StepChange Debt Charity response to Breathing Space: call for evidence

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StepChange Debt Charity London Office
6th Floor, Lynton House, 7-12 Tavistock Square, London WC1H 9LT
Policy Contact: Alison Blackwood
Tel: 0207 391 4583
Email: alison.blackwood@stepchange.org

1. Introduction

StepChange Debt Charity is the largest specialist debt advice charity helping people across the UK. In 2016 we were contacted by almost 600,000 people seeking debt advice. Demand for our services has increased to its highest level in the first half of 2017 when 326,639 people contacted StepChange Debt Charity for help and support with their problem debt. This equates to one person contacting us every 48 seconds.[1]

We welcome the opportunity to respond to this Call for Evidence. StepChange Debt Charity has produced evidence over the last few years on the need for a statutory breathing space scheme for people in problem debt. We have shown that the right support at the right time can help people regain control of their finances and repay their debts. We have highlighted how the current legal protections offered through bankruptcy, individual voluntary arrangement (IVA) or debt relief order (DRO) solutions in England, Wales and Northern Ireland are only suitable for a minority of people seeking help with their debts.[2]

We also have considerable experience of providing a similar scheme, the Debt Arrangement Scheme (DAS), in Scotland. By the end of 2016, StepChange Debt Charity Scotland was the largest provider of approved Debt Payment Programmes (DPPs) in Scotland, submitting over 300 applications per quarter on behalf of our clients.[3] At present, the revocation rate of StepChange-issued DPPs schemes in Scotland is a mere 1.6%, the lowest of any plan that we offer in Scotland.[4]

Our consultation response provides an overview of:

- evidence of the need for a breathing space scheme and a statutory debt management plan (DMP) (section 2);
- the model recommended by StepChange Debt Charity based on our research and discussions with other organisations (section 3);
- evidence-based recommendations to ensure the current model proposed in the Call for Evidence will work as effectively as possible (section 4); and
- a modelled estimate of the direct costs and benefits to the government of introducing a breathing space scheme and a statutory debt management plan (section 5).

Finally, we have answered the more detailed technical questions in the Call for Evidence document (section 6).

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[1] StepChange Debt Charity (2017) Statistics Mid-Year Book: an in-depth look at over 300,000 people struggling with problem debt
[2] StepChange Debt Charity (2015) Safe Harbours
[3] StepChange Debt Charity Scotland (2017) The Debt Arrangement Scheme Survey 2017
[4] 2016 client data from StepChange Debt Charity Scotland

2. The evidence of need for a breathing space scheme and a statutory debt management plan

In this section we summarise the need for a breathing space scheme and statutory debt management scheme and the benefits it could deliver. These include earlier access to debt advice, increased chances of recovery from financial difficulty, support for people to repay their debts and the learning from implementation of the Debt Arrangement Scheme (DAS) in Scotland.

StepChange Debt Charity has supported government action cited in the consultation document to improve the provision of debt advice and creditor practice. However, we still have evidence that not enough people are accessing free debt advice and those that do are often waiting too long before doing so. Over 50% of StepChange Debt Charity clients waited over a year between first worrying about their money problems and finally getting debt advice support.[5] People waiting over six months to seek advice were disproportionately more likely to have debts over £10,000 and had contractual credit repayments that were on average 14% higher than people who sought advice earlier, making their debt problems more difficult to address.[6] The introduction of a breathing space scheme and statutory debt management plan as proposed in this Call for Evidence is, therefore, a welcome additional support for our clients who tell us they wait on average one year from first falling into financial difficulty before seeking debt advice.[7] Feedback from our clients suggests that a new statutory scheme offering the right protections could encourage people to seek debt advice earlier, so reducing the harm and external costs that problem debt can cause.

More support is urgently needed at a time when the number of adults estimated to be in problem debt is increasing along with demand for free debt advice services.[8] A recent survey commissioned by StepChange Debt charity estimates that 3.3 million people in Great Britain are currently in problem debt, a rise from an estimated 2.9 million earlier in 2017.[9] The Office for Budget Responsibility's forecasts project the household debt-to-income ratio to gradually increase in coming years, peaking at 150% at the end of its forecast period in early 2023.[10]

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[5] StepChange Debt charity (2015) Safe Harbours

[6] *ibid*

[7] *ibid*

[8] StepChange Debt Charity (2017) Statistics Mid-Year Book: an in-depth look at over 300,000 people struggling with problem debt

[9] YouGov survey Total sample size was 5,052 adults. Fieldwork was undertaken between 13th - 18th December 2017. The survey was carried out online. The figures have been weighted and are representative of all GB adults (aged 18+).

[10] Office for Budget Responsibility, Economic and fiscal outlook, November 2017, chart 3.27 and pp74-5

High levels of problem debt also need to be addressed as they have both negative economic and social impacts. StepChange Debt Charity estimates that the wider social costs of problem debt are at least £8.3 billion annually in the UK. This is a result of its negative effects on health, productivity and employment, as well as the association between debt and homelessness and the negative impacts on children from indebted households.[11]

The current absence of an effective statutory scheme protecting people in England and Wales in temporary financial difficulty is a significant gap in addressing problem debt.

Breathing Space

A breathing space scheme needs to encourage people to seek advice earlier and protect them while they are being advised. It should also continue that protection until they are in a financial position to access one of the current statutory debt solutions or while their circumstances are stabilising sufficiently to be able to repay their debts.

Only a small proportion of our clients are helped by current statutory debt solutions. In the first six months of 2017 only 16.7% of StepChange Debt Charity clients were recommended a statutory debt solution as the best way to manage their debt problem.[12] The remainder were not guaranteed the protections that these statutory solutions offer. In addition, over 95% of our clients recommended for bankruptcy or a DRO could not afford the fees immediately and would benefit from a breathing space protection to support them to find them.[13]

Over 60% of StepChange Debt clients said they fell into debt because of a life event, such as job loss, reduced income, illness or relationship breakdown, which affected their finances and ability to cope[14]: a temporary financial difficulty that given time they might be able to resolve. But the way that people cope during the period of adjustment makes a big difference. Without the right help and support, problems can get worse, not better. The current statutory debt help schemes in England and Wales focus on debt relief. These meet important needs, but are not the right help for people in temporary financial difficulties or who do not need or want an insolvency option. The current system of statutory debt remedies has a major gap – it offers no help for people in temporary financial difficulties, for whom insolvency is unlikely to be an appropriate remedy, but who are likely to be able to repay their debts if their financial situation improves.

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[11] Baker Tilly & StepChange Debt Charity (2014) Transforming Lives: a review of the social impact of debt advice for UK individuals and families, evaluated using SROI
[12] StepChange Debt Charity data on 172,992 clients, January – June 2017
[13] StepChange Debt Charity data whole year 2015
[14] StepChange Debt Charity data, January – June 2017

In addition our research suggests a voluntary approach to providing those in problem debt with a breathing space is failing to support a large proportion of people who need it. A third of our clients said that before they received debt advice, none of their creditors helped them by freezing interest and charges on their debts or stopping enforcement action[15] – over 50% had not received this support from their local authority when they had asked for help with their council tax arrears.[16] Even when our clients were working with advisers to find the best debt solution, 43% said some or all of their creditors continued to add charges to their debts, 51% said some creditors continued to add interest and 39% said some creditors continued debt collection actions.[17]

With no relief from interest, charges and debt enforcement and collection fees, debts can spiral out of control and many clients use more credit to cope – 61% of our clients who were not offered protection from these additional debt charges went on to take out further credit to keep up with the extra costs added to their debts and 29% said that a creditor's actions prompted them to pay that bill but fall behind on other bills, which escalates their debt problems.[18]

However, 60% of StepChange clients who had interest, charges and enforcement action frozen by creditors said that their financial situation began to stabilise. None of those that did not get this help from creditors said their finances had stabilised.[19]

"It [breathing space] hugely benefits me. Not having to repay the interest was hugely appreciated to give me time to get my finances in order."[20]

A breathing space scheme would also incentivise people to access debt advice earlier. Our clients who waited more than a year before seeking debt advice said this was because they worried about creditors' reactions, felt nothing could be done, or they were uncertain about what help was on offer.[21] 76% of our clients said they would have sought debt advice earlier if they knew it would result in creditors stopping interest, charges and other debt collection and enforcement costs.[22]

Statutory debt repayment plans

Current non-statutory debt repayment plans provide a positive benefit to people in problem debt, allowing them a chance to repay their debts if they have sufficient surplus income. But many of our clients in temporary financial difficulty require up to 12 months to sufficiently

[15] StepChange Debt Charity (2015) Safe Harbours
[16] StepChange Debt Charity (2015) Council Tax Debts
[17] StepChange Debt Charity (2015) Safe Harbours
[18] *ibid*
[19] *ibid*
[20] Quote from StepChange Debt charity client, 2016
[21] Based on a poll of 1,300 StepChange Debt Charity clients in 2014
[22] *ibid*

stabilise their finances to be able to access a repayment option. Around 44% of our token payment plan (TPP) clients who had income solely from benefits at the beginning of their plan were in a position to begin making debt repayments after 12 months.[23] A 12 month breathing space would allow these clients to access a repayment solution.

"My creditors have not frozen my interest or charges even though they know I am in financial difficulty. Yes [it makes things harder], as the money I'm paying back doesn't all go on the debt. I could be debt-free quicker or I could have a little bit of extra money a month to save for a rainy day, pay for unexpected problems. When first told about my problems, my creditors would not even entertain the idea of reducing my payments. They said I had no choice but to carry on paying the full amount." [24]

There are evidenced economic benefits of debt repayment plans to creditors. A social return on investment study of StepChange Debt Charity clients estimated a £750 per client benefit to creditors of debt advice to support clients to repay their debts at an affordable rate.[25] Specialist debt advice has also been shown to deliver an estimated £239 extra in debt repayments to social landlords per tenant supported when compared against residents not receiving debt advice support.[26]

"our experience is that....giving people an option to pay a smaller amount [of their debt repayments] on average works better for us financially" [27].

For example, the debt purchaser and manager, Arrow Global supports customers in financial difficulty by referring them to a wide range of free debt advice providers and providing breathing space while they develop voluntary debt repayment plans. The customers that took advantage of the free debt advice were more likely to have multiple debts and larger overall balances, but were able to start stabilising their finances much more quickly than those who did not ask for debt advice. Over the first six months of 2016, customers who had taken debt advice were on average able to make 20% higher debt repayments and were less likely to break arrangements to pay than those who had not received debt advice.[28]

The benefits of the Scottish Debt Arrangement Scheme (DAS)

In Scotland the Debt Arrangement Scheme (DAS) is already delivering some of the protections we believe are needed across the rest of the UK. Any proposed scheme should aim to build upon and use the lessons from the DAS in Scotland to provide a workable scheme for England.

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[23] StepChange Debt Charity data, 2016
[24] Quote from StepChange Debt Charity client, 2016
[25] Baker Tilly & StepChange Debt Charity (2014) Transforming Lives: a review of the social impact of debt advice for UK individuals and families, evaluated using SROI
[26] Evans G.& McAteer M, (2011) Does debt advice pay? A business case for social landlords. London: Financial Inclusion Centre
[27] Financial service provider at StepChange Debt Charity Breathing Space roundtable, 9 February 2016
[28] Money Advice Service (2017) Working collaboratively with the debt advice sector

There are two stages connected to DAS:

- The six-week moratorium gives clients protection from court action whilst they are in the process of gathering information and applying for their DPP, or another debt solution. This is different from the breathing space scheme recommended by StepChange Debt Charity and will be discussed in more detail later.
- The DPP, which gives someone breathing space, freezes all interest, fees, penalties or other charges that would have been applied to the client's debt whilst they are repaying their debts in full at an affordable rate throughout the programme.

The DPP has demonstrated many benefits that support our StepChange Debt Charity Scotland clients to repay their debts. The freeze on interest, fees and charges gives them clarity on the amount of debt to be repaid and provides a clear incentive for getting advice. It also ensures that all the money they pay back goes towards paying their debt instead of seeing it escalate.[29] Nearly all (96%) of our Scottish DAS clients said that the most important feature of DAS was the knowledge that their debt would not grow, and being able to repay the debt in a manageable way. 81% of our clients said it made their debt easier to pay and 78% said that they were less stressed as a result.[30]

"I watched and cared for my wife for seven years, through the deterioration in her health from cancer till her death. When she died I was naturally distraught and angry. I seemed to go into self-destruct mode and gambling was the outlet and I soon got into serious debt. I heard about StepChange. I can now say that starting a payment scheme through DAS to pay back my debt has changed my life around. Now my bills are being paid and family are relieved to see me back to eating and living properly. I have still a little way to go as I am still not over my wife's death as we were very close but at least I can see a way forward now thanks to StepChange. The people at DAS are very caring. The DAS advisers are a credit to people who feel there is little point in going on. They should be proud of their work. I urge people to think very hard about burying their head in the sand and seek the help." [31]

There are also economic benefits to creditors from DAS. The total amount repaid during 2016 through DAS was around £9.6 million each quarter with creditors receiving a minimum of 90% of the debt owed to them at the end of the programme (after DAS Administrator and payment distributor fees were deducted).[32] So, evidence from Scotland indicates significant benefits of a type of statutory debt management plan, with a breathing space protection throughout.

"I think DAS has immeasurable benefits to both debtors and creditors. For debtors, it undoubtedly provides security and peace of mind as well as 'light at the end of the tunnel' in the sense that, by sticking to the agreement, the debtor will eventually get to the position of

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[29] StepChange Debt Charity Scotland (2017) The Debt Arrangement Scheme Survey 2017
[30] Survey of 1,496 Scottish clients who had a DPP approved between January 2014 and December 2016
[31] Quote from StepChange Debt Charity Scotland client on a DPP, 2017
[32] StepChange Debt Charity Scotland (2017) The Debt Arrangement Scheme Survey 2017

being debt free. For creditors it provides the assurance that the debt(s) will be repaid within a reasonable period of time." [33]

Learning from the Scottish DAS

However, our experience in Scotland highlights that DAS does not currently provide all the support that our clients need. Indeed it is currently being reviewed for this reason, and we would urge that this learning should feed into the development of an English scheme. This would also have the advantage that the two countries' schemes would be better aligned.

The main features of DAS that do not work for our clients are:

- At six weeks, the moratorium period is not long enough for clients to get the information they need. Our experience of helping people in Scotland suggests that while the six week period may be long enough for people to seek advice, it is not always long enough for people to enter into a statutory debt remedy. Administrative requirements of the DAS scheme mean that it can take around four months between seeking advice and entering the DAS scheme.
- DAS does not work for clients who do not have sufficient disposable income to access the scheme, even though they might be expected to have sufficient income at a future date. As is the case for our clients in England and Wales, many people seeking debt advice will have circumstances in a state of flux. There will be sufficient prospect of a positive change of circumstances to rule out insolvency remedies; but their current circumstances mean that they cannot at that time meet the DAS requirement to have "a reasonable level of disposable income after meeting their basic needs" (even though this is likely in the future). There is not a statutory remedy suitable and available for them at that time.
- The administrative design of DAS creates significant additional costs.
- The public nature of the DAS register puts a lot of clients off applying to the scheme.

For these reasons we have recommended improvements to DAS in Scotland:

- The six week moratorium period should remain, but this should be extendable to up to 16 weeks where a debt adviser needs this time to prepare an application for a statutory debt remedy. For those eligible for DAS, our data indicate that four months is the minimum period needed. However, this does not include people whose financial situation would not yet have improved.
- The DPP needs to be more flexible, allowing clients to make a small, or zero, payment for up to 12 months (following advice from an approved money adviser) where it is likely that a positive change in circumstances would then allow them to repay their debts in a reasonable period. They would then be able to access DAS protections while they stabilised their finances to such a point that they could begin repayments. This would stop debts mounting throughout the time they are in temporary financial difficulty but seeking a solution through debt advice.

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[33] Quote from StepChange Debt Charity Scotland adviser, 2017

- Giving people a period of statutory protection to seek debt advice may do little good if that protection ends before they have a solution for their debt problem. The role of debt advice is of central importance here. In Scotland people can apply for the six-week moratorium before they seek debt advice, but very few were aware of this. A longer period of breathing space protection should be dependent on a full assessment of need by a debt advice provider.

3. The model recommended by StepChange Debt Charity based on our research

To meet the gap identified from the above evidence StepChange Debt Charity proposed a scheme for England that has two separate, but linked periods of protection. The periods are separate in the sense that they are dealing with two different needs. They are linked in that the same person may need to use both periods of protection.

Breathing space and respite

The first period of protection is designed to give breathing space or ‘respite’ to help people recover control of their finances. People seeking debt advice will often be in a period of flux. They may have little or no income at the time they seek advice but the circumstances may be likely to change (finding a new job or recovering from illness, for example). It may not be possible to recommend a long-term debt solution until their circumstances have settled down. Alternatively, debt advisers may be able to advise on a debt remedy (such as a DRO or bankruptcy) that the person cannot immediately access. The breathing space should freeze all interest, charges and enforcement action to provide clarity on the amount of debt to be repaid and a clear incentive for getting advice. It also ensures that all the money paid back goes towards paying the debt. Based on the evidence from our clients the period of time for such a breathing space should be up to 12 months. However, some clients will only need breathing space for the time it takes to set up their debt solution (usually between ten and 16 weeks).

Protected debt repayment plans

Where a person’s circumstances stabilise and the debt advice assessment shows that they would be able to repay their debts in a reasonable period, the protection under the scheme would continue. A statutory protection around these ‘debt repayment plans’ would ensure that people seeking to repay their debts get similar protection to people seeking debt relief, for instance through an IVA or DRO. Where the debt adviser assesses someone as suitable for a debt repayment plan immediately, there would be no need for the period of ‘breathing space’ protection to last longer than the time it may take to activate the plan.

4. Evidence-based recommendations to ensure the current model proposed in the Call for Evidence will work as effectively as possible

The Conservative manifesto commitment describes a breathing space scheme whereby a person may apply for protection from further interest, charges and enforcement action for a period of six weeks. There is also a commitment to follow this with a statutory debt management plan, where appropriate. We support the government's move to take this forward, and would like such support in place as soon as possible, with clear commitments to an implementation timeline. However, it is important that whatever proposals the Government does take forward are as effective as possible in helping people recover from problem debt.

The Conservative manifesto commitment describes a statutory scheme that looks in outline rather like the Scottish debt moratorium and Debt Arrangement Scheme (DAS). Primary legislation for England could take a starting point from the Scottish legislation. While there is a lot of support for the protections that DAS delivers, DAS is administratively complex. We recommend a more flexible administrative approach to statutory debt management plans in England. Legislation should as far as possible work with existing debt advice processes – we describe this as "putting a statutory wrap around the support debt advice charities are already providing".

However, our evidence base (section 1) suggests that to make the Government's breathing space scheme as effective as possible in achieving its goal of supporting people in problem debt and encouraging them to access debt advice earlier, it should include the following principles:

Eligibility based on whether people can afford to pay debts as they fall due based on the assessment of a regulated debt adviser. There are three reasons for this:

- A debt advice assessment is needed to ensure that the breathing space scheme is the best available solution for a person's needs and circumstances. This is similar to the way debt advice is currently the gateway to a DRO.[34] Without such an assessment, breathing space could actually be detrimental compared to other options. If the debt advice provider can immediately recommend another statutory debt remedy (bankruptcy, an IVA or DRO) as the best available option, a person would not be advised to enter a breathing space scheme (other than for temporary protection while an application for another statutory remedy was prepared – as in the StepChange Debt Charity model shown in diagram 1).

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[34] https://www.insolvencydirect.bis.gov.uk/technicalmanual/Ch37-48/chapter46/Part%201/Part%201.htm

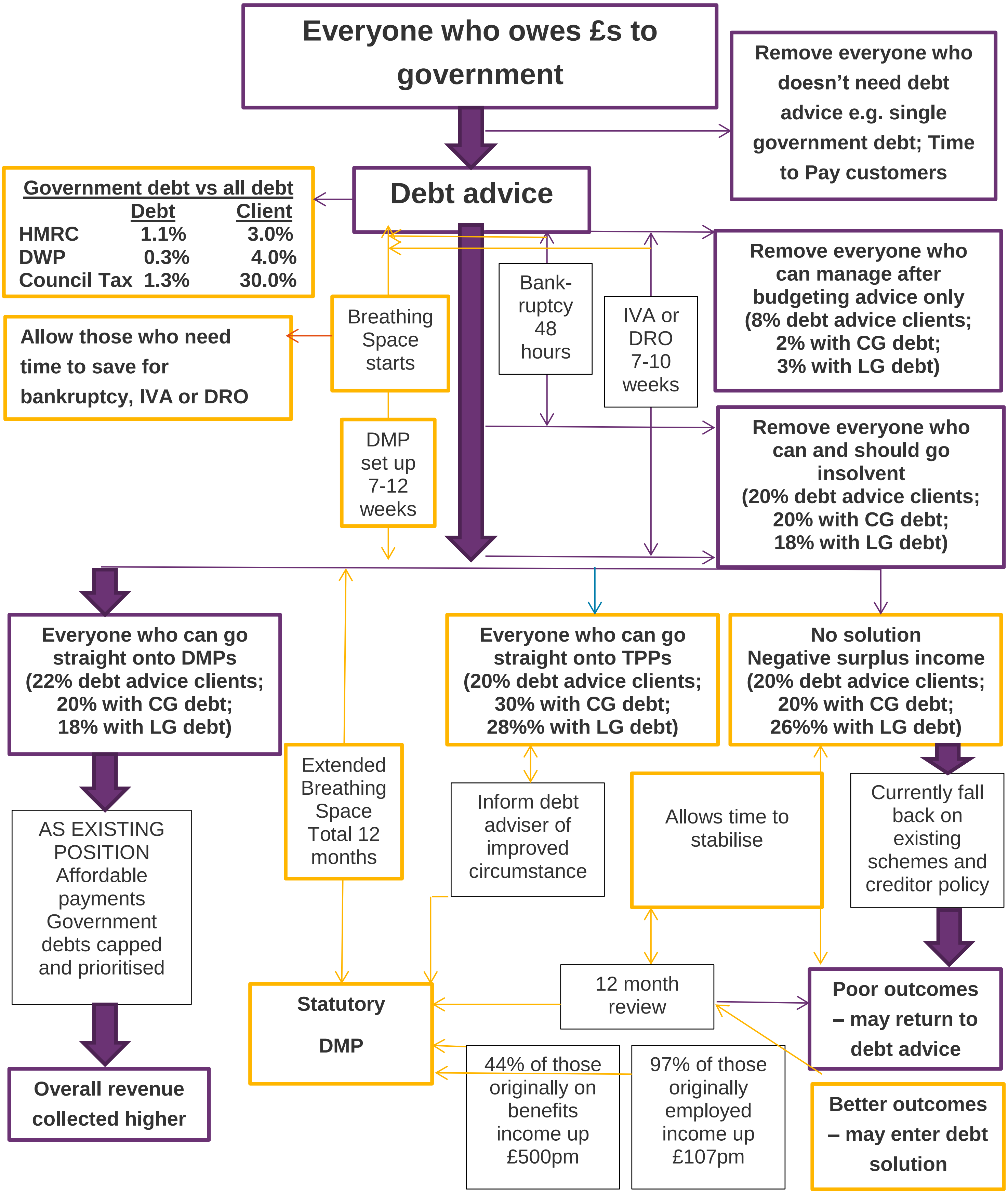

Diagram 1: showing how the StepChange Debt Charity model for breathing space and a statutory debt management plan would work based on StepChange Debt Charity data 2016
CG = central government; LG = local government; TPP = token payment plan; DMP = debt management plan

- Granting breathing space without a debt advice assessment may create a moral hazard. Creditors might reasonably expect statutory protections to only apply to people who are independently assessed as being in financial difficulty, and where there is a framework for review to assess their long-term options. If people can apply for a breathing space independently of advice, then the breathing space period needs to be kept short (as the moratorium is in Scotland). But if the gateway to breathing space is an outcome of debt advice, which is more likely to achieve the aim of incentivising people to access such advice earlier, then the period can be longer without the same risk. Only a proportion of people seeking debt advice (we estimate around only 20% of those who use our services) would need an on-going breathing space period.
- A debt advice assessment will be needed to work out the debt repayments a person is able to affordably sustain during a period of breathing space. We do not intend that people seeking breathing space protection would never make debt repayments in that period. We would expect people to make such payments that the debt advice process (based on a commonly accepted budget standard, such as the Standard Financial Statement) says they can afford. In some cases this may be no payments for a period, or token payments, but in many cases it will include debt repayments.

A six week breathing space is helpful but there must be no gap in protection. A six week breathing space is a positive step that will give some people in problem debt the time and protection to seek advice and arrange a suitable solution. But six weeks of breathing space on its own will have little effect on reducing the long-term problems of escalating debt.

Evidence from DAS shows that it takes on average 120 days to seek advice and start a DPP[35], so a longer breathing space would be more helpful. If it is to be six weeks, there should at least be flexibility for a debt adviser to recommend a 'roll-over' into a subsequent breathing space period, or an extension period, whether this is because a repayment plan, or other debt solution, is being arranged but needs more time to be finalised or the person in debt needs more time to find fees for insolvency solutions.

Current FCA rules require credit providers to allow 30 days breathing space, plus another 30 days if needed, for people to get advice. So a six week statutory period for people to get advice could take us backwards if the FCA amended its rules to match the statutory provision.

More importantly, any gap in protection could risk people falling back into problems under pressure from creditors and escalating their debt at a time when they are preparing to address it. An analogy has been made to “putting people into the life boat and then throwing them back before they get to shore” to describe an inflexible, time-limited breathing space

[35] StepChange Debt Charity Scotland data

period that doesn't take account of an individual's circumstances and the free debt advice provision available to them. Whatever the length of the breathing space, the Government should review how well it is working a year after its introduction.

Flexibility of payments within the statutory debt management plan to allow for income fluctuations

Flexibility is crucial to deal with temporary income shocks. The statutory repayment plan option is a vital part of the proposals, as it offers a long-term sustainable solution allowing debts to be repaid in full over time, for those with sufficient budget surplus. This should provide the flexibility to put in place the most effective plan for each individual's circumstances, while they stabilise their finances. In addition, with more and more people on fluctuating incomes, whether this is through self-employment, zero hour or temporary employment contracts,[36] such flexibility is crucial to a successful scheme.

A regulated debt adviser therefore needs to be granted the powers to recommend that the statutory debt repayment plan can begin with a period of nominal 'token payments', allowing a short-term shock to pass before full repayments begin. They should also be able to vary repayments within the plan when income falls temporarily. This would be analogous to the six month payment holidays currently allowed within DAS.

All debts should normally be covered, although certain debts prioritised in terms of payments within the scheme

The statutory debt management plan should include all debts and arrears (although with some possible cases for exemption when it would cause detriment to a sole trader or microbusiness creditor), but not continuing liabilities. It should include debts and arrears owing to national government, local government and public bodies, as repayment plans can become unaffordable if just one creditor does not accept the levels of repayment, recommended in the debt advisers' assessment.

Some types of debt, such as rent arrears and government debt, may need to be prioritised within a repayment plan, as they may cause particular detriment if left unpaid, such as the risk of eviction or imprisonment. Despite the protections the scheme offers, this prioritisation will reduce the probability that clients will be subject to such detriment, if despite making an attempt to repay their debts, a sudden more permanent fall in income means they need to drop out of the plan.

Recommendations should be made on prioritisation of debts within a plan by a regulated debt adviser taking into account the client's affordability assessment and their individual

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[36] StepChange Debt Charity (2015) Navigating the New Normal

circumstances. In effect, it would put a statutory wrap around current best practice in debt advice.

5. A modelled estimate of the direct costs and benefits to the government of introducing a breathing space scheme and a statutory debt management plan using London Economics model

Our figures show there would be little cost to government of introducing a breathing space scheme and statutory debt management plan. In fact over time there would be an increasing cost benefit as government debt collection rates increase: an affordable repayment plan, after sufficient breathing space to stabilise finances, would reduce drop-out rates.

Using a model developed by London Economics (see Appendix 1) it can be seen that the government would see considerable annual cost benefits in debt collection if it's Department of Work & Pensions, HM Revenue & Customs and Council Tax debt were included in a six week breathing space and statutory debt repayment plan (Table 1).

(£millions)	6 week breathing space		52 week breathing space	
	Cost / benefit after 5 years	Cost / benefit after 10 years	Cost / benefit after 5 years	Cost / benefit after 10 years
With no breathing space	£163.79	£169.48	£163.79	£169.48
With breathing space	£168.93	£177.38	£156.79	£176.31
Difference in repayments	+£5.15	+£7.90	-£7.00	+£6.83
Interest charged	£0.036	£0.036	£0.257	£0.257
Net present value in interest	£0.036	£0.036	£0.253	£0.253

Table 1: London Economics Impact Assessment of Breathing Space for details see Appendix 1

The model is based on data from StepChange Debt Charity clients advised in the year 2014 and extrapolated to include all people in severe problem debt in the UK. It shows that there would be short term costs due to interest charges as a result of delayed payment in the first few years. However, the borrowing costs of reduced payments in the breathing space period would be low, following debt advice. These would be compensated over time by the increase in debt repayments which are positive after five years.

Even if the Breathing Space was extended to 52 weeks the government would still see a cost benefit after ten years due to reduced drop out and increased repayments (Table 1). In fact this model overestimates the impact of allowing a Breathing Space of up to 52 weeks, as only a proportion of individuals would need this length of breathing space to stabilise their finances before starting a statutory repayment plan.

6. Consultation questions

We have provided brief answers to the more specific consultation questions in the call for evidence document, with reference to evidence in the section 1, below.

Question 1: In your opinion, how should the government decide who is eligible for a breathing space?

StepChange Debt Charity has worked with other debt advice sector charities to develop a set of eligibility criteria for such a breathing space scheme. These are:

- A person would not be able to apply to enter the scheme unless they have obtained advice from a debt adviser regulated by the FCA (or who satisfies the conditions for exemption).
- A debt adviser must assess that the person is unable to pay one or more of their debts. Ability to pay would be determined using an agreed budget standard (such as the Standard Financial Statement)
- The debt advice would need to show that the scheme was in the person's best interests and appropriate for their circumstances. The new scheme would work within the debt advice provider's best advice model.
- The person must make what debt repayments (if any) that the debt advice process shows to be affordable as a condition of protection under the scheme.
- The person must co-operate and keep in active contact with the regulated debt adviser as a condition of protection under the scheme.
- The scheme is open to both home owners and those who rent their homes.
- There is no upper limit or lower limit on the amount of debt or number of debts that the applicant must have to qualify (subject to best advice).
- The scheme should allow joint applications so that indebted couples can submit a single application and a single financial statement where this is suitable.
- The scheme should be capable of including debts from sole traders or microbusinesses, but with the necessary safeguards.

In legislative terms the DAS (Scotland) Regulations 2004 define those eligible for the Scheme simply as those who have two or more debts (with some exceptions) or those who are subject to enforcement action by a creditor.[37]

In particular:

- **How should the government define serious problem debt in the context of a breathing space?**

As a breathing space scheme should support as many of those in financial difficulty who would positively benefit as possible, the definition of problem debt should be inclusive. A too rigid definition would exclude those who could benefit from seeking debt advice at the earliest opportunity.

The breathing space consultation document defines problem debt as “where debt and arrears absorb an excessive proportion of income”. The Consumer Protection Partnership definition focuses on detriment to the individual: debt "that impacts on the consumer adversely, either because they are unable or struggling to repay the debt itself and/or because it has or potentially will have adverse consequences for them".[38] We would suggest that an approach that assesses whether a person is unable to keep up with repayments without hardship would be a good starting point, as this is broadly in line with current debt advice practice. Building on this a suitable definition of serious problem debt is that the individual is unable to pay their debts as they fall due, without suffering hardship.

In legislative terms the DAS (Scotland) Regulations 2004 define debt as: “including any sum due by a debtor
(i) constituted by–

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[37] (1) Subject to paragraph (2), a debtor may apply for approval of a debt payment programme where the programme provides for the payment of two or more debts.
(2) An application for approval may not be made where–
(a)subject to paragraph (3), payment of a debt of a debtor is being made under a conjoined arrestment order;
(b)a debtor is a party to a trust deed;
(c)a debtor’s estate has been sequestrated, and the debtor has not been discharged under sections 54 (automatic discharge after 3 years) or 75 (amendments, repeals and transitional provisions) of the 1985 Act;
(d)a debtor is a bankrupt, who has not been discharged under sections 279 (duration) or 280 (discharge by order of the court) of the 1986 Act; or
(e)a debtor is subject to a bankruptcy restrictions order (including an interim order) or bound by a bankruptcy restrictions undertaking, under Schedule 4A (bankruptcy restrictions order and undertaking) of the 1986 Act(1).
(3) An application may be made where a creditor, including a creditor of a debt being paid under a conjoined arrestment order in respect of another debt not so paid, has attempted to enforce a debt due by the debtor by any lawful means.

[38] Competition & Markets Authority (2014) Problem Debt: a report commissioned by the Consumer Protection Partnership

(a) decree or document of debt;
(b) judicial or contractual interest;
(c) charges or penalties due under a contract on any default in respect, or breach of, that contract;
(d) lease or tenancy agreement;
(e) enactment;
(ii) secured by a standard security, to the extent that the sum is arrears of a periodic payment due to be paid under a loan agreement so secured;
(iii) recoverable from the debtor as enforcement expenses; and
excludes any sum due by a debtor–
(I)to the extent it is secured by a standard security, other than where that sum is included under paragraph (a)(ii);
(ii) as a liability for the purpose of section 17(2B) of the Legal Aid (Scotland) Act 1986(1)."

- **Should eligibility be determined by a set of defined characteristics, or should there be some discretion to determine eligibility?**

Eligibility should not be determined by a set of defined characteristics as this would limit the benefits of the scheme in reducing problem debt which can affect anyone in society. The debt adviser should be given discretion to determine eligibility based on need, subject to the legally defined eligibility criteria for the scheme, following assessment of income and expenditure and an individual's circumstances.

With the rising number of self-employed workers in Britain, it is particularly important that the scheme does not arbitrarily exclude the business debt of sole traders and microbusinesses, unlike previous unacted legislation for Debt Management Schemes in the Tribunals, Courts and Enforcement Act 2007.

- **If there is some discretion, who should be tasked with exercising it – a regulated debt adviser, or some other person?**

A regulated debt adviser should determine who is eligible for a breathing space.

According to CONC 8.3.7 regulated debt advisers must "provide the customer with a source of impartial information on the range of debt solutions available to the customer in the relevant country of the UK".

Debt advice is now controlled by FCA regulation and the Financial Guidance & Claims Bill additionally proposes standard setting powers for the proposed Single Financial Guidance Body. This should provide sufficient confidence that debt advisers can exercise discretion in a consistent way and in compliance with relevant legislation, rules and standards. This ensures that people in debt receive unbiased financial advice and debt counselling that is specific to their circumstances, and that they understand the commitment they are taking on. There also needs to be more consistency in affordability assessments, for example through the Standard Financial Statement, and the debt solutions recommended to ensure creditor confidence in the scheme.

- **Are there any other entry criteria and / or exemptions the government should consider?**

It might be appropriate to exclude debts owed to individuals where there is likelihood that inclusion in the scheme would cause undue personal hardship to that individual. Sole trader debts owed to another sole trader might be another example.

- **Who should be responsible for regulating and enforcing access to a breathing space and how can disputes be resolved?**

A regulated debt adviser is central for ensuring only those eligible can access a breathing space. There are three reasons for this:

- A detailed debt advice assessment is needed to ensure that the breathing space scheme is the best available solution for a person's needs and circumstances. Without such as assessment, extended breathing space could actually be detrimental compared to other options.
- Extended breathing space without a debt advice assessment may create a moral hazard. It should only apply to people who are independently assessed as being in financial difficulty, and where there is a framework for review to assess the long-term options
- A debt advice assessment will be needed to work out the debt repayments a person is able to affordably sustain during a period of extended breathing space.

An adviser under the scheme should assess whether breathing space is appropriate for a client who is otherwise eligible under the terms of the scheme. This assessment should incorporate a full budgeting process including an assessment of all income and expenditure to complete a Standard Financial Statement.

The adviser would assess eligibility for all debt options as part of a regulated robust and holistic advice process. Where a suitable debt option is identified, the adviser would provide advice on how to access the debt option using the "best advice" model, currently applied by free debt advice agencies in England and Wales. If the applicant was unable to access a debt option identified as suitable (for instance because they have to save up for an application fee for bankruptcy or a DRO, or apply for a grant to cover these fees), the adviser could use discretion to treat this lack of access as a form of temporary financial difficulty for a limited period, as long as they provided a clear and time-bound plan to resolve the access issue.

If a client agrees to the debt adviser's recommendation they should be entered into the scheme. All creditors should then offer the initial breathing space period – indeed this is what currently happens on a voluntary basis for many of our clients. Once the client has a StepChange Debt Charity identification number, many creditors automatically offer breathing space. Regulation of financial service companies by the FCA currently means that they should offer 30 days, or 60 days if necessary, breathing space to those clients receiving debt advice.[39]

Establishing an independent body to deal with disputes about entry into breathing space, could increase the cost of the scheme. If this cost was passed onto people in debt as an application fee, it would introduce an additional barrier to use of the scheme. Currently dispute handling in the financial services industry is handled by the Financial Ombudsman Service, which could provide a funding model.

Alternatively, we have previously suggested that debt advice charities participating in the scheme could establish a governance board to monitor operation of the scheme and deal with complaints. This board could have an independent chair, representatives from the participating debt advice agencies and representatives from other stakeholders such as creditors, regulators, other charities and independent experts. Such a board could provide a mechanism for handling disputes, while also providing a monitoring and scrutiny function for the scheme.

Question 2: What should be the trigger point for a breathing space?

The time when an individual seeks debt advice is probably the best trigger for entering a breathing space scheme. It is possible to set up a mechanism for people to apply before they seek debt advice, perhaps through an online portal, as was the case with the six week moratorium period in Scotland. However, creating such a portal would only add to costs. There would also need to be a mechanism to inform creditors and to ensure that people did follow up an application by seeking debt advice. We question whether this would be more effective than the simpler option of using debt advice as the access point.

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[39] CONC 7.3.11 A firm must suspend the active pursuit of recovery of a debt from a customer for a reasonable period where the customer informs the firm that a debt counsellor or another person acting on the customer's behalf or the customer is developing a repayment plan.
CONC 7.3.12 A "reasonable period" in CONC 7.3.11 R should generally be for thirty days where there is evidence of a genuine intention to develop a plan and the firm should consider extending the period for a further thirty days where there is reasonable evidence demonstrating progress to agreeing a plan.

In particular:

- **Should a breathing space only be available for a person who seeks regulated debt advice?**

Yes. Firstly, we believe that the need for breathing space is only likely to become properly apparent during the debt advice process. If a suitable long term debt remedy is identified and readily accessible that, rather than breathing space, should be the recommended solution. Likewise, around 8% of people advised are able to meet their credit commitments after simple budgeting advice, so breathing space would not be appropriate for them. The need for breathing space can only be properly gauged in the context of full debt advice.

Advising a client on breathing space seems to be covered by the FCA definition of the regulated activity of debt counselling. This is defined as 'Giving advice to a borrower about the liquidation of a debt due under a credit agreement' (Article 39E (1) Regulated Activities Order). Liquidation of a debt is further defined to include agreeing a rescheduling or temporary halt to payments or agreeing reduced payments (PERG 17.3). This would seem to include advice on a breathing space scheme where the debts include regulated credit agreements. If so, the FCA rules on debt counselling require advisers to carry out a reasonable assessment of the customer's financial position, personal circumstances and other relevant factors before giving any advice or any recommendation on a particular course of action in relation to the customer's debts (CONC 8.3.7R). So splitting advice about breathing space from the wider debt advice process may not be compliant with FCA rules.

- **Should individuals have demonstrated they have already taken steps to try to manage their debt?**

No, the aim of the scheme is to incentivise earlier use of debt advice. StepChange Debt Charity research shows that where people do try to manage their debts on their own, they often end up taking out more credit, not paying all their bills or borrowing from friends or family.[40]

- **If so, at what point should the six weeks start – for instance: once a breathing space has been requested, when the first advice session has occurred, or once adviser has confirmed a breathing space would be appropriate?**

Forbearance should start when the client receives their identification or client number from their debt advice provider.

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[40] StepChange Debt Charity (2015) Safe Harbours

Question 3: Should all debts be eligible for a breathing space?

Yes. Our starting point is that a person entering the scheme would be required to list all of their qualifying debts for inclusion in the scheme. This would include 'priority debts' like council tax arrears, fuel debts, mortgage arrears and rent arrears outstanding at the date the scheme commences. Arrears of certain 'continuing liabilities' that accrue after the date that a person enters the scheme would not be included in the scheme; nor would the 'main' outstanding obligations – such as the non-arrears balance of a mortgage, as currently happens with DPPs in Scotland. Regular payments towards continuing obligations, like contractual mortgage payments, would be included in applicants' budgets, as is the case with debt advice now.

- **How should multiple debts be treated; is there a priority order of debts?**

There should not be a priority order of debts for entry into the breathing space scheme. All debts should be included in the breathing space. Prioritisation of debts is only relevant when discussing the level and timing of debt repayments.

- **Should some types of debt be exempt? In particular, where the debt is the late payment of a fine or penalty?**

We previously mentioned that it might be appropriate to exclude debts owed to individuals where there is likelihood that inclusion in the scheme would cause undue personal hardship to that individual. Sole trader debts owed to another sole trader might be another example.

However, the exclusion of one debt from the breathing space would undermine any of the protections from interest, charges and enforcement action placed on other debts and reduces the chances of people with an excluded debt type accessing the scheme.

Even if the debt is the late payment of a fine or penalty, StepChange Debt Charity research suggests that if the level of repayment causes financial hardship it will escalate the debt problem. If the breathing space is sufficient to allow finances to stabilise such that the individual can enter a debt repayment plan, this protection should continue and the fine or penalty can be paid off at an affordable rate. Magistrate's court fines are one of the debts that is currently categorised as a "priority" in best practice debt advice, so is paid off more quickly than non-prioritised debts.[41] Current debt advice includes advice on applying to the court to reduce unaffordable criminal fine payments, where necessary.

[41] http://www.moneyadvicetrust.org/SiteCollectionDocuments/Agency%20resources/Priority%20debt%20strategy%20chart.pdf

- **In particular, should debt owed by self-employed / microbusinesses be included?**

Yes. The Scheme should be able to include the business debt of sole traders and microbusinesses.

Question 4: Should all interest, fees and charges be frozen throughout the breathing space period?

Yes. With no relief from interest, charges and debt enforcement and collection fees, debts can spiral out of control and many clients use more credit to cope – 61% of our clients who were not offered protection from all interest, fees and charges went on to take out further credit to keep up with the extra costs added to their debts and 29% said that a creditor's actions prompted them to pay that bill but fall behind on other bills, so escalating their debt problems.[42] Freezing all interest, fees and charges would also encourage people to seek debt advice at an earlier point, a stated aim of the scheme. 76% of our clients said they would have sought debt advice earlier if they knew it would result in creditors stopping interest, charges and other debt collection and enforcement costs.[43]

Working with other debt advice providers we have developed recommendations, based on our own evidence and experience that for the scheme to effectively achieve its aims of supporting people in problem debt to stabilise their finances and incentivise them to seek debt advice earlier during the period of protection, debt collection action and enforcement action to recover debts cannot be taken. We recommend this includes the following protections:

- Creditors cannot present a bankruptcy petition in respect of a debt in the scheme
- Creditors cannot pursue any remedy for the recovery of a qualifying debt.
- Any existing court proceedings in respect of a debt will be stayed
- Providers of gas and electricity are prevented from disconnecting gas or electricity supply or forcibly fitting a pre-payment meter in respect of a debt included in the scheme. This protection does not extend to any utility debts accrued at a later date as these would be continuing liabilities (see below).
- A creditor may not make a demand for payment in respect of a debt covered by the scheme.

[42] StepChange Debt Charity (2015) Safe Harbours
[43] *ibid*

- A creditor may not reduce or make an application to reduce the amount of a statutory entitlement or payment solely for the purpose of recovering a relevant debt. Once someone has entered the scheme these cannot subsequently be backdated when they leave the scheme.
- A creditor may not charge a person additional interest, fees or other charges in respect of a debt (this would only apply to arrears on 'continuing liabilities')

Question 5: What activities must the breathing space participant continue with to remain eligible? For instance:

- **Should they be required to attend advice sessions?**

Yes, subject to free debt advice provision being sufficient to allow a debt advice session to be accessible to and appropriate for them within the six week period. In current debt advice practice, if a StepChange debt Charity client is well-organised and has all their information together, then six weeks is sufficient to have an advice session, set up a repayment plan and contact creditors. However, the majority of StepChange Debt Charity clients are not in this position, so it can take a lot longer. This demonstrates that six weeks may not be sufficient time to attend more than one advice session and this will be even more unlikely if the client needs to attend face-to-face debt advice sessions. There therefore needs to be an option to extend the breathing space period beyond six weeks, especially since current FCA regulation effectively gives clients 60 days breathing space.

- **Should they be required to make any repayments during a six-week breathing space, if their financial situation allows it?**

Yes. It should not be the intention of the scheme to stop repayments within the six week breathing space if the debt adviser recommends that these are affordable, or recommends a token payment. However, it is unlikely that the six week period will be sufficient time to make such recommendations for the majority of StepChange Debt Charity clients (who have on average 5-6 different debts), because of the time taken to gather and assess information on debts. The average time from the first advice session to activation of a Debt Management Plan at StepChange Debt Charity between January and June 2017 was 10 weeks.[44]

[44] StepChange Debt Charity data January – June 2017

Question 6: Are there circumstances in which a breathing space period could end before six weeks, such as if an appropriate solution is found? Who could be responsible for enforcing this?

Yes. There needs to be a period of continuous protection from entering the breathing space to entry into the appropriate debt solution, or to a stage where the client no longer needs the protection because their finances have improved. If the solution is a DRO, IVA or bankruptcy solution, the breathing space protections already remain in place. If it is a statutory debt management plan the freeze on interest, charges and enforcement should remain in place from entry into breathing space and throughout the duration of the plan.

The regulated debt adviser would recommend the appropriate solution as soon as an individual had completed their assessment as part of the debt advice process.

Question 7: Should breathing space protections only cover debts existing at the outset, or also include new debts arising during the six-week period?

The client should not be able to take out more credit during the breathing space period, with possible exemptions as outlined in current DAS legislation. Under DAS any credit allowed is far less than usual, limited to certain eligibility criteria and capped. However, StepChange Debt Charity clients often do not know the extent of all their debts or their exact amounts at the initial advice session. Therefore, the debts included in the debt advice assessment may often need to be revised during the breathing space period. In addition some debts may fall due during the six week period and these should also be included in the plan.

Question 8: Should a breathing space be noted on a person's credit file?

Creditors make these decisions currently. As the person in debt breaches the terms of their original contract with their creditors, creditors will report missed payments or report the agreement as in default. Creditors should also report payment arrangements in place and this can be 'flagged' on a person's credit file. It could be possible to introduce a breathing space and statutory debt management plan flag.

Although the priority for this consultation is the introduction of a scheme to help people gain control over their financial situation, it may be useful to think in the future about how creditors might report breathing space and people repaying debts through a statutory debt management plan to Credit Ratings Agencies (CRAs). Evidence from our clients suggests that worries about damaging their credit records are a key reason why people do not seek debt advice earlier.[45] Going forward, reducing worries about the possible negative consequences of getting debt advice (which may mean rescheduling payments in a way that is 'reportable' to CRAs) would encourage people to seek help earlier before their debt problems became more difficult to address. It could also provide some form of reward in a more positive credit rating for the repayment of debts.

Question 9: How frequently should a debtor be able to access a breathing space, and what criteria should control the frequency of access?

Under DAS the frequency of access to the moratorium is once per year. The frequency of access to a breathing space should be on the recommendation of a regulated debt adviser. The debt adviser should also be able to recommend a rollover or extension of the breathing space, where to do so would increase the probability that the individual could be entered into a debt repayment plan within a 12 month period.

Question 11: Who would be responsible for notifying creditors that a customer has entered a breathing space? What updates are required during the breathing space period?

We anticipate the need for creditors to know people who are under the protection of the scheme. Debt advice providers will notify creditors identified in the application, but there may be an on-going need for creditors to be able to see 'at a glance' whether someone remains on the scheme.

This might suggest the need for a 'register' or flag of credit data identifying people under the protection of the scheme. However we have serious reservations over setting up an open access public register. Firstly, the register would need to be managed and updated and it is not clear that a public body in England and Wales would take on this task. Secondly we believe that a public register is likely to deter people from seeking the protection of the scheme. Indeed we believe that the more the scheme looks like an insolvency scheme, the less people in temporary financial difficulties may be likely to apply, because they may mistakenly fear loss of their home or sanctions by their employers.[46] Thirdly, public registers (like the DAS register) have the potential to be used as marketing lists targeting financially vulnerable households.[47]

We therefore suggest that a regulated debt adviser should be responsible for notifying creditors that a customer has entered breathing space. Currently StepChange Debt Charity can notify creditors that refer clients to us of the debt advice appointment and whether

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[45] StepChange Debt Charity (2015) Safe Harbours
[46] StepChange Debt Charity (2015) Safe Harbours
[47] As reported by StepChange Debt Charity Scotland

clients go on to follow the debt advice, so there is already a system in place for a debt advice-creditor interface.[48]

Current practice at StepChange Debt Charity involves most major creditors using a secure online portal which gives them bulk data on an individual's debts and arrears. Smaller creditors get individual proposals sent electronically or by post.

Question 12: Would a breathing space scheme impact on business revenue or have any other significant detriment?

Question 14: What benefits could creditors see as a result of a statutory breathing space scheme?

Cash flow difficulties would be balanced out by benefits to creditors in improved debt collection rates over time. We have provided evidence that in the long-term creditors can see higher returns through debt repayments and reduced costs following debt advice (section 1).

The scheme should also encourage better communication and understanding between debt advice agencies and creditors, as is seen in best practice examples involving the regulated financial services market currently. For example, Computershare Loan Services uses a multi-channel to signpost customers in financial difficulty to debt advice on behalf of their creditor clients and shares the same affordability assessment process as the debt advice providers. They have found that investing additional time in a shared customer affordability assessment has led to more sustainable payment arrangements and reduced repeat calls. One of their clients UKAR (the holding company for NRAM, Bradford & Bingley and Mortgage Express) has found the following benefits:

- an 86% reduction in the number of customers three or more months in arrears;
- 48,000 successful repayment arrangements have been made under this new process
- a rise in maintained repayment arrangements from 50% to 80%.[49]

The statutory nature of scheme would also stop one creditor undermining the good practice of others that offer forbearance to those in financial difficulty. This would be a positive benefit for creditors whom already follow best practice debt collection procedures.

Question 13: Should any creditor be exempt due to the size of their business?

Our starting position is that all debts should be qualifying debts under the scheme. However, we believe legislation implementing the scheme should include a rule making power that

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[48] Money Advice Service (2017) Working collaboratively with debt advice agencies page 20
[49] *ibid*

would allow certain debts, or debts accrued in certain circumstances to be excluded. For instance, it might be appropriate to exclude debts owed to individuals where there is likelihood that inclusion in the scheme would cause undue personal hardship to that individual. Sole trader debts owed to another sole trader might be another example.

Question 15: How could the government ensure that a breathing space works with and adds value to existing support structures?

Question 18: How could a statutory debt repayment plan be administered?

Rather than setting up a whole new body to administer a breathing space scheme, it would be more cost-effective to build on the current best practice debt advice models in England. As stated before, we recommend putting a "statutory wrap" around best practice in debt advice and debt management. StepChange Debt charity and other debt advice providers have built up experience over many years, including experience of advising on DAS and administering DPPs in Scotland. FCA regulation of debt advice should provide scrutiny and accountability, while creditor-debt advice interfaces can be built using existing well-established portals. Building on existing debt advice support structures would also ensure the scheme is clearly distinguished from insolvency debt solutions, is understood to be about supporting people to repay their debts in an affordable way, where possible, and so would encourage earlier uptake of debt advice.

The Wyman Review[50] will shortly make recommendations on future funding of the debt advice sector. Following this review there will be an opportunity to consider how the introduction of a breathing space and statutory debt repayment plan could impact on free debt advice provision.

Question 16: What safeguards are needed to prevent the scheme being abused?

Working with other debt charities we have developed a set of further duties on applicants entering the scheme that should provide useful safeguards for the scheme:

- Continued engagement is a condition of on-going protection under the scheme.
- Applicants will only enjoy the protection of the scheme if they remain engaged and maintain payments that have been assessed as part of the advice process as affordable and sustainable.
- Applicants must co-operate with scheme providers and respond to communications.

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[50] https://www.moneyadviceservice.org.uk/en/corporate/independent-review-of-the-funding-of-debt-advice/preview

- Applicants will need to provide proof of debt and any proof of income and outgoings required by the scheme provider.
- Applicants in the scheme have a duty to report any change of circumstances to the scheme provider.
- Applicants must take part in any scheduled reviews or reasonable requests for review. People will be expected to be proactive in contacting the advice provider at the agreed time for review.
- If an applicant does not make contact at agreed times, does not respond to requests for contact, or fails to co-operate with the advice provider, they will be given notice to comply within one month.
- If the applicant still does not respond to the notice in that time period they will be given a final notice of a specified period.
- After this notice expires the applicant will be removed from the protection of the scheme.
- The applicant can be readmitted to the scheme only at the scheme provider's discretion where there is good reason for previous non- engagement.

The use of a regulated debt adviser as an entry point and the acceptance of a single affordability assessment, such as the Standard Financial Statement, should ensure the scheme is not abused.

Question 17: Should a breathing space be extended to Wales and Northern Ireland as well as England?

Yes. This would make the scheme easier to administer and reduce the need for creditors who work across the United Kingdom to have in place different systems for dealing with their clients in financial difficulty. There is also a clear need for such a scheme in Northern Ireland and Wales. In relative terms, from January to June 2017 StepChange Debt Charity advised 27 out of 10,000 people in Northern Ireland and 66 out of 10,000 people in Wales. This compares with a figure of 66 out of 10,000 people in England.[51]

Question 19: What challenges would be faced in administering a statutory repayment plan?

StepChange Debt Charity has considerable experience of administering voluntary debt management plans (DMP) in the United Kingdom and DPPs in Scotland. So we are fully aware of the challenge involved in supporting a large number of individuals to enter into

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[51] StepChange Debt Charity (2017) Statistics Mid-Year Book

DMPs and reviewing and maintaining these over time. We have an administrative structure in place, which already includes creditor oversight and audit. This could provide a strong foundation on which to build the administration of a statutory repayment plan.

Our experience of administering both DMPs and DPPs allows us to make some comparisons. A DPP is more expensive to administer than a DMP because of the administrative requirements in Scotland. These include a separate portal which requires double data entry and verification. The experience of administering the DAS in Scotland provides learning for the introduction of a breathing space scheme and statutory debt management plan in England:

- The administration of DAS is very time consuming and therefore much costlier than it needs to be.
- In 2015, the moratorium was extended in Scotland to include any clients seeking debt relief through bankruptcy or trust deeds. As a result all moratorium notices are now recorded in another free public register, the Register of Insolvencies. This is maintained by the AiB.
    - Our advisors report that the fact that people have to have their names on a public register is a major disincentive to accessing debt advice – people worry about the consequences for their job prospects of being on the register, and it could potentially act as a free marketing database for high cost credit and paid-for debt management firms.
- Legislation commenced in Scotland from April 2015 has introduced greater requirements on clients to provide their approved money advisers with evidence of their income and expenditure. This has created uncertainty for money advisers and undermined their confidence in processing DAS applications. As a result we saw a marked reduction in the number of DPPs approved from Quarter 1 of 2015-16.

A key challenge for administering a statutory repayment plan will be in ensuring the administrative requirements allow efficient provision and do not add unnecessary or avoidable costs.

Question 20: What protections should apply during the statutory repayment plan?

- **For instance, should it protect debtors from interest and fees and charges or just a selection of the three? If a selection, which of these three should be prioritised?**

The experience of StepChange Debt Charity clients and creditors set out in this report shows how the success of a statutory repayment plan will depend on getting effective protection from three key drivers of worsening debt problems:

- Further default interest and charges inflating debts

- Pressure to meet unaffordable repayments
- Collection and enforcement action by creditors

Removing any one of these protections would jeopardise the affordability of the plan, and increase the probability that repayment agreements would be broken. As with the breathing space we recommend the protections include:

- Creditors cannot present a bankruptcy petition in respect of a debt in the scheme
- Creditors cannot pursue any remedy for the recovery of a qualifying debt.
- Any existing County Court proceedings will be stayed
- Providers of gas and electricity are prevented from disconnecting gas or electricity supply or forcibly fitting a pre-payment meter in respect of a debt included in the scheme. This protection does not extend to any utility debts accrued at a later date as these would be continuing liabilities (see below).
- A creditor may not make a demand for payment in respect of a debt covered by the scheme.
- A creditor may not reduce or make an application to reduce the amount of a statutory entitlement or payment solely for the purpose of recovering a relevant debt. Once someone has entered the scheme these cannot subsequently be backdated when they leave the scheme.
- A creditor may not charge a person additional interest, fees or other charges in respect of a debt (this would only apply to arrears on 'continuing liabilities').

Question 21: For whom and for what debt solutions will a statutory repayment plan be most appropriate?

Those who a regulated debt adviser assesses are in a position to begin repaying their debts within 12 months will be the most appropriate for a statutory repayment plan. StepChange Debt Charity currently uses the criteria that full repayment of debts through the debt repayment plan should not exceed ten years, although we recommend that there should be some flexibility around this, for debt advisers to recommend extensions, depending upon individual circumstances. This would cover those of our clients who are currently recommended a voluntary DMP and those who are put on manged TPPs for one year (see diagram 1).

Question 22: How will a debt adviser determine if a statutory repayment plan is appropriate?

Question 23: If a statutory debt repayment plan cannot be agreed, how could the behaviour of creditors be managed immediately after the Breathing Space?

- **How should multiple debts be treated; is there a priority order of debts which should be included as part of a breathing space arrangement?**

Question 24: Should the repayment plan apply to all debt?

Question 25: For the included debts, should some debts be prioritised for repayment?

Question 28: How should changes in income be dealt with? Should it be possible to suspend a plan, or have reduced payments for a period of time?

In answering these questions together we outline how we see a plan working in practice. The scheme should follow the existing and well established principles used by debt advice charities to establish affordable sustainable repayments. This is what we mean by placing a "statutory wrap" around current best practice in debt advice. The scheme should provide support to as many people as possible who are in temporary financial difficulty but are likely to be able to repay their debts in the future. It is therefore an important principle that individuals have a continuous period of breathing space protection from first accessing debt advice, throughout plan activation and throughout the time they are a member of the statutory debt management plan.

As the scheme is designed to assist those in temporary financial difficulties, it is accepted that many applicants will have little or no available money for debt repayment when they apply. In these circumstances a token payment at intervals assessed by the debt adviser is required.

Where the Standard Financial Statement preparation identifies an available income after essential bills and outgoings are covered then the applicant will be required to make monthly payments under the scheme. On-going liabilities, such as rent or mortgage payments and energy costs, should be included in the expenditure budget so a true assessment of affordability can be assessed.

We propose that the scheme should broadly follow the DAS definition of continuing liabilities. These are as follows:

- A mortgage or secured loan
- Rent
- An insurance premium
- A duty, local or general tax or rate
- A domestic water or sewerage charge

- A periodic allowance, child maintenance or child support
- The supply of electricity, gas, broadband, or fixed telephone line services
- Heating oil or fuel oil
- A hire purchase or conditional sale agreement
- A court fine
- Other items prescribed in regulations.

We would suggest that a hire purchase or conditional sale agreement should be treated as a continuing liability where the goods in question are deemed to be essential for the applicant. This follows existing debt advice practice where hire purchase agreements are conditionally priority debts. Agreements secured by a bill of sale might also be classed as conditionally continuing liabilities

Any other debts that were omitted from the application but which existed at the date the scheme commenced can be added into the plan at a later date.

Provision would also need to be made to make on-going payments to excluded debts (as defined as causing significant hardship to individuals) using available income to clear arrears.

The scheme could follow the existing general debt advice principles on allocating repayments to priority and non-priority debts that are eligible under the scheme. Priority debts get the first call of any budget surplus for debt repayment. Payment amounts may be individually negotiated with creditors and may vary between priority creditors depending on the legal framework for enforcement of each priority debt. So, for instance, mortgage arrears payments will tend to be higher than fuel arrears payments. For non-priority debts a *pro rata* distribution of available income will be expected to be made.

At the moment debts are prioritised on the basis of the sanctions available to creditors - how bad the consequences of not paying that bill would be. So debts are likely to be treated as priority debts where non-payment could result in losing your home or going to prison, or losing essential goods (such as a car needed for work)

However, as a purpose of the scheme is to prevent enforcement against debts where the person is making reasonable repayments, the question arises as to the basis on which a debt in the scheme might be described as a ‘priority’. The current definition based on the sanction available to creditors would no longer apply.

The DAS scheme in Scotland treats all debts equally and splits payments on a pro-rata basis. However some debt advice charities have highlighted how this can leave private tenants exposed to eviction; as a private landlord may refuse to renew a tenancy where they feel rent arrears payments are too low.[52]

As a result the debt advice charities generally agreed that the scheme should treat arrears in respect of the main home (e.g. mortgage or rent) as “priority debts”.

All debts should be included. Exempting public sector debt would significantly undermine the value of the scheme. Indeed our clients are more likely to say public sector creditors (and bailiffs collecting public sector debt) treated them unfairly.[53] Public sector creditors currently have powers to recover debt (for example, through deductions from benefits, wages and bailiff action) that can and do create hardship and make debt problems worse, particularly if more than one debt is being collected through these powers. Our research shows that just over a quarter of our clients report they’ve had money deducted from benefits to go towards arrears. Over a quarter of those currently having money deducted have two deductions in place and almost one in ten have three simultaneous deductions in place, which leaves them in significant hardship. It is clients in a vulnerable position who are more likely to report they've had money deducted from their benefits.[54]

This demonstrates that public sector creditors have not fully accepted the idea of affordable and sustainable debt payments. But given estimated the social costs of problem debt, the Government should adopt these ideas through the breathing space / statutory debt management plan scheme.

There is also an argument that certain government debts, such as tax arrears, should be treated as priority debts, given the wider public benefit. The scheme could allow for certain government debts to have some priority in payment, but government creditors would still be bound by the protections of the scheme.

If the scheme allowed for some debts to be prioritised for payment, a system of defining the amount of such payments would need to be developed. This should build upon current best practice in debt advice in England & Wales.

Debt repayments are subject to change during the life of the scheme in accordance with changes in applicant circumstances and at review.

Any change in circumstances that results in an increase or decrease in income or outgoings should be assessed using the Standard Financial Statement principles. This means payments may increase or decrease over the life of the scheme. Currently there are around 500 DPPs approved each quarter in Scotland. On average they repayment term is just

[52] Christians Against Poverty (2017) Increasing flexibility in the Scottish Debt Arrangement Scheme
[53] StepChange Debt Charity (2016) Creditor Conduct
[54] StepChange Debt Charity (2017) Third party deductions

under seven years. Of the total live cases, around 4.5% (around 600) will be varied each month due to client changes in circumstances.[55]

Any debts that were omitted from the scheme that existed at the date the scheme commenced could be added into the scheme at a later date. This may result in the need for a revised distribution of available income.

Payment holidays should be at the discretion of the scheme provider where an unexpected short term cash flow issue, such as an item of expenditure or reduction in work hours, has occurred for the applicant. The reasons should be recorded.

The scheme would also need to consider how 'informal' debts, such as debts owed to family and friends would be treated.

Question 26: What should happen if one or more creditors disagree with the plan?

A clear scheme design should minimise creditor disagreements. Creditors should only be able to disagree on certain grounds and these should be few in number and tightly defined.

Acceptance of the Standard Financial Statement as a measure of affordability across all creditors, both government and private companies would also reduce the chances of creditors' disagreeing with the plan. Financial service providers, whose regulation by the FCA resulted in the introduction of breathing space and affordable repayment plans for customers in financial difficulty have provided evidence that such plans are less likely to be broken and that their debt collection rates rise.[56]

As such the regulated debt adviser recommendations of affordable payments, assessed using the Standard Financial Statement and agreed with the client, should be binding on creditors.

The scheme could also provide for creditors to object to inclusion in the scheme. We would welcome this as a necessary safeguard, but we believe that the grounds to object would need to be drawn carefully in the legislation. Care is also needed when thinking about the forum for such objections. For instance, legislation could provide for creditors to apply to the court; but this could be costly and unwieldy in practice. Creditors would also need a forum to raise other issues that might arise, such as a person's continued eligibility under the scheme or conduct by a scheme provider

We have previously suggested that debt advice charities participating in the scheme could establish a governance board to monitor operation of the scheme. This board could have an

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[55] StepChange Debt Charity (2017) Debt Arrangement Scheme survey 2017
[56] Money Advice Service (2017) Working collaboratively with debt advice agencies

independent chair, representatives from the participating debt advice agencies and representatives from other stakeholders such as creditors, regulators, other charities and independent experts and would have the powers to resolve disputes. Alternatively some form of alternative dispute resolution for the scheme could be established building on existing schemes such as that of the Financial Ombudsman Service.

Question 27: What activities must the statutory debt repayment plan participant continue with to remain eligible? Must they simply meet agreed repayments to remain eligible?

Working with other debt advice charities we have produced a suggested list of activities that a participant must continue with to remain eligible for the scheme's on-going protections. These are:

- Continued engagement
- Maintaining payments that have been assessed as part of the advice process as affordable and sustainable.
- Co-operation with scheme providers through responding to communications.
- Provision of proof of debt and any proof of income and outgoings required by the scheme provider.
- A duty to report any change of circumstances to the scheme provider.
- Participation in any scheduled reviews or reasonable requests for review. People would be expected to be proactive in contacting the advice provider at the agreed time for review.

If an applicant does not make contact at agreed times, does not respond to requests for contact, or fails to co-operate with the advice provider, they should be given notice to comply within one month. If the applicant still does not respond to the notice in that time period they should be given a final notice of a specified period. After this notice expires the applicant should be removed from the protections of the scheme.

The applicant should be readmitted to the scheme only at the scheme provider's discretion where there is good reason for previous non- engagement.

The scheme should also require plans to be reviewed at least annually by the scheme provider. A review could be scheduled at any suitable time and over a shorter period where the provider sees fit. Where applicants who enter the scheme highlight future points where they expect a change of circumstances, reviews should be scheduled for that time.

Where an applicant's financial position improves and they are able to make higher debt repayments the protection offered by the scheme should continue. In such cases the scheme protection should continue via a protected debt management plan under the scheme.

Question 29: What happens if a plan fails? Should creditors be able to apply any interest, fees or charges that they were prevented from charging during the plan?

No. If someone was assessed as eligible for the Scheme they would have been in severe financial difficulty. The sudden addition of all interest, fees or charges would only spiral them further into financial difficulty. Our client research suggests that they would simply borrow more or not pay other bills to try and cover the interest and charges added[57]. The fact that those who enter the scheme have made an effort to repay their debts should be acknowledged by creditors and, if possible, a new affordability assessment should be undertaken with revised repayments suggested.

The certainty and guarantee of protection provided under the scheme will be important to help people recover and in encouraging them to seek debt advice at an earlier time. The contingency that debts could suddenly spiral upwards due to unexpected changes in income would undermine both these benefits.

It should also be noted that a plan might also end early because the individual's income has recovered sufficiently to pay off their debts and they no longer need the protections of the scheme anymore. While it might be reasonable to start charging interest from a point of improvement, loading on back charges from the period of financial difficulty would act as a disincentive to increasing income or initiate a new round of increasing financial difficulty.

Question 30: Should there be a regime for sanctioning debtors where there is misconduct in relation to a breathing space or statutory debt repayment plan, as there is for bankruptcy and DROs?

Where there is proven misconduct in relation to the scheme the individual should have the scheme's protections removed and be subject to appropriate sanction.

[57] StepChange Debt Charity (2015) Safe Harbours

Question 31: Should a statutory debt management plan be extended to Wales and Northern Ireland as well as England?

Yes. Ideally there should be alignment between the systems in England, Wales, Scotland and Northern Ireland to reduce the bureaucratic burden for creditors, particularly those who work across the UK, debt advisers and people in debt. See also answer to question 17.

Question 32: For each of (1) a six-week breathing space, and (2) a statutory debt management plan, please describe in detail, and with supporting evidence, the positive impact expected through:

- **Improved access: How will it encourage more people to seek debt advice earlier?**

A survey of StepChange Debt Charity clients in 2012 found 50% of client had been worrying about their debts for over a year before seeking advice. Another 24% had waited over six months before seeking advice. This confirmed the findings of earlier surveys and two further client surveys in 2014 found similar results. This shows that around three-quarters of StepChange Debt Charity clients were worrying about their debts for six months or more before seeking advice.

Assuming that the holds true for all of the 1.5 million or so people who do seek debt advice, some 1,125,000 people who did seek debt advice might have benefited from seeking advice earlier.

So in total perhaps 2,125,000 people could benefit from incentives to seek debt advice earlier.

We also asked a sample of StepChange Debt Charity clients to tell us what would have encouraged them to seek debt advice earlier than they did.

- 65% said knowing that getting advice could stop interest, charges, and other collection action and help me make lower payments for a temporary period would have encouraged them to seek advice earlier.
- 50% chose “Knowing that I had a right to temporary help from my creditors if I asked”;
- Only 7% chose ‘I don’t think anything would have encouraged me to get help earlier’

This suggests that a better guarantee of help might be successful in encouraging people to seek advice earlier.

Other StepChange Debt charity research shows that a large number of people in financial difficulty did not seek debt advice earlier because they thought debt advice could only help with already unmanageable debt problems:

- 43% said “I wasn’t aware debt advice could offer help to people like me”

- 32% chose “I thought debt advice could only get more drastic solutions, like bankruptcy or insolvency”
- 24% said “I thought debt advice was only for more serious debt problems”

This suggests that there is a perception among people in financial difficulty linking debt advice and the solutions it offers to long-term debt relief remedies. So while there was strong support for a better offer of specific protections (freezing interest, charges and enforcement action), there seemed to be a perception that the remedies currently available were not well focused on helping people manage temporary financial difficulty that had not yet progressed to the need for more drastic solutions. Again this suggests that a well-publicised breathing space / statutory debt management plan scheme, that offers people in temporary financial difficulties more support and was clearly distinct from bankruptcy, DRO and IVA debt solutions, would encourage more people to seek debt advice earlier.

- **Better support: How will it improve outcomes for customers who are already in problem debt?**

We are able to gather some evidence of financial recovery outcomes by comparing the incomes of StepChange clients on managed payment solutions (debt management plans and token payment plans) at the time they sought advice and at review up to one year later.

Some key pointers from this data are:

- Average incomes for clients on DMPs and TPPs tended to increase in the period between seeking advice and review.
- For clients starting a TPP between Jan and June 2014, who only had benefit income at the time they initially sought advice, the average income uplift at review was £263.
- 43% of these had moved into paid employment
- 20% had moved to ‘employment income only’ with an uplift of £528 on average
- 23% had income from employment and benefits with an average uplift of £630

At review (between 6 months and one year after advice), at least a quarter of TPP clients had either completed the plan, settled their debt, were able to make payments to creditors directly or had been re-advised into another plan. For the other 75% we do not have such definite outcome data as these clients did not complete review. We can speculate that in some cases it will be because they no longer needed our help (a £600 monthly uplift in income may change debt advice need!), in other cases circumstances may not have changed and debt problems won’t have been resolved. Note also the evidence above on clients whose finances don’t stabilise when creditors do not show forbearance.

In Scotland we asked clients to reflect on the DAS process and consider how it had affected them:

- 72% said that their finances are now stabilised

- 81% said it was now easier to pay their debts
- 78% said that they were less stressed and could sleep
- Over 60% say that they were more confident and their creditors treated them better
- 60% no longer worried about essential bills and
- nearly 60% said their debt repayments were no longer causing them hardship

"Quite frankly The DAS and StepChange support transformed my life. My only regret is I did not go for this help a lot earlier on."

"Using DAS almost immediately took away the pressure and stress that the debt was causing. The advisors were excellent and immediately gave me the feeling that I was not alone in dealing with the debt. The only regret I have is that I did not contact them earlier as it would no doubt have saved me a lot of stress."

"It has helped so much. I know how much I have to pay each month and I don't dread the phone ringing now. Times are still hard but things are now manageable, whereas they were not before my DAS."

- **Increased repayments: How will it increase the amount of debt repaid to creditors?**

An important feature of DAS, and debt advice more generally, is how it helps people to repay debts and keep up to date with on-going liabilities. This has clear potential benefits to creditors along with the additional benefit of reduced collection costs for clients making affordable repayments. StepChange Debt Charity has some quantifiable evidence of this. A Social Return on Investment (SROI) study of StepChange Debt Charity's debt advice service by Baker Tilly included evidence provided by Arrow Global, a leading debt purchase firm. Arrow Global reported that their rate of recovery where people were advised by StepChange Debt Charity was 33%, compared to 23% otherwise - a gain of 10% in returns.

Generalising this across creditors and adding in the benefits of reduced collection costs, Baker Tilly estimated that debt advice from StepChange created gains for creditors of around £82 million in respect of 109,000 clients.

This complements other research showing how a "debt advice" approach to dealing with financial difficulties can benefit creditors as well as households. For instance, Wells *et al* found that debt advice might improve financial sector creditor recoveries by over £1billion.

We would also highlight how a "debt advice" approach focusing on affordable, sustainable repayments can also produce better results for local government creditors. In April 2015

Lambeth Council introduced a new policy for collecting council tax arrears from Council Tax Support claimants. Lambeth's use of bailiffs to collect council tax arrears from Council Tax Support claimants went from 3,244 cases in 2013–14 to zero in 2015-16. This was accompanied by a significant reduction in summonses from 8,933 in 2013-14 to 2,176 in 2015-16 and an increase in arrears collections rates for Council Tax Support claimants from around 80% in 2014-15 to 93% in 2015–16.

From the perspective of creditors, a successful breathing space / debt repayment plan scheme would:

- Builds a budget which caps the debt and ensures that on-going liabilities can be met on time out of income
- Organises debt repayments to ensure that arrears on priority items are settled more quickly than other debts.

The message from our DAS client survey and previous research is that these benefits can be maximised by encouraging people to seek advice more quickly and providing the conditions for people to make sustainable affordable repayments.

Question 33: Once implemented, how could the government determine whether the breathing space and statutory repayment plan have been successful? What metrics would be appropriate to use?

StepChange Debt Charity would be very happy to work with the Government to develop success metrics while the scheme is being designed and implemented. We are already developing a methodology to capture detailed debt advice outcomes for our clients over an extended period after seeking advice. We would be very happy to share our developing insight on this. This builds upon the client and business information that we currently capture. It should be possible to combine these approaches to develop robust and insightful metrics for both breathing space and statutory debt management plan outcomes.

Appendix 1: Details of London Economics impact assessment tool

Overview

The tool has been developed to estimate the direct cost and benefit to the government of a 'breathing space' scheme for individuals with debt problems with the flexibility for the user of the tool to assess the outcomes under different scenarios. The direct cost to the government of a 'breathing space' scheme will be the interest charged on the additional borrowing required to offset the loss of repayments during the 'breathing space' period. The direct benefit is measured by the ability of more individuals being able to make repayments and clear their debt balance after a 'breathing space' period.

The tool models three groups of government debt; namely:

- Debts owed to the Department for Work and Pensions (DWP);
- Debts owed to HM Revenue and Customs (HMRC); and,
- Council tax arrears.

For each type of government debt, two debt solution options are modelled:

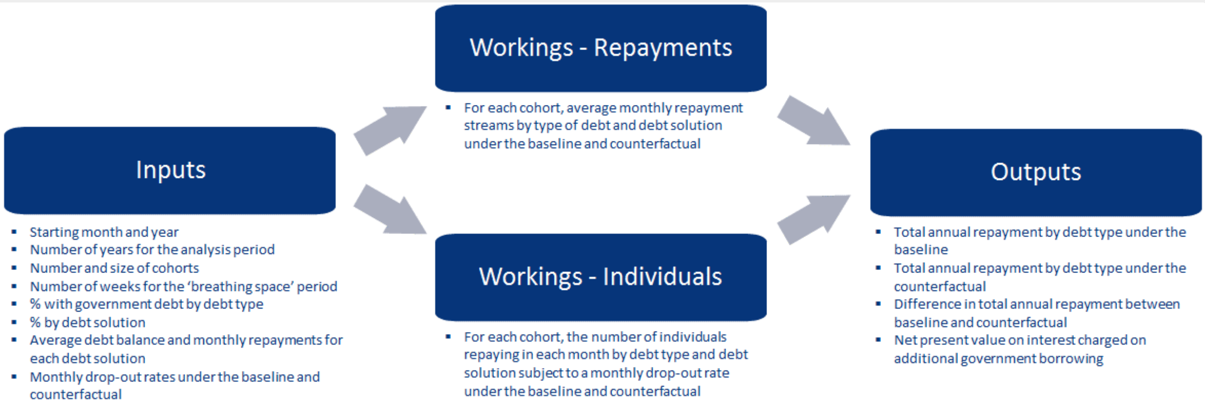
- Debt Management Plans (DMPs); and,
- Other – which includes all other debt solutions associated with repayments, i.e. excluding insolvencies.

The tool is based on the number of clients advised by StepChange Debt Charity from 2014 to mid-2017; however, a national assessment can also be explored. As a simple estimate, the national assessment multiplies the number of clients advised by StepChange Debt Charity by a factor of 10, which is based on intelligence from the YouGov Debt Tracker dataset.

Structure

The tool models up to 60 cohorts for each debt solution and group of government debt, beginning in any month from 2014 to 2018 for up to a maximum of 15 years. As shown in Figure 1, the user is able to select and modify all key inputs and assumptions. These inputs and assumptions feed into the workings for repayments and number of individuals repaying in each month in the analysis period. The repayments and number of individuals repaying in each month are calculated under the **baseline** assuming there is no 'breathing space' scheme in place and the **counterfactual** which assumes there is a 'breathing space' period as defined by the user.

Figure 1 Tool structure



Modelling repayments

For each debt type, data on the outstanding debt balance was provided by StepChange Debt Charity for each year from 2014 to mid-2017. From 2018 onwards, the average outstanding debt balance over 2014 and mid-2017 is used.

Data on the average monthly repayments for each debt type was also provided by StepChange Debt Charity. It was also available from 2014 to mid-2017 and the average is computed and used from 2018 onwards. These vary by the debt solution selected, i.e. if under DMP or other solutions (excluding insolvencies). The average repayment under each debt solution was provided by StepChange Debt Charity. Average monthly repayments under a DMP or any other solution are modelled until the average outstanding debt balance is equal to zero.

Table 1 below shows the outstanding debt balance and the average monthly repayments by debt solution for cohorts advised in 2016.

Table 1 Average outstanding debt balance and monthly debt repayments in 2016

Debt type	Outstanding debt balance	Average monthly repayments under:		
		No solution in place	DMP	Other
DWP	£2,888	£121	£35	£4.60
HMRC	£4,978*	£241	£203	£2.70
Council tax	£298	£23.70	£17.73	£5.00

Note: *HMRC debts are also subject to a late payment interest rate, which is applied in each month to the amount outstanding.
Source: StepChange Debt Charity data

It is assumed that there is a 9-11 week period between advice and activation of a DMP. In this period, it is assumed that clients make repayments as if there is no solution in place.

The average term for a DMP is used to model the number of months in which the DMP is in place. Once, the DMP is complete and if there is outstanding debt, it is assumed that clients make repayments as if there is no solution in place. Average repayments for other debt solutions are assumed to begin immediately and remain until the debt balance is cleared.

Under the counterfactual (i.e. assuming there a ‘breathing space’ period), all average monthly repayments are equal to zero and no interest is charged on the outstanding HMRC debt balance for the number of weeks selected by the user.

Modelling the number of individuals

StepChange Debt Charity data is used to compute the number of clients by debt type and subsequently, the debt solution selected (DMP or other) for each debt type. That is, 1.8% of all advised clients have DWP debts, 2.6% have HMRC debts and 29.73% have council tax arrears.

- Of the 1.8% with DWP debts, 14.6% select a DMP and 22.9% select another debt solution.
- Of the 2.6% with HMRC debts, 15.5% select a DMP and 13.5% select another debt solution.
- Of the 29.73% with council tax arrears, 12.7% select a DMP and 24.8% select another debt solution.

These proportions are assumed to be the same across all years.

Using StepChange data, a monthly drop-out rate (i.e. the proportion of individuals who are unable to repay their debts and hence ‘drop-out’ from the analysis) of 0.87% is assumed when no solution is in place in the baseline (assuming there is no ‘breathing space’ scheme). Once under a DMP or another solution, a lower drop-out rate of 0.79%[58] is assumed.

In the counterfactual, a ‘breathing space’ period is modelled such that it is implemented immediately in the first month of the analysis. In this period, the drop-rate is assumed to be 0%. Once the ‘breathing space’ period is complete, a drop-rate of 0.55%[59] is assumed, which is lower than the drop-out rates when there is no ‘breathing space’ period. Therefore, more individuals are able to repay their debts after a ‘breathing space’ period is implemented.

A simple example using one cohort of 10,000 individuals with DWP debts is provided below under the baseline and counterfactual cases assuming a two month ‘breathing space’ under the counterfactual.

[58] Data from Baker Tilley analysis of StepChange Debt Charity data (2014)
[59] Data from Computer Loan Services analysis of data from StepChange Debt Charity clients (2016)

Baseline

- Under DMP (14.6%)

Month 1	*Month 2*	*Month 3*	*Month 4*	*Month 5*	*Month 6*	....
1,460	**1,447**	**1,436**	**1,425**	**1,413**	**1,402**	....

Under DMP, in the first two months, a drop-out rate of 0.89% is assumed until the DMP is active.

Once the DMP is active, a drop-out rate of 0.79% is applied.

- Other solution (22.9%)

Month 1	*Month 2*	*Month 3*	*Month 4*	*Month 5*	*Month 6*	....
2,290	**2,272**	**2,254**	**2,236**	**2,218**	**2,201**	....

For all other solutions, a drop-out rate of 0.79% is assumed from the first month onwards.

Counterfactual

- Under DMP (14.6%)

Month 1	*Month 2*	*Month 3*	*Month 4*	*Month 5*	*Month 6*	....
1,460	**1,460**	**1,452**	**1,444**	**1,436**	**1,428**	....

Assuming a two month 'breathing space', there are no drop-outs.

Once the 'breathing space' period has expired, a drop-out rate of 0.55% is assumed.

- Other solution (22.9%)

Month 1	*Month 2*	*Month 3*	*Month 4*	*Month 5*	*Month 6*	....
2,290	**2,290**	**2,277**	**2,265**	**2,252**	**2,240**	....

All other solutions are modelled in the same way as under a DMP when a 'breathing space' is implemented.

Calculating the total cost and benefit

For each month of the analysis period, total repayments are calculated by multiplying the number of individuals repaying their debt by the average monthly repayment. This is calculated for each debt type and chosen debt solution under the baseline and counterfactual.

Debt repayments in the last month are adjusted such that the total outstanding debt balance is not exceeded.

The difference in the total repayment streams between the baseline and counterfactual is calculated. For any given month in which the counterfactual total repayment is lower than the total repayment under the baseline, the government has to borrow the difference.

The cost to the government is then the interest charged on the additional borrowing required to offset the loss of repayments with the introduction of a ‘breathing space’ scheme. The effective interest rate on short-term debt is used to calculate this cost. The monthly effective interest rate is calculated by taking a weighted average rate of 1-month and 3-month UK treasury bills from January 2014 to November 2017. The rates are sourced from the Bank of England and the amount issued (used as weights) from the Debt Management Office. Thereafter, the OBR forecast of the effective interest rate on short-term debt is used.

Since repayments are made across numerous years, the net present value of the cost to the government is calculated and presented. Costs are discounted by an annual rate of 3.5% as recommended in the Green Book.

The potential benefit of a ‘breathing space’ scheme is also calculated as a lower drop-out rate after a ‘breathing space’ period results in more individuals repaying their debt in the counterfactual compared to the baseline. The net present value of the benefit is also provided.