Briefing on Third Party Deductions

Context

Today 2.9 million people are struggling with severe debt problems. Over 9 million more are showing signs of financial distress[1]. StepChange was contacted by nearly 600,000 people last year, this equates to one person every 53 seconds seeking help with problem debt.

For these households, financial difficulty can be a vicious cycle of escalating arrears and intensifying privation. This harms individuals and damages UK society. We estimate the social cost of debt problems is £8.3 billion[2].

Good debt recovery practices can both prevent and reduce these problems. But where creditors do not act appropriately the impact can be severe. Research with our clients found people who were not given forbearance by their creditors said their debt problems continued to worsen. Six in ten who didn't get the help they need from creditors borrowed more money[3].

Third Party Deductions (TPD) straddle the line of good and bad arrears management practice by offering creditors a way of recovering arrears from benefit payments. For many customers a TPD can offer a positive method of repaying debt and managing bill payments. However, our research shows that TPDs can be harmful for a significant minority.

A Freedom of Information request by StepChange has revealed at least 1.1 million Deductions occur in a typical month.

Over a quarter of those seeking debt advice has had a TPD in place at one point.

Deductions can make it difficult for families to pay for essentials or force them to turn to further credit to keep on top of bills. Deductions can also create perverse debt collection practices, with creditors using the DWP-set TPD level (£3.70) as a minimum floor for all arrears repayments.

Rule changes in Universal Credit are likely to exacerbate problems by increasing the amount that can be deducted from benefits.

[1] StepChange Debt Charity (2017), A chance to turn around lives held back by debt
[2] StepChange Debt Charity (2017), An Action Plan on Problem Debt: How the UK Government can reduce the £8.3 billion social cost of problem debt
[3] StepChange Debt Charity (2015), Safe Harbours

It is difficult to see how this will help families struggling with household bills. It appears at odds with current Cabinet Office work on fairness in debt collection and regulatory rules that place an emphasis on appropriate collection practices.

This paper – aimed at the Government, service providers, regulators and other third sector organisations – suggests policy responses that would address the problems with the current system.

- **We believe TPDs should *only* be used when they are affordable and helpful to the customer, allowing them to keep up with essential bills.**
- A new minimum Deduction of £1 should be introduced.
- Write new rules on the treatment of vulnerable people.
- Firms, guided by regulators, should move away from using deduction rates as a benchmark for debt collection.

Background

What is a Third Party Deduction?

A TPD is where the Department for Work and Pensions (DWP) deducts a fixed amount from benefit payments to clear household arrears. The amount deducted is paid directly to a creditor until the debt is cleared.

The following are the main household arrears recovered using deductions:

- Housing costs
- Fuel costs
- Council Tax
- Unpaid fines
- Water and sewerage charges

The following benefits may have a third party deduction:

- Income Support
- Income-based Jobseeker's Allowance
- Pension Credit
- Income-related Employment and Support Allowance
- Universal Credit

How do they work?

The DWP can take a maximum of three deductions at any one time. It will apply a priority order when more than three applications are made.

Prior to applying for a deduction, DWP rules require creditors to have tried other methods to recover the arrears, for example negotiating different ways of paying and managing bills. There must be a real threat of enforcement action before a deduction is considered.

When making a deduction decision, the DWP should consider if a deduction is in the interests of the individual.

Fuel suppliers and water suppliers can take an additional amount to cover ongoing consumption, except where an individual is on a pre-payment meter. Landlords can take an additional amount to cover ongoing rental costs[4].

How much can be taken?

	Deduction rate	**Maximum deduction**
Income Support **Income-based Jobseeker's Allowance** **Pension Credit** **Income-related Employment and Support Allowance**	5% of the personal allowance of a single claimant aged not less than 25 (£3.70) each time a benefit is paid	Consent is needed by the individual where the total amount of all deductions including any amounts to cover current costs, exceeds 25% of the main benefit, including any Child Tax Credit and Child Benefit in payment
Universal Credit	5% of the 'standard allowance' for gas, electricity, water, owner-occupier housing costs and Council Tax **BUT** • At least 5% but not more than £108.35 per month for fines • Between 10% and 20% for rent	The DWP may deduct an amount from a claimant's award of UC under one or more items of 40% of the standard allowance There are exceptions, where the DWP considers it to be in the claimant's best interest, when deductions could exceed this.

[4]This is not the same as having benefits paid directly to landlords automatically, as happens with Housing Benefit but not Universal Credit (excepting Alternative Payment Arrangements).

How common are Third Party Deductions?

StepChange Debt Charity made a Freedom of Information request to the DWP to find out the number of deductions made from Income Support, Jobseekers Allowance and Pension Credit in a typical month (February 2016).

These figures show that almost 500,000 people claiming Income Support had deductions in place in February 2016, with 224,100 (45%) of them having money deducted for arrears. For Jobseekers Allowance, Income-based Jobseekers Allowance and Pension Credit around 200,000 claimants have deductions in place[5].

For Jobseekers Allowance and Income-based Jobseekers Allowance around 50% of individuals are having money deducted to clear arrears.

Freedom of Information request: Number of deductions

	Feb-16			
	Arrears	**Current**	**Both**	**All**
Income Support	152,600	270,900	71,500	**495,100**
Jobseekers Allowance	75,500	103,900	19,900	**199,300**
Income-based Jobseekers Allowance	74,300	101,100	19,800	**195,200**
Pension Credit	33,800	150,300	28,100	**212,300**

StepChange clients

In a survey of StepChange Debt Charity clients, just over a quarter (26.5%) report they have had money deducted from benefits to go towards arrears. Clients who are in a vulnerable position are more likely to report (28.6%) they have had money deducted from benefits[6].

For those currently having money deducted, the majority (61.9%) have a single deduction in place, but over a quarter have two deductions in place (28.3%), and almost one in ten have three simultaneous deductions in place (9.6%).

Which creditors use Third Party Deductions?

Our clients are mostly likely to have money deducted for Council Tax arrears. Around a quarter (22.4%) with deductions in place pay their local authority in this way.

However, a range of other creditors commonly use deductions. Over one in eight (15.4%) are repaying water arrears through a deduction; a similar proportion have a deduction in place for a Magistrates' Court fine (12.6%).

[5] Data on Universal Credit was not available at the time of request

[6] Survey of 827 StepChange Debt Charity clients, December 2016: Vulnerability in this context refers to one of the following: Difficulty with English language, Visual impairment, Hearing impairment, Stress / anxiety, Terminal illness, Ongoing mental health condition, Depression.

Lower proportions are repaying mortgage arrears or fuel arrears through a TPD. This could reflect access to other collection options. For example, gas and electricity suppliers can install Prepayment Meters (PPMs) as a way to ensure ongoing payment for service, diminishing the need for a deduction. Figures from Ofgem show there has been a long-term growth in the number of PPMs[7].

	Which of the following arrears have you had money deducted from your benefits for? (Select all that apply)
Mortgage	3.3%
Rent	11.4%
Fuel	4.9%
Water	15.4%
Council Tax	22.4%
Fines	12.6%

What impact do Third Party Deductions have?

When making a deduction decision, the DWP guidance says it will consider if a deduction is in the interests of the family. Despite this, our client survey makes it apparent that deductions do often cause harm.

Of those who have had money deducted directly from benefits, 71% say that it has caused them and their family hardship.

A quarter (25.7%) has cut back on food spending as a result of a deduction and a further 24.6% have found it difficult to pay for heating as a result of direct deductions.

	Have you ever found it difficult to pay for any of the following due to deductions from benefit payments (Select all that apply)?
Food	25.7%
Clothing	24.2%
Heating	24.6%
Social activities	19.0%
Childcare	2.2%

Where people have avoided cutting back, often they have only done so by turning to borrowing. One in five clients surveyed (19.4%), who had had money deducted from

[7] Since Q2 2012, the proportion of customers repaying a debt to their supplier using a PPM for a) electricity has increased from 32% to 39%, and b) gas has increased from 38% to 42% (Ofgem data portal, accessed June 2017)

their benefits, had turned to credit pay essential household bills (rent, mortgage, energy bills, and council tax) due to deductions.

	Did having money deducted from your benefits contribute to any of the following? (Select all that apply)
Getting hit by late payment or overdraft charges	23.8%
Falling behind on your essential household bills (rent, mortgage, energy bills, council tax)	39.9%
Using credit to pay essential household bills (rent, mortgage, energy bills, council tax)	19.4%

Best practice with deductions

DWP rules on deductions say that prior to applying for one a creditor must have tried other methods to recover the debt. This should include negotiating different ways of paying and managing bills.

The evidence from our survey indicates that creditors are not necessarily attempting contact prior to applying for a deduction. Far fewer had been referred to independent debt advice.

	Before imposing a deduction, did your creditor refer you to a debt advice provider?
Yes	21.9%
No	66.9%
Don't know	11.2%

Only 22% of clients said they were referred to debt advice by their creditors prior to a deduction being imposed. Alongside DWP guidance, regulatory guidance implies that firms should make a far greater effort to contact those in financial difficulty.

DWP rules also state there must be a real threat of enforcement action before consideration is given to applying for a deduction. This rule is problematic as well, because it potentially creates a perverse incentive for creditors to threaten or go straight to enforcement action, rather than try to speak with their customer to work out an affordable repayment plan.

Third Party Deductions as a minimum floor

Not all creditors can deduct money from benefits and others that can choose not to apply. However, many still use the £3.70 per deduction limit as a minimum floor for their collections i.e. they refuse to accept any offers of repayments less than £3.70 per week. This is problematic because it prevents individuals repaying debt at a rate appropriate for their circumstances.

If we model the effect when a £3.70 rate pushes somebody in financial difficulty into deficit, we can see the potentially unhealthy impact. If one of our clients has deductions in place which causes them to go into deficit, over the course of six months the total loss, which must be accounted for by borrowing or radically reducing spend on essential, on average will be £75. This is a significant amount of money for people on a tight margin. If that amount was borrowed from a short-term lender, the additional payments would take it up to £96[8].To put this into context, £96 equals 1.6x the average client's monthly surplus e.g. their disposable income for almost two months.

Around two-thirds of clients say a range of creditors have refused to accept less than £3.70 per week as debt repayments. Creditors most likely to do this are local councils, and water and electricity suppliers. Again, the latter could be a reflection of the use of PPMs in energy. Research by Citizens Advice has shown that suppliers using PPMs set debt repayment rates in line with the £3.70 limit, even though they could show greater flexibility[9].

The practice of energy suppliers in this area seems to be at odds with Ofgem's Principle 4 on debt recovery, which states suppliers should be, 'setting repayment rates based on ability to pay.' It also conflicts with EnergyUK's 'Safety Net objectives', which provide guidance on appropriate collections behaviour by energy companies. The objective on debt repayment options commits suppliers to 'offer a range of debt repayment options in order to find the most appropriate solution for vulnerable customers to manage any debt'[10].

Universal Credit

Rule changes in Universal Credit are likely to exacerbate problems created by deductions by increasing the amount that can be taken from benefits. The total amount that can be deducted under Universal Credit is much higher compared with the other eligible benefits. Most pertinently under UC, deductions for rent arrears can be between 10% and 20% of the standard allowance, as opposed to 5% of the housing allowance payment.

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[8] Based on typical high-cost, short-term credit rate

[9] Citizens Advice (2016), Staying Connected: How energy suppliers can help and support prepayment customers who self-disconnect

[10] EnergyUK (2016), Safety Net Audit

Using our client data we can estimate the increased negative impact deductions under Universal Credit may have[11].

The analysis shows that for individuals with a very tight budget, the imposition of a TPD can result in a negative budget i.e. it will mean they cannot keep up with bills. It further shows that where people are receiving Universal Credit, with its higher deduction rates, this is much more likely to happen.

Under TPD rules applying to benefits not including Universal Credit, assuming all clients with rent arrears will be liable for a deduction the imposition of a deduction forces an additional 21.7% of clients with rent arrears into a negative budget. However, under Universal Credit, the imposition of a deduction forces an estimated additional 35.3% of clients with rent arrears into a negative budget.

Clients forced into a negative budget by a deduction[12] are far more likely to be affected by a mental or physical health vulnerability – 8% of clients in this situation self-report a mental or physical health vulnerability, compared with 4% of those who can maintain a surplus.

Policy questions and challenges

Third Party Deductions are not necessarily a bad thing for people struggling with bill payments. Indeed, for many they represent a positive opportunity to repay arrears and keep on top of outgoings.

However, as our research shows, for a sizable minority they can create additional financial difficulties.

So what questions and challenges do Deductions raise for government and creditors?

Appropriate levels

The experience of our clients shows that the current level of deductions is not always appropriate and is causing hardship and further financial difficulty in some cases. Therefore, we recommend that deductions should be affordable for all, with a new minimum level created and greater creditor consideration given to not using deductions at all when they are unaffordable. Many debt advice organisations recommend “token payment plans” for those with very little available income. Under these plans debtors offer creditors £1 per debt as a promise of their desire to repay debts when they are able to do so.

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[11] We use the following assumptions (based on most typical situation of a StepChange client living in rented accommodation): 1) Private rented accommodation, 2) Two bedrooms, and 3) Using the Local Housing Allowance for a randomly selected postcode in England (Central Lincoln) - £100.22 per week

[12] Under TPD rules applying to benefits not including Universal Credit

The DWP should consider £1 as a potential new minimum for deductions both in Universal Credit and in other benefits.

The consequences of not providing such help are clear: 29% of our clients said that a creditor's demands prompted them to pay that bill and fall behind on other bills, and 28% said the associated stress made it harder for them to apply for new or better paid work[13].

Vulnerability

Regulators of financial services and the energy sector have recently increased their focus on ensuring service providers pay attention to the needs of vulnerable consumers. For example, the Financial Conduct Authority published an influential Occasional Paper on the subject in 2015 and the energy regulator Ofgem recently consulted on its vulnerability rules as part of a wider refresh of its consumer policies.

The DWP should refresh its rules on deductions to better reflect the needs of potentially vulnerable individuals and the transient nature of vulnerability itself.

Minimum floor

A firm using the £3.70 level of DWP deductions as a minimum point for starting negotiations drastically reduces the options of their indebted customers. Although addressing the issue raised by point one above would help resolve this, firms should consider if their policies best help customers. We suggest this could be an issue regulators help them examine.

Creditors who use £3.70 as a minimum for Third Party Deductions should commit to changing their policy without having to wait for the DWP to adjust legislation, moving to a more affordable rate (which could include not seeking repayment for a period of time).

Next steps

StepChange is keen to work with stakeholders – the Government, service providers, regulators and other third sector organisations – to understand better the effect of Third Party Deductions and the policy changes that can be made to reduce their negative impacts.

If you are interested in discussing this further, please contact joseph.surtees@stepchange.org.

[13] StepChange Debt Charity (2017), A chance to turn around lives held back by debt