

# Briefing Document



# Falling into the red:

## How overdrafts can lead to problem debt

October 2016

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## Introduction

Overdrafts are one of the most widely used credit products. Almost three in ten (29%) people with personal current accounts in the UK have been overdrawn in the past year.<sup>i</sup> Although most only use their overdrafts for a couple of months a year, there is a minority (10%) of households that are much more frequent users, going overdrawn in nine months or more in a year.<sup>ii</sup> There are also those that are regularly going over their overdraft limit and being hit by expensive unarranged overdraft charges. Once people are in a cycle of overdraft repayments and charges, it can be very difficult to escape.

At StepChange Debt Charity, we know that overdrafts are a significant part of the debt landscape. More than half of our clients have overdraft debt and:

- Overdrafts are the second most common type of debt we see (after credit cards) – 52.8% of our clients have overdraft debt.
- We helped 93,000 people with overdraft debt in the first half of 2016.
- The average overdraft debt among these clients is £1,679

We are calling on the FCA to act. It should set a cap on unarranged overdraft charges and require banks to identify people who are struggling and offer them an affordable way to pay down their overdraft debt.

## How overdrafts can lead to problem debt

Many households, particularly those on tight budgets, turn to credit products like overdrafts to cover shortfalls in their household finances. Our research shows that four million people are regularly relying on credit to meet essential and emergency expenses and these households are significantly more likely to be getting into financial difficulties.<sup>iii</sup> Overdrafts are one of the main types of credit used by these families and more than four in ten (41%) are using overdrafts to get by.

We surveyed our clients with overdraft debt to explore their experiences of overdraft charges.<sup>iv</sup> We found that:

- People coming to us with overdraft debt are regularly going into the red - on average they had been in their arranged overdraft in 11 of the last 12 months.
- Almost two thirds of the people (62%) we help with overdraft debt have regularly had to exceed their arranged overdraft limit, doing so in an average of five out of the last 12 months.
- They faced charges of £45 a time on average (for going into an unarranged overdraft).
- They are therefore being charged around £225 a year in unarranged overdraft charges.
- From this we estimate that, in any given month, the people approaching us for help with overdraft debt will have paid more than £1.3 million in penalty fees between them in the year before they came to us.<sup>v</sup>

Therefore we conclude that regularly having to go into an overdraft or over an overdraft limit can lead to and exacerbate financial difficulties for many financially vulnerable households. Many hard-working families are struggling to get by. Their chronic financial difficulties can force them into impossible choices between meeting their essential costs and going further overdrawn or over their overdraft limit. These households can struggle to get out of their overdraft as fees and interest on arranged overdrafts can build up over a long period of time making it increasingly more difficult to get out of the red. They are also more likely to be at the edge of their overdraft limit and if they go over they face more substantial unarranged charges that push them into further difficulties.

## What needs to be done about overdraft debt?

The Competition and Markets Authority (CMA) recently undertook their retail banking market investigation and it included a focus on overdrafts.<sup>vi</sup> This proposed a maximum monthly charge (MMC) covering all unarranged overdraft charges. However, we are concerned that the MMC is likely to have limited impact as the CMA have called for it to be set by the banks themselves. The four major high street banks that make up 77% of the market already have monthly maximum charges on unarranged overdraft charges that can be as much as £90 a month. There is little financial incentive on the banks to lower their existing charges given the substantial revenues they generate: the CMA found that £1.2 billion of banks' revenues in 2014 came from unarranged overdraft charges. It is essential that the FCA goes further than the CMA and take action to tackle the role of overdrafts in problem debt.

**There is a clear need for an unarranged overdraft charge cap to be set by the Financial Conduct Authority (FCA) as an independent regulator.** The FCA is best placed to balance the competing priorities of lenders and consumers and set an effective and fair cap on unarranged overdraft charges. They have a track record in this area, as they introduced a comprehensive price cap on payday loans.

**The FCA also needs to undertake a review of persistent overdraft debt and do more to tackle the detriment it causes.** This should include looking at the product features and charges associated with both unarranged and arranged overdrafts. It could explore what more can be done by lenders to support people who are trapped in an overdraft cycle and give them better and more affordable ways of paying down their debts. For example, banks could identify where customers are struggling with their overdraft and separate their debt from the transactional banking facilities. This would bring vital stability to household finances and provide a sustainable and affordable way of repaying their debt balance.

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<sup>i</sup> GfK NOP (2015) Personal current account investigation: A report for the Competition and Markets Authority

<sup>ii</sup> GfK NOP (2015) Personal current account investigation: A report for the Competition and Markets Authority

<sup>iii</sup> StepChange Debt (2016) [The credit safety net](#)

<sup>iv</sup> StepChange Debt Charity carried out a survey of 1,019 clients with overdrafts in September-October 2016.

<sup>v</sup> This is calculated by the charity being contacted by around 15,500 people with overdraft debt. Based on the survey results, the charity estimates that approximately 9,600 go into an unarranged overdraft, doing so in an average of five of the 12 months before they seek debt advice. Around 6,000 would pay an average of £45 per charge, a total of £225 for the year. We therefore estimate that those seeking advice on overdraft debt in any given month will have paid at least £1.35 million in unarranged overdraft fees between them over the last year.

<sup>vi</sup> Competition and Markets Authority (2016) Retail banking market investigation: Final report