Theory and Practice
of over-indebtedness in Germany

Prof. Dr. Udo Reifner
RA Michael Knobloch

iff institute for financial services, Hamburg
Over-indebtedness is a Symptom for a Mismatch between Income and Expenditure in Time

1. Earning one’s living means being able to have those **liquid assets in time** when they are necessary for expenditures to fulfill basic needs of consumption and reproduction.

2. Since modern money society creates ever more **unstable income streams** (unemployment, third labour market, early retirement) on one side while on the other the increasing need to **prefinance necessary consumption** (transport, transport, household equipment, mass communication), privatised education, illness, accidents, mishaps and provide for old age the gap between the flow of income and expenditures in time has to be bridges by credit and savings.

3. Professional financial services are **productive** if they manage to bridge this gap and make lifetime income available whenever it is needed.

4. The rise of over-indebtedness in society reflects the **decreasing ability of banks** and other financial institutions to fulfill this task properly and provide for productive credit and productive savings.
Income Fluctuations of Women (30-40) and Credit Needs

Frauen 30-40 Jahre
Expenditures, Income and Credit in Time

- Income 1a
  - Transfer Income (Housing, Family allocation)
  - Unemployment Benefits
  - Social Welfare ALG II

- Income 1b
  - Credit
  - Verzichtbar

Time periods:
- Jan 07 to Jul 09
- Jan 08 to Jul 10

Values:
- Income 1a: 0 to 5000
- Income 1b: 0 to 5000
- Unemployment Benefits: 0 to 2000
- Social Welfare ALG II: 0 to 2500
- Credit: 0 to 5000
- Verzichtbar: 0 to 1000

Reifner/Knobloch Theory and practice of over-indebtedness in Germany
To Cure Over-indebtedness requires Understanding of its Reasons

5. Over-indebtedness is surrounded by a number of myths which are promoted to obscure the deficits of the existing system of credit and debt.

6. Over-indebtedness is more than lack of money. This is why it cannot be cured by providing money but needs adaptation of income and expenditure in time (positive cash flow).

7. Empirical research has shown that at least 80% of over-indebtedness is due to an unproductive provision of financial services while less than 20% to unproductive use of it.

8. In the relatively few cases of unproductive use of credit most people affected have less lifetime income than expenditures. In these cases credit, worsened by the usurious exploitation of their fate as high risk, aggravates their situation.

9. The false ideology that over-indebted people can be held responsible for their own fate is materialised by systems of seemingly functioning self-help and self regulation, especially: micro lending, financial education and ethical investment. All three of them have little proven effects on over-indebtedness in general but are the core solutions to a problem which is ignored.
10. Credit viewed only from an investor’s instead of a user’s perspective is incapable to develop adequate means to cope with over-indebtedness. Markets do not care for those without money.

11. The state has to provide rules, means, supervision and authority to guarantee the constant development of productive forms of credit.

12. In this respect the development of small credit (Microcredit) for those with moderate means is an important educational laboratory.

13. Financial education is necessary to enable consumers to use credit properly, to exercise political and market pressure for better supply and to reject usurious offers which exploit instead of overcome their weakness.
What we need

14. The State has to provide a frame like ECRC has given it with its **Principles for Responsible Credit**.

15. Over-indebted families need a **state supported credit market** in which they can satisfy their basic needs for cash flow adaptation even where market forces discriminate against them.

16. Past debt leading into over-indebtedness has to be integrated into future lives through **responsible personal bankruptcy procedures** (better called “debt rescheduling procedures”)

17. **Independent empirical research** at a high scientific level should investigate equally the social conditions of the over-indebted people, the social effects of existing products and supplier behaviour and the effectiveness of legal, educational and self regulatory measures all on a statistical basis instead of using individual cases or model assumptions.
D. Money Problems: How did the Crisis come about? 136

I. Subprime in the USA and the UK 136

1. Mortgage Credit  136
   a) Subprime-Mortage-Market 136
   b) House Prices 137
   c) Higher Credit Cost for the Poor 138
   d) Risk transfer for Market Rate Increases – variable Rate Credit 139
   e) Credit Traps 140
   f) Credit Break Down 141
   g) Effects on Capital Markets 143

2. Credit Card Credit 143

   www.responsible-credit.net
   (multilingual)
   Reifner/Ford (eds), Banking for People, New York/Berlin 1992

II. Subprime in Germany 147

1. Subprime-Mortgage Credit  147
   a) Early Repayment Fees 147
   b) Loan&Savings Agreements in Housing 148
   c) Capital Life Credit  149
   d) Variable Rates 150

2. Subprime-Instalment Credit 151
   a) Usurious Credit through linked Credit Life Insurance 151
   b) Usury through Chain Credit and Refinancing 154
   c) Risk Based Pricing for the Lower Classes 155
   d) Credit Card Credit and Overdraft 155

3. Subprime-Banks – three Examples 158
Practice of over-indebtedness in Germany

- **Over-indebtedness is often related to unemployment**
  - Unemployment rate (Bundesarbeitsagentur)
  - Unemployment indicators of over-indebted households (iff)
  - Number of over-indebted individuals (Creditreform)

- Do financial services help to overcome over-indebtedness?
  - Credit cancellations (SCHUFA)
  - Current account cancellations (iff)

- Does the Government help to overcome over-indebtedness?
  - Affected households (iff/Statistisches Bundesamt)
  - Bankruptcy proceedings (Statistisches Bundesamt)
  - Duration of over-indebtedness
Unemployment main trigger of over indebtedness in Germany

<table>
<thead>
<tr>
<th>Unexpected problems</th>
<th>Unemployment or forced reduced working hours</th>
<th>Divorce or separation</th>
<th>Sickness or illness</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>12,9 %</td>
<td>7,0 %</td>
</tr>
<tr>
<td></td>
<td></td>
<td>1,2 %</td>
<td>0,2 %</td>
</tr>
<tr>
<td></td>
<td>Consumption behaviour</td>
<td>11,4 %</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Bad management of the household budget</td>
<td>2,8 %</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Criminal behaviour</td>
<td>1,8 %</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Ignoring social benefit entitlements</td>
<td>0,4 %</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Damage claims due to liability</td>
<td>0,2 %</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Low income earner (poor)</td>
<td>5,4 %</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Addiction</td>
<td>4,5 %</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Other</td>
<td>3,5 %</td>
<td></td>
</tr>
<tr>
<td>Other reasons</td>
<td>Inappropriate mortgage</td>
<td>2,9 %</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Obligation to pay as an guarantor</td>
<td>2,1 %</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Birth of a child</td>
<td>1,3 %</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Inadequate credit and guarantee advice</td>
<td>1,0 %</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Failed self-employment</td>
<td>11,8 %</td>
<td></td>
</tr>
</tbody>
</table>

0 %  5 %  10 %  15 %  20 %  25 %  30 %  35 %
Unemployment rate in Germany 2006 to Aug 2009

Reversal of trend
Unemployment related indicators of over-indebted households 2006 to Aug 2009

Expected reversal of trend
Number of over-indebted individuals

<table>
<thead>
<tr>
<th>year</th>
<th>number (Mio.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>7.34</td>
</tr>
<tr>
<td>2008</td>
<td>6.87</td>
</tr>
<tr>
<td>2009</td>
<td>6.19</td>
</tr>
<tr>
<td>2010 (estimation)</td>
<td></td>
</tr>
</tbody>
</table>
Practice of over-indebtedness in Germany

- Over-indebtedness is often related to unemployment
  - Unemployment rate (Bundesarbeitsagentur)
  - Unemployment indicators of over-indebted households (iff)
  - Number of over-indebted individuals (Creditreform)

- **Do financial services help to overcome over-indebtedness?**
  - Credit cancellations (SCHUFA)
  - PPI insurance claims ratio (BAFIN)
  - Current account cancellations (iff)

- Does the Government help to overcome over-indebtedness?
  - Affected households (iff/Statistisches Bundesamt)
  - Bankruptcy proceedings (Statistisches Bundesamt)
  - Duration of over-indebtedness
Consumer credit failure ratio according to credit volume

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Percentage</td>
<td>2.2%</td>
<td>2.3%</td>
<td>2.4%</td>
<td>2.5%</td>
<td>2.6%</td>
<td>2.5%</td>
<td>2.3%</td>
<td>2.5%</td>
<td>2.7%</td>
<td>2.8%</td>
<td>2.5%</td>
<td>2.6%</td>
<td>2.6%</td>
</tr>
</tbody>
</table>
Payment protection insurance claims ratio according to insured volume

3,066,000 PPIs in 2007
Current accounts of over-indebted households

- Current bank account, fully functional
- Current bank account, no overdraft possible
- No current account

<table>
<thead>
<tr>
<th>Year</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>%</td>
<td>25.1%</td>
<td>21.1%</td>
<td>19.3%</td>
<td>19.1%</td>
<td>19.5%</td>
<td>18.5%</td>
<td>17.2%</td>
</tr>
<tr>
<td>%</td>
<td>36.8%</td>
<td>47.9%</td>
<td>50.7%</td>
<td>54.0%</td>
<td>59.6%</td>
<td>59.7%</td>
<td>63.6%</td>
</tr>
<tr>
<td>%</td>
<td>38.1%</td>
<td>31.0%</td>
<td>29.9%</td>
<td>26.9%</td>
<td>20.9%</td>
<td>21.8%</td>
<td>19.2%</td>
</tr>
</tbody>
</table>
Practice of over-indebtedness in Germany

- Over-indebtedness is often related to unemployment
  - Unemployment rate (Bundesarbeitsagentur)
  - Unemployment indicators of over-indebted households (iff)
  - Number of over-indebted individuals (Creditreform)
- Do financial services help to overcome over-indebtedness?
  - Credit cancellations (SCHUFA)
  - Current account cancellations (iff)
- Does the Government help to overcome over-indebtedness?
  - Affected households (iff/Statistisches Bundesamt)
  - Bankruptcy proceedings (Statistisches Bundesamt)
  - Duration of over-indebtedness
## Affected households

<table>
<thead>
<tr>
<th>Household Type</th>
<th>German population 2006 (total)</th>
<th>German population 2007 (total)</th>
<th>German population 2008 (total)</th>
<th>Over indebted households 2006</th>
<th>Over indebted households 2007</th>
<th>Over indebted households 2008</th>
<th>Factor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Singles</td>
<td>38.8%</td>
<td>38.7%</td>
<td>39.4%</td>
<td>46.8%</td>
<td>49.3%</td>
<td>51.8%</td>
<td>1.32</td>
</tr>
<tr>
<td>Men</td>
<td>17.9%</td>
<td>17.8%</td>
<td>18.2%</td>
<td>31.1%</td>
<td>32.4%</td>
<td>33.4%</td>
<td>1.83</td>
</tr>
<tr>
<td>Women</td>
<td>21.0%</td>
<td>21.0%</td>
<td>21.2%</td>
<td>15.7%</td>
<td>16.9%</td>
<td>18.4%</td>
<td>0.87</td>
</tr>
<tr>
<td>Couples</td>
<td>53.1%</td>
<td>53.3%</td>
<td>52.5%</td>
<td>36.4%</td>
<td>33.9%</td>
<td>31.8%</td>
<td>0.61</td>
</tr>
<tr>
<td>Couples without children</td>
<td>28.6%</td>
<td>29.0%</td>
<td>28.9%</td>
<td>11.9%</td>
<td>12.6%</td>
<td>12.0%</td>
<td>0.41</td>
</tr>
<tr>
<td>Couples with children</td>
<td>24.5%</td>
<td>24.3%</td>
<td>23.6%</td>
<td>24.5%</td>
<td>21.3%</td>
<td>19.8%</td>
<td>0.84</td>
</tr>
<tr>
<td>Couples with minor</td>
<td>18.0%</td>
<td>17.6%</td>
<td>17.0%</td>
<td>21.8%</td>
<td>19.0%</td>
<td>17.5%</td>
<td>1.03</td>
</tr>
<tr>
<td>3 or more children</td>
<td>2.1%</td>
<td>2.1%</td>
<td>2.0%</td>
<td>4.2%</td>
<td>3.6%</td>
<td>3.6%</td>
<td>1.75</td>
</tr>
<tr>
<td>Lone parents</td>
<td>6.7%</td>
<td>6.6%</td>
<td>6.7%</td>
<td>16.2%</td>
<td>16.5%</td>
<td>16.0%</td>
<td>2.40</td>
</tr>
<tr>
<td>Fathers</td>
<td>0.9%</td>
<td>0.9%</td>
<td>0.9%</td>
<td>2.6%</td>
<td>1.8%</td>
<td>1.5%</td>
<td>1.75</td>
</tr>
<tr>
<td>Mothers</td>
<td>5.8%</td>
<td>5.7%</td>
<td>5.8%</td>
<td>13.6%</td>
<td>14.7%</td>
<td>14.4%</td>
<td>2.50</td>
</tr>
<tr>
<td>Lone parents with minors</td>
<td>4.1%</td>
<td>4.0%</td>
<td>4.0%</td>
<td>14.0%</td>
<td>14.4%</td>
<td>13.8%</td>
<td>3.48</td>
</tr>
<tr>
<td>Other household types</td>
<td>1.4%</td>
<td>1.4%</td>
<td>1.4%</td>
<td>0.5%</td>
<td>0.3%</td>
<td>0.4%</td>
<td>0.29</td>
</tr>
<tr>
<td>n</td>
<td>2,387</td>
<td>2,716</td>
<td>2,610</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

* Over indebted households 2008 compared to 2006.

**Note:** The table compares the percentage of over-indebted households across different household types and years.
Personal bankruptcy procedures (openings)
Fresh start through debt releaf scheme?

- **4 years**
  - Over-indebtedness trigger
  - Start of debt advice

- **1-2 years**
  - Start of bankruptcy proceedings

- **6 years**
  - Debt discharge

- **3 years**
  - Deletion from credit registers (e.g. SCHUFA)

- **14-15 years**