legislation of this kind, outcomes of court hearings tend to be harsh.

**Bankruptcy provisions** are another important part of a comprehensive approach to over-indebtedness and have been introduced for individuals in most of the countries studied.

## **Key ingredients of an ideal judicial debt settlement scheme:**

- Link to an amicable procedure that is designed to avoid cases going to court and assist people where it is necessary;
- Unrestricted access (except in cases of fraud);
- Compulsion on lenders to participate;
- Oversight of payments by a trustee or a mediator, with an appropriate balance between support for debtors and ensuring strict adherence to repayment plans;
- Realistic payment levels that leave the debtor with income for an adequate standard of living, with an automatic procedure triggering revisions to payment plans when default occurs;
- Time limit of no more than five years on the payment plans, plus debt write-off, following consideration of whether both lending and borrowing was responsible;
- Total debt write-off for those too poor to repay, whose situation is unlikely to change in the future;
- Link to a programme of assistance with money management and budgeting to help with rehabilitation and to prevent further problems.

# Coordination of policies

The ***diversity of actors*** tackling over-indebtedness raises the issue regarding ***coordination***.

***Two member States have developed specific schemes of coordination***, namely Ireland and the United-Kingdom. Their experience can be used for additional Member States aiming at better coordination of over-indebtedness policies:

***(1) In Ireland, MABS (the Money Advice and Budgeting Service)*** was established in 1995 by the Department of Social and Family Affairs to address all problems of money lending and over-indebtedness.

***(2) In the UK***, the issue of coordination is addressed by a ***cross-ministerial group*** in charge of reviewing and defining strategy for tackling over-indebtedness (***the Over-indebtedness Task Force***).

This coordination ***can also be enhanced by not-for-profit associations*** being subsidized by governments like for example the Information and Advisory Service on Over-indebtedness in Luxembourg. Lastly, research institutions have joined forces so as to analyse and define policy in a number of countries.

# III. Organisations

**Four types of organization** play a role in tackling over-indebtedness:

- (1) Public bodies
- (2) Credit reporting agencies
- (3) Financial intermediaries
- (4) Not-for-profit sector

## **PUBLIC BODIES**

**Involvement** of public bodies *varies across countries*. In countries where credit has not yet expanded to a larger extent, such as in Eastern European countries, public policies are still relatively under-developed. In contrast, in countries where over-indebtedness has been a growing social problem for many years, the responsibility of the state has progressively been recognised.

**Ministries of social affairs, of economy and finance and of justice** are the most frequent administrative bodies responsible for enforcing public policies. In some countries the **Ministry of Education** intervenes to make personal finance training available to school children. As a last resort, **public agencies** and **courts** manage debt relief or bankruptcy procedures.

**Central Banks** influence debate indirectly by monitoring the impact of lending to households on the financial stability of the banking sector. For example, the increase in the number of over-committed households was considered as a sign of economic overheating in the Baltic countries. Central Banks hold important data from banks, some of them manage a public credit register. In one case (France), the Central Bank is also responsible for coordinating most of the curative policies.

In terms of data, **national institutes of statistics** are, in general, responsible for their country's contribution to the EU-SILC survey, which is one of the main sources of harmonized information on over-indebtedness in Europe, as stated above. Complementary data, including data resulting from surveys is available from central banks, professional bodies and researchers.

## **CREDIT REPORTING AGENCIES**

Credit reporting agencies collect personal financial data on individuals which contributes to the prevention of over-indebtedness as they enable banks and other lenders to detect over-borrowing. Across the different states in Europe, data collections differ (positive and negative information), the sample of reporting institutions differs as well as the coverage of the population. For instance, whereas credit information markets such as the UK, Italy or Germany are highly developed, there is a public monopoly in France and markets are in an early stage of development in Bulgaria and the Czech Republic.

## **FINANCIAL INTERMEDIARIES**

Financial intermediaries obviously participate in all aspects of over-indebtedness issues. On a day-to-day basis, lenders have to re-schedule or cancel parts of debts of their over-committed clients. Bank mediators (or ombudsmen) can also be mobilized when other internal procedures of banks have failed. Several professional associations of banks have established codes of conduct for the marketing policy of their members. Some banks (such as Volksbank in the Netherlands) and Credit Unions provide an access to cheap micro-credit, an alternative to extortionate practices of some money-lenders or a tool for negotiating repayment plans with creditors.

## **NOT-FOR-PROFIT SECTOR**

The not-for-profit sector (consumer associations, trade-unions, family associations, among others) play an important role in countries where over-indebtedness has not yet been recognized as a major problem requiring public policy. SOS in the Czech Republic, the Financial and Consumer Advice Centre (ODFiK) in Poland, Caritas of Bolzano in northern Italy, DECO in Portugal and ADICAE in Spain are good examples of such associations engaged in financial education and giving advice to over-indebted people. But one should not over-estimate the role of the not-for-profit sector; their area of intervention is often narrow due to a lack of financial resources. Furthermore, there are examples of countries where the not-for-profit sector has not developed despite the weak intervention of public authorities.