Over-indebtedness in a high inflation and high interest rate landscape

Explainer

Fredrik Andersson and Beatriz Pozo Pérez

Introduction

Households have experienced heavily varying credit conditions over the past few years, starting in 2020 with the Covid-19 pandemic, going all the way to the Russian invasion of Ukraine in 2022 (and the subsequent energy crisis) – two events that have had a very large impact on the EU's economic activities.

First, as consumption initially dropped due to the strict health measures enforced by governments, central banks across the EU introduced additional expansionary monetary policy measures. The fear of deflation was a haunting spectre over European economies.

However, in February 2022, things changed dramatically. The Russian invasion of Ukraine created much market uncertainty and during the course of the year, energy prices surged and living costs sharply increased. The European Central Bank (ECB) and other central banks across the EU increased interest rates to counter inflation, raising them to levels that had not been experienced in decades. The deposit facility rate in the eurozone is currently at the highest levels since the introduction of the single currency, at 4 %. High interest rates have had large consequences on households which have seen the costs to access credit spike.

This very sharp and rapid increase causes consumers to face substantial capital costs, on top of those faced due to the rising cost of living. All of this challenges household economies, endangering their ability to repay their loans and increasing their likelihood of becoming over-indebted.

Over-indebtedness is a difficult-to-measure concept, which is exacerbated by the lack of an established and harmonised definition. Nonetheless, a recent European Commission study has estimated a marked increase in the number of over-indebted households in the EU up until 2032, from 17 million in 2022 to 22 million by 2032. The main causes of this jump in domestic over-indebtedness are the phase out of Covid support measures and inflation.

The challenge to access private finance and the capacity to pay back loans has clear economic impacts for households. Its spillover effects also impact the quality of life for many, with decreasing living standards and decreasing individual feelings of wellbeing. Amongst other societal impacts, over-indebtedness can cause mental and physical health problems and it's also a driver for homelessness. Additionally, over-indebtedness can cause social exclusion and drive the debtor into a vicious circle that prevents them from contributing positively to the economy (and society).

Despite the negative impacts, policymakers can also develop policies to support households that have found themselves in a state of over-indebtedness. The recent review of the Consumer Credit Directive has proclaimed preventing over-indebtedness as one if its main objectives. A review of the other big piece of European legislation addressing over-indebtedness, the Mortgage Credit Directive, should be conducted over the next few years. Further action can also be taken on the remedial side.

Most of the work to combat over-indebtedness falls within the competency of Member States. They are required to develop legislation for implementing the Consumer and Mortgage Credit Directives, and can act beyond this with further measures to protect households. Finally, the development of services to support over-indebted consumers can only happen at national, regional and local levels.

What is over-indebtedness and how do we measure it?

There is no generally accepted definition of over-indebtedness. Member States normally use a definition of over-indebtedness that can be found within national law, which has made understanding what over-indebtedness actually is slightly different in each country. Often, qualitative terms that are non-specific and difficult to quantify are used. An example is the French definition, which contains a mention of having 'well-meaning intentions'. Suffice to say, this has made comparing over-indebtedness across the EU challenging.

To undertake a comparable mapping exercise of over-indebtedness, the Commission presented a definition in 2013. Ever since, it has been used in multiple reviews conducted by the European institutions. Households are, according to the definition, over-indebted if '*they are having – on an ongoing basis – difficulties meeting their commitments, whether these relate to servicing secured or unsecured borrowing or to payment of rent, utility or other household bills*.' What's relevant to note in this definition is the use of the term 'household' rather than consumer. The reason for this is the fact that households most often merge their incomes, and thus face credit issues as a single unit.

As the definition of over-indebtedness diverges, so do the indicators quantifying the challenges faced by consumers caused by over-indebtedness. With no universally accepted indicators measuring over-indebtedness, as was highlighted in a recent Commission study, cross comparison is also complex. This results in the need to resort to proxies for measurement. This challenge then subsequently trickles down to decision-making over how to tackle over-indebtedness.

To gather comparable data, the European Commission published a research note in 2010, that tries to define the measures that should be used to evaluate over-indebtedness. The report included five main measurements and are defined as:

1. **Scope at household level**: Households pool their resources so it is better to take the household as the unit of measurement rather than individuals.
2. **Comprehensive approach**: All household financial commitments must be considered, including both the long and short term.
3. **The timeframe**: Defined as the recurrent inability to repay expenses, thus indicating not a temporary but a structural repayment issue.
4. **Substantial challenge for the household**: The struggle to repay must also be large enough that taking out a loan would not be sufficient to bring the household back on track.
5. **Substantial commitments by the household**: In terms of reducing expenses or income increases to get out of an indebtedness loop.

While the definitions above help to understand and compare when households are classified as over-indebted, they also impose limitations. Some of the measurements are very subjective, making it almost impossible to measure. Hence, a lot of studies continue to use other definitions and measurements.

Over-indebtedness and its consequences

Over-indebtedness has significant consequences both for society and for individual households. Over-indebtedness is linked to social exclusion with low-income groups significantly more likely to be in arrears than higher income households. A household that cannot repay their loan(s) runs the risk of falling into a vicious circle where the pressure caused by its incapacity to repay also has consequences on other – if not all – aspects of life.

Over-indebtedness has mental and physical health consequences. According to the Swedish Consumer Agency, 53 % of those that have had to engage in debt settlement have bad health. Multiple studies link over-indebtedness to different diseases, including chronic ones, in particular psychoses and diabetes, as well as to pain. Anxiety, depression, lack of sleep, feelings of fear and despair or panic attacks are common consequences of over-indebtedness. Such mental health problems can also lead over-indebted people to suicide. A recent study shows that one in five over-indebted persons have tried to commit suicide while another finds that those that have experienced financial indebtedness are two and a half times more likely to commit suicide than those that haven't.

Over-indebtedness also comes with a social stigma and a feeling of shame which contributes to exclusion. This affects other areas of life – for instance it can alter family relationships and social connections, and it is a major driver for homelessness. It can also reduce productivity and lead to unemployment.

All this can result in a vicious cycle. For instance, a person who is over-indebted experiences anxiety and depression which hampers their ability to remain employed or find a job which results in a further loss of income. This can drive that person further into debt by taking out credit with even worse conditions that they have little possibility of being able to repay.

Over-indebtedness is bad for the economy not only on a personal basis but also because, as a driver of social exclusion, it prevents people from actively contributing to the economy, dragging it down. As indicated by the IMF, there is a negative relationship between household debt and future GDP growth. Over-indebtedness impacts consumption levels and has financial stability implications as it increases the chances of a banking crisis occurring. For instance, non-performing loan increases are linked to rises in the number of over-indebted households. Combatting over-indebtedness is thus needed from both a social and an economic viewpoint. It's also necessary from the lenders' point of view, as it's naturally always better for a credit institution if the money they loan is paid back.

How to tackle over-indebtedness

Preventive arm

Most of the action to combat over-indebtedness at European level is preventive and is led by two Directives, the Consumer Credit Directive (CCD) and the Mortgage Credit Directive (MCD).

The CCD concerns consumption loans. It was transposed by Member States in May 2010 and aimed to create a more harmonious credit market across the EU, as well as protect consumers and clarify requirements for lenders. It covers consumer credit ranging from EUR 200 up to EUR 75 000 and tries to regulate how credit is granted by balancing households' access to credit while ensuring safety nets

to avoid them falling into over-indebtedness. It's in this regard that it sets out the obligation to perform a creditworthiness assessment of the consumer in Article 8, highlighting the importance of including sufficient data and limiting the amount of credit to be in line with the consumer's capacity to repay.

On top of this, the CCD also defines how information is shared with the consumer, to ensure that the loan conditions are easy for the consumer to understand. Easy-to-understand information, including costs and conditions, allows the consumer to understand how much of an impact the loan will have on their finances. This then reduces the risk of a consumer taking out loans that might be too much of a burden and leads them to jeopardise their economic stability.

To align with the market's consistent evolution, the New Consumer Credit Directive (CCD2), was officially adopted in October 2023, with transposition by Member States set to no later than November 2025, and the deadline for its measures to be applied by November 2026. One of its main objectives was again to combat over-indebtedness.

Consumer credit below EUR 200 is now included under the CCD2's scope. It's relevant for households as smaller amounts of credit, also known as 'payday loans', are normally easy to access but come with enhanced risk, as their interest rates are normally much higher than loans taken out from standard credit institutions. Households that resort to multiple small loans accumulate high interest rate fees, increasing the costs and exposing the more vulnerable. As the amount of credit increases, households run the risk of losing track of their credit, generating an accumulation of high fees.

To protect the consumer, other types of loans were added to the scope, including overdrafts and 'buy-now-pay-later' schemes. Crowdfunding, having become increasingly popular, is covered by the CCD2 when the provider facilitates credit granting between creditors. To understand if expanding the scope is necessary to further protect consumers, the Commission will assess the situation in 2025.

Equally, the CCD2 mentions caps on fees. Multiple Member States currently have caps on the fees for small volume loans. Set up to prevent excessive interest rates or related fees, the CCD2's regulation does not set a limit on fee caps. There is, however, under Article 31, Paragraph 4, required action by the European Banking Authority (EBA) to publish a report assessing the measures in place to prevent excessively high fees on consumer credit. The report will establish if any of the methodologies implemented are relevant and whether they could be applied as a standard rule across the entire EU.

Modifications to the creditworthiness assessment were also introduced. The assessment now needs a positive outcome for credit to be granted, with exemptions possible only in very specific cases. Other relevant measures refer to prohibiting certain types of advertisements and the obligation to include clear and prominent details of the loan's costs.

The Mortgage Credit Directive (MCD) is also essential for protecting consumers from over-indebtedness. The MCD sets out rules to inform and protect consumers from the risks related to purchasing real estate. Similarly to the CCD, the MCD mandates a proper creditworthiness assessment before any credit is granted to consumers. It also includes other measures to protect against over-indebtedness such as preventing advertising worded in such a way that creates false expectations, the prohibition of tying practices, imposing information requirements where Member States should ensure that there is clear and comprehensible general information available about credit agreements, on the annual percentage rate that can be charged, and that creditors provide adequate explanation to the consumer on proposed credit agreements. Member States also have to promote measures to support educating consumers on responsible borrowing. The MCD should be reviewed in the next institutional cycle (2024-29).

On top of this, it's relevant to mention the role played by public credit registers and/or private credit bureaus (also known as credit reference agencies), which play an intermediate role in the market and are responsible for managing the data to assess the financial credibility of consumers and businesses. In short, a consumer approaches a lender to get a loan and then that lender goes to the credit registry or bureau which possesses positive and negative data[1] on the consumer and performs the creditworthiness assessment. Because of this, they play a key role in ensuring that consumers will not be granted credit that they cannot pay back.

Remedial

The focus of European legislation is clearly preventive, with the measures to help already indebted and over-indebted people mostly left at Member State level. Nonetheless, the CCD2 in its Article 36 requires Member States to ensure debt advisory services are made available at a reasonable price to consumers who are likely to face or are facing financial difficulties in meeting their financial commitments. It also calls for Member States to define debt advice in a non-ambiguous manner. This is relevant as the provision of debt advice services in Europe has been deemed insufficient with over 90 % of over-indebted EU households not receiving this service. In fact, in 13 countries – mostly in southern and eastern Europe – debt advice is non-existent or only provided sporadically.

Not only are policymakers held accountable by Article 36 for setting up services and supervising creditors, creditors are also required to have processes and policies in place that detect when consumers are starting to face repayment issues. It's also the creditor that's responsible for informing consumers about available advisory services and to facilitate consumers being able to access them.

Debt advice has proven to have multiple benefits. A European Economics study from 2018 found that for each euro spent on universally available and free debt advice, between EUR 1.4-5.3 would be generated in the form of, for example, an increased ability to pay and the reduction of healthcare expenses, amongst others. The most obvious benefit of debt advice is an increase in credit recovery rates. Debt advice also increases mental and physical health, enhances productivity, reduces homelessness, improves family relationships and has a positive effect on small businesses, as many self-employed people have been found to suffer from over-indebtedness.

All Member State governments will now have to make sure that these services exist and are readily available to citizens. Multiple models exist, from those fully publicly managed at national level and well-funded agencies like MABS in Ireland, to debt advice provided by municipalities, as in Belgium or the Netherlands. In some countries the main role is played by NGOs or social organisations and in others it is done by consumer organisations. Interesting public-private partnerships exist such as Crésus in France, which is funded by financial institutions that also have a detection service to drive their more vulnerable costumers to seek advice and assistance from Crésus.

In any case, regardless of the institutional framework, it's important that debt advice services are well funded and follow a comprehensive approach to not only covering legal advice but also psychological and financial management support. Debt advisors should also be able to adapt to innovations given the surge in new forms of credit. Additionally, they ought to aim for detecting cases early, as the earlier a case is identified, the more likely it is that there will be a positive outcome. However, as a social stigma exists regarding over-indebtedness, most people only go to debt advice services when it's already too late.

[1] Positive data consists of data on an existing bank account, credit card or instalment loan; negative data are mostly data on payment defaults.

Beyond debt advice, it's important to also focus on personal insolvency procedures. These are currently regulated at Member State level, thus resulting in 27 different schemes. Their aim is to guarantee a fresh start for the indebted person and can consist of procedures including debt settlement or bankruptcy. The Commission's Financial Services User group recently called for harmonised EU personal solvency rules and indicated that in many Member States these procedures are too expensive. They also take too long, an average of five years, and are not sufficiently tailormade to the consumer. All this makes them ineffective and results in them not being able to reach their lofty objective of providing the consumer with a second chance.

Creditors also have a role to play. On many occasions it's not necessary to go to court, and an informal and amicable agreement can be reached between creditors and debtors. This saves costs for both creditors and debtors, and can be more effective than an insolvency procedure. However, a climate of trust is needed – debt advisors can play a very important role here. These agreements can be *ad hoc* but also results from collective covenants with pre-established rules.

Over-indebtedness, inflation and interest rates

The period from 2013 to 2020 saw the number of over-indebted households in the EU decrease. The Commission estimates that in 2020 over-indebtedness affected 17.2 million households and almost 40 million people in the EU. The recent inflation hike that has been accompanied by an increase in interest rates would intuitively point to an increase in the number of over-indebted households. In fact, the same Commission study also estimates that by 2032 there will be an additional five million over-indebted households in the EU.

However, in 2024, the data is more nuanced. With the lack of a common definition of over-indebtedness and of a commonly agreed indicator to measure, it's prudent to not make strong statements. The proxies commonly used to measure over-indebtedness, such as data on arrears or debt to income measures, indeed indicate an increase in over-indebtedness but this is not as pronounced as one could expect. But let's start at the beginning…

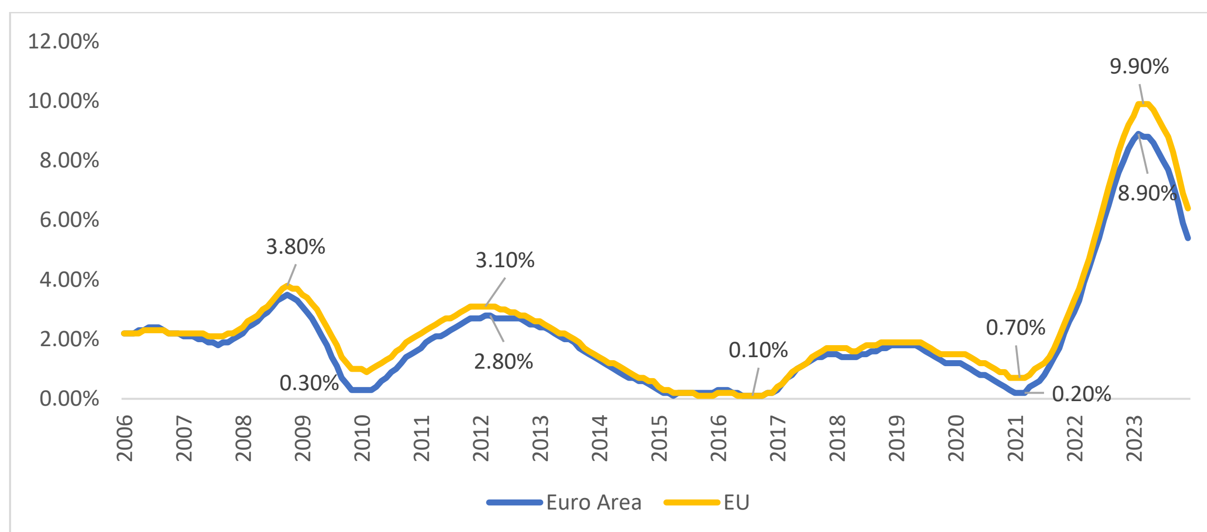
Inflation and interest rates

A rapid increase in prices, as has been witnessed over the last two years, negatively impacts the consumer's capacity to repay their loans. Whilst slow and steady inflation indicates a healthy economy, a rapid change has long-term effects on household finances. For most of the time since 2005, the EU has experienced relatively slow and stable price evolution, never exceeding 3.8 %. As illustrated in **Figure 1** below, price increases observed in 2022 and 2023 were beyond anything Member States had witnessed during the 21st century. The first increase took place during the 2007-08 financial crisis, ahead of the sovereign debt crisis. This was followed by more than a decade of stable and slow price increases in the EU.

This came to an abrupt end in 2022. While some signs of price increases started to emerge in 2021, in the aftermath of the pandemic, it was the rapid increase in energy prices, a major consequence of the Russian invasion of Ukraine, that triggered interest rate rises in 2022. As a result of the increases in energy and food prices, as well as the interest rate rises, inflation skyrocketed. Annual inflation in the EU peaked at 9.2 % in 2023, more than three times the 2.9 % of 2021. The eurozone alone had a somewhat reduced rate – its peak was an average of 8.9 %. The increase in living costs was particularly significant in 2022 in terms of consumer prices for housing, water, electricity, gas, and other fuel which registered an average increase of 18 %. This (thankfully) dropped to 3.4 % in 2023.

In relation to over-indebtedness, such rapid price increases put pressure on households with low margins, increasing their risk of not being able to repay loans and/or make ends meet. Inflation spikes can – unless measures are in place – lead to new households falling into over-indebtedness. A measure used by a minority of Member States to tackle the loss of purchasing power is automatic salary indexation. An example of this is Belgium, where salaries are indexed (read: increased) once the price increase of a defined pool of products has surpassed a certain threshold. The downside of this is that those salary rises could also further fuel inflation.

Figure 1. Harmonised index of consumer prices (12-month average).

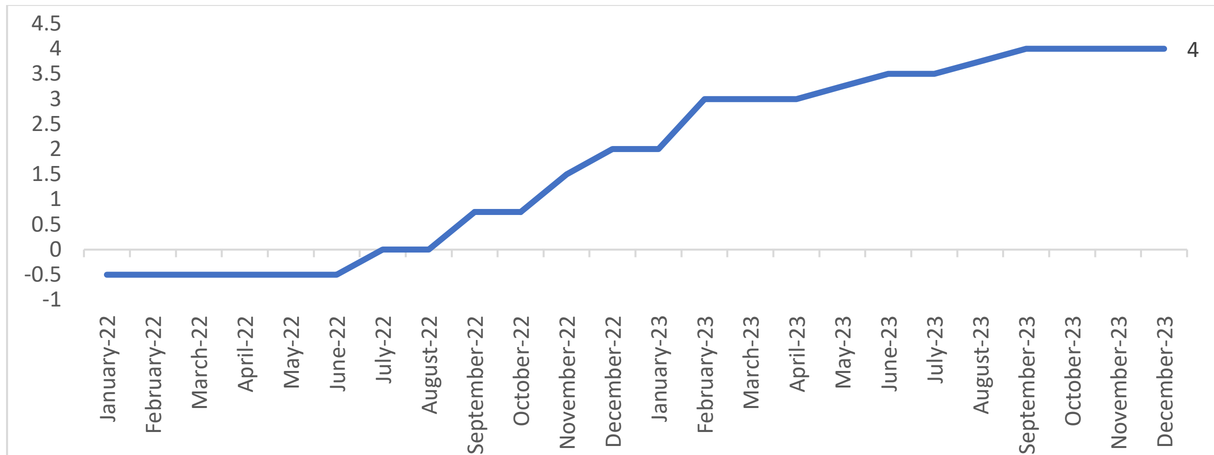


Source: Eurostat

Soaring inflation also led to interest rate rises. As can be seen below, the ECB has rapidly increased its interest rates from 2022. The deposit facility interest had a negative rate of -0.5 % in June 2022. In December 2023, it stood at 4 %, a 4.5 point increase compared to 18 months earlier.

This rise in interest rates has had major implications for credit. Any surge in interest rates results in an increase in borrowing costs, affecting both new credit and existing variable rate loans. Combined with inflation, the major hikes in interest rates on credit reduce households' disposable income. Additionally, It's typically under these circumstances, with increased base product prices, that households with limited economic leeway turn to small short-term loans. Vulnerable households that are granted these short-term loans will, under increased interest rates, face a much higher risk of becoming over-indebted, unless they are able to get their finances under control relatively quickly.

Figure 2. Deposit facility interest rates since 2022.



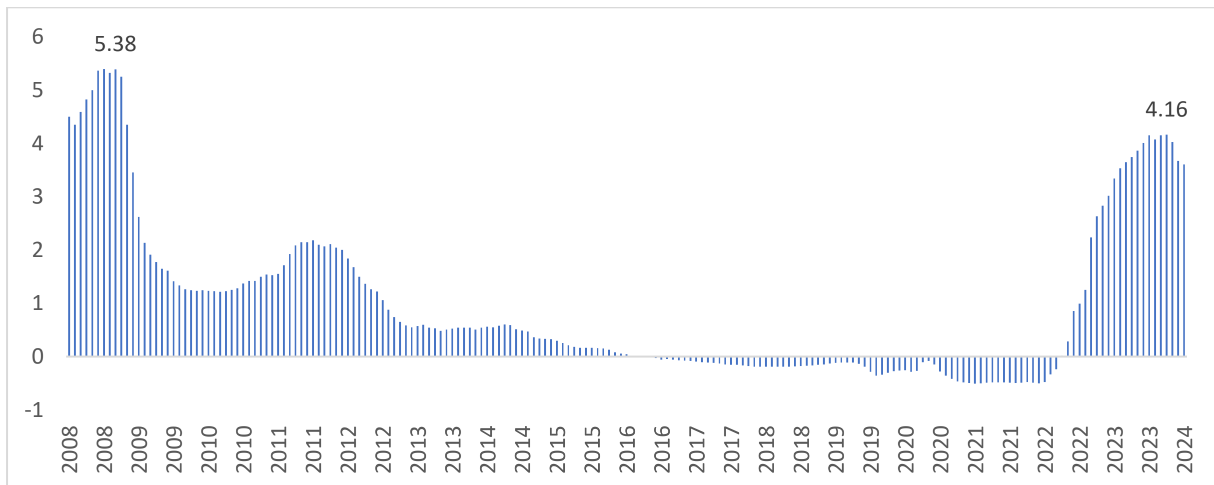
Source: ECB

Regarding housing, those holding mortgages with a variable interest rate have been particularly exposed to the increase in interest rates. Fixed interest mortgages are more common in countries such as France, Belgium, the Netherlands and Germany, while variable interest rates are prevalent in Spain, Italy, Greece, Austria and Portugal.

The Euribor is one of the most used indexes for calculating variable interest rate revisions for mortgages. In October 2023, the 12-month Euribor stood at 4.16 %, the highest level since 2008. There has been a very sharp increase since 2022, which can be seen below in **Figure 3**. In fact, at the end of 2021, the rate was negative at -0.5 %. This increase is testimony to the increased costs for those who have a variable interest rate mortgage, which produces a significant burden for households. The Euribor has been decreasing since October 2023 but it remains at a very high rate compared to previous years.

According to the ECB, since June 2016, interest rates on household loans for home purchases were on average below 2 % in the euro area, with the lowest rate of 1.30 % reached in multiple months of 2021. This stable low interest rate trend was broken in the spring of 2022, when interest rates began to significantly and consistently increase. In November 2023, the interest rate was at 4.05 %. This was the highest interest rate eurozone consumers had had to contend with since the financial crisis.

Figure 3. Euribor monthly average rate.



Source: ECB

Indebtedness and over-indebtedness measures

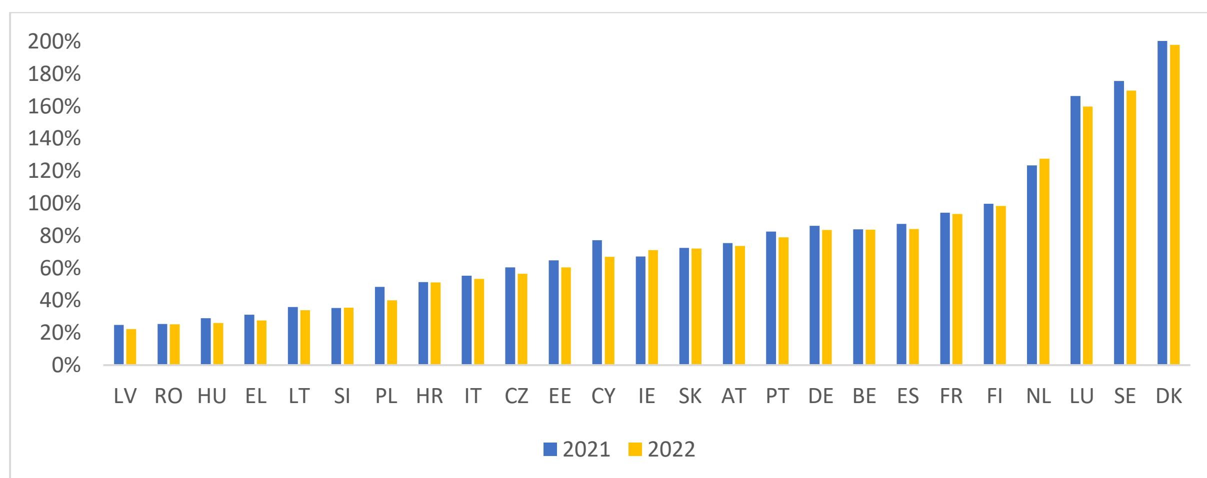
Several indicators have been used in the past to measure over-indebtedness. One of them is the share of household disposable income-to-lending ratio. This measure tries to quantify indebtedness. However, the link between indebtedness and over-indebtedness is not linear. Very indebted countries do not necessarily have more over-indebted households. Nonetheless, they are more exposed to economic fluctuations.

Playing a potential role in the level of household indebtedness in a limited number of Member States is the credit repayment period. Longer repayment periods entail a larger share of the population being permanently indebted, hence increasing the income-to-debt ratio at the national level.

As can be seen below, indebtedness decreased in 2022 from 2021 levels in 24 out of the 25 Member States for which there is data. The share also shows clear differences in indebtedness levels across markets. Member States with the highest GDP per capita normally have the highest lending rates. All over Europe there has been a decrease in the number of consumer (and other) loans granted in the previous year. Northern European countries, which have the highest levels of household indebtedness in the entire EU, are the ones that have seen the greatest reductions.

An example of this is Sweden, where recent high inflation rates halted economic growth, leading the Swedish Central Bank to express concerns about the state of household finances. With limited insight into household indebtedness caused by the lack of data and the grim economic outlook, policymakers fear that there might be a sharp rise in the number of over-indebted Swedish households. This highlights the value of having both a comprehensive understanding and hard data on how (and by how much) households are indebted, as this allows policymakers to take appropriate action.

Figure 4. Total credit to households as a percentage of households' disposable income.



Source: ECRI Statistical Package 2023, ECB

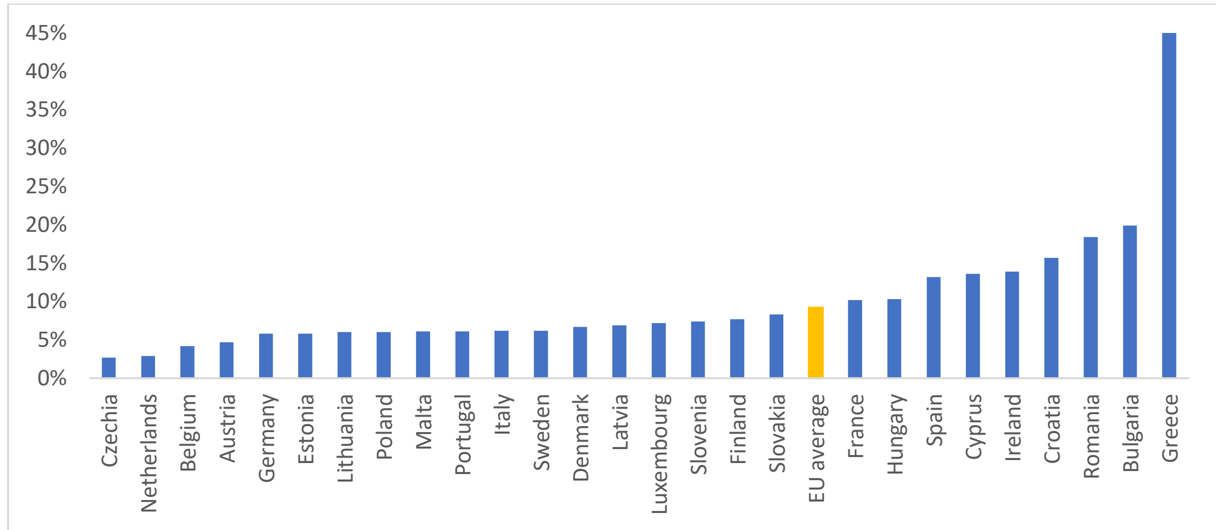
In any case, as already mentioned, a high rate of indebted households doesn't necessarily translate into substantial over-indebtedness. The occurrence rate of arrears for different types of credit provides a better understanding of households' credit and their ability to repay it.

In **Figure 5** below we can observe the percentage of the population who have outstanding credit to repay, split per Member State. While the EU average is of 9.2 %, Greece is the Member State with the largest share of the population facing arrears, 45.5 %. This is more than double the country with the second highest share, 19.90 %, in Bulgaria. On the other end of the spectrum is Czechia and the

Netherlands, with respectively 2.7 % and 2.9 % of the population in arrears. Two thirds of Members States count less than 10 % of the population in arrears.

This indicator points to high indebtedness not leading to a high level of arrears. Looking more closely at the three Nordic countries (Denmark, Sweden and Finland), three of the top five most indebted Member States in **Figure 4** above, they are nonetheless all below the EU average when it comes to arrears on mortgages, rent and utility bills.

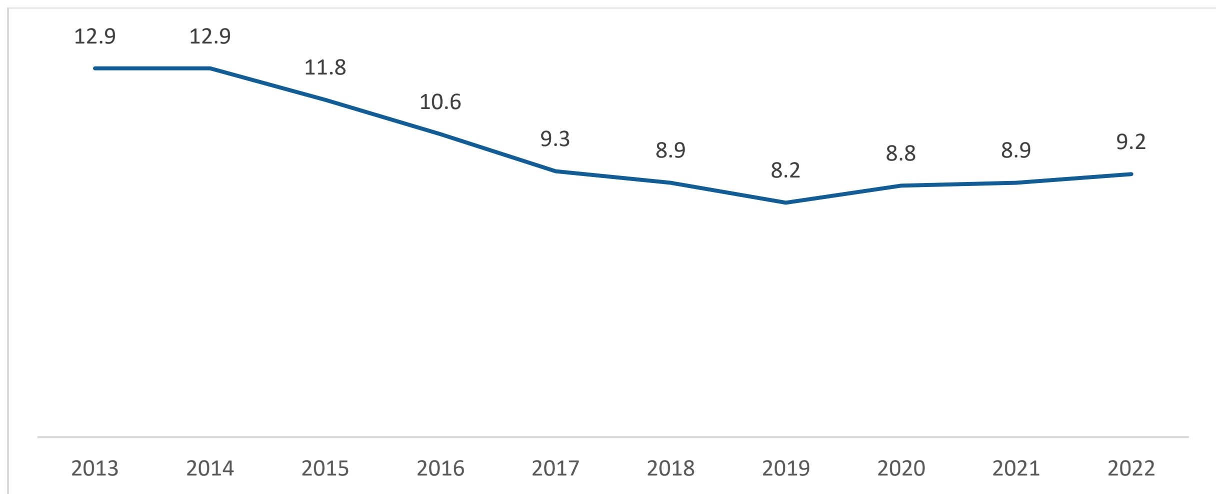
Figure 5. Share of people living in EU households with arrears for mortgage, rent, utility bills or hire purchases in 2022.



Source: Eurostat, Arrears on mortgage or rent, utility bills or hire purchase – EU SILC survey.

Regarding the evolution of arrears in the EU, **Figure 6** below shows a negative trend between 2013 and 2019. It does, however, seem that the Covid-19 pandemic, followed by the increased levels of inflation and subsequent interest rate rises, is likely to have led to arrears becoming more frequent. At the lowest point, in 2019, the average share of the EU population facing arrears was of 8.2 %. After three years of consistently increasing, it reached 9.2 % in 2022.

Figure 6. Percentage of arrears on mortgages and utility bills from 2013 to 2022 in the EU-27.



Data Source: Eurostat

Current drivers of over-indebtedness

The high levels of inflation and the rise in interest rates has created the fear of a substantial increase in over-indebtedness in Europe. Through focus groups, a European Commission study found that there was a broad consensus that 'debt was becoming more prevalent over time' (p. 79) due to inflation and low or stagnating wages and unemployment. The Commission's Financial Services User Group recently warned that the over-indebtedness situation in Europe is 'likely to have worsened and is set to get worse' due to the cost of living crisis. Similar alerts have been mentioned by other organisations such as consumer organisations BEUC and Finance Watch.

The arrears data analysed above does indicate an increase in the number of over-indebted households. However, in relation to the rise of inflation and interest rates, it hasn't been that significant. Several reasons could explain this. One is that savings have provided a buffer for households when prices have increased and access to finance has become more complicated. In fact, according to Eurostat, EU households' savings and disposable income have been increasing since 2013. The greatest increase, of 2.8 %, was in 2021, coinciding with the pandemic. The share of that income saved by households was also very high during the pandemic years jumping to 18.5 % in 2020, from averages of 11-13 % in the 2010s decade. Many households would have accumulated enough savings to weather the inflation storm and thus avoid falling into over-indebtedness. This, of course, would not apply to all households and that's why arrears have slightly increased since the pandemic.

This savings hypothesis would be consistent with the decrease in overall indebtedness levels shown in the reduction of the share of household disposable income-to-lending ratio. It would indicate that households have preferred to settle their debts and not take out more loans. Another explanation is that the measures implemented by governments to protect consumers from inflation have worked. For instance, 18 Member States had discretionary fiscal measures in place in 2023 to mitigate inflation's impact on households and businesses which amounted to a 1 % of GDP on average. These included subsidises covering gas and electricity consumption, a reduction of energy taxes, transport subsidies, and direct support to vulnerable households and sectors.

The effectiveness of creditworthiness assessments could also explain why the increase in over-indebted people is not higher, particularly when considering variable rate mortgages, which are very sensitive to higher interest rates. Good creditworthiness assessment could also be the reason why those countries with a greater share of lending as a percentage of total disposable income are not those where there is a higher percentage of the population facing more arrears.

In fact, the most significant loans in terms of debt-to-income (normally mortgages) are not the most linked to over-indebtedness. The previously mentioned Commission study indicates that over-indebtedness is mostly driven by consumer loans and credit card debt. People with a higher income are more likely to pass creditworthiness assessments and thus have access to mortgages. Those with a lower income have less access to mortgages as they are less likely to pass the creditworthiness assessment. However, those on a low income are significantly more likely to be in arrears than higher income households.

On the other hand, consumer loans and credit card debt normally have higher costs. They also usually consist of small quantities, which makes keeping track of them more difficult. All this turns them into high risk products. However, more vulnerable consumers often only have access to these forms of risky credit, for instance payday loans, which makes them much more likely to end up over-indebted. Additionally, the internet has made these products more easily accessible to consumers.

Another element that drives over-indebtedness are unexpected life events. Creditworthiness assessments, done properly, and with access to the relevant data, have the capacity to restrict consumer credit risk to the bare minimum. However, they cannot predict the unpredictable.

Conclusions

Current data shows the downward trend on over-indebtedness during the last few years in the EU going into reverse. This was to be expected given inflation and interest rates increases. The normalisation of higher interest rates will inevitably imply that consumers will be more exposed to over-indebtedness. This means that national competent authorities need to take action now to promote good practices that limit the ability of financial institutions to undertake *sub par* creditworthiness assessments, ensure access to quality data for all institutions, increase financial literacy and set the market up for success by utilising digital tools that make it easy for the consumer to have a clear overview of all their loans.

Measures taken thus far seem to be working, as the rise in over-indebted people has not been as large as expected. Creditworthiness assessments, despite their inability to predict unexpected events, appear to be particularly effective with no correlation found between indebtedness and arrears. The type of products that seem to drive over-indebtedness are in fact those that involve smaller – but more risky – credit, which until recently were excluded from the CCD's scope. On top of this, Covid-19 support measures seem to have been quite effective in preventing over-indebtedness but they are now slowly being phased out.

This indicates that the focus should be put more on vulnerable consumers who are most likely to take out riskier products such as payday loans, are more financially unprepared for unexpected events and may also be most impacted from the gradual phasing out of Covid support measures. The CCD2 will provide new tools to help mitigate this, something that the upcoming review of the MCD should also do. Equally, as in other industries, credit markets are being transformed by digital innovation, particularly the use of data, AI and emerging new types of products. This has to be taken into account when formulating new legislation and when setting up new services linked to over-indebtedness.

The expansion of debt advice services mandated in the CCD2 should also provide precious support to over-indebted households. Member States will have to ensure that debt advisors have enough resources to effectively conduct their work. To better support more vulnerable households, these services should follow a comprehensive approach that at least covers legal advice, financial management and (mental) health support, and that allows for the early identification of those in danger of falling into over- indebtedness.

Providing more clarity to consumers could be another line of action, particularly in countries where variable rate mortgages are more common. In a context of volatile interest rates, it's much more complicated for consumers to accurately predict the costs of their loans. Similarly to what happens with some retail investment products, credit institutions could be required to provide documents simulating how the product's interest rate could evolve based on different scenarios. This type of documentation would allow consumers to be better informed and better understand their credit's future interest rates.

Nevertheless, the best solutions are not always government-led. Credit institutions' ultimate aim is to be reimbursed and they are in a unique position to know what their clients need for them to pay back their loans. There are already many good examples across Europe where credit institutions have set structures, agreements and actively cooperate with governments and debt advisors to prevent over-indebtedness.

Beyond the debate over which policy options can or should be chosen or which private initiatives can or should be undertaken, any strategy to reduce over-indebtedness should start by properly measuring the problem. Right now, trying to accurately analyse the situation across Europe leads one to run into several limitations. Thus, it would be beneficial to establish a common definition to be used across the entire EU, which could lead to a common understanding of the topic and facilitate cross-country comparison. Equally, significantly more data could be collected to provide a more comprehensive picture of the status of over-indebtedness across the EU. Credit institutions, the only entities present in all Member States, could play a very important role here. Other actors that could contribute are debt advisors and credit registries. Defining a common matrix to measure over-indebtedness on the basis of a set EU definition would also greatly facilitate the task and allow for a much better overview of the situation across Europe.

European Credit Research Institute

The European Credit Research Institute (ECRI) is an independent, non-profit research institute that develops its expertise from an interdisciplinary team and networks of academic cooperation partners. It was founded in 1999 by a consortium of European banking and financial institutions. ECRI's operations and staff are managed by the Centre for European Policy Studies. ECRI provides in-depth analysis and insight into the structure, evolution, and regulation of retail financial services markets in Europe. Through its research activities, publications and conferences, ECRI keeps its members up to date on a variety of topics in the area of retail financial services at the European level, such as consumer credit and housing loans, credit reporting, consumer protection and electronic payments. ECRI also provides a venue for its members to participate in the EU level policy discussion.

For further information, visit the website: www.ecri.eu.

Centre for European Policy Studies

CEPS is one of Europe's leading think tanks and forums for debate on EU affairs, with an exceptionally strong in-house research capacity and an extensive network of partner institutes throughout the world. As an organisation, CEPS is committed to carrying out state-of-the-art policy research that addresses the challenges facing Europe and maintaining high standards of academic excellence and unqualified independence and impartiality. It provides a forum for discussion among all stakeholders in the European policy process and works to build collaborative networks of researchers, policymakers and business representatives across Europe.

For further information, visit the website: www.ceps.eu.