

The *Real* Cost of Christmas

Assessing the impact of illegal money lending on consumers



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1. EXECUTIVE SUMMARY – JANUARY 2010

The economic downturn and subsequent recession has had a profound impact on low income households. It is estimated that between 650,000 and 850,000 households in the UK have lost access to legal forms of borrowing including commercial home credit companies, who have restricted access to loans and implemented more selective criteria about who they are lending to. As a result, the use of loan sharks as a last resort lender is on the increase with over 200,000 taking on credit from this illegal source annually, an increase of 22% since 2006.

It is estimated that each household in the UK will spend an average of £469 on Christmas 2009 with 66 per cent of people taking out credit to do so¹. The Financial Inclusion Centre has sought to make informed estimates and calculations about the likely debt problems associated with loan shark activity during Christmas 2009.

KEY FINDINGS:

- **Up to 100,000 households turned to loan sharks during Christmas 2009**
- **The value of illegal loans taken out over Christmas 2009 was an estimated £29m**
- **The final cost of repaying Christmas 2009 debt, with exorbitant interest rates, will be £82m**
- **The average interest rate charged by an illegal money lender over Christmas 2009 was equivalent to an APR of 825%**
- **A consumer who took out a £288 loan from an illegal money lender with an APR of 825% will end up paying back nearly three times this initial amount (£820)**
- **It will take over a year before the typical family manage to pay back their Christmas 2009 loan shark debts**
- **Borrowing from a third sector credit provider like a credit union instead of a loan shark at Christmas 2009 would have saved a typical low income household £500 (based on an original loan of £288)**

¹ Research undertaken by American Express (2009)

2. BACKGROUND

2.1. METHODOLOGY

'The Real Cost of Christmas' was conducted by the Financial Inclusion Centre. The Financial Inclusion Centre is an independent, not-for-profit think-tank, whose aims are to promote greater financial inclusion and provision, so that consumers' core financial needs are met.

'The Real Cost of Christmas' incorporated desk research and analysis of existing data sources and studies on illegal money lending in the UK. Due to the illegal nature of the problem and the secrecy surrounding the subject, the body of research on this problem is limited to a select number of reports.

The research team have applied this gathered information and statistics to develop a series of scenarios that seek to quantify the scale of expected illegal money lending in the UK over Christmas 2009, taking into consideration the current economic downturn and the expected problems in accessing legal finance for the UK's poorest households.

So, what is the value of the average loan taken out from loan sharks? Clearly, the average amount borrowed from legal doorstep lenders varies considerably, depending on the type of borrowing and the circumstances of each customer. However, we do know that the likely level of borrowing at Christmas, based on the most recent figures for the average amount borrowed from legal commercial home credit companies, was estimated to be £288 with loans typically in the £100 to £500 range. The repayment period is on average 56 weeks². But why should that be the basis of any calculation on illegal doorstep loans? Well, there is also other research available: surveys in 2006 have found customers borrowing average sums close to £250³ from loan sharks, again taken out on average for just over a year. Factoring in the impact of inflation over four years on this, £250 brings us to a figure of £285. For the purposes of this paper we will use the £288 figure as our 'average' estimate for the initial value of illegal **doorstep** loans taken out over Christmas 2009.

2.2 RESEARCH BACKGROUND

The onset of the credit crunch and subsequent economic downturn has resulted in the restriction of available credit on a scale never experienced before. It is not just the high street banking sector that has constrained its lending practices, doorstep lenders previously willing to lend to low-income, high-risk customers have also withdrawn from certain markets, narrowing their lending criteria and becoming more selective about the individuals they lend to. This has left up to 850,000⁴ families without access to this extortionate but regulated form of borrowing over the last two years.

² Elaine Kempson, Anna Ellison, Claire Whyley, and Paul A. Jones (2009) Is a not-for-profit home credit business feasible? Joseph Rowntree Foundation.

³ Ellison, Forster and Collard, (2006) Illegal Lending in the UK. PFRC and Policis for the then DTI

⁴ Chris Leslie and Alex Hood (2009) Circling the Loan Sharks: Predatory lending in the recession and the emerging role for local government. New Local Government Network.

Illegal money lenders have increasingly filled the vacuum left by the market retreat of legal doorstep lenders. Recent research shows that more people are resorting to loan sharks with 200,000 people in Britain now thought to be in debt as a result of illegal money lending (see Table A below). Based on our conservative estimates, these individuals are borrowing over £57 million, with repayments totaling more than £164m each year, approximately £720 per victim⁵.

'The Real Cost of Christmas' looks to attach a numerical value to the activity of loans sharks, who have a damaging impact on the most vulnerable in our communities, over the Christmas 2009 period.

2.3 CURRENT LANDSCAPE – ILLEGAL MONEY LENDING IN THE UK

Illegal money lenders offer unsecured loans at exorbitantly high interest rates. They are unlicensed, operating outside the Consumer Credit Act, and are commonly referred to as 'loan sharks'. Exploiting the most vulnerable and desperate in our society, they often lock their customers into unaffordable loans that quickly lead to spiralling levels of debt. Failure to pay back these loans can result in blackmail, violence and intimidation.

In October 2008, the proportion of benefit dependant households with outstanding unsecured (legal and illegal) debts of any kind was 41%, an average of £3,590 of debt per person. This level increases to 53% amongst low income earners⁶. Current estimates show that more than 200,000 UK households are borrowing from loan sharks each year – equivalent to approximately 6% of households in the most deprived areas in the country (See Table A below).

Research into the use of illegal money lenders has found a link between illegal money lending and legal doorstep lending. Around half of all users of illegal credit suppliers have borrowed from a home credit company lender within the past 12 months⁷.

Victims of illegal lenders typically tend to be women aged between 30 and 40 years old with children⁸. They will be reliant on state benefits and living in social housing located in some of the UK's poorest communities. Illegal lending is shown to mainly occur in areas with a high incidence of crime, social problems and substance abuse⁹.

The highest incidences of illegal lending are shown to occur in Scotland, the North and the West Midlands. These are the regions most at risk with pockets of illegal lending activity also occurring in the South, several regions London (including Newham and Tower Hamlets), Portsmouth and Plymouth¹⁰.

⁵ Financial Inclusion Centre - conservative estimates based on weighted averages of number of victims and size of loans.

⁶ Resolution Foundation (2009) Squeezed - The low earners audit.

⁷ Ellison, Forster and Collard, (2006) Illegal Lending in the UK. PFRC and Policis for the then DTI

⁸ ibid

⁹ ibid

¹⁰ Ibid

3. THE *REAL* COST OF CHRISTMAS – 2009

It is estimated that households will spent an average of £469 on Christmas 2009. This figure represents a reduction of almost £90 compared to 2008, with £260 being spent on presents, £141 on festive food and drink, and £67 on decorations and cards¹¹. This amount is on top of households' regular financial commitments.

Increasingly, Christmas budgets have become more difficult for consumers to manage. Research by moneysupermarket.com in October 2009 found that 66 per cent of adults did not think they would save enough money to fund Christmas 2009, and would need to borrow to fund the festive period.

3.1 INTEREST LEVELS CHARGED BY ILLEGAL MONEY LENDERS

Average APR levied by illegal money lenders, Christmas 2009: 825%

It has been estimated that credit taken from an illegal money lender is, on average, three times the cost of the same loan from the highest cost legal lender.¹² This is based on credible Government research showing that the amount households paid back to loan sharks was, on average, £285 per £100 received. To put this in perspective, the average level of interest charged by legal doorstep lenders varies considerably, but is typically between 188% APR to 500% APR.¹³

Knowing that illegal doorstep lenders are typically three times more expensive than legal options, we project that interest rates from illegal lenders will currently be in the range of 566% APR to 1,500% APR. Based upon these figures, the Financial Inclusion Centre has concluded that the equivalent average APR used by illegal money lenders is likely to be around 825%, this is based on the above research suggesting that people pay back £285 per £100 received. This APR is then derived from those baseline figures and average time to repay of 56 weeks.

It should also be noted that interest rates between 8,000% APR and 117,000% APR have commonly been uncovered by the Financial Inclusion Centre's research team, with a significant minority of individual cases citing loan sharks charging APR interest in the millions.

¹¹ Research undertaken by American Express (2009)

¹² Ellison, Forster and Collard, (2006) *Illegal Lending in the UK*. PFR and Policis for the then DTI,

¹³ Competition Commission (2006) Home credit market investigation.

3.2 THE TOTAL HOUSEHOLD COST OF LOAN SHARKS – CHRISTMAS 2009

*22 % increase in households turning to loan sharks (2006-2009)
Up to 100,000 took out illegal loans over Christmas 2009
Cost of Christmas 2009: loan shark debt totals £82m*

From 2006 – 2009 the estimated use of loan sharks in the UK increased from 165,000 to over 200,000 households per annum. This data, drawn from Department of Trade and Industry research (2006) and the New Local Government Network¹⁴ (2009) - included in Table A below – is the starting point for our Christmas 2009 analysis.

The two data sets demonstrate a headline increase in illegal doorstep loans of 22 per cent over the last three years – a direct consequence of diminishing activity of legal doorstep finance companies and growing proliferation of loan shark activity to meet this vacuum.

A 2006 survey found that the typical increase in household spending around Christmas results in a spike in demand for illegal doorstep loans¹⁵. We estimate that between one third to one half of all illegal annual loans will be taken out during the Christmas period – see Table B below.

Based on the existing data about loan shark activity, this represents between 66,800 and 100,100 households taking out credit from loans sharks to pay for Christmas 2009. We use the upper end of this scale (100,100) which, given the unprecedented nature of the economic downturn and the disproportionately large impact it is having on access to legal credit on the lowest income households, is considered to be a fair assumption.

Assuming that these households borrow the estimated average of £288 (see methodology), we predict that the total repayments will reach well over £82 million, based on an APR of 825%. See Table B below for full data.

Table A: Estimate of numbers using loan sharks

Category of the population	Population falling into category	Policis/PFRC estimates of incidence of loan sharking (2006)	Policis/PFRC estimates of users of loan shark users (2006)	Likely incidence of loan sharking by end of recession	Likely number of loan shark users by end of recession
Most deprived estates as measured by IMD percentile above 95%	1,400,000	5.6%	77,400	5.6% (constant)	77,400

¹⁴ Chris Leslie and Alex Hood (2009) Circling the Loan Sharks: Predatory lending in the recession and the emerging role for local government. New Local Government Network.

¹⁵ Illegal Lending in the UK (November, 2006). Policis and the Personal Finance Research Centre.

Other most deprived 20% of areas as measured by IMD between 80% and 95%	4,100,000	2.1%	87,400	3% (0.9% rise)	123,000
Total	5,500,000		164,800		200,400

Table B: Estimated total cost of borrowing from illegal money lenders for Christmas 2009

Estimated number of households borrowing from loan sharks for Christmas 2009	Total borrowed	Total interest	Total cost
66,800	£19,238,400	£35,592,376	£54,830,776
100,100	£28,828,800	£53,335,282	£82,164,082

*borrowing an average amount of £288 with an average interest rate of 825% APR

3.3 THE ALTERNATIVE: THIRD SECTOR CREDIT PROVIDERS VS LOAN SHARKS

*£50m could have been saved by the UK's poorest households
A £288 loan from an illegal lender will end up costing consumers £820 in repayments*

The typical length of time to repay a loan shark loan is estimated to be just over a year – 56 weeks. What the following analysis demonstrates is the extra length of time it would take for a consumer to repay a typical loan from a loan shark rather than borrowing from a 'fair lender' such as third sector credit providers like credit unions or a Community Development Finance Institution (CDFI).

Again, these figures are based on the estimated average size of a loan from illegal lenders being approximately £288. Repaying this amount over 56 weeks at an APR of 825% would mean the borrower pays nearly £15 a week – a total of around £820. But as Table C indicates below, borrowing the same amount from a credit union would cost just under £6 a week – or £327.

Across, the whole of the UK, therefore, if these already vulnerable households had alternative access to fair and affordable credit and had been able to take out their Christmas 2009 loans with a third sector credit provider instead of an illegal money lender, we calculate that the total savings could have been between £32,955,112 and £49,383,334.

Those resorting to loans sharks to borrow credit do so as a method of last resort, often having exhausted other lines of credit. If these households were able to access credit from alternatives sources, the potential savings and benefits for some of the worst off families could be huge.

As is indicated in Table C, if a shopper had borrowed from a credit union instead of a loan shark for the 2009 Christmas period they could have saved nearly £500. If every person who borrowed from a loan shark over Christmas had done the same, up to £50 million could have been kept in the hands of residents in some of Britain's poorest communities.

Table C: Estimated cost of borrowing from alternative sources of credit.

Amount borrowed	Type of lender	Loan term	Interest rate	Weekly repayment	Total interest	Total cost	Total potential saving
£288	Loan Shark	56 week	825% APR	£14.66	£532.82	£820.82	-
£288	Home Credit Loan – Provident Personal Credit ¹⁶	56 weeks	272.2% APR	£9.97	£270.40	£558.40	£262.42
£288	Credit union	56 weeks	26.8% APR	£5.85	£39.48	£327.48	£493.34

4. CONCLUSION

The UK's poorest households are suffering at the hands of loan sharks after Christmas 2009. The economic downturn in the UK is impacting on low income families most profoundly. From our expertise working on financial exclusion issues, we believe that the estimates contained within this paper reflect likely loan shark activity over Christmas 2009. The proliferation of loan sharks has been a marked feature of the credit crunch for low income households. The Christmas season is when loan shark activity reaches a peak: in all likelihood Christmas 2009, with the UK technically remaining in recession, will have been the worst in a generation in terms of the volume of loan shark activity. Already vulnerable families are left to struggle with high debt repayments for, on average, well over a year. The withdrawal of legal doorstep lenders has left a gap, and that gap has been filled by illegal money lenders.

¹⁶ Provident Personal Credit are the largest provider of home credit in the UK with approximately 60% of the market share. Relative APR figures checked using loan calculator on www.providentpersonalcredit.com/home-credit/loan-calculator/ (site accessed 26/11/09).

5. APPENDIX

How to tackle financial inclusion

As a leading provider of affordable housing with over 187,000 residents, Circle Anglia is well placed to help tenants who are facing financial difficulty. We work directly with thousands of people across the UK, who are often amongst the most vulnerable to loan sharks. We work hard with residents and communities to enhance Life Chances by helping our residents become financially included and aim to ensure every resident should be offered access to five basic financial services: advice, banking, credit, insurance and saving. We:

- Promote bank accounts to increase number of tenants, who have a bank account
- Offer basic debt and money advice to residents in financial difficulties
- Offer advice, education and training to help residents make good financial choices
- Ensure residents know where to go to find relevant agencies for money / debt advice such as the Citizens Advice Bureau thereby reducing their reliance on doorstep lenders and loan sharks
- Help our residents make good financial decisions and to maximise their income
- We work in partnership with Community Development Finance Institutions such as credit unions to help residents access affordable credit
- We make realistic arrangements for payment of arrears, sympathetic to genuine hardship situations
- We offer tenants low cost home contents insurance schemes to protect the things that are valuable to residents
- Help tackle fuel poverty to ensure residents are able to adequately heat their homes

Providing residents with access to fair, affordable credit: Fair Finance / Circle 33

One of Circle Anglia's London housing associations, Circle 33 Housing Trust (owns over 15,000 homes across London and in 48 local authority areas) has developed a partnership with third sector credit provider Fair Finance to promote wider access to affordable loans for our residents. Fair Finance is a social business based in London that offers a range of financial products and services designed to meet the needs of people who are financially excluded. For those Circle 33 residents, who have been supported to repay their loan on time, Fair Finance will ensure they receive a credit rating and therefore have access to mainstream affordable loans. So far Fair Finance has helped hundreds of our residents with advice, loans and assistance in opening bank accounts, and in 2009 72 residents were provided with affordable loans to replace loans from expensive doorstep lenders.

Wherry Housing Association: Tackling loan sharks in Norfolk

Wherry Housing Association is one of our partners; owns and manages over 7,000 homes in Norfolk, Suffolk, Lincolnshire and Cambridgeshire. Wherry Housing Association is leading the sector with their model of mainstreaming financial inclusion services and have dealt with £2.6 million of resident debt since the service launched in November 2006.

Wherry Housing Association works jointly with the East of England Trading Standards to tackle loan sharks in Norfolk. To turn the spotlight on illegal money lending among staff and residents, in April Wherry completed a doorstep survey of 400 residents. The results were:

- 26% had been offered a cash loan
- 3% had been threatened when they couldn't pay
- 9% said what they owe keeps growing even though they were making payments
- 5% were not given any paperwork stating what they borrowed or how much they owe
- 2% said their bank card or something else had been taken from them as security

Mole Valley: providing advice and support

Mole Valley Housing Association is one of our partners and manages 3,800 homes including 17 sheltered schemes in Surrey. Some of Mole Valley residents that do not have access to the most basic financial services such as having a bank account, access to affordable credit and money advice. Mole Valley sponsors a Citizens Advice Bureau (CAB) worker to work on behalf of residents two days per week. The CAB worker is trained to provide debt and benefit advice and can access other specialist support and advice if necessary. The CAB service was introduced at the end of August 2009. In only the first two months, approximately £5,000 was raised in respect of benefits for tenants.

MVHA intends to launch "credit crunch lunches" for the community with its local partners such as the CAB and some national agencies and support services, such as the Financial Services Authority, during the first quarter of 2010. This partnership approach will enable residents to access a wide-range of information, advice and support in an informal way. This was a successful initiative carried out by Wherry Housing Association in 2009.

Mercian Housing Association: affordable loans to help people improve their homes

Mercian Housing Association, one of Circle Anglia's partners, owns and manages 3,400 properties in the Greater Birmingham area. Mercian Housing Association own ART Homes Limited (AHL), an FSA authorised, not-for-profit organisation that works in partnership with local authorities and provides regulated financial advice and affordable loans to vulnerable and low income home owners living in poor housing. Loans are available to help people to improve or repair their homes or relocate if affected by clearance or

regeneration programmes.

AHL loans are targeted at those who are assessed as eligible for support by local authorities and who are unable to obtain affordable finance from high street lenders. In 2008 / 09 loan completions rose by 50% - Mercian Housing Association have now provided over £20m in affordable loans to vulnerable and low income home owners living in poor housing.

Circle Anglia:

- Circle Anglia is one of the UK's leading providers of affordable housing. With a dedicated team of more than 2,000 staff, Circle Anglia manages more than 51,500 homes, including supported and sheltered housing, for more than 187,000 people across the UK.
- Its mission is to enhance the Life Chances of its residents by providing great homes and reliable services, and building sustainable communities.
- The Circle Anglia group includes 11 partners - eight registered providers (RPs): South Anglia Housing, Wherry Housing Association, Old Ford Housing Association, Circle 33 Housing Trust, Roddons Housing Association, Mercian Housing Association, Mole Valley Housing Association and Russet Homes; two support & care partners: EPIC Trust and Invicta Telecare, as well as Commercial Services Circle Anglia for shared ownership, market rent and private sale properties.
- For more information about Circle Anglia and its partners, please visit www.circleanglia.org, email pressoffice@circleanglia.org or call 0845 234 0824.

Financial Inclusion Centre:

The Centre is committed to the highest level of standards in research and analysis. Previous initiatives into financial exclusion and consumer behaviour in financial services have included:

- quantifying the extent of financial exclusion and underprovision;
- analysing the impact on consumers – including regional impacts, and how exclusion affects specific groups of consumers;
- identifying and analysing the root causes of financial exclusion so that solutions and policies are effective;
- providing insights into consumer behaviour so that financial capability initiatives have greatest impact and products are better designed to meet consumers needs;
- assessing the impact of government and regulatory policy, 'environmental' trends in society such as changing socio-economic conditions and demographics, and market developments on consumers.