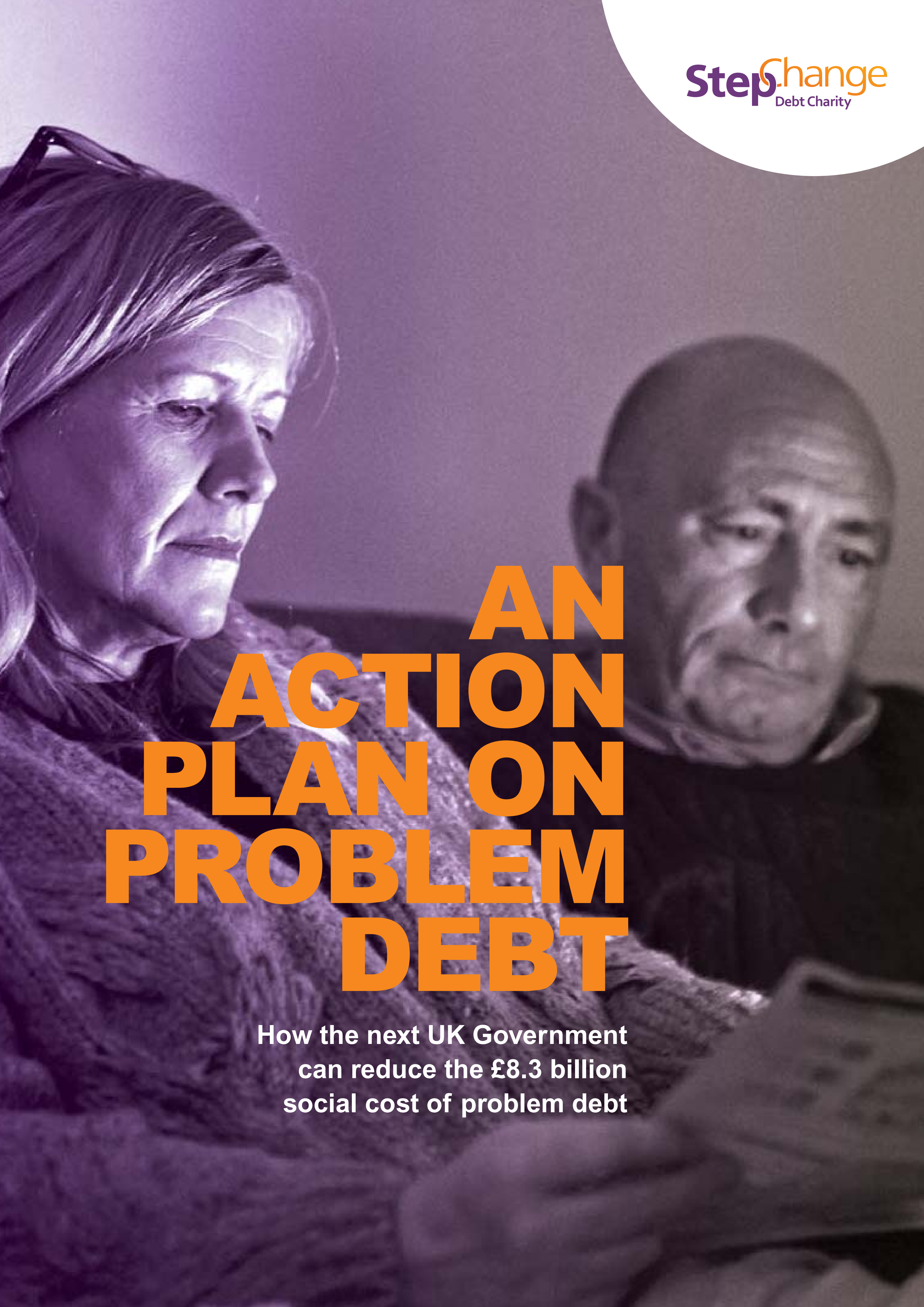


StepChange Debt Charity

AN ACTION PLAN ON PROBLEM DEBT

How the next UK Government can reduce the £8.3 billion social cost of problem debt

The case for action on problem debt

Personal consumer debt in the UK stands at £168 billion and it's rising at its fastest rate since the credit crunch.[1] Debt in itself is not always a problem. Nearly everyone needs to borrow at some time, for example to spread the cost of large purchases like a home. Many people cope well with borrowing and debt, but for too many, debt becomes a serious problem.

Almost three million people are in problem debt in Britain.[2] More than 10,000 people struggling with problem debt seek help from StepChange Debt Charity every week.

The main causes of problem debt are job loss, illness and relationship breakdown. Many of us are vulnerable to falling into problem debt following such life events, as too few have the financial resilience to cope. Thirteen million people do not have the savings to keep up with essential bills for even one month if their income dropped by a quarter.[3]

The kind of problem debt which StepChange Debt Charity sees every day places a heavy burden, not just on individuals and their families, but on wider society. The cost of problem debt to society is conservatively estimated at £8.3 billion.[4] Debt is a brake on aspirations, on peoples' ability to get a job or keep a job. It hinders people's contribution to social and economic growth.

There is more that can be done to prevent problem debt and to help people get back on their feet quickly when they fall into debt.

We are calling on the next Government to commit to an Action Plan on Problem Debt to ensure families come out of the next five years more resilient and better able to weather shocks to their finances. The next Government should commit to:

1. **Ensure that every family has £1,000 in savings to cover a sudden cost or income shock;**
2. **Ensure all low income households can access low cost credit products;**
3. **Scale up free debt advice so that it reaches the 1.4 million people who urgently need advice but aren't getting it;**
4. **Ensure everyone dealing with their problem debt gets the protection against interest, charges, enforcement and collections they need;**
5. **Protect children and families from the harm of aggressive debt collection practices;**
6. **Ensure debt solutions are fit for purpose, and do not have a disproportionate impact on people's life chances.**

Some of these actions to make a positive difference will come with a bill to which the whole of society needs to contribute. However, the costs of not taking action, of letting the damage caused by problem debt continue to plague society, are significantly higher. It is in everyone's interests to prevent problem debt happening in the first place, as far as possible, and to provide support to get people out of debt and back into a sustainable financial situation for the long term.

How an action plan on problem debt will help families on the edge

James and Sally are constantly juggling bills and commitments to make ends meet for their family.

A lack of Government action will see many more families fall off the edge when they face shocks and rely on costly credit to pay essentials.

The family uses their overdraft and credit card to get by.

James and Sally face a shock to their income (e.g. the end of Sally's fixed term contract). Their precarious balance becomes unmanageable.

They don't seek debt advice because they are not aware it can help with their short term difficulties. They carry on using credit.

James and Sally face a sudden cost (e.g. fridge breaking down) and need to borrow money to pay the cost.

A lack of mainstream lending options, and difficulties navigating the complex array of local grants and loans leaves the family turning to a payday loan to meet the cost.

A Government plan of action on debt can help people adjust to shocks and changes without falling into further difficulty.

£1,000 savings help the family cope with expenses while they wait for help to come through.

A government programme with better savings incentives for low income households, combined with auto enrolment, helps people build a precautionary savings buffer.

The family are able to get the interest, charges and collections activity on their debts paused while they pay off arrears at an affordable rate.

The Extended Breathing Space Guarantee and increased funding of advice means more, better help is available.

James and Sally are able to get a low interest, long term loan to spread the cost of payments and avoid high cost credit that deepens their debt.

A rounded Government response to the borrowing needs of low income households leads to more sustainable credit products being available alongside a more coherent offer of state support.

What's driving the scale of problem debt?

There are 2.9 million people in Great Britain in severe problem debt.[5] But the problem extends beyond those in severe debt. Many are not currently in debt, but they are only just getting by and at risk of falling into difficulty. They are living on the edge. The Money Advice Service estimates 9 million people are over-indebted.[6] There are 21 million people struggling with their bills and 18 million worried about making their income last until payday.[7]

With so many people already in difficulty, and millions more close to a financial precipice, the problem is too big to ignore.

Even though the economy is growing, many families living on the edge could find themselves falling into problem debt as they struggle to deal with income shocks or increases in living costs without resorting to credit.

Insecure and part-time jobs and an unprecedented wave of new self-employment may have prevented headline unemployment rates from reaching the same heights as in previous recessions, but they have nevertheless exposed many families to a 'new normal' of volatile and unpredictable income, putting them at risk of shocks that many simply can't afford to adjust to. **Almost two thirds (63 percent) of the workforce worry about how they would cope if they experienced an income shock.**[8]

People struggle to adjust to changes in their income, because under successive governments, many families' incomes have failed to keep pace with rising essential costs, leaving them with little spare income to save for a rainy day. Many people start using credit to keep up with essentials until payday, and then find their commitments growing and becoming ever more unmanageable, while others may have had manageable consumer spending debts that then became unmanageable after a shock to their income.

Over the last few years, these acute pressures have led to a worrying trend of **people relying on credit as a distress 'safety net'. But using credit to pay for essentials leads families into a debt trap.** If people struggle to pay essential bills one month, they will certainly struggle the next month: as arrears, high interest and charges build up.

The peril of using credit to cope has been exacerbated by people's increasing reliance on high cost loans, which have filled a gap left by the retrenchment of mainstream lending and cuts and changes to Government funds for emergency grants and loans. **Since the 'credit crunch', StepChange Debt Charity has seen a fifteen-fold increase in the number of people needing help with payday loan debt.**

The outlook for problem debt

The economic outlook suggests that pressures on family finances will continue. Modelling by the Centre for Economics and Business Research (Cebr) commissioned by StepChange Debt Charity shows that with all major political parties committing, effectively, to another Parliament of austerity, the squeeze on wages of the lowest income households are likely to continue as a result of further real-term cuts to welfare payments.[9]

For those on middle incomes, Cebr shows that interest rate rises will make it harder for those with mortgages to keep up with their bills, while projected rises on already high rents will hamper private renting families' ability to meet essential costs.

Cebr's analysis shows that the pressure on families' incomes is likely to be exacerbated by a backdrop of a patchy economic recovery across different parts of the UK, low-middle earners expected to see a slower recovery in disposable income than upper-middle earners, and under-employment expected to remain high even as unemployment falls.

The Bank of England acknowledges the role that debt and low wage growth have played in the length of the recession.[10] **Consumer credit debts are rising at the fastest rate since 2006 (6.4 percent) to £168 billion at the end of 2014**[11], and coupled with weak income prospects, policy-makers should be concerned about the pressure on household finances over the coming years and its effects on the recovery.

Addressing the public's concerns about problem debt

The consequences of debt are devastating for individuals and their families, but also for the wider economy and public services. **The fallout of problem debt leads to social and economic costs of £8.3 billion** – through lost jobs and reduced productivity, and the knock-on costs of people losing their home, and relying more heavily on support services.[12] Once people are in debt, additional stress and anxiety can make it harder for people to focus on getting a new or better paid job.[13]

Worryingly, problem debt hampers the chances of the 2.4 million children growing up in indebted families. These children are more than twice as likely to say their parents argue over money, and are almost twice as likely to be bullied at school. Stress at home and school can have a long term impact on children's education and employment chances.[14]

Problem debt is not inevitable and there is a strong social and economic imperative to take action. The next government has an opportunity to help the 2.9 million people currently in severe problem debt back onto a steady footing and paying their debts off at an affordable rate, so that the weight and stress of their debts does not hamper their employment chances and their children's prospects.

The next government must provide a counter-balance to the risks and strain that families expect to face, to prevent the next generation falling into a debt trap that could hamper their chances of contributing to the economic recovery. **6 in 10 Britons believe politicians should do more over the coming five years to help people like them stay out of financial difficulty.**[15]

Rising to the challenge of helping shore up the finances of the 21 million people struggling with their bills is crucial. Almost three quarters (73 percent) of those struggling think that politicians are not doing enough to protect people like them from falling into financial difficulty, and the same proportion say that politicians' lack of concern for people like them affects their political outlook and how they might vote.[16]

Addressing problem debt requires the next Government to provide real leadership to join up the pieces that prevent people falling into debt in the first place, and ensure better help is available when they are in difficulty.

1. Precautionary savings to help families build financial resilience

Families often fall into problem debt because they lack the financial resilience to deal with an income shock, such as redundancy or relationship breakdown, or an unexpected and unavoidable bill. They are too often left with an invidious choice: take out credit, or fall behind on an essential household bill, such as rent or energy.

Thirteen million people do not have the savings to keep up with essential bills for a month if their income dropped by a quarter.[17] As such, it's not surprising that 58 percent of people are worried about how they would cope with a sudden large cost, and 63 percent of those in work are concerned about how they would survive financially if they experienced an income shock.[18]

Savings can prevent people from falling into problem debt. New analysis by Select Statistical Consultants commissioned by StepChange Debt Charity shows that **500,000 households would have avoided problem debt if they had £1,000 saved.** Low income households in particular would see their chances of falling into debt reduced if they had 'rainy day' savings.[19]

Given the £8.3 billion costs of people falling into problem debt, there is a huge incentive to help people build up savings. With £12 in social costs and costs to creditors saved for every £1 spent on preventing problem debt, there is little doubt about the value for money of such a move.[20]

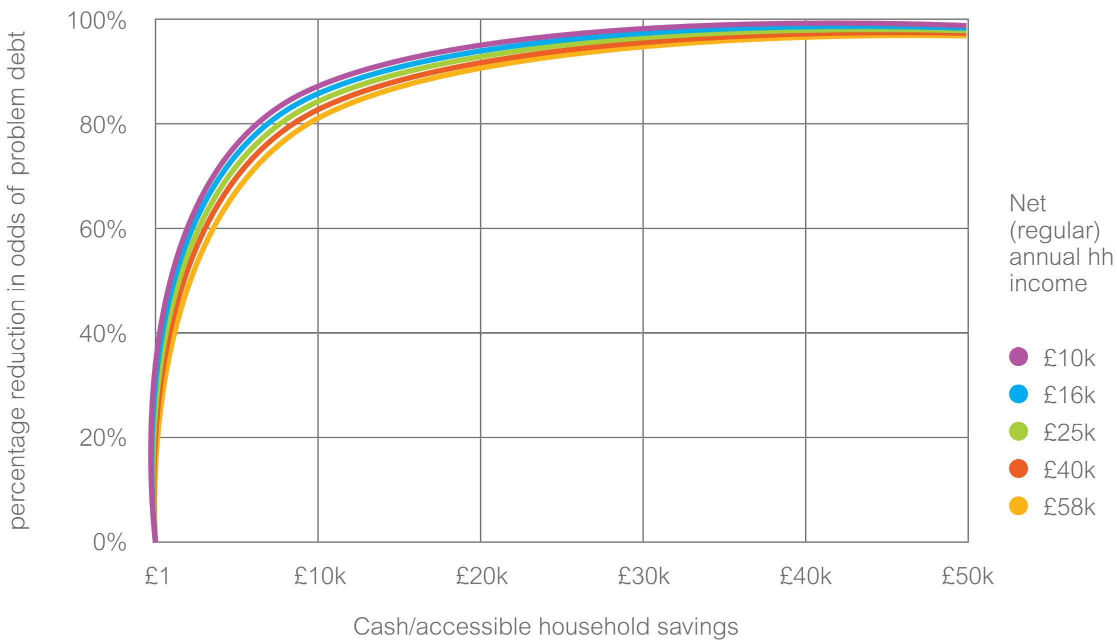
Yet, the number of households who are saving is in decline.[21] The Office for Budget Responsibility is forecasting that the household savings rate will halve between 2012 and 2018. Just a fifth of StepChange Debt Charity clients saved at all prior to falling into financial difficulty. **96 percent of clients were forced to turn to credit to pay their household bills directly as a result of not having sufficient savings, including 11 percent who used a payday loan as a result of not having savings.**[22]

Those on low and middle incomes are least likely to have the savings to cope. 42 percent earning less than £15,000 a year and 34 percent earning £15 - £25,000 a year do not have a month's worth of savings. This compares to 27 percent of all households.[23]

But the cornerstone of current savings policy, the ISA, is not serving lower income households well. Households earning up to £26,000 - the national average household income - are just half as likely as those earning £50 - £80,000 to have an ISA.[24]

ISAs are a significant taxpayer investment in personal saving. The estimated Exchequer cost of the tax relief for ISAs in 2013-14 was £2.85 billion[25], while moves to increase the tax free ISA allowance to £15,500 a year will cost the Government an additional £565 million by 2018/19[26], bringing the total ISA budget up to £3.42 billion.

Meanwhile, the new tax relief on low income savings announced in the 2014 Budget – through which households with low incomes will be able to reclaim all tax on a proportion of their savings income – is expected to cost £355 million by 2018/19.[27] This is just a tenth of the total ISA budget. This policy change has not been heavily publicised, and little information has been published about the profile of low income households expected to take it up.



The policy problem

Low income and high living costs are key reasons why people aren't saving.[28] However, problems are exacerbated by ingrained behaviours. Behavioural economists argue that part of the reason people do not save is due to procrastination and inertia.[29] This suggests a clearer and stronger incentive is needed to "nudge" people into saving.

ISAs are designed to help people save. But they disproportionately benefit those with greater assets and income[30], and the incentive design - a tax relief - means little to those on the lowest incomes paying little tax.[31] Unfortunately, the proposed increase in tax-relief for low income households' savings income has the same incentive framing, and is significantly more complicated to administer than an ISA.

There are more effective incentives available. One is "matching" a proportion of the amount saved. The Institute for Fiscal Studies argued that a matching rate of 20p for every £1 saved would be effective at boosting savings among low- and middle-income households[32]. Tax relief is a form of matching, but there are much clearer ways to frame it. A quarter of StepChange Debt Charity clients say that a matching rate of 20p per £1 saved would have encouraged them to save or save additionally.[33]

The policy solution

The Government should set a target of every household having £1,000 saved for a rainy day. Key to reaching this target among low to middle income families is harnessing these behavioural insights to improve the incentives for people on low incomes to save, and making saving a default choice.

The Government should build a "rainy day" savings pot into the pensions auto-enrolment framework with the first £1,000 saved being short term saving with subsequent sums going into a pension. Savers would be incentivised via tax relief and employers' contributions.

The pot of short-term precautionary savings would be transportable, like a pension pot, and so people would retain the pot if they fall out of work or move employers.

The incentive for saving would be improved by the reward being presented as matching. It would use the same tax relief as pensions, but in line with pensions, the tax relief would be framed as Government and employers matching the contribution – which has proven successful in boosting pension savings rates and reducing 'opt out'.

By building savings into the existing pensions auto-enrolment framework, the only direct costs would be through increased take-up, which would be driven by stronger incentives to save. The significantly stronger national resilience to problem debt that this would create would make it more than cost-effective for government and employers – the total social cost of problem debt is £8.3 billion, of which £2.3 billion is the cost of lost productivity and employment.[34]

There are limits to this proposal: people earning below £10,000 will not be automatically enrolled into pensions saving, and self-employed people fall out of scope too. Additional interventions will be needed to boost savings rates among these households. Along with more direct matching for savers with the lowest incomes, raising the National Insurance contributions threshold in real-terms to the same level as the personal allowance would give low income households more take-home pay, as proposed by the Resolution Foundation.[35] This could be conditional on people saving some of the benefits. Employers could be helped with the costs of setting up such schemes by reductions in Employers' NI.

2. Better alternatives to the destructive 'credit safety net'

Low income households are using payday loans and other forms of high cost credit as a 'safety net' to pay essential household bills, and in paying the significant essential costs that anyone could face - a new boiler, a car failing its MOT, letting agent fees on a rented flat.

In just five years we've seen the number of people coming to us for help with payday loans rise fifteen-fold. Meanwhile, polling suggests that almost 6 million people are using credit to last until payday, and almost 3 million are using credit to keep up with essential household bills.[36]

The emergence of a 'credit safety net' has been driven by both demand and supply-side factors.

On the **demand-side**, tight and insecure household finances lead to bigger and more frequent gaps between income and essential outgoings, and too often credit seems to be the only realistic option for too many. This comes from rises in the number of people in self-employment, zero hours and temporary contracts who have more unstable incomes. Meanwhile, overall pay levels have remained stagnant in real terms, and people have struggled to get effective relief from their debts.

On the **supply-side**, the 'credit crunch' saw high street lenders become more cautious in their lending, which had a disproportionate impact on access to mainstream credit for low income households, perceived as being higher risk. Meanwhile, access to the state provision of loans and grants for struggling households has been tightened, with significant changes to the safety net.[37] Just 7 percent of people think they'd be eligible for a government welfare loan, and only 5 percent would know how to go about applying for one.[38]

The policy problem

While credit can offer the flexibility that people need, the 'credit safety net' is a problem because of the circumstances in which people are using credit to cope, and because of the pricing, design and delivery of the credit products people are increasingly reliant on, as well as the conduct of lenders.

The following product features may lead to people on low or unstable incomes relying on more credit to keep up, or increasing the risk of default:

- Products where high interest and charges quickly mount up and become unaffordable to pay off;
- Products where the repayment date is too soon after people took out the credit for them to have realistically raised the funds to repay their debt;
- Products which spread high borrowing costs over the long term but nevertheless take up a disproportionate amount of borrowers' income.

If people are using products with these features to pay essential bills, it will be more difficult to meet the next commitments that come along – the bills keep coming, and now there is also the loan and interest to repay too. But these products may also be unsustainable for people with low or unstable incomes spreading the cost of larger purchases. The FCA found that taking out a high cost short term loan led to overdraft breaches and missed payments of 33 percent and 60 percent respectively.[39]

The regulation of consumer credit has been transferred to the FCA, and early indications suggest its approach to regulation could reduce a significant amount of harm caused by particularly harmful high cost short-term credit products. The regulator's plans now include reviewing the unsolicited marketing of high cost credit, examining conduct and products in mainstream credit markets, and toughening the regulation of credit brokers.

But regulation will have little impact on improving the sustainable alternatives to high cost credit that are available – Credit Union and CDFI loans, charity grants, and the state's provision of low interest loans and grants through Local Welfare Assistance. People with tight finances are more likely to respond to simple, certain options.[40] Despite being more sustainable than many commercial products, there is a significant way to go in ensuring these options appeal to struggling families.

- **Just 17 percent think they'd be eligible for a credit union loan, and only 7 percent think they would be eligible for government support**. This contrasts with 21 percent who think they'd be eligible for a payday loan, and 44 percent who think they'd be eligible for an overdraft.
- **Just 10 percent of people know how to apply for a credit union loan**, and 5 percent know how to apply for a government welfare loan. But 12 percent would know how to apply for a payday loan, and 30 percent would know how to apply for an overdraft.
- **Only 6 percent of people believe they would get a credit union loan quickly**, and just 2 percent believe they would get a government welfare loan quickly. Meanwhile 16 percent believe they would get the money quickly with a payday loan, and 23 percent think they would with an overdraft.[41]

Such confusion and uncertainty is understandable: there are approximately 600 credit unions in the UK.[42] Every area has its own local welfare assistance scheme, each with its own criteria and approach. There are also loans, grants, and benefit advances provided by central government. The entire provision of state-provided loans and grants has changed in the last few years, and future Government policy is uncertain.

Under-scoring this is the lack of capital for credit products that are genuinely sustainable for low income households. Commercial providers can only service certain consumer profiles while meeting commercial needs and regulatory conditions (prudential and conduct).

The state has recognised through a number of policy initiatives the need to take on certain non-commercial lending segments itself. Most high profile is the Help to Buy mortgage guarantee, in which the Government has committed up to £12 billion in guarantees to underwrite higher risk low deposit mortgage lending.[43]

The state directly funds low income lending via local welfare assistance and benefit advances. That provision is now being cut back and de-centralised, leading to disproportionate rationing of support, with four in ten local authorities spending less than half of their allocated funds in the first three quarters of 2013/14.[44] The state has also recognised its role in addressing the gap in low income lending capacity by providing £38 million in funding to build capacity in the credit union sector.[45]

These examples show that **successive governments have recognised the problem of a lack of sustainable borrowing options for low income households. Despite these actions, payday lending has grown to a market worth £2.8 billion**[46]. We are starting to see signs of payday lending decreasing following FCA action but it remains unclear what is the Government's overall strategy to provide rounded, sustainable policy alternatives to both where people are relying on credit for unsustainable circumstances, and where people can only access credit products that have features likely to exacerbate difficulties.

The policy solution

Preventing the harm caused by the credit 'safety net' means providing a better alternative in circumstances where:

• People are using credit to pay for essential costs, where any form of credit with interest is likely to be unsustainable;

• People are using unsustainable credit for 'income smoothing' – spreading the cost of larger purchases.

Our Extended Breathing Space Guarantee proposal would help people manage arrears and debts they can't immediately afford to service without resorting to credit unsustainably. But this will not address circumstances where people simply do not have enough money to pay the very essentials. To address this, the next Government must take sustained action on low pay, and address the extra costs on everyday bills that see people with the least money paying the most for goods and services – the "poverty premium".

Low income households still need affordable credit to spread the cost of larger purchases without falling into further difficulty. The Government's simultaneous but separate discussions on credit union capacity, 'affordable' community lending, and the future of local welfare and the social fund, seem unlikely to address the core questions about the role of credit for low income households, and how suitable products should be designed and delivered.

The next Government should instigate a broad review of affordable credit – and alternatives to credit - for low income households, with an objective of making significant progress in developing a large-scale, mainstream offer of suitable credit products by the end of the next Parliament.

73 percent of people agree that Government should ensure that low interest loans are available to people on low incomes to buy essential items to prevent people using payday loans.[47]

In reaching this objective, based on our analysis of the shortfalls in the current approach to affordable credit, the review should focus on:

Developing a range of credit product structures and prices that are sustainable for people in a range of circumstances.

• Products should spread costs over the longer term, but at an affordable level of interest that does not see people paying as much as four times the retail price, as is the case with some rent-to-own providers.

• Repayment timescales should be differentiated to recognise some can repay their loan immediately, while others can reasonably expect to repay when their income improves, and those whose circumstances are unlikely to improve need grants or very long term, low interest loans.

Ensuring there is effective financing of loans for low income households, so they can be confident about the availability of loans they are eligible for.

• In the short term, local authorities should pool the range of support available locally to overcome duplication and identify gaps in provision.

• In the longer term, Government should review how it can best financially support the provision of sustainable credit products, and plug gaps in capacity and eligibility. This should consider the most effective mix of direct funding and lending risk under-writing to meet the need for different product types for low income households with different circumstances.

Making sustainable credit products available through 'mainstream' outlets

• Struggling consumers prefer to access affordable credit from more 'mainstream' outlets. 34 percent of the 21 million people in Britain struggling with their finances would prefer to apply for low interest loans via an online 'one stop shop' and 32 percent via their high street bank.[48]

• Struggling consumers are less likely to want to apply for low interest loans from the sources through which they are currently available: 16 percent would be happy going to a credit union, 15 percent a local authority, 13 percent a job centre and 10 percent a local charity.

In carrying out this review, we believe policy-makers should investigate the Australian Good Shepherd microfinance programme, which pools a range of charitable, government and financial services support and funding, provides a range of different low income loans and grants to suit different circumstances, and provides access via mainstream banks and high street outlets locally.

Good Shepherd loans are available in 650 locations across Australia, more than 150,000 households have so far benefited from the support, and they have a 97 percent repayment rate[49] – showing that, with the right product structures and lending conditions, low income households can manage credit effectively.

In addition to these efforts, the next Government needs to continue to support the work of the FCA to address conduct and product issues in the mainstream credit markets, so that households struggling with these products are treated fairly and do not get into further difficulty. The FCA has the potential to play a more significant role in making markets work for low income and vulnerable consumers, but it needs a more explicit mandate on financial inclusion. We believe the next Government should consider clarifying the FCA's remit on taking action to promote financial inclusion.

3. Expanding free debt advice to help everybody with problem debt

Debt advice is critical to helping people deal with their debts and get their finances back on track. Problem debt can have a debilitating impact on people's ability to cope with their circumstances – leading to increased risk of mental health problems, family breakdown and reliance on care and support services.

Debt advice can make a significant difference in helping people pay down their debt and improve their emotional well-being.[50] It can turn people's lives around. StepChange Debt Charity clients reported the following significant improvements after receiving advice:

- 79 percent said that their anxiety reduced
- 74 percent are able to sleep more easily
- 47 percent said it led to family relationships improving
- 32 percent of those who had been out of work said it made it easier to apply for a new job
- 27 percent of those who had been out of work said it made it easier to sustain a new job
- 83 percent of those in work said it made it easier to sustain their current job.[51]

But the Money Advice Service finds that just 1.5 million people are currently receiving free advice.[52] With 2.9 million people in severe problem debt, there are another 1.4 million people in difficulty not getting the help they need and it is likely that their position is getting worse.[53] Some 50 percent of our clients waited a year to get advice – yet in just 6 months, a client with a typical range of debts and arrears could face an additional £2,300 debt.

The policy problem

There is a gap in the funding for debt advice. Funding for debt advice is sometimes paid for by people already in debt, i.e. they pay fees to commercial companies, sometimes by levies on financial services companies, and sometimes by donations from creditors. Some local authorities fund local advice agencies to provide debt advice. In Scotland the Scottish Government and Money Advice Service provide joint funding for debt advice. We take the position that free debt advice should be available to all who need it.

In rising to the challenge of getting free debt advice to the remaining 1.4 million people in severe problem debt, further funding is needed to ensure there is sufficient capacity. There may be an added problem in that it is likely that some of the commercial companies currently providing debt advice may leave the market, either because they are not authorised by the FCA who took over responsibility for regulating consumer credit in 2014, or they choose not to seek authorisation. Therefore the free advice sector may need to pick up their existing clients and the future stream of clients who would have chosen a commercial provider of debt advice.

A key solution for people on low incomes with intractable debts is the Debt Relief Order (DRO). DROs help people who don't have enough income to pay back their debts, but can't afford or don't have significant enough debts to go bankrupt.

But debt advice agencies only receive £10 from the Insolvency Service to administer each DRO application, drawn from the £90 which people in debt need to pay to the Insolvency Service to apply for a DRO. However it costs us nearly £250 to do the work in putting the application together for the person in debt. Four in every five DROs are arranged by free debt advice agencies who offer solutions according to need, not profit.[54] But when each DRO costs advice charities far more than they receive in income, that's money we can't use to start to close the advice gap. Furthermore, the applicant has to provide £90 to the Insolvency Service; a sum that many indebted people struggle with.

There is also a significant challenge in positioning advice as a relevant and helpful solution to people with both resolvable and unresolvable debt problems: 49 percent of our clients said they weren't aware debt advice could offer any help to people like them, and a third thought debt advice could only provide drastic solutions, like bankruptcy or insolvency.[55]

Part of this is because many people using credit to get by do not perceive that they are in deep difficulty. 29 percent were optimistic they could manage their finances by juggling bills and credit, 9 percent thought they were on top of their finances, and 15 percent thought they'd be able to get their finances back on track without additional help.

The policy solution

In overcoming the barriers to people thinking that debt advice is only for unresolvable debt problems, the debt advice sector needs to be able to demonstrate, clearly and simply, how it can guarantee help for people with solvable problems.

Our Extended Breathing Space Guarantee proposal would give people struggling with their finances a clear, certain offer of help that would give them a stronger incentive to seek advice to deal with their financial difficulties. If the next Government implemented this proposal, it would be vital for advice providers and Government to develop messages and activities to promote the help that emphasised its benefits to people with resolvable debt problems, as well as reaching those who still believe they are coping with their finances.

Rising to the challenge of helping all 2.9 million people in serious problem debt get free debt advice means providing further funding to support the charities providing free debt advice. For every £1 spent on advice, £12 is saved in societal costs and costs to creditors. There is a strong 'spend to save' rationale for Government in increasing the funding for advice, and **78 percent of public think Government should ensure there is enough funding for free debt advice to help all people with serious debt problems.**[56]

The costs of plugging the gap will depend on the mix of debt advice channels used. Advice is provided on a face to face basis, on the telephone and online. All are necessary but the costs vary with face to face being most expensive and online being least expensive. Advice should be available in the channel people need, but responding to a demand of this level is most likely to be affordable if people are served by the most economic model consistent with their needs.

We should therefore aim to meet the bulk of growth in debt advice through the telephone and online. In 2013, StepChange Debt Charity helped 507,863 clients, of whom 57 percent sought advice by telephone and 43 percent online. In that year, our funding was £37 million.

Extrapolation using StepChange Debt Charity's figures gives a broad estimate of the cost of closing the advice gap using a mix of phone and online channels, which most commentators agree is how the bulk of the need will have to be met. On this basis, **we calculate it would cost around £100 million to help the remaining 1.4 million people in problem debt who are not currently getting advice**. However, our social return on investment analysis estimates that, if all 2.9 million people in problem debt received effective debt advice, £3.1 billion in the social costs of problem debt could be saved.

The next Government should raise additional funding for debt advice to provide capacity to help the 1.4 million people in severe problem debt not currently getting advice. The Government could raise this funding through a number of methods:

The FCA could collect an increased levy on high cost credit providers, whose loans lead to a disproportionate strain on the debt advice sector.

Encouraging creditors providing essential services (energy, water, mortgage lenders and landlords) to make contributions to debt advice charities where their customers are receiving help to pay back their arrears.

The Government could investigate the scope for social impact bonds as a mechanism for funding debt advice, based on the demonstrable social returns generated by debt advice.

If the current Insolvency Service review of DROs does not deliver an increase in funding for administering this debt solution, the next Government should act to increase the funding available to cover debt charities' costs.

4. New legal protection for people with resolvable debt problems

Struggling to adjust to changes in income and circumstance is a key trigger for people falling into deeper financial difficulty. Almost two thirds of StepChange Debt Charity clients cite an income shock as the key factor that led to them falling into debt – including redundancy, reduced hours, illness or a change in caring responsibilities.

With millions lacking savings, only a third (34 percent) would be able to cut back sufficiently to meet their essential costs, and just one in 10 believe that welfare payments would cover their essential costs.[57]

People's only realistic hope of stopping their debts worsening is getting help from their creditors. **Of our clients who got help from their creditors, 60 percent reported that their finances stabilised.** A lack of support from creditors often makes a bad situation worse:

- 60 percent who did not get the help they needed took out more credit to try and cope with their debt – 21 percent took out a payday loan.
- 29 percent said that a creditor's actions prompted them to pay that bill and fall behind on other bills.
- 28 percent said that the stress from debt made it harder for them to focus on applying for new or better paid work.[58]

Once people start defaulting on their debts and don't get help, arrears and interest added can make their debts grow quickly. Based on the size and distribution of our clients' debts, **we estimate that people falling behind and struggling with bills and commitments for just six months could see their debts worsen by £2,300 in interest and charges alone**.

Interest and charges mount up because half of clients wait more than a year before seeking advice, and when creditors do not help:

- 32 percent of those with credit debts said none of their creditors helped by freezing interest, charges or enforcement action.
- 33 percent said none of their utility providers helped.
- 38 percent said their landlord hadn't helped.
- 50 percent with council tax arrears said their council had not helped.[59]

The policy problem

Debt advice can help people arrange affordable debt payments and achieve a freeze on interest, charges and enforcement as they try to get back on top of their finances.

But **the effectiveness of advice is undermined by gaps in the protection for people with temporary financial difficulties**. In most of the UK, advice charities are not able to offer a guarantee of protection from interest, charges, and enforcement and collections activity for people in a position to repay their debts or who reasonable expect to do so in the foreseeable future.

Solutions for people with deeply entrenched and unresolvable financial problems, such as Bankruptcy or Individual Voluntary Arrangements, lead to guaranteed, well-understood protections against the debts inflating and against further enforcement action. 22 percent of our clients have a debt solution with statutory protection.

By contrast, **the debt solutions for people who can start to repay their debts, or reasonably expect to do so soon – namely Debt Management Plans, Token Payment Plans and "zero offers" – come with no guaranteed protection from interest, charges or enforcement action**. We are only able to persuade creditors to stop interest, charges, collections and enforcement activity through negotiation on each individual case, and in most cases we are successful. But this means we cannot promise to do so in advance. Such a promise would encourage more people to seek help, and to seek help earlier, in confronting their debts.

This uncertainty of protection for people with temporary or resolvable financial difficulties means people often see a reason to soldier on and try to cope by themselves and this often leads to the problem getting worse.

Statutory protection is vital to ensure that people taking action to deal with their debts do not face additional creditor pressure that could jeopardise efforts to keep on top of their commitments. Just one creditor reneging on an agreed payment and demanding the full payment could force someone to borrow more money and get into deeper difficulty.

The need for statutory protection is made more pressing by the collections actions of local councils and landlords, who seem to be more inclined to pursue enforcement action and less inclined to offer flexibility than banks and consumer credit providers.[60]

The policy solution

The millions of people who face an income shock or change to their circumstances need a stronger, more certain guarantee of protection against interest, charges, enforcement and unaffordable debt repayments if they seek advice. This is vital to helping people cope sustainably through periods of temporary financial difficulty without getting into further debt.

Scotland has statutory protection for people with solvable or temporary financial difficulties through the Debt Arrangement Scheme (DAS). This protection allows people the space and time to regain control of their finances – by making affordable repayments to creditors, and freezing all charges from the date of application – as soon as debt advice is sought.

There are some elements of DAS that require improvement – for example, the length of time that people get protection from interest, charges and enforcement whilst they prove they can afford the payments is unreasonably short at six weeks. **We believe the Scottish Government should extend this protection from 6 weeks to 12 months for people who do not initially have the income to repay their arrears, but reasonably expect to in the foreseeable future.**

Nevertheless, England, Wales and Northern Ireland need a scheme that builds on the most successful aspects of DAS

The next Government should to introduce an Extended Breathing Space Guarantee: a new statutory protection against interest, charges, collection and enforcement action while people get help with their finances to repay their debts.

- People would access the Extended Breathing Space Guarantee by seeking advice from an FCA regulated debt advice organisation.
- Following a budget assessment through debt advice, advisers would assign clients on an affordable repayment scheme – such as a Debt Management Plan, a Token Payment Plan, or indeed no payments while a client seeks to improve their income.
- For an initial period of normally up to 12 months, the Extended Breathing Space Guarantee would secure a freeze on interest, charges and enforcement action, while they made the agreed contribution to their arrears.
- After 12 months, some people would have paid off their arrears and would no longer need the protection, while others who were able to repay their debts in a reasonable period would continue to receive protection while they were on an agreed repayment plan. Otherwise, they would be assessed for an appropriate longer term debt solution.

The legislative base for such an Extended Breathing Space Guarantee is already on the statute book for England and Wales. Unimplemented clauses in the Tribunals Courts and Enforcement Act 2007 make provision for such a statutory scheme to be created. All that is required is for Government to implement these clauses and work with the debt advice sector to draw up the specifics of a scheme. **62 percent of voters agree that Government should protect people from interest, charges and enforcement if they are getting help to manage their debts.**[61]

The effectiveness of a Guarantee relies on high standards of collection practice across all sectors. Council tax collections compares poorly against all other sectors in terms of help and flexibility offered to struggling consumers. The next Government needs to ensure that all arms of the state act as a fair creditor and give people the best chance of repaying their debts. **70 percent of the public believe that people behind on their council tax payments should be allowed to pay it back at a rate they can afford.**[62]

The Cabinet Office should lead a review of debt collection practice across local and national government.

The review should examine the most effective way to implement a cross-government approach to debt collection that ensures people are treated fairly and minimises the risk of people falling into more entrenched difficulty. This should look at early signposting of advice and, instead of demanding the arrears to be paid in one lump sum, offers a range of more feasible longer term repayment options.

5. Protect children from the harm caused by problem debt

In the UK **over 2.4 million dependent children live in indebted households.**[63] These children suffer hardship and mental distress due to their parents' financial problems, which can harm their education and limit their prospects.

More than half of children aged 10-17 in families with problem debt are embarrassed because they lack the things that their peers have, and nearly one in five have been bullied as a result – twice as the proportion among children whose parents do not have problem debt. Around a quarter of children in problem debt are unhappy with their life at school.[64] This may have a long-term, detrimental impact on their prospects.

Families' debt problems are not just the result of consumer credit: parents are increasingly falling behind on household bills, building up arrears gas and electricity, which could result in a loss of goods or services for them and their children.

It is not a case of children missing out on luxuries. Interviews with the children of our clients show that it is items of fundamental importance that are not provided. One told us her sole wish was to be able to afford a bus-pass to visit her friends, but this was impossible due to her parents' debt problems. This was not an isolated case: almost three-quarters of children whose parents are currently in arrears note that their parents found it hard to pay for their social activities.[65]

As parents struggle with their finances, efforts to ensure their children enjoy a more stable future are hindered by children being bombarded by negative influences and not given the opportunity to learn the best way to handle money. Almost three quarters of children aged 13–17 say they have seen at least one payday loan advertisement in the last week and over two thirds say they had seen at least one on television. Conversely, only 21 percent of children (aged 10-17) say that their school taught them about debt and money management.

We believe children should learn about money from their parents and their schools, not from the exploitative adverts for credit they see on television.

The policy problem

The challenge facing parents is made more acute by wider issues such as changes in benefit provision and stagnant incomes. A lack of disposable income means parents are often forced to cut back on essentials in order to meet credit commitments, resulting in their children missing out; around a quarter of parents in debt have cut back on food, clothing or heating within the last month in order to pay their creditors.[66]

But when their parents seek help they are often treated poorly. **Some 42 percent of parents who have struggled with bills or credit commitments think they are being treated 'badly' or 'very badly' by creditors, with payday lenders most likely to be treating vulnerable parents negatively**.[67]

Parents who sought help from their council were less likely to find that support helpful than those who asked for support from their creditors. A third of people who sought help from their council found it 'not helpful at all', compared to 28 percent of those seeking help from a creditor or creditors.[68]

The policy solution

The government must address these problems to both help the 2.4 million children currently affected, and protect future generations. We believe all of our policy proposals will make a significant difference to families affected by and at risk of problem debt. In addition to these, we believe the next Government should take the following steps to protect children from the harm caused by problem debt.

To ensure a more consistent and sensitive approach to debt collection for households with children, **the Cabinet Office should develop a binding code on appropriate debt collection and enforcement standards, based on the FCA's forbearance rules and Treating Customers Fairly framework, where creditors are aware there are children in the household.**

The government should pilot savings accounts for children via credit unions or other providers – linking this in to financial education in schools, to promote the effectiveness of savings to young people.

The next government should stick to the current government's commitment to review the case for tighter restrictions on loan advertising seen by children. Children and young people should learn about borrowing, credit and debt from their school and family, not from lenders advertising on television or other media.

6. Modernise debt solutions to help everyone in need

StepChange Debt Charity

The consumer credit market has changed dramatically in the almost thirty years since the principal parts of our insolvency options were introduced in 1986.

Household debt-to-income ratios almost doubled between 1987 and 2007[69], the number of credit cards available to consumers has increased manifold, and whole new credit markets have emerged in response to the changing risk appetites of mainstream lenders, rising household costs, and people relying on credit to cover essential bills.

After a piecemeal approach to amending credit regulations failed to prevent excessive and irresponsible lending in the run up to the financial crisis, the Government has taken steps to modernise credit regulation accordingly through the Financial Conduct Authority. The newly constituted FCA is already demonstrating that it is a modern and effective regulator.

As the credit market has changed, so too has the nature of problem debt in the UK, the profile of people who find themselves in difficulty, and the kind of debts they have.

The 1986 Insolvency Act introduced today's provisions for bankruptcy and the Individual Voluntary Arrangement (IVA). In 2007 Debt Relief Orders (DROs) joined the landscape in a well-intentioned but piecemeal reform. Alongside insolvency options to write off people's debts, the debt advice sector has developed solutions for people who are in a position to pay their debts off, such as Debt Management Plans (DMPs) and Token Payment Plans (TPPs).

The policy problem

Looking at the different aspects of the principal insolvency solutions shows significant variance in the fees charged, their flexibility to a client's circumstances, and their consequences for people in different situations.

- **Access.** Unaffordable upfront fees can deter people from taking out a solution that may be appropriate for their circumstances, particularly the £705 fee for bankruptcy. This fee would take the average StepChange Debt Charity client who decided to go bankrupt 28 months to save up, as this group of clients have an average 'surplus budget' of £26.50 a month. In Scotland the fee is £200, and it is payable in instalments.
- **Gaps.** A client might have too high an income for a DRO, not enough for an IVA, but not enough cash to pay for bankruptcy – leaving them with no option that offered statutory protection from interest, charges and further enforcement. A client with serious debt problems who owned their home but did not have enough to qualify for an IVA would be left with the option of bankruptcy, which would entail losing their home.
- **Flexibility.** Remedies can be inflexible to changing circumstances. IVAs may fail if a client's income drops significantly (e.g. they lose their job) whilst paying an IVA. Around 30 percent of IVAs terminate early.[70] People may then find themselves unable to access an appropriate debt solution that offers them protection from fees and charges.

Meanwhile, people who are in a position to pay back their debts, through a Debt Management Plan or Token Payment Plan, do not have statutory protection against fees, charges and enforcement action while they are repaying their debts.

The effects on a credit file for people repaying their debts through a Debt Management Plan are longer than for insolvency options where people's debts are written off. The lower than contractual payments that people make through a DMP will show up on a credit file, and any adverse marks will stay on a credit file for six years. DMPs last an average of five years, so credit files are affected for 11 years.[71] By contrast, Bankruptcy, IVAs and DROs only appear on a credit file for six years from when the order was granted or the plan was started.

Marks on credit files not only affect future borrowing options, but the chances of getting a job or a private rented home, where credit checks are increasingly the norm. Moreover, it seems unfair that people who have repaid more of their debts could experience the negative effects of a mark on their credit file for longer than those who have undergone insolvency.

The policy solution

It is vital that debt solutions are adequate and effective in helping people deal with problem debt, and helping them get back on their feet while and after they repay their debts. The status quo shows there are significant anomalies than can undermine the help that people get.

People in problem debt need a coherent set of solutions that reflect the realities of their position. Our proposal for an Extended Breathing Space Guarantee would plug the gap in statutory protection in debt solutions for people with resolvable debt problems.

Nevertheless, further work is needed to rationalise the anomalies across the range of debt solutions, and to understand the impact that debt solutions on credit files have on people's employment, housing and borrowing options.

The next government should review current insolvency options, with a view to making targeted changes to improve how debt solutions serve all people in problem debt. This should look at addressing financial barriers to appropriate debt solutions, improving the protection against interest, charges and enforcement while people are repaying their debts, and ensuring that solutions do not have a disproportionate impact on people's financial recovery.

The next government should also instruct the FCA to conduct a thematic review of how credit reference files are used, including the practical impact of debt solutions on people's work, housing and borrowing options.

1 Bank of England, 2014. 2014 Q3 Total outstanding consumer credit debt.

2 Calculated based on the 6 percent of GB adults identified in a StepChange Debt Charity commissioned YouGov poll (Total sample size: 4,442 GB adults. Fieldwork undertaken: 17th - 20th December 2013) as showing three or more signs of financial difficulty. These signs of financial difficulty are: using credit to keep up with existing credit payments and essential bills, using credit to last until payday, routinely incurring late payment charges, making minimum payments for longer than 3 months and falling behind on essential bills. The 2.9 million figure is obtained from extrapolating the 6 percent to the 48.8 million given by Office for National Statistics 2012 population estimate.

3 StepChange Debt Charity commissioned online survey from YouGov. Weighted sample: 4,442 GB adults. Fieldwork: 17th - 20th December 2013.

4 StepChange Debt Charity, 2014. Cutting the cost of problem debt.

5 Calculated based on the 6 percent of GB adults identified in a StepChange Debt Charity commissioned YouGov poll (Total sample size: 4,442 GB adults. Fieldwork undertaken: 17th - 20th December 2013) as showing three or more signs of financial difficulty.

6 Money Advice Service, 2013. Indebted lives.

7 StepChange Debt Charity commissioned an online survey from Populus. Total sample size is 2,322. Fieldwork was undertaken 24th-26th October 2014. The figures have been weighted and are representative of all GB adults (aged 18+). Estimates of the number of adults affected have been calculated by StepChange Debt Charity. These estimates are based on 2012 population estimates from the Office of National Statistics which indicate that there are 48.8 million adults in Great Britain.

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StepChange Debt Charity London Office
6th floor, Lynton House
7- 12 Tavistock Square
London WC1H 9LT

Email: policy@stepchange.org
Web: www.stepchange.org
Twitter: @stepchange

For help and advice with problem debts call
0800 138 1111 Monday to Friday 8am to 8pm
and Saturday 9am to 4pm