

# THE SOCIAL MARKET FOUNDATION

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# FINANCIAL EDUCATION AND PERSONAL DEBT

THE ROLE OF THE STATE, THE  
MARKET AND THE INDIVIDUAL

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## FOREWORD

Provident Financial is pleased to sponsor SMF's work on financial education. We believe we can make a strong contribution to this debate.

We take a keen interest in it because it is important to our customers. Financial education is a tool which can help them to make the right choices from a range of different products and services.

We are also keen to help legislators arrive at effective policy decisions. In this way, we can help to ensure that consumers enjoy both high levels of choice and appropriate protection.

I am sure you will find the three submissions thought-provoking and informative.

Robin J. Ashton  
Chief Executive  
Provident Financial

## INTRODUCTION

Roger Wicks, Research Fellow, Social Market Foundation

The issues of financial education and personal debt have critical implications for the state, market and the individual. How can the state and the market work together to ensure, as far as possible, that the use of credit does not lead to over-indebtedness? Where does the correct balance lie between the responsibility of the consumers, creditors and state services?

Based on three presentations given at the SMF on 5th November 2002, this paper aims to tackle these fundamental questions. Melanie Johnson MP, Parliamentary Under-Secretary of State for Competition, Consumers and Markets at the Department of Trade and Industry, sets out the Government's strategy on debt and the role of education. Picking up on the significance of education, Keith Tondeur, Director of the charity Credit Action, highlights the importance of basic numeracy skills. Finally, Malcolm Hurlston, Chairman of the Foundation for Credit Counselling, considers the role debt charities such as his play and the obligations, he believes, creditors should assume.

They disagree strongly on the role of financial education. Improving the financial literacy and numeracy of consumers is a key Government objective and Melanie Johnson sets out policies designed to "build a generation of empowered consumers" who understand "the choices open to them and their implications". Keith Tondeur argues that the state must ensure that pupils are prepared for the amount of credit they will be offered when they turn eighteen. Malcolm Hurlston, meanwhile, is more sceptical about the role education can play, arguing that consumers have more sense than they are given credit for.

Both he and Keith Tondeur are naturally scathing about fee-charging debt management companies that operate, as Hurlston says, "in a parasitical fashion". Both heads of charities, they make a powerful ethical case for greater support from the creditors, either through financial backing, as Hurlston demands, or by informing their customers that free confidential debt advice is available, as Tondeur recommends.

The commentators offer both moderation and condemnation in well crafted fashion. More importantly, their papers provide informed analysis and recommendations for change. Beyond the question of credit, there are crucial

implications here on issues as diverse as the funding of higher education and the future of the social fund.

A comprehensive, DTI-led, government review into over-indebtedness and financial education will be published in the Summer of 2003. It will set out future policy in response to the recommendations in the PIU (now Strategy Unit) report, "Lending Support: Modernising the Government's Use of Loans" (March 2002). We hope this publication will contribute both towards this policy-making process and the wider debate. Our thanks are due to all those who participated in this event, in particular to the speakers.

## PRESENTATIONS

### 1 Melanie Johnson MP, Parliamentary Under-Secretary of State for Competition, Consumers and Markets at the Department of Trade and Industry

Personal debt is on the increase. The amount we owe on credit cards and other forms of consumer credit is at a record high. As a nation, we seem to be increasingly in debt. But debt is not necessarily a problem. Debt is *not* the same as over-indebtedness. And while the amount of money we borrow is rising, the number of accounts in arrears remains constant. Credit is a growing part of our day-to-day lives. Most of us have loans, or other credit, which can be managed without difficulty. And borrowing can be a useful tool to help households smooth their income over time. So it is the use of credit as a tool – an enabler – that is increasing. Debt only becomes a problem when people cannot afford the repayments.

And when debt *does* become a problem – when it turns to over-indebtedness – it has a cost; a cost to the debtor in terms of the impact of debt on people's lives, a cost to industry in terms of outstanding loans, in terms of goods not paid for. And a cost to Government in terms of debt collection and enforcement.

We want to build a generation of empowered consumers who can manage their credit effectively. Who understand why it is important for them to master their finances, and how they might achieve that. Who can make appropriate decisions about their finances. Who understand the choices open to them and their implications.

Ultimately, individuals have the responsibility to manage their own finances effectively. But Government has a role to empower them to do so. We need to look at the big picture. In November 2002 we published research looking at why people get into debt, how much debt they get into, and the impact it has. We are also conducting a review of Government policy on over-indebtedness.\* This review will investigate the demand for debt advice and financial literacy programmes. It will clarify the roles and responsibilities of Government departments on over-indebtedness. And it will make recommendations on future Government policy on reducing over-indebtedness.

But debt cannot be seen in isolation. The Treasury are also developing a

\*<http://www.dti.gov.uk/ccp/topics1/overindebtedness.htm>

strategy on the wider picture – a Government strategy for financial information, education and advice. This is likely to focus primarily on the importance of savings, as well as looking at other financial services, including those related to credit and debt.

This ongoing work will set Government policy on over-indebtedness in context.

But there is already a clear role for Government in tackling personal debt on a variety of levels.

We need to ensure that consumers have the basic literacy and numeracy skills they need to access information and advice. To ensure that consumers are financially literate. To ensure that appropriate generic information on financial management and financial products is available to them.

Basically, to ensure that consumers are able to make informed judgements and take effective decisions about the use and management of money.

We also have a role to play later in the debt cycle – in dealing with over-indebtedness when it happens. We need to ensure that *all* consumers have access to debt advice and debt management programmes when they need it. And we have a role to play later still, in debt collection and enforcement. Finally, we have a role in creating the right regulatory framework – both in terms of consumer protection, and in terms of facilitating a competitive market environment.

### Financial literacy and generic financial information

Up to 7 million adults in Britain have literacy skills below those expected of an average 11 year old. Even more have a problem with numbers. Research shows that adults with the poorest skills are least likely to have savings and investment, and are more likely to admit being in debt. We need to ensure that consumers are able to make informed judgements and take effective decisions about the use and management of money. To ensure that consumers have the basic literacy and numeracy skills they need to access information and advice. And when consumers have these basic skills, we need to ensure that they are aware of, and understand, the options available to them.

Even when people have the basic financial skills they need, many don't know what they don't know, or what they need to know. They don't know how advice might help them. They may think that financial advice is for the rich, or means high-pressure selling. They may find financial services baffling. That is why we are working to improve financial literacy, and to ensure that consumers have the information that they need.

In schools, students have the opportunity to be taught personal finance education throughout Key Stages 1 to 4 in the school curriculum. For example, the Department for Education and Skills' guidance suggests that schools teach:

- 5 –7 year olds, that money comes from different sources and can be used for different purposes,
- 7-11 year olds, to look after their money and realise that future wants and needs may be met through saving,
- 11-14 year olds, what influences how we spend or save money, and how to become competent at managing personal money,
- and 14-16 year olds, to use a range of financial tools and services, including budgeting and saving, in managing personal money.

Championing financial literacy in schools, the Financial Services Authority are working with the Department for Education and Skills, the main curriculum agencies and other organisations to help teachers deliver personal finance education.

In addition, the Department for Education and Skills, the FSA and industry, jointly fund the Personal Finance Education Group, or PFEG. PFEG aim to promote and facilitate the education of all UK school pupils about financial matters.

For example, they have produced a quality mark for recommended teaching resources. This mark will help teachers to feel confident about the educational relevance of teaching materials. They are also running a major four year project – the Excellence and Access Project – that aims to enable teachers to become skilled and confident in the teaching of personal finance.

For adults, the Department for Education and Skills are funding the Basic Skills Agency to develop a programme of support for financial literacy and basic skills. The programme focuses on helping financial institutions, tutors, and money advisers to recognise the basic skills needs of consumers, and thus help them to access appropriate financial services. The Financial Services Authority also produce a number of free booklets and information on a range of issues about financial services, backed up with an extensive consumer web site and a financial planning CD-ROM.

And the FSA and the Basic Skills Agency are working together to develop an Adult Financial Capability Framework. The framework is aimed at all those involved in financial capability education and training, and will support the creation of learning programmes and resources. Consumers can also access a range of information in relation to credit and debt produced by the Office of

Fair Trading. And the OFT have run debt awareness campaigns aimed at improving consumer understanding of credit issues, and highlighting the dangers of over-indebtedness.

Finally, focusing on financial exclusion, the Department for Education and Skills is funding a pilot Community Finance and Learning Initiative. This initiative will support existing trusted local community based organisations, such as Credit Unions and Citizens' Advice Bureaux, to work in partnership to deliver literacy and numeracy support, access to mainstream financial services, and access to micro-finance.

But the solution isn't just in the hands of Government. We need to build on existing public, voluntary and commercial sector partnerships to motivate consumers to act. To inform them about their choices, and to allow consumers to arrive at decent outcomes.

#### Debt advice

As well as financial education, Government also has a role to play where debt turns to over-indebtedness. When debt becomes a problem and people cannot afford to keep up the repayments, often through no fault of their own, we need to help consumers find a way out. In March 2002 I launched a pilot project for a national debt telephone helpline. Funded jointly by Government and the private sector, the helpline offers a real and vital helping hand to people with debt problems. We also provide a block grant to the National Association of Citizen's Advice Bureaux, who provide face-to-face debt advice through local CABs.

#### Collection and Enforcement

At the bottom end of the debt spiral, where over-indebtedness leads to court proceedings, the Lord Chancellor is conducting a wide ranging review of the Enforcement of Judgement Debts. For those debtors who find themselves involved in court proceedings, the Legal Services Commission is funding debt work as part of its £2 million telephone advice pilot. The scheme supplements current services, making quality assured legal advice and help accessible to people who cannot easily visit their local solicitor or advice agency across many rural areas such as North Wales and Northumberland.

#### Regulatory Framework

And it's not just about education and advice. Government also has a role to play in making sure that the market framework is right, and that the right

regulatory framework exists to foster a competitive, innovative financial services industry, whilst ensuring that proper consumer protection is in place. We've set up a Task Force on over-indebtedness, looking at practical ways of achieving more responsible lending and borrowing.

I am also in the process of undertaking a radical shake up of our consumer credit laws, which are now 30 years old. This review of the Consumer Credit Act will ensure that it is up to date and relevant for the way in which today's modern credit market functions. It will also deliver the Government's manifesto commitment to improve protections against loan sharks. We have already consulted on increasing or removing the Act's financial limit and expect to publish our response to the consultation shortly.

Before the end of the year, we will publish our proposals for allowing credit agreements to be made online and, most crucially, improvements to the consumer credit licensing regime, to make it more focused on enforcement and on strengthening consumer protection against extortionate credit. All this work is being undertaken in parallel with European developments on credit regulation.

The European Commission has recently published its proposals for a revised Consumer Credit Directive and my officials are working on ensuring that it enables the innovative and competitive credit market that operates in the UK to continue, while ensuring consumer protection measures are appropriate and effective.

Negotiating this directive is likely to be a lengthy process, but one that enables us to address the benefits we have seen for consumers and suppliers alike in this market of competition and choice. So whilst personal debt – or rather the use of credit facilities – is on the increase, this is not the same as saying that over-indebtedness is on the increase.

Most consumers manage debt effectively. But for those who do become over-indebted, or who struggle to manage their finances, the Government is working on a number of initiatives to help them. Initiatives designed to keep over-indebtedness to a minimum now, and in the future.

## 2 Keith Tondeur, Director, Credit Action

I am the director of the national money education charity, Credit Action, which works with both local and national organisations such as the Armed Forces, to improve personal money management skills. Credit Action is widely used in the media and we also work closely with organisations such as the Consumer Credit Counselling Service that offer free independent and confidential advice to those already suffering with debt problems. As I am sure that Malcolm Hurlston will be focussing on the debt issues, I would like to concentrate on the need for much improved personal money education.

I am very grateful to Carol Sergeant, a managing director of the Financial Services Authority, for her recent comments on our lack of skills when it comes to handling money. Speaking at a conference on the 24th October 2002 she stated that consumers are “extremely ignorant and unsophisticated” about financial issues and have trouble adding up. She went on to say that the public’s lack of numeracy skills posed as much a threat to banks as fraud. “It is hard to overestimate financial literacy among consumers.” I have to say that everything in my experience as Director of Credit Action would concur with these statements and all statistics bear this out. With the use of credit growing in the region of 15% a year and with millions of people seeking help in Britain each year it is essential that something is done. With Debt Agencies referring to average unsecured debt cases being in excess of £25,000 compared to an average annual salary of £21,000 it is clear that there is no time to lose.

If this is correct it does show that there needs to be a significant increase in the scale of personal money education in this country and that it also has to start at a very basic level. There seems to be little point in concentrating on the intricacies of Annual Percentage Rates if many of us struggle to add up and work out what change we should receive when we go shopping.

In order to improve matters I believe that State, Market and the individual all have roles to play.

### The State

Certainly there have been improvements here in recent years with both a commitment for financial literacy to be taught in schools as well as improving numeracy targets being set. But I believe that the State has to do more than this and to do it urgently. Not just in schools, although this of course is vital, but to try and find ways that will reach the adult population now. The sensible use of credit can be a very helpful factor in personal financial planning, but it

can also bring real distress to those who have not learned to handle it wisely.

When it comes to what the State can do to improve financial education there are various options that I would propose:

- i Continue to improve the basic numeracy skills that are taught in schools and give special attention to the basics such as budgeting. It is my experience that most people do not budget. They do not know how to and as a result do not have a clue as to where their money is actually going.
- ii Teach priorities in spending. All of us continually spend more than we have and nearly everyone when in debt thinks that they need another loan. In actual fact they may simply need to address their spending habits to ensure they are not overcommitted.
- iii Ensure that pupils are prepared for the amount of credit that will be offered to them when they turn eighteen.
- iv Seriously consider the impact that student loans are having on our young people. Not only are many of our graduates now leaving university with debts of over £10,000 but this system is actually sending a message to them that to get on in life and have the things they want they should go ahead and keep on borrowing. I believe this is a fundamental mistake in educational thinking that will soon lead to most young people remaining in full time education until they are twenty-one and most of us not retiring till we are at least seventy!
- v Reform the way benefits are given. Everyone leaves school with no knowledge as to how the Benefits System works, yet many people will be entitled to them at some stage in their lives. Names and numbers may change and frequently do but some sort of guidelines need to be given. In addition, enquiring about benefits can be intimidating. The free-phone enquiry help-line, scrapped a few years ago, should be immediately restored and efforts should also be continued to ensure that anyone making enquiries about their own individual circumstances should be able to speak to just one adviser rather than being passed from person to person. Is there any wonder that so many benefits go unclaimed?
- vi The state needs to address the issue as to where people who are struggling financially can seek help. As a director of a money education charity I find it distressing that, as the level of over-indebtedness continues to rise in this country, a multitude of organisations have

sprung up that charge fees to offer help to those in debt. Investigations into some of their practices by the Office of Fair Trading show that others have similar concerns. Yet everyone through Citizens Advice Bureaux and the Consumer Credit Counselling Service can get excellent help that costs nothing. The latter body was actually set up as a charity by the credit industry to provide the very safety net that is needed when the current amount of credit is being used. Clearly, as charitable organisations they do not have the resources to advertise as widely as the profit-making fee-chargers. I would therefore like to see some release of State funds either to directly advertise that free debt counselling is available or to give funds to the organisations concerned to enable them to do so.

It is my belief that unless the State addresses these issues with urgency the level of personal debt will rise to a level that will be far too high for a population that has not been educated in how to handle money effectively.

### The Market

Debt counselling is being addressed in the Market and some money education is going into schools but I believe a lot more needs to be done.

- i The credit industry has a key role to play here. Already a financially naïve public have in recent years suffered the problems of mis-selling of endowment policies, private pensions and extended warranties. The credit industry must recognise that they are dealing with a public unsure as to exactly what and when to borrow and who probably don't understand the big print never mind the small. I would therefore urge those with power in this industry to concentrate on money education as well as on debt counselling. Prevention and cure need to be working side by side.
- ii It is therefore imperative on the industry to ensure that all of their customers who get into difficulty are made aware that free confidential debt advice is available. Many I know do this already but it is my experience that many people still claim they do not know where to go for help. Does every lending organisation write to their customers when they fall a payment behind and let them know where they can get free debt advice? It would help a great deal and prevent much misery for the person concerned, as well as much less work for the Agencies trying to deal with the case. In addition they could be making more money

available to enable the free debt agencies to advertise their services much more widely and particularly on television. It is in their own interests to do so.

- iii The Market already reflects the different groups that need credit and the providers should be considering what these groups need. A couple taking out a twenty-five year mortgage of £100,000 through a clearing bank, for example will have very different requirements from someone borrowing £200 over twenty weeks from an organisation that visits them weekly in their home. But all will need the very basics spelled out to them - what they are borrowing, how much they will be paying back each week or month and what the total cost will therefore be to the customer. The simpler the better! This is why Credit Action produces a range of guides for Families, Single Parents, Employees, Self-Employed and Students for example. Everyone needs to know the basics of budgeting but other requirements will be very varied.
- iv There are already some organisations providing money education particularly into schools, but they tend to be banks, and at the end of the day it could be argued that they have a vested interest. The material they produce, is, however, excellent and it would be a pity that their very badging of product resulted in many pupils not acquiring the basics of sound money education.
- v All employers should be considering the impact of debt and lack of money education on their employees. Debt and money worries can lead to stress, relationship breakdown, lack of concentration and time off work. Many employers have told me that the first time they knew of someone's debt problem was when they were caught stealing. If booklets were issued to all employees it would aid towards a much more effective handling of money, as well as point out where to go for free confidential help. In addition posters advertising the debt counselling available could be displayed and contact details be put on wage slips.

When it comes to money education and debt counselling the market may not be the ideal way of dealing with things. Unlike selling products, if you are a debt counselling agency offering free advice, the more successful you are the greater the cost. The need is however great which is why so many fee charging agencies have sprung up, putting even more pressure on the individual with debt problems. It is in my view much fairer that both the State and the credit industry do more to ensure they are aware of the excellent free advice already available.

### The Individual

I come lastly to the hapless individual trying to get his head around the Consumer Credit Act and APR's. Never having been taught how to handle money he is bombarded by 0% credit offers and nothing to pay until April. The Government is telling him to borrow more otherwise the economy may go into recession and he may well lose his job. At the same time it is also telling him he needs to start saving otherwise he'll be spending his retirement in poverty. He thinks he might be entitled to some Benefits but he doesn't know where to go to find out never mind what questions to ask.

He's in a lot of debt. His emotions are in turmoil. He just doesn't know where the money goes but he's starting to get letters from his Building Society and other creditors. Which is most important to pay? He doesn't have a clue. He knows he owes a lot but he hasn't told his wife a thing. He doesn't want to worry her but this has gone on for over a year now and she's bound to find out soon. What's she going to say when she finds out? He knows she'll never trust him again. All this worry. He's found himself unable to concentrate at work and recently had to go to the doctor's because of the stress. He fears he may lose his job if he doesn't get his act together soon. But where can he turn?

If only there were somewhere he could go to get help with his budgeting and handling his money effectively. If only he could get free debt advice and make one payment to an organisation each month who would distribute this to his creditors free of charge.

The good news is that he can receive both money advice and debt counselling free of charge. The bad news is that there are millions of people like him who have not been made aware of this.

### 3 Malcolm Hurlston, Chairman of the Foundation for Credit Counselling

Let me start by outlining my position. I am in favour of credit; I think the fact that credit is readily and on the whole responsibly available in Britain is one of the key factors in keeping our economy afloat. Although I am happy with the operation of creditors in general, there is a great deal that needs to be improved. I would single out for praise the Banking Code Standards Board, which has made an excellent start. I am sceptical about education. I think consumers have more common sense and apply it better than they are given credit for, and I also think the state should create climates, not try to do more than it has to.

The Foundation for Credit Counselling is a charity I founded ten years ago with help from a number of companies, including the Provident and Registry Trust, which I also chair. From a standing start we have grown to become Britain's biggest and most successful debt charity. We have 165 staff of whom nearly 100 are in counselling and we help about 100,000 people a year. Some 30,000 people are now making repayments to their creditors through us. We ask creditors to give us a percentage back to fund our operation and in the main, they do.

For them it's a fantastic deal – ask the boss of Britain's biggest debt purchase company. Not only do they get a lot of money back they might not otherwise have had, but they are relieved of a great deal of hassle and admin. I don't begrudge it to them. After all they have lent the money, on the whole, prudently, and that is what is keeping us all in work. But I would be happier if some of them were a bit more grateful.

We at the charity can parlay this benefit to lenders into a better deal for our clients. For most people who come to us we can speedily arrange a softer approach, with no hassle, interest frozen and penalties stopped. This is good as far as it goes, but my vision for the charity is that it should provide a safety net for everybody who is in difficulty as a result of being a consumer of credit. Additionally, creditors should pay for our safety net. We have never asked the government for a penny and we have no intention of doing so. We ask for ministerial visits and messages and I sometimes claim we are the most ministerially visited small business in Britain, but no cash. No cash, no strings.

The reason that creditors should provide every penny of the cash needed to provide the safety net is not because they are guilty, but because it is in their interest to do so. The totality of lending leads to the totality of debt.

I would, however, put in two caveats. Lenders should not be expected to fund services which are inefficient, unnecessary or antagonistic, and a clear

line should be drawn between over-indebtedness, which flows from the credit society, and impoverishment, ie, the problems of those who face exclusion. The latter really comes under the Government's remit, and it is right that Government should pay for it through Citizens Advice Bureaux, independent advice centres and the community legal service.

In the future, money advice should come primarily either from us, paid for by creditors and providing the safety net for the credit society, or from the Citizens Advice Bureaux, paid for by the Government and helping people who are excluded. There is room for specialist players too.

There was quite a furore from the established interests when we set up the charity. Few were ready to believe that the repayment ethic was widespread. Our detractors still like to suggest that we are soft on creditors. I can assure you we are not. What we have proved is that what most people in debt really want is not to find an easy way out but help in getting themselves straight. That is why they come to us and that is why, when they come to us, they are more likely to stick to their plans and get themselves straight than through any other channel.

We are not yet reaching enough people. Most of those who come to us have been encouraged to do so by their creditors, and we have grown to the size we are now by meeting that demand. But a growing number, perhaps a quarter, now come from recommendations – family and friends and the Press, and we are ready to grow to meet whatever the demand might be. To provide an efficient and universal network, we need to bring all the free services to the over-indebted under our banner and I am glad to say we are already co-operating very closely with Keith Tondeur's Credit Action and looking for similar arrangements with National Debtline so we can all do what we are best at.

Together we can tackle more efficiently the fee-charging debt management companies of which Keith rightly complains. They operate, frankly, in a parasitical fashion, and it is our aim to see that nobody pays for help without knowing that better advice is available without having to pay for it. There will be a double squeeze on debt management companies. The guidelines of the OFT are already beginning to bite and I have set up a monitoring group with the Federation of Independent Advice Centres, the Scrutiny of Advertising Group. This year we have been testing advertising in Scotland and next year we shall be stepping it up – to tell people they have a choice.

Despite the fuss about over-indebtedness over the last couple of years, there is no acute problem at the moment. Average household debt is high but

it is affordable, interest rates are low and so is unemployment. All that is on our debt dashboard. There are, however signs on the horizon that there is no room for complacency; it is just as well that the minister has been looking at over-indebtedness ahead of the need.

I am concerned by the amount of secured lending which is taking place and putting people's homes at risk. That is raising the ante too much. I believe that anybody who offers a loan which is advertised as being for consolidation should be under an obligation to ensure it is used for that purpose.

I have asked the financial intermediaries body, FISA, for action, as yet without result, and we are now backing strongly the move in the Consumer Credit Directive to bring in a test of purpose for mortgage lending. If mortgage lending is not for a house or anything to do with it, it will come under the Directive. Howls of protest from the mortgage lenders but they have yet to put their houses in order.

If creditors are sensible they will give their compliance officers a free run over marketing and collections. The Government will look at the ideas of the Consumers' Association for entry level financial advice – that's the kind of thing a charity like ours could get stuck into – and consumers will consume, applying their good common sense and reliant on a marketplace which is both efficient and sympathetic. After all, we're all in this together.