



Household Default Index 2024

Supporting borrowers as we emerge
from the cost of living crisis



Introduction:

UK lenders are feeling the strain as much as consumers

By Sho Sugihara, Co-Founder and CEO, Fuse



We may be in a new year, but the same problems remain.

Research from StepChange highlights that one in three households with children couldn't afford Christmas in 2023. This follows analysis by Debt Justice revealing nearly 13 million adults in the UK are struggling to pay their bills.

This is only set to rise further as the cost of living crisis continues, with already stretched households unable to manage their everyday costs and bills.

Our research shows two in five (40%) people in the UK are more concerned about their financial position now than at any point in the last three years. And **a quarter (24%) are using their savings to pay everyday expenses**, but the saving pots of many are either now precariously low or already empty.

As a result, consumer reliance on credit is surging, with 15% of people telling us they are now wholly reliant on credit to help pay for the basics. Increased borrowing and dependence on credit is likely to lead to a significant increase in defaults – which we're already seeing evidence of in the market.

We have analysed the annual reports of 20 of the UK's biggest lenders to assess Expected Credit Loss (ECL) - which encompass a range of financial risks including expected customer defaults, the impact of inflation as well as changes to the size of the loan book.

Across the board it's clear that lenders are anticipating a spike in credit losses and defaults over the next 12 months.

Focussing on consumer outcomes could resolve the lending challenge

The total ECL provision has increased by nearly £800M in just 12 months. This is a staggering figure.

In the face of such significant increases, what can lenders do to protect consumers and prevent defaults?

The FCA's new Consumer Duty rules came into force in July 2023. These rules have been implemented to drive better outcomes for the UK's consumers, and the FCA is now actively monitoring how financial firms are responding, and promises severe action against those that aren't compliant.

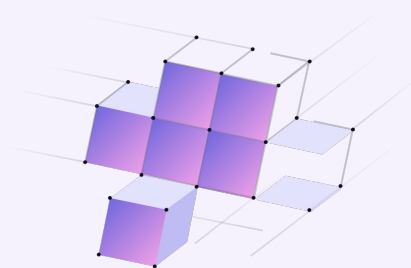
Regulation like the Consumer Duty can help to kickstart lenders and other financial institutions to shift to a more consumer-focused approach, but it can only go so far.

The cost of living crisis has highlighted what many of us have known for years: **the UK financial system is in need of systemic change if the financial health of consumers is to sit properly at its heart.**

We must redesign our financial system around a more outcomes-based approach. This will only be achieved if the industry comes together to identify, explore, and implement the technology and expertise needed to build the foundations of a brighter future.

Greater insight into affordability and vulnerability is needed to ensure lenders have enhanced oversight into borrowers' ability to repay, and any potential challenges that may impact their vulnerability.

In this report, we shine a light on the extent of the ECL surge facing UK banks and the forward-looking solutions needed to protect and support Britain's consumers.



1

The impact of consumer struggles

Increased reliance on credit should be a concern for the UK as a whole. Not only is it indicative of prolonged pressure on household finances, which ultimately has a knock-on impact on the UK economy, it also highlights a future risk of increased debt piles.

By researching the ECL provision of 20 of the UK's largest lenders, Fuse has uncovered worrying insight into the scale of borrower defaults.

Overall, **the largest lenders are expecting to lose an additional £788M over the next 12 months** as the cost of living crisis continues and borrowers face rising costs which they are struggling to meet.

Over the next year, UK lenders are expecting to lose over £19B compared to reporting an ECL provision of £18.3B 12 months previously.

Drilling into the detail, however, reveals some concerning trends. Half of the 20 lenders in the research reported at least a 10% increase in expected losses, with **three of these expecting a spike of at least 50%.**

Only four of the UK's largest lenders were expecting credit losses to shrink in their latest financial reporting compared to 12 months earlier.

What has led to this stark total increase?

One major factor is undoubtedly the financial pressures consumers have been facing. Although with energy bills dipping and rises in food costs slowing, there are green shoots that the worst of the cost of living crisis may be behind us, the easing of financial pressure has come far too late for many people.

Millions across the UK have been reliant on savings to pay essential costs throughout the cost of living crisis - our research shows that a quarter of people dip into savings pots for everyday expenses. Unfortunately, the longer this financial pressure has dragged on, the more people have been forced to dip into their savings pots to survive. In many cases, these pots are now empty.



£19.05B

provisioned for ECL in 2023
versus £18.3B in 2022

32%



of lenders saw an increase in customers defaulting on payments

Seeking more credit to cover existing debts and meet repayments is a short-term solution that quickly builds more debt, ruins access to affordable credit options and pushes up the risk of defaults.

Interest rate changes have added additional strain too - with the Bank of England base rate increasing from 0.1% to 5.25% in under three years, borrowing has rapidly become more expensive. With higher repayment inevitably comes higher defaults.

Given this, it's perhaps no surprise that our research indicates that a **third (32%) of lenders are seeing an increase in customers defaulting** on payments.

This is echoed by recent research from the Bank of England's Credit Conditions Survey, with 24% of lenders reporting increased default rates in the final quarter of 2023.

However, the research suggests that the situation may be about to get worse as 40% of lenders expect default rates to rise in Q1 2024.

This has created a perfect storm which has led to an increase in the proportion of financially vulnerable consumers - 35% of UK lenders reported they've seen this shift.

And the figures highlight the disproportionate impact that the economic climate has had on those classed as financially vulnerable (those who have gone into debt in the past 12 months) as the UK's financial gap widens. This ever-growing group are more likely to take out credit products - **52% of financially vulnerable people have used a credit card in the last 12 months**, compared to an average of 40% across the UK.

And they are also twice as likely to end up in debt - **more than four in ten (44%) financially vulnerable people say they ended up in debt when taking out new credit products** compared to the UK average of 22%.

Unsurprisingly this is impacting their financial resilience and ability to pay essential costs. Over the last 12 months, more than a fifth of financially vulnerable people have been unable to pay their bills or eat as regularly as they previously had done (compared to a UK average of 7% and 9% respectively).

Shockingly, financial pressures have become so severe that more than one in ten (13%) financially vulnerable people say they've been worried they may lose their home, compared to 5% across the UK as a whole.

Of course, the increase in ECL isn't purely driven by likely customer defaults - there are numerous factors which have combined to push their total expected loss up by almost £1B.

Rising inflation over the last 12 months has clearly had an impact, as did interest rates. However, in some cases the rise in ECL may be due to an increased loan book due to acquisitions or a large spike in customers.

For example, NatWest reported a 4% increase in its loan book for its retail arm - increasing to over £388B, but its overall ECL provision increased by 17%. The rise in total loans to all its customers from £366B to £381B is hugely significant here too.

44%



of financially vulnerable people said they ended up in debt when taking out new credit products, compared to the UK average of 22%

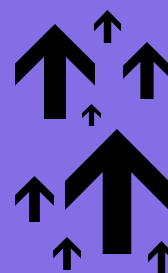
Although a larger loan book size drives the increase in ECL, its significance should not be overstated, in some cases, lenders have reported a large increase in expected losses without a rise in lending.

For example, Virgin Money reported a spike in its ECL provision from £457M to £617M in its latest financial results representing a 35% jump despite seeing little change in the size of its loan book. However, this may change in future. Since the most recent financial reporting, Nationwide has reached an agreement to acquire Virgin Money in a £2.9B deal, marking the largest UK banking takeover since Virgin Money itself acquired Northern Rock in 2012, and would create the UK's second largest mortgage and savings group.

HSBC's reporting offers a different perspective on the relation between allowance for ECL and loan book growth. Despite total loans to customers rising by 4% to almost £212B, its allowance for ECL on retail products actually fell by almost a fifth.

£788M

**total increase in
ECL provision
across twenty
of the UK's
largest lenders**



2

The struggle to meet mortgage payments

For any homeowner, ensuring funds are available to cover mortgage payments is likely to be the number one priority when budgeting each month.

Although mortgage costs are likely to be the largest single monthly outgoing, people may look to make savings elsewhere in order to ensure payments are met on time and in full.

Yet, research into ECL for the UK's largest building societies and mortgage providers indicates that missed payments and defaults are on the rise at a much higher rate than for other credit products.

22%



increase in ECL provision for mortgages versus a 4% increase in total ECL provision

Although the total ECL has risen by 4% over the last year, there has been **a huge spike of 22% in ECL on mortgage products alone**, with defaults expected to rise to £760M from around £625M.

Increased mortgage defaults appear to be a growing issue for many of the UK's largest building societies. Nationwide, Coventry Building Society, OneSavings Bank and Newcastle Building Society have **all seen mortgage ECL provision increase by more than 15% over the last 12 months**.

There are other factors at play behind increasing ECL beyond simply customer defaults - for example, Newcastle Building Society's merger with Manchester Building Society in Q3 2023 will have extended the former's loan book therefore increasing ECL provision.

For Skipton Building Society, ECL allowance has quadrupled (from approximately £10M to over £40M), however this is likely largely due to several factors including 27% increase in mortgage advances over the last 12 months, a 43% rise in loans to first time buyers and the launch of its 100% mortgage for the first time since 2008.

Clearly, it's been a turbulent period for the UK housing market – interest rates have risen steadily throughout the cost of living crisis which has had a knock-on impact on mortgage costs.

12%



of people last year were **reliant on credit to pay their mortgage costs**

Millions of people have come off generous long-term fixed rate deals and face a significant spike in costs almost overnight. Those who moved onto new fixed rates faced no option but to accept much higher repayment terms.

For those unable to secure a new fixed rate deal and stuck on mortgages with variable rates, many saw rapidly rising costs each month over the last year, eating into savings and putting further pressure on monthly budgets. This trend is likely to be a contributing factor to the rise in ECL reported by many of the major mortgage lenders in the UK as homeowners face higher monthly mortgage costs, leading to increased risk of missed or late payment or ultimately defaults.

This is compounded by the fact many households have had no option but to turn to new loans in order to continue making their mortgage repayments. Last year, **more than one in ten (12%) people were reliant on credit in order to pay their mortgage costs**. Whilst this may not have impacted mortgage ECL, it's likely to place the strain elsewhere and could lead to increased credit card defaults or a higher ECL on household loans or other credit products.

Unfortunately, the financial pressures driving increased consumer reliance on credit, missed payments and defaults are unlikely to ease anytime soon. In fact, the situation could worsen for the millions of people in the process of remortgaging but are struggling to find affordable options. This is stoking fears that defaults will only increase further in the near future.

Firstly, struggling homeowners need enhanced access to more personalised support solutions. Improving support to consumers is one of the main goals of the FCA's Consumer Duty legislation that came into force July 2023 - the ECL research suggests that nowhere is this more sorely needed than in the mortgage market.

Although each lender has its own process in place to identify potentially vulnerable homeowners and step in with effective solutions, these are often reactive rather than proactive, and can lack nuance. For example, basic rules-based models are often employed to flag customers at certain milestones (e.g., receiving a pension), however this misses granularity over which of their customers are actually in a position to see potentially worse outcomes. Self-reporting is better at this for those vulnerable from a tangible cause, but as our research shows there are many who are vulnerable due to the wider financial context of the cost of living crisis.

Secondly, lenders need to access and utilise more accurate insights during affordability checks to highlight potential issues at a much earlier stage, offer more bespoke products and support customers with more manageable payment terms.

However, both of these approaches as they're currently deployed tend to identify those in need of support when they've already entered financial difficulties. New approaches, including data sharing between lenders and embracing artificial intelligence (AI) tools, could allow mortgage lenders to identify vulnerable customers more accurately and intervene before these individuals become trapped in dire financial trouble. Doing so would undoubtedly ease the mortgage default crisis.



£760M

in ECL provision for mortgages
in 2023, versus ~£625M in 2022

3

Cost of living pressures on UK's credit card bill

Bank of England stats shows that credit card borrowing in the UK has grown 12.7% over the last year as people turn to expensive forms of credit to make ends meet. Research from UK Finance also demonstrates that outstanding balances on credit cards have grown by 9.8% over the twelve months.

With millions reliant on credit to pay essential costs, and research into household defaults showing that total ECL is rising, it's perhaps surprising that the figure for credit cards from the big four banks has slightly **dropped by 3% over the last 12 months – from £5.08 billion to £4.94 billion.**

A closer look at the data shows that ECL on credit cards differs hugely across the big four - NatWest expects an increase of over £100M in its ECL provision (largely driven by a 4% rise in the group's total loan book). Despite this figure, NatWest has made great efforts to support its credit card customers. According to its latest annual report, the bank has reduced the number of customers in persistent credit card debt by 28% - achieving this through a variety of approaches including personalised repayment options for customers.

Some of the UK's biggest banks have seen ECL on credit card products drop over the last 12 months - both HSBC and Barclays report lower expected credit loss provisions in their most recent financial statements, with the latter reporting this figure to fall by more than £200M on its balance sheet.

Given Barclays' subsequent acquisition of Tesco Bank for £600M, including taking over its credit card loan book, it will be interesting to see how Barclays reports expected credit loss provisions in future financial reports.

Interestingly, HSBC's expected credit loss allowance on credit cards shrank by 29% despite growth in its share of the UK credit card market share. HSBC now accounts for 9.3% of the market, up from 8.5% last year as the lender advanced over £3B in new personal loans to its customers.

Lloyds was the other high-street lender our research into ECL on credit card products focused on. The bank reported a slight increase (6%) in its expected credit loss allowance on these products compared to 12 months previously, likely in part driven by the bank's one percentage point growth in credit card spend market share since 2021.



£4.94B
down from £5.08B

**in ECL provision for credit cards
from the largest four UK banks**

28%



of lenders report an increase in the number of borrowers with multiple lines of credit

Only 26%



of 18-34 year olds used a credit card in the last year versus 48% of 35-54 year olds

The research also uncovered additional insight around credit card spending across the travel industry. Data from Halifax (a subsidiary of Lloyds) revealed that **credit card spending has now eclipsed pre-pandemic levels, up 27% from the amount in 2019.**

Credit card spending with airlines has jumped 40% in a year and 36% on pre-pandemic levels (since 2019) - with the average payment increasing to £288 from £253.

Whilst not necessarily a major driver of ECL, it hints at the direction of travel when it comes to the UK's reliance on credit cards and appetite to borrow using these products.

Focussing on the total ECL credit card figure, it appears that households are increasingly prioritising paying off their credit card bills. This is a unexpected development given reliance is on the rise and the average credit card debt now stands at £1,160 (according to [Compare the Market](#)).

However, the fact that credit cards are one of the easiest and quickest forms of credit to obtain may also be a factor behind this – given almost three in ten (28%) lenders report an increase in borrowers with multiple credit products, it may be that borrowers are juggling their debts across several products, only meeting the minimum repayments in order to avoiding defaulting.

After all, research from Compare the Market indicates that a fifth of people only managed to make the minimum repayment on their most recent credit card bill.

Is the prevalence of multiple credit cards leading to a slightly misleading view of the UK's credit card use?

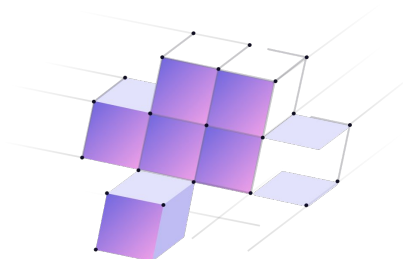
This would be a highly risky development for UK households. Many people may find it increasingly difficult to keep track of payment terms and total amounts borrowed with multiple, smaller credit card bills. This can increase their chances of falling into longer-term debt.

The dip in expected credit loss on credit cards is no doubt also due to the relatively low numbers of young people using these products - **just a quarter (26%) of 18-34 year olds used a credit card in the last year compared to 48% of 35-54 year olds.**

Younger people are more likely to be struggling to make ends meet - **nearly three in ten (28%) young people admit they're reliant on credit to pay everyday expenses compared to just 4% of over 55s.** Low levels of credit card usage amongst the younger demographic could be a factor in credit card ECL, with older borrowers seen as more likely to meet repayments.

Again, lenders must ensure they are monitoring for signs of financial vulnerability or struggle amongst borrowers. Borrowers who routinely only meet the minimum repayment or who regularly pay late should clearly be targets for proactive support from lenders but there may be a large group of borrowers who are taking out new lines of credit or juggling overdrafts on current accounts to meet repayments.

This is where enhanced technology insights can play a key role. A more integrated AI approach, that supplements existing models, has the potential to provide a clearer overview of a borrower's complete financial situation and allow for more effective support before it's too late.



4

How lenders can enhance support solutions

It is somewhat of a paradox that as reliance on credit grows, there is a corresponding decline in people's ability to access it in a safe, affordable way.

Our research shows that nearly one in five (16%) believe access to credit has worsened since the pandemic and one in seven (14%) are struggling to access the credit products needed to pay essential costs, rising to more than a quarter (26%) among younger people.

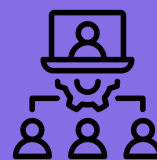
As the cost of living crisis continues to stretch finances to breaking point, it's likely we will see continued growth in this reliance and inaccessibility paradigm. This pressure isn't just being felt by consumers, lenders are also feeling the strain.

A third (32%) of lenders admit that there has been an increase in consumers asking to borrow more than they can safely afford to repay and two-thirds (65%) say that they've turned down a higher proportion of prospective borrowers due to failing affordability checks.

From a purely commercial standpoint, this is unsustainable for lenders over a long period of time. While, of course, lending must be done in a safe and responsible way that protects vulnerable consumers, it's essential that lenders have the tools required to create and provide credit products to borrowers from a range of economic backgrounds, as well as to support customers who find themselves in difficulty.

This is particularly important when it comes to public perception. Many believe that banks are to blame and could be doing much more when it comes to support and helping consumers access what they need - a quarter (26%) of financially vulnerable people believe that it is banks that are responsible for getting them into debt.

To turn the tables, lenders must ensure they have the right tools in place to accurately assess a person's creditworthiness, ensure they are offered a credit product that is right for them, and monitor for any areas of potential vulnerability on an ongoing basis.



14%

are struggling to access the credit products needed to pay essential costs, doubling to 26% among young people

At Fuse, we believe traditional methods of assessing creditworthiness, such as manually generated income forms or credit scores, do not offer this level of insight, and are not fit for tackling the default epidemic that has been outlined throughout this report.

New AI solutions are already starting to play an important role in helping lenders to improve their decision making processes, understand when to step in with support solutions for borrowers, and ultimately reduce defaults. Our clients have found they are able to **increase automated acceptances by over 40%**, and our credit risk solution has shown a **decrease in losses by as much as 30%**.

Utilising AI is key to tackling the rise in defaults and will support lenders to unlock increased insights and data to more accurately identify borrower affordability and vulnerability. In doing so, they will be empowered to offer tailored support to help meet the individual needs of each borrower, whilst complying with sector regulations to provide better, more personalised solutions for all consumers.



26%

of financially vulnerable people
believe it is the banks that are
responsible for getting them in debt

Conclusion:

It's time for change

As documented throughout this report, lenders are facing expected losses of almost £800M over the next 12 months. Against this backdrop, consumer demand for credit continues to grow as day to day financial pressures continue to erode the incomes and savings of people across the country. Ultimately, this risks driving lender expected credit losses even higher.

More effective support solutions are desperately needed. Even before the introduction of the new Consumer Duty in 2023, financial institutions have been scaling up their solutions to support vulnerable customers, and this has never been more important as reliance on credit grows and defaults surge.

Harnessing the power of AI is key to addressing this head on. Many lenders have already integrated technology in the process of assessing creditworthiness and affordability, but enhancing the use of AI for vulnerability monitoring is one of the most effective steps that can be taken to improve support for borrowers and bring down defaults.

That's why we recently launched Health Signals, a new solution to help risk and compliance teams at financial institutions measure financial vulnerability, predict arrears risk, and monitor the impact of financial products and services on their customers. We've developed Health Signals in collaboration with some of the UK's leading banks, ensuring that the platform is forward-thinking, and that are empowered to step in before problems fully manifest.

We would now like to see this ambition matched by the creation of an industry-wide standard when it comes to identifying vulnerable borrowers. This would help to create a fairer financial system for millions across the UK, and it's something we would urge the FCA and other regulatory bodies to carefully consider.

Progress has been made, but there can be no doubt that, as it stands today, we are sitting on a ticking time bomb. But if we join forces to apply the might of technology, genuine care for consumer outcomes, and supportive regulation, I've total faith that we can, and will, diffuse it.

Methodology

Analysis of Expected Credit Loss (ECL) for 20 of the UK's largest lenders based on gross lending, from most recent financial statements publicly available in February 2024.

Financial results analysed during the research include (in no particular order): HSBC; Barclays; Lloyds Banking group; NatWest; Standard Chartered; Santander; Nationwide; Virgin Money; Yorkshire Building Society; Co-operative Bank; Coventry Building Society; TSB Bank; Skipton Building Society; Leeds Building Society; OneSavings Bank; Metro Bank; Principality Building Society; Bank of Ireland; Newcastle Building Society; Atom Bank.

Opinium research of 100 UK lenders. Research undertaken between 17th April and 2nd May 2023.



www.fuseinsight.com

partners@fuseinsight.com