

# Consultation Response



## Public Financial Guidance

### StepChange Debt Charity response to HM Treasury

December 2015

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We are an independent charity dedicated to overcoming problem debt. Our advice and solutions are effective, tailored and importantly, free. Foundation for Credit Counselling. Wade House, Merrion Centre, Leeds LS2 8NG. Company No 2757055. Charity No 1016630. [www.stepchange.org](http://www.stepchange.org)

## Introduction

StepChange Debt Charity is the UK's largest specialist not for profit debt advice and solutions provider. In 2014 we were contacted by almost 600,000 individuals in financial difficulty. We welcome the opportunity to respond to this consultation on Public Financial Guidance.

We are responding in parallel to HM Treasury's Financial Advice Market Review. That contains evidence and commentary relevant to this consultation as well. We therefore attach our response to that review in an appendix.

### **Q1. Do people with protected characteristics under the Equalities Act 2010, or any consumers in vulnerable circumstances, have particular needs for public financial guidance or difficulty finding and obtaining that guidance?**

Those with protected characteristics are likely to have particular need for public financial guidance. The Government should additionally recognise financial difficulties are a form of vulnerability. The Financial Conduct Authority (FCA) recognised this in its 2015 paper on consumer vulnerability:

*"A vulnerable consumer is someone who, due to their personal circumstances, is especially susceptible to detriment, particularly when a firm is not acting with appropriate levels of care .... Consumers in vulnerable circumstances, however, may be significantly less able to represent their own interests, and more likely to suffer harm than the average consumer."*<sup>1</sup>

There is a well-evidenced connection between problem debt and poor mental and physical health. The mental health charity MIND, for example, has shown that one in four adults with a mental health problem lives with debt and arrears and that three times as many adults with mental health problems report debt or arrears, compared to those without mental health problems<sup>2</sup>.

People in financial difficulty, including those who are in or at risk of problem debt, face constrained choices, exacerbated by creditor action demanding repayment.

When people are in problem debt, dealing with creditors is often seen as more important than seeking advice, even when seeking advice is the rational thing to do. Such a constrained decision can make matters worse in the medium to long term. This explains why fewer people seek advice than would benefit from it, and why a large number of people do not turn to advice until an absolute crisis triggers them to do so. It suggests that policy around guidance and advice on debt needs to be considered alongside strategies for prevention and mitigation of debt (for instance, our ideas around a new "breathing space" protection, and consistent regulatory vigilance on collection and enforcement standards).

## **Q2. What additional, or alternative, functions and structures could a statutory body put in place to effectively coordinate debt advice provision?**

A statutory body must focus on addressing the “advice gap” in debt advice, complementing and supporting the provision of appropriately regulated debt advice and ensure the most effective and efficient use of any levy funding it controls.

### Current supply and the debt advice gap

According to the Money Advice Service’s (MAS’s) *Financial Capability Strategy* just one in six of the 8.2 million people currently in need of debt advice is seeking help<sup>3</sup>. Our own research suggests 2.6 million of people in debt are in severe difficulty. A statutory body must be focussed on ensuring that this gap is filled in the most appropriate way<sup>4</sup>.

Consumer demand is met is met by a mix of free advice and for-profit advice, with free advice comprising the vast majority of current provision.

Free debt advice accounts for an estimated 83.5% of provision (1.169 million advice sessions out of 1.4 million). This reliance on the free sector will increase if, as is widely expected, the commercial market shrinks in response to economic and regulatory pressures.

It is important the Government does not make any changes which are likely to diminish current supply. Government should seek to close the debt advice gap by promoting more free debt advice. A large proportion of people seeking debt advice will not have much or any spare money at the point of seeking advice. A quarter of people contacting StepChange Debt Charity have a negative budget. They are not able to pay for advice, or they are seen as economically unviable by commercial providers.

### Maintaining current funding

Free advice is paid for by a “mixed economy” of statutory and voluntary funding. Funding for free debt advice comes from<sup>1</sup>:

- The MAS debt advice levy: £45 million
- Donations: £74+ million, of which
  - FSC = c£54 million
  - Other = c£20 million

This “mixed economy” is a source of strength:

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<sup>1</sup> Estimated figures

- It secures statutory funding to provide an essential public good, ensuring that provision can be directed towards meeting aggregate need, including in response to immediate issues like serving clients impacted by the exit of commercial providers.
- It brings in donations from funders who wish to support particular objectives or organisations. It makes providers directly accountable to funders for balancing efficiency, effectiveness, innovation and reach.

It would be inappropriate to move voluntary donations on to a statutory footing because that would:

- Create a new tax/levy, which would require legislation, extensive design work and consultation and would subsequently require additional collection and distribution infrastructure.
- Have a negative impact on future voluntary donations.
- Mean creditors are less represented, as they will no longer have a direct relationship with front line advice providers.
- Create rigidity in a model that can evolve naturally.

Overall, if free debt advice is a public good, it is best funded by both public funding and voluntary giving. A mixture of both is most likely to strike the right balance of efficiency, effectiveness, innovation, reach and responsiveness to change. Therefore the Government should adopt a principle of not disrupting existing funding streams that work satisfactorily

#### Increasing statutory funding

Consumer credit lenders pay for the majority of free debt advice. However, they also receive the majority of the benefit from such advice. Research from the Friends Provident Foundation shows creditors recover in excess of £1 billion (or collectively, £1,100 per advised individual) extra, where independent advice is given

However, consumer credit lenders are not the originators of all problem debt and the standards to which they are held in terms of product design and conduct towards people in difficulty are arguably higher than those that apply elsewhere. Annex 1 shows how StepChange Debt Charity's clients owe money to various creditors in many different sectors. The FCA levy is a convenient way of levying creditors who are regulated financial services providers, but it is not fair that financial services creditors foot the whole bill.

In 2014, 135,681 (39.8%) of StepChange Debt Charity clients advised had arrears on essential household bills, compared to 68,522 (34.9%) in 2012. This means an

increasing proportion of the costs incurred by the free debt advice sector are related to providing guidance on these arrears<sup>5</sup>.

Any model based on the harm caused by problem debt and the benefits generated by free debt advice should attract a significant contribution from government itself. A statutory body could hold the Government accountable for this and furthermore supplement the FCA levy with statutory contributions from others, including utility providers, ensuring a funding mix which is rational, transparent, accountable, fair, and above all sufficient (Annex 2).

### Implications for the role and responsibilities of any statutory body

A statutory component of funding requires certain jobs to be done. These include:

- Comprehensive analysis of total provision vs total need.
- Gap analysis, by geography and channel, along with action to ensure that the support is available in the form people need it.
- Funding and distributing multi-year funding on an open and transparent basis
- Accountability for distribution and guaranteeing the value for money of statutory funding.

Other roles and responsibilities of a statutory body might include a function to ensure market and policy developments which could increase the need for debt advice are accompanied by mitigation measures. Government departments and agencies should conduct a debt impact assessment on new policies, and ensure that any debt impact is mitigated. A statutory debt co-ordination body could provide a useful check on the quality and consistency of such assessments. Part of this function may already reside in the Financial Conduct Authority's 'have regard' for access to financial services products and services.

Several of these jobs are currently carried out by the Money Advice Service (MAS). We have worked well with MAS in their role, and would continue to do so if the review concludes that they should continue to carry out the same functions, or an amended version. Equally we would work constructively with any alternative arrangements the Government chooses to put in place.

We have identified two options for who could carry out such functions.

1. A special purpose statutory body to work alongside free debt advice providers: this could be close to the current MAS arrangements, though the consultation might wish to recommend some changes (see Q3 below) e.g. a stronger voice in governance for practitioners and funders.

2. Self-governance based on partnership within the sector itself. The three main debt advice charities (Money Advice Trust, Citizens Advice and StepChange Debt Charity) together provide a well-functioning ecosystem of provision and we are working together to ensure a seamless journey between our services and will be exploring this further with other organisations. This work, which began in early 2015 and is independent of the MAS Debt Advice Steering Group, will continue with this consultation in mind.

The optimum balance might be a body operating under a refreshed statutory remit, with strategic development focused on and driven by practitioners and funders. The key objective is to minimise the number of barriers between consumers and advice as these barriers stop people taking advice by complicating the customer journey. There is no need for the statutory body to be interposed between the source of advice and people in need, e.g. through a role as a “hub”.

A statutory body would be accountable for addressing the advice gap, understanding need and demand and ensuring free advice is available to meet this demand. In executing this role, it could be required to complement voluntary funding. Its coordination role could be primarily ensuring that levy funding is appropriately allocated. There should be a focus on extending the reach of free, not-for-profit debt advice.

The funding body should be aware that it allocates only one element of sector funding, levy funding, and ensures this funding does not lead to duplication, which would risk the withdrawal of voluntary funding from the sector.

The funding body should ensure value for money via appropriate channel decisions. While face-to-face advice remains vital, free sector reach and cost-effectiveness can be improved. Data from the main non-profit providers shows that telephone advice is four or five times cheaper than face-to-face provision, with online services cheaper still.

Another aspect of “rationalising” funding is to improve the efficiency and flexibility with which funding is allocated. All free sector providers should be able to apply for funding on an equal footing. This would make objectives clearer, allow more transparency between funding and expenditure, and foster innovation. There is also scope to use funding in new ways, for instance a debt advice ‘Challenge Fund’, which could encourage innovative new projects and partnership arrangements and improve the effectiveness of the sector in meeting client need. The statutory body could continue to contract for particular services, where need is not otherwise being met.

### **Q3. What role should a statutory advice body have in providing quality assurance and setting standards for debt advice?**

Although a statutory body should have structures in place to agree KPIs are achieved in funded projects, this is not the same as saying the funding body needs to engage in double regulation by creating its own advice standards. Any funding body can rely on the rigorous regulatory standards of the FCA to decide to remove funding from free providers. There is also no need for a statutory body to oversee the outcome of voluntary funding, which already requires recipients to demonstrate value to funders, who are subject to FCA rules.

We refer here to the Financial Conduct Authority's feedback on its CP15/6 consultation (*Consumer Credit – proposed changes to our rules and guidance*).

*In response to suggestion 'Money Advice Service advice quality standards should be reflected in the FCA regime.'*

"We do not believe this is necessary at this time, as the scrutiny we apply to firms at authorisation exceeds the scrutiny required for a firm to meet the debt advice quality standards."

#### **Q4. What scope is there to rationalise the funding of public financial guidance provision on debt?**

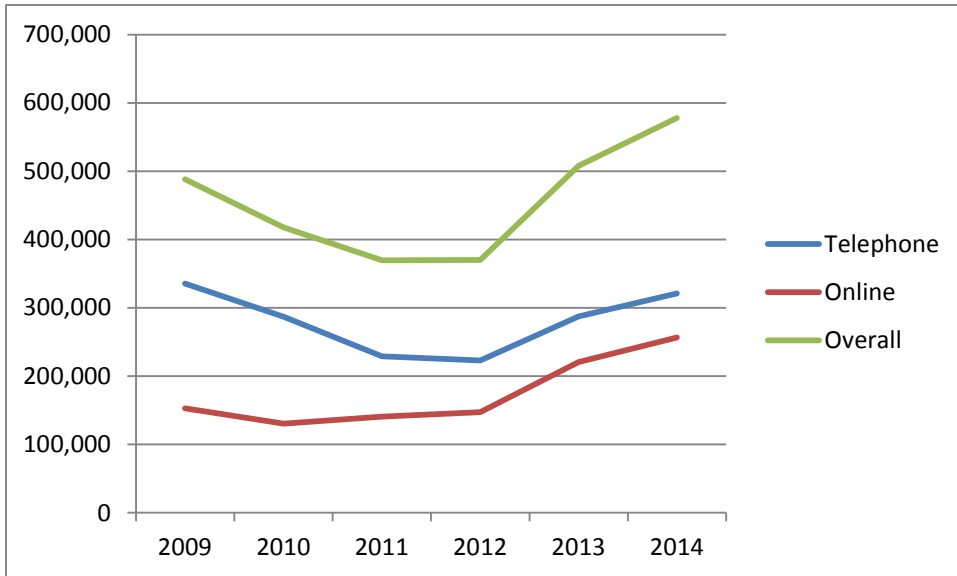
The proposals above (Q2) would achieve transparency and rationality in the funding of public financial guidance provision on debt, in particular by:

- Clarifying the respective roles of statutory and voluntary funding.
- Delivering appropriate governance over the former.
- Ensuring both drive efficiency, effectiveness, innovation and reach.

But "rationalisation" must not mean "reduction". Given the advice gap, a rational level of funding is higher than we see now.

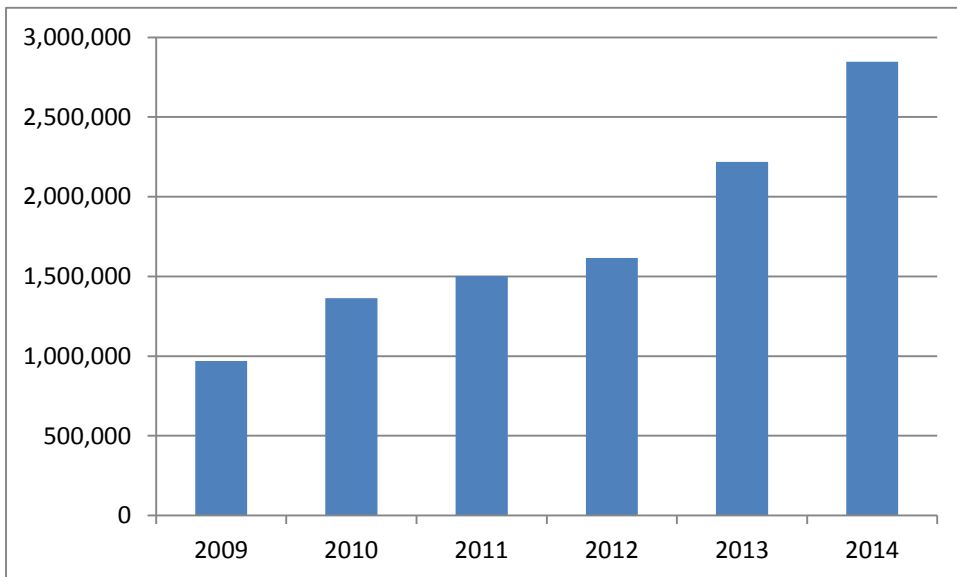
There is a need to ensure sustainable ongoing funding for the free debt advice sector. Currently increasing demand is placing new pressures on free debt advice providers. The number of people approaching the sector for help has increased substantially in the last few years. For example, in 2014 StepChange Debt Charity was contacted by 577,677 people with problem debt in 2014, a 56% increase on 2012 (Figure 1). We are seeing increasing numbers of people with more complex needs, with less ability to repay debts and who are more vulnerable to welfare state changes.

#### **Figure 1: Demand for debt advice<sup>6</sup>**



In response the free sector has developed broader services and additional supported solutions, which has increased the cost of serving clients. It has also sought to provide additional information and services online by investing in websites and digital services. This has further increased the number of people we help (Figure 2). At the same time, the sector faces the additional cost of FCA regulation.

**Figure 2: Online advice<sup>7</sup>**



**Q5. What additional, or alternative functions and structures could a statutory body put in place to effectively coordinate public financial guidance on pensions?**

No comment.



**Q6. How could the organisational delivery of public financial guidance on pensions be improved to provide greater efficiency?**

A significant number of people reach pensionable age with unsecured debt. The current combination of regulated advice on pensions, investments and retirement options, PensionWise and regulated debt advice does not make it easy for organisations to offer joined up advice for consumers.

Providers must work together to create better services through partnerships and joint initiatives, but policymakers can help by:

- Clarifying the boundary of different forms of regulated advice
- Increasing the confidence of regulated organisations to offer “generic” advice outside these boundaries
- Clarifying the insolvency treatment of pension pots, which has become very confused.

**Q7. What scope is there to rationalise the funding of public financial guidance provision on pensions?**

No comment.

**Q8. Are the statutory objectives underpinning MAS the right ones?**

No. MAS’s statutory remit pre-dates the move to bring consumer credit and associated services like debt advice into FCA regulation. We believe this change removes the need for MAS, or any alternative statutory body, to have any role relating to the “quality” of debt advice. See answer to Q3 above.

In the context of the current review, we think that MAS’s statutory remit relating to debt advice should be thoroughly reviewed with the objective of improving the coherence between the funding it administers, the sectors and activities it seeks to co-ordinate, and its role in policy formulation and meeting overall need.

**Q9. What role, if any, should a statutory body have in providing general money guidance?**

It is crucial that general money guidance is available so people can acquire the skills, knowledge and confidence to achieve long term financial resilience. Money guidance supports resilience and helps people avoid problem debt when it focuses on:

- Appropriate budgeting.
- Saving.
- Prudent borrowing.

- Seeking advice quickly.
- Acting on advice to resolve a debt situation.

For example, our research shows that an average family with £1,000 in accessible cash savings is 44% less likely to fall into problem debt than a family without savings<sup>8</sup>.

We are sympathetic to the Farnish review's conclusion that money guidance matters directed to boosting resilience, avoiding and resolving debt should be aligned with other debt-related activity to give a coherent view across prevention, remediation and rehabilitation. Again, we believe MAS could continue in its current role or that the role could be amended or re-allocated. Here we focus on what should be done, not who should do it.

A statutory body has a triple role in money guidance, whether this is within a wider remit or not.

One, the statutory body can assess gaps in current provision and direct funding to fill these gaps. It may choose to do this by producing its own guidance or funding free, independent guidance offered by others. Part of this will be about providing adequate articulation of the relationship between general money guidance and debt advice.

Two, the statutory body can understand how different families access and use money guidance. Some families need little advice, or only need advice on one aspect of financial capability. Other families need more intensive advice or advice on all the aspects listed above. The statutory body has to understand this spectrum and work with providers to get advice to the right people at the right time.

Three, as with debt advice, there is likely to be additional need for general money guidance, which may increase in future if pressures on family budgets grow. Therefore a statutory body needs to have an eye on bringing extra finance into the sector, primarily through working with voluntary funders and providers but also through maintaining or expanding levy funding. The statutory body must of course ensure the independence of providers receiving funding.

**Q10. What role, if any, should a statutory body have in supporting financial capability?**

No comment.

**Q11. What scope is there to rationalise the funding of public financial guidance provision on money matters and / or financial capability?**

We would be concerned if any rationalisation of the funding of public financial guidance provision on money matters resulted in a reduction in the focus on, and funding available to, financial capability work.

MAS has invested heavily in the financial capability strategy, which has involved pulling together research, insight and evidence from across a number of separate fields. The review needs to consider where such an overview role would sit in any alternative structure.

### **Q12. How do you think that the government could best complement voluntary sector provision of financial guidance?**

The public sector is an increasingly important creditor, and a particularly aggressive one in terms of collection practices and lack of forbearance. It is therefore an increasingly large generator of work in the free debt advice sector. Our work on the £8.3bn social cost of problem debt also indicates the significant benefits that accrue directly to public authorities from free debt advice, and to the economy as a whole<sup>9</sup>. There is thus a strong “fairness” argument for public funding (i.e. from general taxation) to support free debt advice. This could take the form of

- Grants.
- Contracts for services – any department executing a policy that might create the risk of problem debt could be required to also fund a mitigation scheme (e.g. by contracting with a free advice provider).
- Proper funding for debt-related statutory services. It costs us £200 to administer a DRO, for which the Insolvency Service pay £10. That is £190 we cannot spend helping more people.

Additionally, one of the most effective ways in which Government can help ensure sufficient funding of debt advice, and boost its efficiency and effectiveness, is via policy action to reduce the incidence of problem debt, reduce its impact where it does strike, and speed recovery from it.

#### Breathing space

There is no watertight guarantee that debt advice in England, Wales and Northern Ireland will relieve pressure from creditors, which reduces our ability to get people to take action and confront their debt problems.

We estimate that severe problem debt costs the state and society £8.3 billion in external costs; including debt-related physical and mental health problems, lost productivity and jobs, family breakdowns and housing issues<sup>10</sup>.

The trigger for severe financial difficulties is often a life event like job loss, reduced hours or illness that causes a drop in income. Almost two thirds of StepChange Debt Charity clients cite this as the main cause of their debt problem.

Household resilience to income shocks is low: thirteen million people do not have the savings to keep up with essential bills for a month if their income dropped by a quarter<sup>11</sup>.

People can and do recover from temporary income shocks. But without the right help and support financial difficulties become entrenched and unmanageable. We know that 'breathing space' is vital – 60% of clients we surveyed told us that their financial situation stabilised once creditors agreed to freeze further interest, charges and enforcement action. But none of the people who said they did not get this help said their situation had stabilised<sup>12</sup>.

The Government could best complement voluntary sector provision of financial guidance by introducing a scheme capable of providing two broad protections similar (but not identical) to the Scottish Debt Arrangement Scheme (DAS). The crucial features are (i) they incentivise people to take advice and stick with a solution; and (ii) the protection persists until debt is resolved.

- An initial 'breathing space' period like DAS, but longer than the six weeks DAS provides. Six weeks will generally give people enough time to seek advice. But where people have suffered an income shock their circumstances may not have stabilised enough in six weeks for debt advisers to recommend a long term debt solution. Therefore we suggest a period of breathing space of up to one year – subject to continuing engagement by the individual and review of their circumstances by the debt advice provider.
- Like the DAS scheme, a scheme for England and Wales should continue to freeze interest, charges collection and enforcement action where people are able to repay debts within a reasonable period. This would give people repaying their debts similar protection to that the law currently gives to people who need debt write-off via an insolvency remedy.

### Saving

Families need savings. If every household in Great Britain had at least £1,000 saved it would reduce the number in problem debt by 500,000. However, families are facing a savings crisis: 22 million adults in Great Britain are not confident they're saving enough to cope with a rainy day<sup>13</sup>.

Young adults, people on low-moderate incomes, people living in living in rented accommodation and families with young children, can find it particularly difficult to save.

There already exists in the UK an incentive-based scheme for getting people saving: auto-enrolment for pensions with a matching element, where government and employers "match" individual saving contributions.

This scheme could be adapted to help families build up short term precautionary saving, harnessing behavioural incentives to ensure families save the amount they need but also use incentives to encourage them to maintain their savings balance for moments of greatest need.

But more needs to be done. Financial services providers and government need to help families who are not part of the auto-enrolment system, either because they fall below the relevant income thresholds or because they don't have an employer.

We want financial services firms to work with partners to develop and pilot saving accounts better suited for individuals who can only start saving with a low initial deposit and only make intermittent deposits subsequently. They should explore greater use of saving incentives such as prizes which are effective incentives for lower-income families.

Government should seek to build a savings element into the welfare system, via income thresholds and work allowances within tax credits and Universal Credit. It should do more to get children saving to ensure the UK builds a precautionary savings culture in the long term.

### Safety nets

Despite low headline unemployment figures, for millions income shocks remain a fact of life, and the primary driver for problem debt - 73% of people in problem debt experienced an income shock in the last year.

14 million people in Britain experienced at least one income shock in the last 12 months, including 4.5 million people who experienced two or more.

People who experienced multiple income shocks in a year were three times more likely to fall into severe problem debt than those who experienced a single income shock<sup>14</sup>.

People who fall into severe problem debt after an income shock are likely to see a long term drop in their income and security, making it harder to pay back their debts, and leaving them at greater risk of further shocks to their income.

Action is needed to boost people's personal safety nets.

Key to boosting families' financial resilience is plugging the gap between people's reduced income and their essential costs after they've faced an income shock. People need support at the point they experience a drop in income. This support would help meet their essential costs while they seek to stabilise their finances, and avoid them being driven to make drastic, life changing decisions which could delay their aspirations by years. There are a number of options, such as a greater contributory element to welfare payments, a bolstered system of income protection insurance, and an enhanced provision for low cost loans that are available to a wider demographic of households.

**Q13. Do you think that the government could offer a more integrated public financial guidance service to consumers, throughout their lives? How do you think this could be achieved?**

The principles we think policy should apply are:

**1/The job to boost Britain’s financial capability is incomplete and these parallel reviews need to provide a spring board for the next chapter.** Financial capability remains too low in too many areas, which holds back markets, competition, consumer protection and economic security for individuals and families.

**2/The need for “money guidance” has not gone away, and again the reviews should set out how that agenda is taken forward.** The Thoresen Review set out principles for success, which still read well. They included “free, expert, on your side, not selling”.

**3/Technology provides new opportunities and challenges.** People are taking peer to peer advice on social media and online forums. This is plugging some of the advice gap, but without quality control. Regulators should embrace this activity, not seek to squash it, but ensure it does not cause detriment.

**4/Design solutions around people, not product silos.** Legislation tends to artificially divide – insurance, mortgages, debt, and retirement. People just see wants and needs.

**Q14. Do you think the government should explore any alternative options for the provision of public financial guidance?**

There is no straightforward trade-off between product simplicity and people’s need for help and advice with managing their money. Even if all products were radically simplified, people would still need guidance on non-product matters (e.g. budgeting) and advice they can trust when life circumstances means they would benefit from approaching a market they might instinctively prefer to avoid. The Government may wish to consider bringing money guidance ideas closer to the point of sale, so that guidance is signposted, but with a clear separation from the sale itself.

**Q15. Are the suggested core services the right ones? Should any core services be added?**

No comment.

**Q16. Are the suggested principles the right ones to underpin the statutory provision of the core services? Should any principles be added or removed?**

The government should add an additional principle not to interfere in any area of the sector, including funding, that is already working well for consumers.

**Q17. Do you think that statutory provision should be restructured to improve the guidance service to consumers, and if so, how?**

No comment.

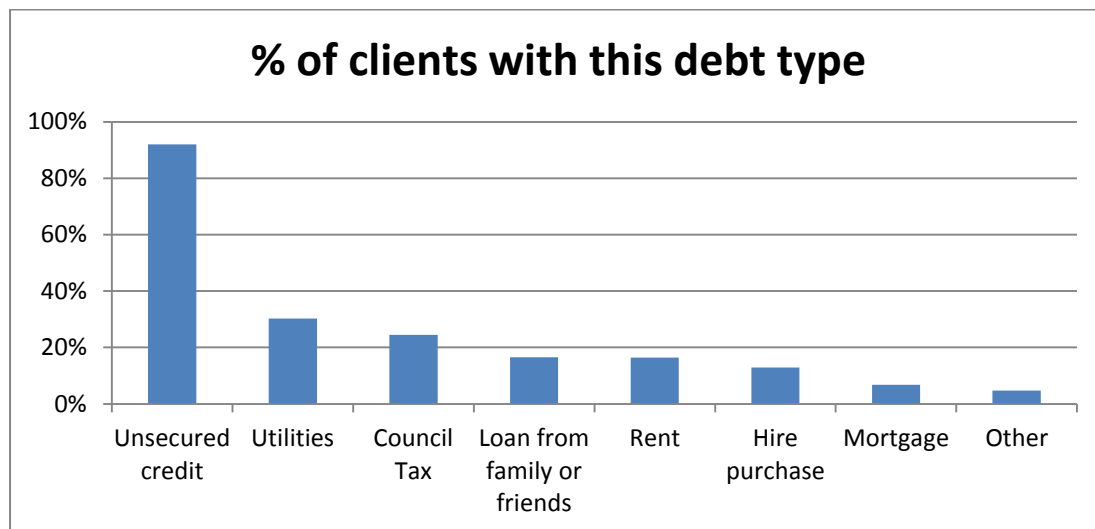
## Annex 1 – “Polluter pays”: the pattern of our clients, their creditors and their debts

Arguably the costs of free debt advice should take account of who is responsible for allowing, or worse encouraging, people to take on unmanageable debt, and for making debt worse via their collection and enforcement practices. This is the “polluter pays” principle.

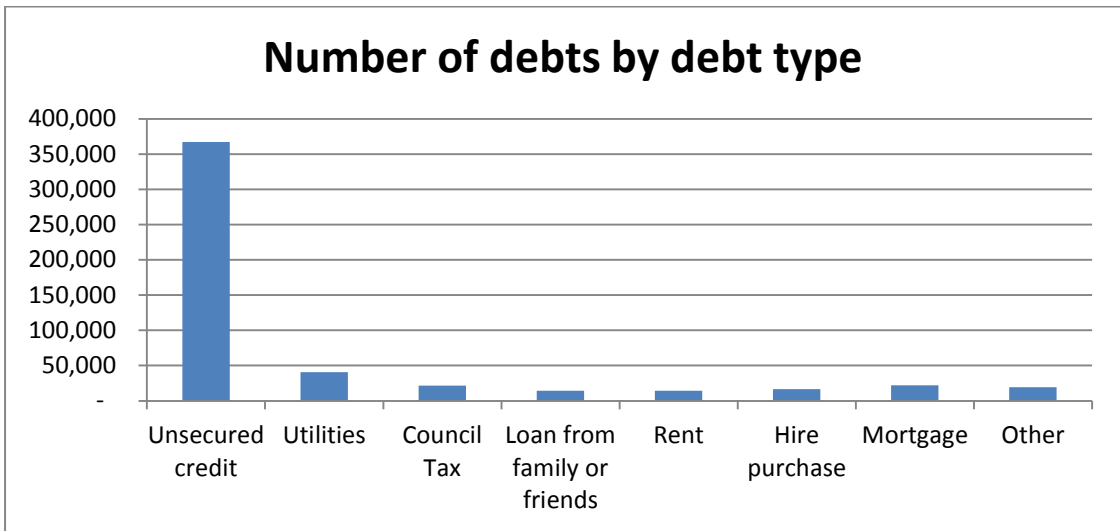
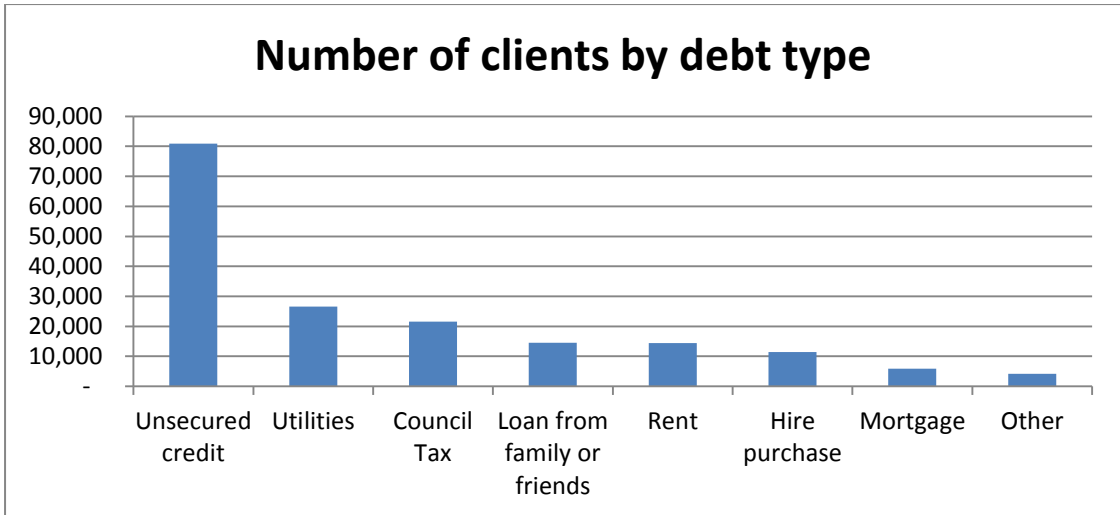
The ‘polluter pays’ principle is the commonly accepted practice that those who produce pollution should bear the costs of managing it to prevent damage to human health. For instance, in the environmental sector a factory that produces a potentially poisonous substance as a by-product of its activities is usually held responsible for its safe disposal<sup>15</sup>.

This principle underpins most of the regulation of pollution affecting land, water and air. However, it has long been argued the principle “tracks across” to debt advice, where there is a similarly direct relationship between cause and effect<sup>16</sup>.

The Charts below show that numerous sectors and organisations create the need for debt advice, but some of these do not currently contribute to funding this advice<sup>2</sup>. Two “polluting” sectors stand out as “under-contributing”. These are the public sector and private landlords.



<sup>2</sup> All data are from our telephone service in the first half of 2015.



The amount of free debt advice activity relating to local authorities can be seen from the “Council Tax” columns in these charts. Additionally, in the first half of 2015, StepChange Debt Charity advised on over 7,000 debts owed to HMRC and DWP by our telephone clients. Each month, we repaid over £1 million to HMRC and DWP on behalf of our clients.



## **Annex 2 – levy options**

### **(1) Alter the way the current financial services levy works**

FCA did not use the arrival of 50,000 consumer credit businesses to increase the levy overall, instead in 2015 it reduced the levy by 2.5%<sup>17</sup>. But with most consumer credit businesses still in interim authorisation, or in the first year of full authorisation, many are not yet subject to the full charge. Once the sector is fully authorised, FCA could consult on criteria for the medium to long term distribution of the levy. Options it might consider include making the levy reflect firms' separate voluntary support for free debt advice, so as to lay the burden slightly more on those who historically decline to contribute in that way.

The levy could be supplemented by revenues from fines on some or all financial services firms, which are currently put towards other public goods.

In principle the levy could be made to work “counter-cyclically” so that lending in boom times pre-funds future debt advice at the opposite end of the cycle. This could smooth demands on levy payers over time, and also allow for longer term funding even than MAS's current 3-year deals.

We would not favour the creation of new levies. Any entirely new levy would need consultation, legislation and design work. Voluntary funding streams, however, can evolve quickly and efficiently. New levies would also create the very real risk of a corresponding reduction in voluntary funding. There are obvious political objections to “new taxes” and you'd need to create objective and transparent governance and representation to accompany such a move.

### **(2) Additional levies on other sectors**

Utilities and telecoms are regulated sectors who are creditors in an increasing proportion of problem debt cases. Sector regulators could be empowered to raise levies for debt advice. Or one could build on the current ability of OFGEM to direct that firms they fine pay the money to particular charitable causes. The big risk with the levy approach (less so with fines) is that this will result in a reduction in voluntary funding from these sectors. It is clear that many firms prefer to contribute voluntarily.

## **Annex 3 – response to FAMR**

StepChange Debt Charity is the UK's largest specialist not for profit debt advice and solutions providers. In 2014 we were contacted by almost 600,000 individuals in financial difficulty. We welcome the opportunity to respond to the Financial Advice Market Review (FAMR).

We are responding in parallel to HM Treasury's Public Financial Guidance consultation. That contains evidence and commentary relevant to this review as well. We therefore attach our response to that review in an appendix.

We only have evidence and ideas relating to certain issues within FAMR, so our response only contains answers to selected questions.

**Q5: Do you have comments or evidence on the types of financial needs for which consumers may seek advice?**

Evidence from our client base shows that the following people are contacting the Charity in greater numbers and are disproportionately likely to seek advice<sup>18</sup>:

- Those on a low-income: 70.4% of clients advised earn less than £20,000 (net) annually.
- Women: in 2014 the proportion of female clients was 57%, up from 54% in 2012.
- Single parents: now represent close to one in five (18.3%) of those advised by the Charity compared to 16.1% in 2012.
- Those living in rented accommodation: almost three-quarters (71.4%) of StepChange Debt Charity clients in 2014 lived in rented accommodation, compared to 61% in 2012.

The problems clients present with are changing rapidly, and the Government and Financial Conduct Authority (FCA) must be aware of this when making its decisions based on this consultation. The last five years have seen significant reduction in the number of people with very high consumer credit debts, but rapid growth in the number of families struggling with arrears on essential bills, such as rent or heating.

The most worrying trend of the last few years has been the huge rise in the number and proportion of clients who have arrears on an essential household bill, including council tax, electricity, gas, mortgage payments, rent and water bills. In 2014, 135,681 (39.8%) of clients advised had arrears on essential household bills, compared to 68,522 (34.9%) in 2012<sup>19</sup>.

One important note here, while overall the level of unsecured debt is falling, debt levels are beginning to rise on some products where lending is generally smaller scale. These are catalogues (where the average debt increased by 14% between 2012 and 2014) and home credit (2%). Although the average total debt clients owe on payday loans fell between 2012 and 2014, the average debt owed on each payday loan rose from £552 to £576<sup>20</sup>.

The spiral of harm caused in people's lives by problem debt can be stopped when people get independent advice and some respite from ever growing debts and demands for payments that they cannot afford. Our clients have told us how their finances started to stabilise when their creditors agreed to freeze further default interest, charges and debt collection activity against them. One in six of our clients said that their financial situation had stabilised once all of their creditors agreed to freeze further interest, charges and enforcement action. However, no one said their

financial situation had stabilised in cases where none of their creditors had agreed to give them this help.

A key reason for people needing debt advice is an unexpected income shock leading to a crisis situation. Income shocks are the primary driver of problem debt. More than 7 in 10 people in problem debt experienced an income shock in the last year. Where people use credit to keep up after an income shock, they are 20 times more likely to end up in severe problem debt than those who don't use credit. In the last 12 months, 14 million people in Britain experienced at least one income shock; 4.5 million people experienced two or more<sup>21</sup>.

People who experienced multiple income shocks in a year were three times more likely to fall into severe problem debt than those who experienced a single income shock.

However, often people wait too long between experiencing an income shock and seeking advice. Half of our clients wait a year between realising they are in financial difficulty and seeking help from a debt advice provider. Instead of seeking advice, they are instead often turning to further borrowing, even though this does not objectively seem like a rational decision. Almost three quarters of our clients got loans from their family and friends to keep up with essential costs once they started to struggle. A similarly high proportion used credit cards and overdrafts to keep up with essential costs, while around 1 in 5 used high cost forms of credit such as payday loans, pawnbrokers and home credit providers<sup>22</sup>.

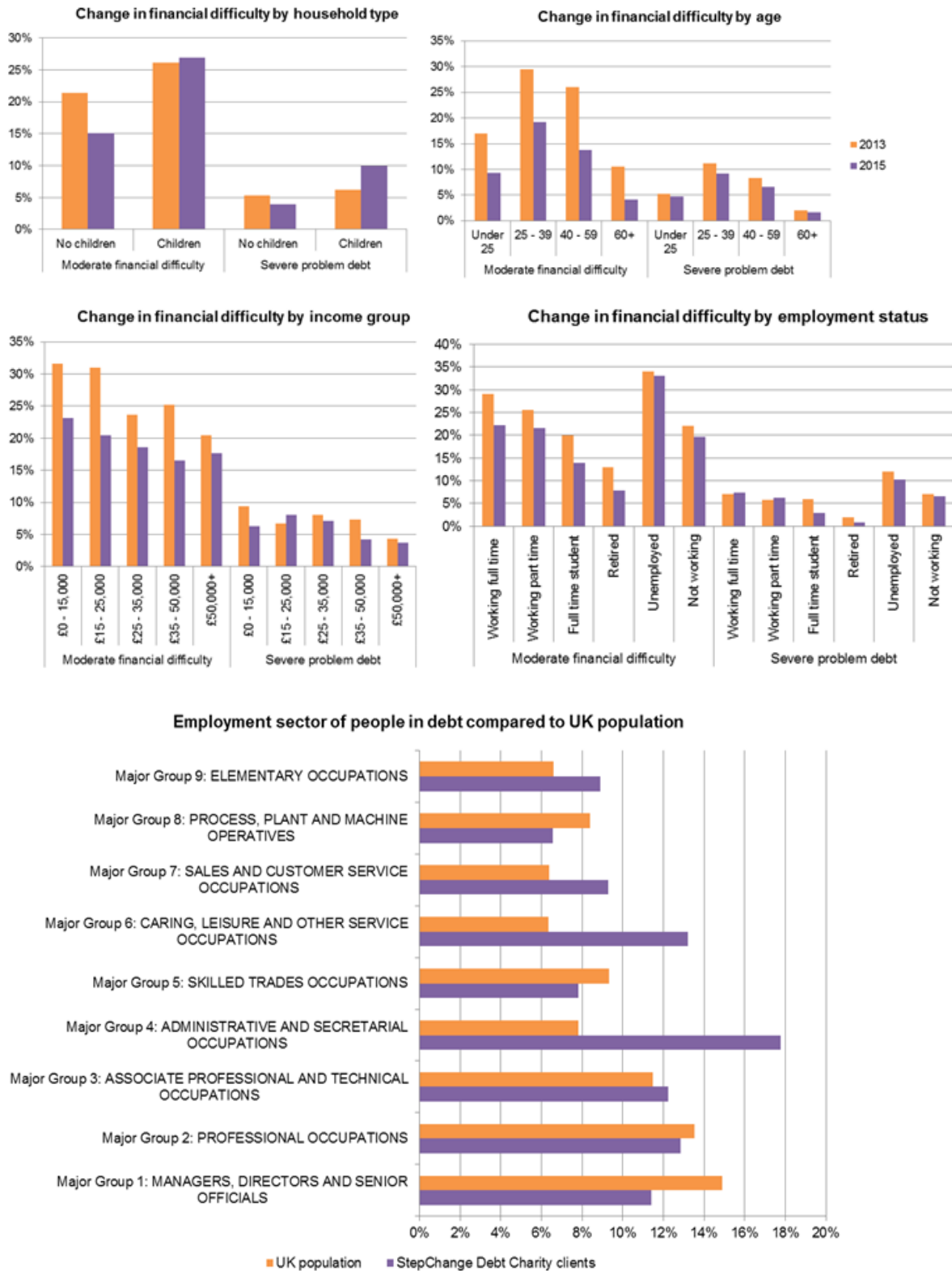
Where people have savings they can use these to help avoid financial difficulties becoming a debt crisis. Our research shows that an average family with £1,000 in accessible cash savings is 44% less likely to fall into problem debt than a family without savings. However, not enough families have savings 22 million adults in Great Britain are not confident they're saving enough to cope with a rainy day<sup>23</sup>.

#### **Q6: Is the FCA consumer spotlight segmentation model useful for exploring consumers' advice needs?**

We believe the FCA consumer spotlight segmentation model should prove useful for exploring consumers' advice needs.

The following data may augment the FCA's work in understanding demand for debt advice<sup>24</sup>.

## Problem debt in 2015: who's in debt now and how has it changed since 2013?



The FCA may furthermore consider exploring how its model correlates with that suggested by the Money Advice Service as part of its 'Indebted Lives' research.

**Q9: Do you have any comments or evidence on why consumers do not seek advice?**

People in financial difficulty, including those who are in or at risk of problem debt, face constrained choices, exacerbated by creditor action demanding repayment.

When people are in problem debt dealing with creditors is often seen as more important than seeking advice, even when seeking advice is the rational thing to do. Such a constrained decision can make matters worse in the medium to long term. This explains why fewer people seek advice than would benefit from it, and why a large number of people do not turn to advice until an absolute crisis triggers them to do so. It suggests that policy around guidance and advice on debt needs to be considered alongside strategies for prevention and mitigation of debt (for instance, our ideas around a new “breathing space” protection, and consistent regulatory vigilance on collection and enforcement standards).

**Q10: Do you have any information about the supply of financial advice that we should take into account in our review?**

According to the Money Advice Service’s (MAS’s) *Financial Capability Strategy* just one in six of the 8.2 million people currently in need of debt advice is seeking help<sup>25</sup>. Our own research suggests 2.6 million people in debt are in severe difficulty.

Free debt advice accounts for an estimated 83.5% of provision (1.169 million advice sessions out of 1.4 million)<sup>26</sup>. This reliance on the free sector is likely to increase as the commercial market retreats in response to economic and regulatory pressures.

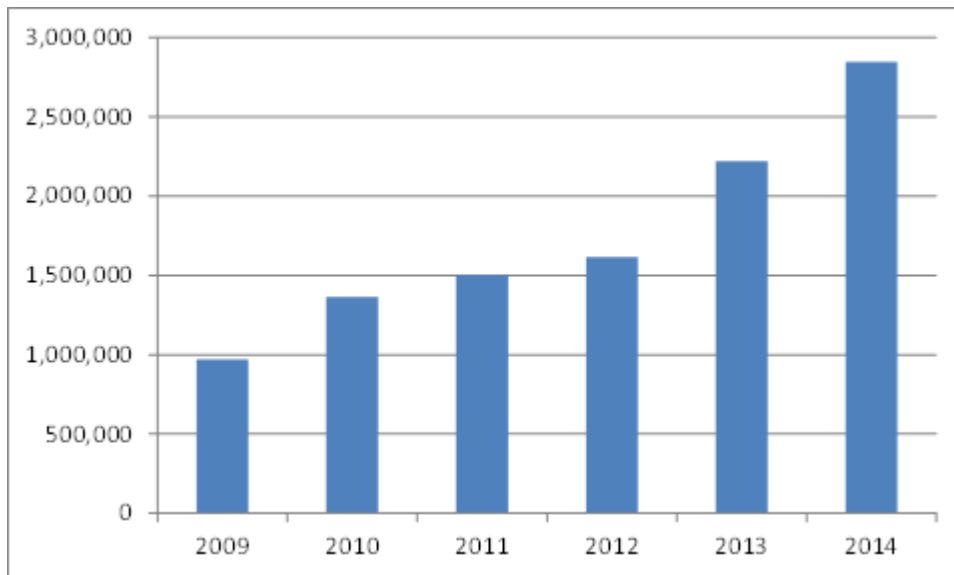
It is important the Government does not make any changes which are likely to diminish current supply. Government should seek to close the debt advice gap by promoting more free debt advice.

Commercial debt management is increasingly challenged, and many larger providers rely on mobile capital from larger overseas groups. Most, if not all, are living off a back book of DMPs; new business is not self-funding. The need to remunerate capital has led to front loaded client fees and aggressive conduct which caused significant detriment. It remains to be seen if there is a model which can meet both economic and regulatory conditions.

**Q12: Do you have any comments or evidence about the role of emerging technology in delivering advice?**

The free debt advice sector has sought to provide additional information and services online by investing in websites and digital services. This has further increased the number of people we help (the chart below shows the rise in the number of visitors to the StepChange Debt Charity website in recent years).

**Online advice**



Increasingly free advice providers engage directly with those in financial difficulty via online forums. In 2015 StepChange Debt Charity has responded to almost 1,000 questions in online forums, such as those run by MoneySavingExpert.

**Q13: Do you have any comments on how we look at the economics of supplying advice?**

The review must not assume all regulated advice is for-profit. We are, of course a charity, so our economic model is different. We receive funding because we are able to demonstrate to funders that there are cost and risk benefits from charity-provided debt advice compared with carrying out the same activities themselves. Creditors are prepared to fund:

- Advice.
- Repayment and non-repayment debt solutions.
- Other activities (publicity and engagement, budgeting, financial education, policy, campaigning and rehabilitation).

Provided:

- We can demonstrate efficiency and productivity improvements over time.
- They can carry out due diligence on quality.
- We work together with other agencies in pursuit of improvements for clients.
- Any surpluses are re-invested in provision of client services.

**Q21: Which advice gaps are the most important for the Review to address?**

We discuss the gap in debt advice in our response to Q2 in the public financial guidance consultation.

In addition, we believe more needs to be done to address the UK's savings crisis.

Young adults, people on low-moderate incomes, people living in living in rented accommodation and families with young children can find it particularly difficult to save<sup>27</sup>.

- Only a third of 16-24 year olds have at least £1,000 saved.
- Only 55% of households earning less than £14,000 a year have at least £1,000 saved.
- Only 41% of households living in rented accommodation have at least £1,000 saved.
- Only 58% of households with dependent children under five have at least £1,000 saved.

**Q23: Do you agree we should focus our initial work on consumers with some money but without significant wealth? What exact income/wealth thresholds should we use to determine which consumers we will focus on?**

There are dangers in drawing lines in terms of asset and income levels that “qualify” people to be of interest to the review. Income and assets grow and decline over time, especially in response to life events (for example, divorce, illness, job loss) and advice is vital at these points. Three-quarters of StepChange Debt Charity clients are in the bottom 40% of the income range, however 73% of them are in debt because of an unavoidable income shock or change in their circumstances<sup>28</sup>.

Our research shows<sup>29</sup>:

- People on low and middle incomes are more likely to experience shocks: 32% of the lowest earning households (£0 - £15k) and 28% of those on low-middle incomes (£15 - £25,000) experienced an income shocks - those on higher incomes were significantly less likely to experience an income shock.
- People with less secure jobs are more likely to experience shocks: 59% of those working a fixed term contract job, 67% of those working a zero hours contract, 53% of those who are self-employed.
- Families with children are more likely to experience income shocks: 37% of those with dependent children at home experience an income shock or change of circumstance in the last year, compared to 25% of those without children.

- Working age adults are more likely to experience income shocks: People aged 25 - 39 were most likely to experience a shock or a change (37%) and 40 - 59 year olds were also disproportionately likely to (33%).

More than 600,000 people who experienced one shock in the last 12 months ended up in severe problem debt and 2.8 million people (31%) ended up in moderate financial difficulty. Just fewer than 1 million people (22%) who experienced two or more income shocks in the last 12 months ended up in severe problem debt and 1.2 million people (28%) ended up in moderate financial difficulty<sup>30</sup>.

Four in 10 said their income had dropped by more than £500 a month in the last five years. Around two in 10 saw their income drop by less than £500, some saw their income remain stable, and just 15% have seen their income increase at all in that time<sup>31</sup>.

The scale of drop that people had to their income, and the reduction in job security also have an impact on people's ability to meet their essential costs: 54% of our clients who faced a £500+ drop in earnings no longer have enough money to make ends meet, 45% of clients who faced a drop in earnings of less than £500 a month did not have enough money to meet their essential costs<sup>32</sup>.

It is also worth noting that in pensions saving, anyone earning more than £10,000 annually is automatically enrolled, and faces complicated decisions around how much to contribute, and which funds to invest in.

**Q36: Do you have any comments on the extent to which firms are able to provide consistent automated advice at low cost? Are you aware of examples of this, either in the UK or other jurisdictions?**

In 2006, Debt Remedy became the first online tool to provide free, anonymous debt advice and has since helped thousands of people access free debt help. In 2015 we project our website will receive 2.9m visitors, 110,000 of whom will use Debt Remedy (48% of all advice given this year).

The online journey using Debt Remedy involves the client inputting all their information to complete the financial assessment. Debt Remedy uses the same criteria used within the telephone journey to identify the suitability of debt solutions based on the information entered. Clients can save their progress and return.

The client is guided through this data input step by step and many are able to complete their journey totally online. We have a dedicated team of advisors to support clients through the process if they require help or guidance. Digital Support is also available by phone, webchat and email to provide support for clients who may be struggling to complete the online journey unaided. They will help the client to resolve whatever difficulty they may be experiencing and if appropriate, they will complete the process on the client's behalf. By the end of 2015, the Charity expects the Digital Support team to handle c24k calls and c29k web chats.



Clients receiving advice online get the same advice they would via the telephone. On average, it takes a client approximately 25 minutes to complete the online journey and over 70% of clients go through the full process in one session. Online advice provides clients with choice, and an option for those who aren't willing or able to talk about their debts over the phone.

We estimate that the direct cost of giving online advice is approximately one fifth of the cost of doing so over the phone. Both channels are of course supported by marketing. Our online marketing includes search engine optimisation and pay per click.

**Q37: What steps could we take to address any barriers to digital innovation and aid the development of automated advice models?**

While face-to-face advice remains vital, free sector reach and cost-effectiveness can be improved. Data from the main non-profit providers shows that telephone advice is four or five times cheaper than face-to-face provision, with online services cheaper still.

**Q39: What are the main options to address the advice gaps you have identified?**

We discuss ways to address the debt advice gap in our response to the public financial guidance consultation. In summary:

- A significant, sustained, increase in funding, based on a rationalised statutory and voluntary funding mix
- Channel shift where possible
- Public policy change to address the root causes of problem debt and mitigate its impacts
- Collaboration within a diverse charity sector to make services as effective as they can be

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<sup>1</sup> Financial Conduct Authority, 2015. 'Occasional Paper No. 8: Consumer Vulnerability.'

<sup>2</sup> Mind, 2008. In the red: Debt and mental health

<sup>3</sup> Money Advice Service, 2015. Financial Capability Strategy.

<sup>4</sup> StepChange Debt Charity, 2015. Navigating the new normal.

<sup>5</sup> StepChange Debt Charity, 2015. Statistics Yearbook, 2014.

<sup>6</sup> Ibid.

<sup>7</sup> Ibid.

<sup>8</sup> StepChange Debt Charity, 2015. Becoming a nation of savers.

<sup>9</sup> StepChange Debt Charity, 2014. Cutting the cost of problem debt.

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- <sup>10</sup> Ibid.
- <sup>11</sup> StepChange Debt Charity, 2014. Life on the edge.
- <sup>12</sup> StepChange Debt Charity, 2015. Safe Harbours.
- <sup>13</sup> StepChange Debt Charity, 2015. Becoming a nation of savers.
- <sup>14</sup> StepChange Debt Charity, 2015. Navigating the new normal.
- <sup>15</sup> LSE, 2014. What is the polluter pays principle?
- <sup>16</sup> Money Advice Trust, 2012. Financial Services Authority, Regulated fees and levies: Rates proposals 2012/13.
- <sup>17</sup> Financial Conduct Authority, 2015. FCA Regulated fees and levies: Rates proposals 2015/16.
- <sup>18</sup> StepChange Debt Charity, 2015. Statistics Yearbook, 2014.
- <sup>19</sup> Ibid.
- <sup>20</sup> Ibid.
- <sup>21</sup> StepChange Debt Charity, 2015. Navigating the new normal.
- <sup>22</sup> Ibid.
- <sup>23</sup> StepChange Debt Charity, 2015. Becoming a nation of savers.
- <sup>24</sup> StepChange Debt Charity, 2015. Navigating the new normal.
- <sup>25</sup> Money Advice Service, 2015. Financial Capability Strategy.
- <sup>26</sup> Department for Business, Innovation and Skills, 2013. Credit, debt and financial difficulty in Great Britain, 2012.
- <sup>27</sup> StepChange Debt Charity, 2015. Becoming a nation of savers.
- <sup>28</sup> StepChange Debt Charity, 2015. Navigating the new normal.
- <sup>29</sup> Ibid.
- <sup>30</sup> Ibid.
- <sup>31</sup> Ibid.
- <sup>32</sup> Ibid.