The Impact of Independent Debt Advice Services on the UK Credit Industry

Jackie Wells with John Leston and Mary Gostelow

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Further information
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Friends Provident Foundation
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Abbreviations

BACS	Bankers' Automated Clearing Services
BBA	British Bankers Association
BIS	Business, Information and Skills
CAB	Citizens Advice Bureaux
CCCS	Consumer Credit Counselling Service
CCJ	county court judgment
CFEB	Consumer Finance Education Board
CFS	Common Financial Statement
DMC	debt management company
DMP	debt management plan
DRO	debt relief order
FSA	Financial Services Authority
HMRC	Her Majesty's Revenue & Customs
IMA	Institute of Money Advisers
IVA	individual voluntary arrangement
MALG	Money Advice Liaison Group
MAT	Money Advice Trust
MOJ	Ministry of Justice
NAO	National Audit Office
NDL	National Debtline
NVQ	National Vocational Qualification
OBR	Office for Budget Responsibility
OFT	Office of Fair Trading
ONS	Office for National Statistics
R3	brand name of the Association of Business Recovery Professionals

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- 1st Credit
- BBA (British Bankers Association)
- Department for Business Innovation and Skills
- Citizens Advice
- Christians Against Poverty
- Consumer Credit Counselling Service
- The Insolvency Service
- Money Advice Liaison Group (MALG)
- Money Advice Trust
- National Debtline
- Nationwide Building Society
- Northumbrian Water
- Paymex

Executive summary

With increasing demands on debt advice services during the past two to three years, emerging cuts in public sector spending and expectations of rising interest rates, concerns about sustainable and adequate funding have increased. A 2009 study by Morag Gillespie and Louise Dobbie for Friends Provident Foundation identified that the current funding framework for free-to-customer debt advice is 'inadequate and unsustainable' (Gillespie and Dobbie 2009).

A considerable body of work exists on the benefits to individuals and the wider society of debt advice services. However, much less work has been done to establish a direct link between the provision of independent debt advice and benefits to the private creditor industry. *The key objective of this research was to deliver a much better understanding, and, if possible, a quantification of the impact that independent debt advice has on creditors.* As a first step in a new field, the quantitative findings and modelling are expected to be tentative.

This report's findings and conclusions are based on:

- an extensive review of existing literature and research data;
- interviews with private creditor firms, debt advice agencies and other relevant stakeholders;[1]
- challenging and refining the hypothesis that debt advice leads to positive outcomes for creditors;
- a model quantifying the benefits to creditors of debt advice, albeit with limitations.

The research sought to understand debt advice from the perspective of a range of private sector creditors, including mainstream banks, other consumer credit organisations and utilities. It did not consider the impact on public sector creditors such as local authorities.

Consumer debt and the credit cycle

Since the current economic crisis began to be felt in 2007, lenders have reduced the availability of credit to households. Nevertheless, levels of personal debt in the UK continue to remain close to all-time highs at just under £1.5 trillion.

In response to these changed economic conditions consumers have shown increased signs of financial stress, evidenced by rising levels of default, higher levels of write-off by creditors, a rise in the number of personal insolvencies and a growth in the number of debt cases brought before the courts.

Whilst there are some signs of improvements in default rates in 2010 and the debt crisis has not been as great as some anticipated, the prospect of higher interest rates, uncertain employment prospects and high levels of inflation suggest that this trend could easily reverse.

The supply of debt advice

The provision of debt advice is fragmented, with a complex patchwork of different types of not-for-profit and private organisations. Each of these operates different service models, with the result that the distribution of clients between services is not optimal. Both of these aspects from the creditor perspective make working with the debt advice sector less cost effective and efficient than it might be. Creditors generally recognise the value they derive from debt advice, particularly where it encourages dialogue between debtors and creditors, leading in most instances to a payment plan.

Creditors differentiated quite clearly between the different types of independent advice organisations in terms of the advantages and disadvantages that they derived from them. Smaller fee-paid debt management companies and claims management companies were criticised for poor customer service. They were not felt to be operating in the interests of the consumer or the creditor. Other advice agencies (e.g. Citizens Advice Bureaux, other not-for-profit, Fair Shares funded and larger, established fee-paid agencies) tended to be regarded favourably for encouraging consumers to resolve their debt problems and in some cases taking responsibility for trying to ensure that payment plans did not 'break'.

Unsurprisingly, creditors would like to see their interaction with debt advice services operate more cost effectively through greater use of BACS (the electronic processing of financial transactions), email and spreadsheets and through reductions in communications delays that may arise when a third party is involved.

The supply of debt advice remains inadequate, with many consumers failing to get the advice that they need.

The demand for debt advice and its outcomes

Around 2.0 million to 2.5 million households are in arrears with bills or credit payments, and there are an estimated 3.6 million households who may be in danger of falling into arrears. While many of those in arrears are on low incomes, a significant and growing minority (20 per cent) are higher earners. Of those in arrears, around 1 million have sought independent debt advice, but many of the remainder avoid contact with their creditors. In addition, around 1 million who stated that they were struggling financially but not currently in arrears also use debt advice.

Most of those who use debt advice and who are in arrears have been in arrears for some time and across multiple creditors. There appear to be few attitudinal or demographic differences between those in arrears who use advice and those who do not; however, advice users typically have more and larger debts and are more likely to have been chased by their creditors.

Those who receive debt advice are satisfied with the advice they receive and tend to follow the advice given. Those who have recently received advice exhibit a number of characteristics that are potentially of benefit to creditors. They are:

- more likely to have cut back on spending across various categories;
- more likely to have taken on an extra job;
- less likely to have borrowed more on an overdraft or credit card;
- considerably more likely to be using a structured debt management plan (at least twice as likely);
- considerably more likely to have contacted their creditors (between 8 per cent and 24 per cent more likely, varying by the type of creditor).

Many report a drop in level of contact and chasing by creditors, and that they have avoided creditors taking legal action. Research also suggests that, in some cases, advisers tend not only to stimulate greater action from their clients, they also undertake a lot of tasks on their behalf (many of them potentially beneficial to creditors).

Approaches to managing consumer default

Once lending has occurred, there are a number of different approaches to managing consumer default that may be creditor-initiated (e.g. debt collection, county court administration order, bankruptcy) or consumer-initiated (e.g. debt management plan, debt relief order, individual voluntary arrangement). These give rise to different costs for creditors and their customers and potentially change the profile of recovery for creditors.

The impact of independent debt advice on creditors: Research studies

A mixed picture emerges from the available studies that have sought to identify the direct total impact on creditors of debt advice:

- A limited UK-based study showed a greater improvement in debtors' own assessment of their debt situation among those taking advice compared to those who did not, but no measurable improvement in their arrears.

- A US study found that advice led to a substantial reduction in debt among those using the service but attributed some of the improvements in creditworthiness among those using advice to motivational or other characteristics of those using advice.
- Another US study showed that a credit card company experienced significantly lower losses with customers using debt management plans compared to those not doing so, and that the difference was approximately twice the level of Fair Shares contribution made by the creditor.
- A comparison of a sample of recent UK users of debt advice with a sample who either had not received advice or had not received it recently revealed that those receiving advice had lower debt levels after nine months and those without advice had higher debt levels over the same period.
- A further UK study that tracked advice users revealed a 40 per cent reduction in the average amount owed to creditors but a reduction in the monthly amounts paid to creditors.

However, overall, the results of existing research are not definitive in demonstrating the benefits that creditors derive from independent debt advice.

Quantifying the impact of debt advice on creditors: A model

To assess the impact of debt advice on the creditor market, a hypothesis was developed for testing during research and to form the basis of the modelling of improved creditor outcomes. The theory forming the basis of the modelling states that:

> The use by the over-indebted of crisis debt advice leads to better outcomes for creditors when compared to other pathways to resolution of defaults.

Though recognising the potential for second order benefits, the model focuses on first order effects of improved recovery rates and lower costs.

Model caveats

The model described below has been built upon very limited published data and incorporates a number of assumptions, which we have made explicit. We present the model not so much as a statement of what we believe the position to be, but rather, as an 'Aunt Sally' which we hope will encourage dialogue, challenge and further research.

The baseline results shown below are based on our best efforts but readers should not give any disproportionate weight to the baseline when comparing to the sensitivities.

The model is based upon current volumes of debt advice provision and the current profile of debt of customers using these services, and compares the hypothetical rate of recovery achieved by creditors in two scenarios:

1 The first scenario calculates the percentage of debt recovered where individuals in arrears receive independent debt advice (based on the current experience of individuals receiving independent debt advice).

2 The second scenario calculates the percentage recovered from the same individuals, were independent debt advice not to be available (based on the experience of creditor-led debt recovery procedures).

The results of the model indicate that, in the first scenario, creditors on average recover 51 per cent (£12.6bn) of the debts owed. Without debt advice, they would recover 46 per cent (£11.3bn) of the debts owed.

The difference between the two scenarios suggests that creditors might *recover £1 billion more where advice is given*. Allowing for the estimated £45 million already spent by creditors on Fair Shares payments, the creditors of an average debt advice customer collectively recover in excess of *£1,000 more per individual*. Individual creditors will typically gain less than this amount since individuals are typically in arrears to more than one creditor.

Sensitivity analysis show that the model is highly sensitive to recovery rate assumptions and to the mix of outcomes but that any one assumption has to change quite substantially before debt advice does not deliver improved recovery rates for creditors.

At the outset of the project, we envisaged being able to collect robust data from creditors on their administrative costs of recovery from creditors. Such data has proven to be unavailable to us. However, there is plenty of anecdotal evidence that creditor costs associated with debt recovery are also reduced by the provision of independent debt advice. Creditors themselves imply cost savings arising from:

- reduced costs for each creditor arising from the need to continue to chase customers in arrears;
- an overall reduction in the need to spend time understanding the customer's financial position – this cost saving would be magnified across the group of creditors, since the time spent understanding this is undertaken only once, rather than by each creditor independently;
- reduced costs in pursuing customers through the courts.

The only data on creditors' arrears administration costs available to us, on which to base any estimate of quantification, are published by Ofwat. They suggest that water companies spend £76 million per annum on debt recovery (excluding write-offs) against debts of £1.4bn, so costs equate to 5 per cent of their debts.

If the same proportion of debt is applied to the £24.7bn used in the recovery costs model above as being owed by those customers who seek debt advice, we would find that costs amount to £1.3bn, or more than £1,100 per customer. This per customer average is more than four times the cost of delivering the most expensive form of debt advice – face-to-face (£265 per customer[2]), 26 times the cost of delivering phone based advice (£51) and 83 times the cost of web based advice (£16).

Consequently, if creditors' administration costs were reduced by more than 24 per cent for debtors having received a single face-to-face advice session, then their process savings alone would exceed the total cost of providing the advice session. This is before any improvement in recovery rates is taken into account. Comparable figures for debtors receiving a single telephone advice session or accessing advice online are that creditors would save more in administration expenses than the advice cost to deliver were they to save just 5 per cent or 1 per cent respectively of their process costs as a consequence of debtors acting differently in response to that advice.

In practice, individual debtors may well need to access more than one advice session. The Money Advice Outreach Evaluation calculated a total cost per closed case of £454 based on a sample of more than 5,000 cases. This will be a significant over-estimate of advice costs generally since outreach services are expensive to deliver. Nevertheless, even in this example the total cost of delivering advice would be covered, without any improvement in recovery rates, if process costs alone reduced by slightly over 40 per cent.

Whilst this project has not been able to quantify the cost savings to creditors of customers using independent debt advice, on the basis of views expressed by those creditors interviewed, it would appear likely that creditors do make some cost savings.

Taken together with the improvements in recovery costs modelled above, there would appear to be considerable support for the hypothesis described at the start of this chapter.

Funding and cost of debt advice

There is growing concern in the advice sector that its funding base is already unsustainable and likely to come under further strain as a result of cuts in public sector support. Not-for-profit services are predominantly supported from the public sector, with only minority contributions from creditors through Fair Shares (estimated at £45 million) and corporate donations (estimated by Gillespie and Dobbie at £4 million).

Creditors generally recognise that they benefit from debt advice services but also see a number of barriers to contributing, including: perceiving the sector as fragmented and not as efficient as possible; and a feeling that, for several reasons, there is no direct correlation between support given and benefit to the individual creditor.

Conclusions for creditor funding

Creditor funding of independent debt advice is, at present, limited to:

- those organisations who operate free-to-customer debt management plans; and
- irregular charitable funding of other free-to-customer initiatives.

In total we estimate that creditor funding represents in the region of £45 million to £50 million pa, most of which takes the form of Fair Shares payments.

The quantitative analysis carried out as part of this project supports the case for further creditor funding of debt advice on the basis of benefits received (we imply no responsibility on the part of creditors for the difficulties encountered by consumers in this economic climate). When measured against even the most costly form of advice (face-to-face), the uplift in recovery of debt and the reduction in costs, each suggest that creditors benefit from advice.

Our limited research among creditors suggests that there remains a strong reluctance to move towards a statutory levy on the industry, particularly in the light of other new taxes and costs being placed on the banking sector. However, the degree of commitment to the current Fair Shares voluntary scheme suggests that a voluntary scheme can be made to work (both Consumer Credit Counselling Service (CCCS) and Payplan have been able to increase their capacity in response to higher demand on the back of Fair Shares payments). The scheme benefits from clarity between the cost of the scheme and the benefits received by creditors (both repayment of debt and cost efficiencies gained through efficient systems). It is also seen as broadly equitable, albeit that some creditors do not participate and yet benefit. Removing such creditors from the scheme would appear at face value to make the scheme more equitable but would bring with it increased problems in sustaining debt management plans (DMPs).

However, the scheme is not without difficulties, most particularly in that:

- it only funds repayments that are made through structured DMPs and does not fund repayments through do-it-yourself arrangements or other debtor-led solutions;
- by definition, it does not fund the advice delivered by those agencies who serve those most in need of advice but are least able to repay their debts.

It was not the task of this research to suggest a new funding arrangement; indeed we found creditors, unsurprisingly, reluctant to engage in a discussion of future funding. However, it is clear from our research that any new funding scheme would need to engage all of the private sector creditor industry, clearly align costs to benefits and be equitable between creditors (although creditors may have different views on what constitutes equitable treatment).

However, the difficulties in reaching an agreement, as set out clearly by the National Consumer Council in their 1992 report on the funding of money advice services, remain (National Consumer Council 1992a).

Chapter 1
Introduction

Recent research has identified that the current funding framework for free-to-customer debt advice is 'inadequate and unsustainable' (Gillespie and Dobbie 2009). With increasing demands on debt advice services during the past two to three years, emerging cuts in public sector spending and expectations of rising interest rates, concerns about sustainable and adequate funding have increased.

A considerable body of work exists on the benefits to individuals and the wider society of debt advice services. However, much less work has been done to establish a direct link between the provision of independent debt advice and benefits to the private creditor industry. The key objective of this research was to deliver a much better understanding and, if possible, a quantification of the impact that independent debt advice has on creditors.

In particular, the research aimed to gather, analyse and present information on:

1. The credit profile of clients using independent debt advice.

2. Indicative arrears management and debt collection costs in various parts of the creditor industry.

3. Qualitative perceptions from within the private sector creditor industry of the impact of debt advice.

4. Quantitative evidence and modelling of the impact of debt advice. An important element of this is an estimation of the potential effect on levels of defaults due to referrals for debt advice.

(Friends Provident Foundation 2010)

As a first step in a new field, the quantitative findings and modelling reported here are somewhat tentative.

Scope of the project

This project focuses on debt advice as it affects *creditors*. We have reviewed research dealing with the nature of over-indebtedness as well as information relating to the structure and capacity of the supply of debt advice. However, neither of these subjects is core to this project.

Similarly, we have reviewed and comment on the funding of independent debt advice. Whilst there are outputs from this project that concern the future funding of the independent advice sector, resolving the complex issues of funding was not a primary objective of this project.

In examining independent debt advice, we have included both free-to-customer and fee-based debt advice organisations that offer support and advice services through face-to-face, telephone, online or other channels. The report does not consider the debt counselling type services delivered by or directly on behalf of creditors. Generic financial advice ('money guidance') offered by FSA/CFEB is also excluded. Money guidance is the generic name for the Money Made Clear service offered by the Consumer Finance Education Board (CFEB), previously the Financial Capability Division of the Financial Services Authority (FSA).

The research sought to understand debt advice from the perspective of a range of private sector creditors, including mainstream banks, other consumer credit organisations and utilities. It did not consider the impact on public sector creditors such as local authorities.

The scope of this project evolved as it progressed, reflecting in part the limited supply of relevant data. At the outset, we specifically excluded local authorities and other government creditors from the analysis. However, whilst we originally envisaged analysing the impact of debt advice on secured and unsecured creditors,[3] it quickly became clear that the bulk of the issues dealt with by independent debt advice organisations concerned unsecured debt, albeit that this included some unsecured priority creditors, such as utility providers.[4] The decision was made during the project to focus the bulk of our work on unsecured lending.

Methodology

Our approach to this project comprised:

- a literature review of reports, papers and company annual reports to understand:
  - the supply, funding and demand for debt advice; and
  - the different approaches open to creditors and debtors in managing arrears and defaults and associated costs.
- a limited number of interviews with organisations in or related to the creditor and debt advice sectors;
- developing a theory of how independent debt advice affects creditors and testing it in creditor and adviser interviews;
- building a model to assess the impact of debt advice on creditor recovery rates and a descriptive analysis of cost effects.

Desk research

The first stage of the project involved an extensive literature review to recap on existing evidence on the demand for, and the scale, funding and benefits of debt advice.

The literature review included the following key sources:

- government reports and data from the Financial Inclusion Taskforce, Business, Information and Skills (BIS), Ministry of Justice (MOJ), Her Majesty's Revenue & Customs (HMRC), The Insolvency Service, Legal Services Commission, National Audit Office, Office for National Statistics (ONS), Bank of England;
- academic research such as the Scottish Poverty Information Unit, Glasgow, the Personal Finance Research Centre, Bristol and the Institute for Employment Research, University of Warwick;
- industry research from R3 (the brand name of the Association of Business Recovery Professionals) and US sources;
- third sector research and data from Citizens Advice, Money Advice Trust (MAT) and Credit Action;
- national press and press releases of creditors, charities and debt advice agencies;
- reports from regulators/licensing organisations such as Ofwat and Office of Fair Trading (OFT);
- Internet sites of free-to-customer and fee-based debt advice agencies.

Relevant documents are referenced throughout the report.

Hypothesis

We did not take it as a given at the outset of the project, that debt advice would lead to positive outcomes for creditors. However, early analysis of evidence available suggested that this could be the case. In order to structure thinking and further research, the hypothesis was summarised as:

> The use by the over-indebted of crisis debt advice leads to better outcomes for creditors when compared to other pathways to resolution of defaults.

Interviews

In total, 12 interviews were conducted. Interviewees came from private creditor firms (financial services and a utility company), debt advice agencies (both free-to-customer and fee-based), trade associations and experts related to the creditor sector.

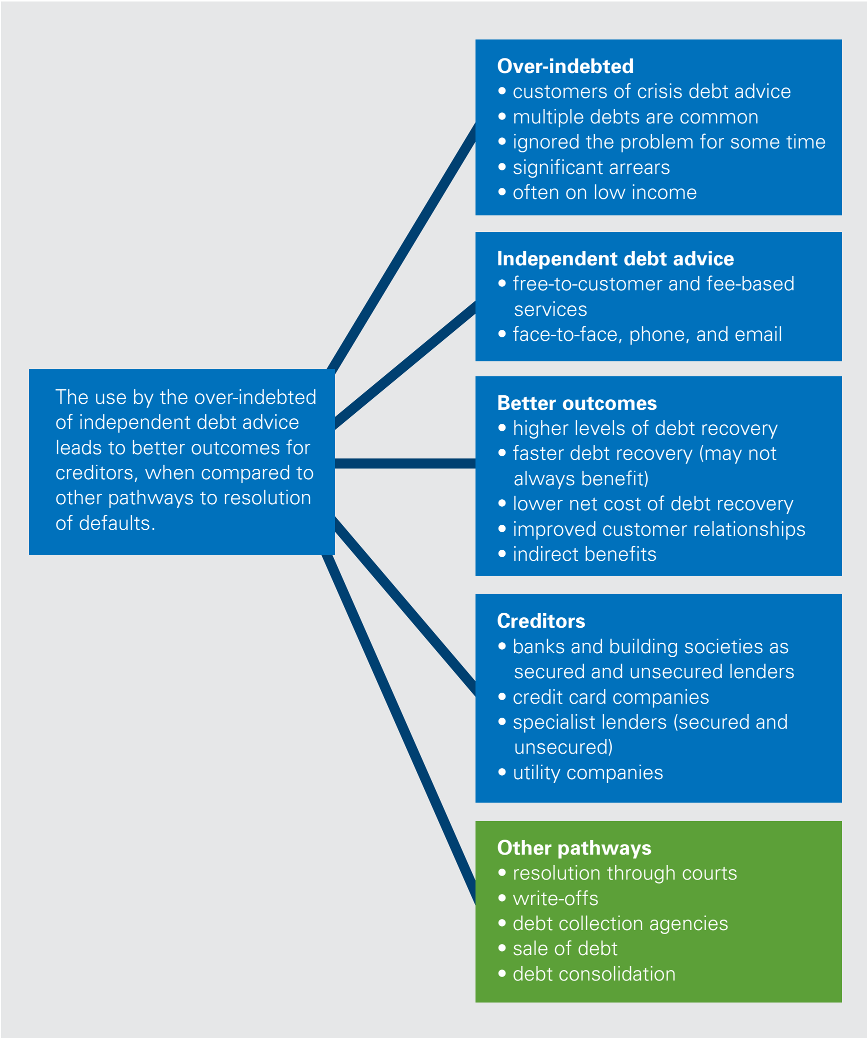

Figure 1
A theory of improved creditor outcomes.

The purpose of the interviews was to:

- understand current attitudes to debt advice and how these varied by organisation and/or advice provider;
- identify the potential benefits to creditors of debt advice;
- understand the relationships between creditors and different debt advice agencies;
- identify any data that may be available for input to the model;
- test our theory of how independent debt advice affects creditors.

Modelling

Whilst an aim of the project was to quantify, as much as possible, the effect of debt advice, it was clear at the very outset that robust data would be difficult to come by. We anticipated that creditors would either not maintain records in a form that would prove useful for this project, or they would be reluctant to share such information. Having interviewed a small number of creditors and sought to speak to several others, we are convinced that such records are not maintained, although we have also encountered some reluctance on the part of creditors to engage in discussion on the subject. It was accepted that there would be limitations to any quantitative modelling of the benefits to creditors of debt advice.

The modelling included in this report has therefore been based on very diverse pieces of data and, in some cases, the authors' assumptions. We have documented the information used and where we have had to make assumptions.

Report structure

The remainder of this report is structured in the following way:

Chapter 2 examines the economic and market context for independent debt advice and creditor losses from personal lending. The chapter highlights the difficulties being encountered by debtors and creditors alike in the current environment as well as the impact of the economic environment on demand for independent debt advice.

In **Chapter 3** we describe the supply of independent debt advice and creditor attitudes towards debt advice and the organisations that provide it.

In **Chapter 4**, using existing research, we profile consumers who are struggling with debt, and compare those who are users of advice with those who are not. The chapter also describes how users of advice respond to it and the effect it can have on relationships with creditors.

Chapter 5 describes the different approaches to resolving defaults that arise where debt advice is and is not used, and the impact that different approaches can have on costs and outcomes.

In the first of two chapters examining the impact of debt on creditors, **Chapter 6** contains an evaluation of existing research. **Chapter 7** contains the findings from our own modelling of the impact of advice on recovery rates and administrative costs.

In **Chapter 8** we conclude with a look at current funding arrangements and creditor attitudes towards funding, and draw some tentative conclusions about the implications of this research for future funding.

Chapter 2
Consumer debt and the credit cycle

SUMMARY

This chapter draws on desk research and secondary analysis of existing data to describe the profile of personal debt in the UK (the context against which demand for debt advice is growing), and the high-level impact on creditors of increasing financial stress. Key findings include:

- Signs of financial stress among individual debtors became more evident from early 2008. While absolute levels of personal debt in the UK have stabilised since, they remain close to an all-time high.
- Net lending has fallen, with evidence of net repayments of credit card debt. Net mortgage lending remains positive.
- For creditors, levels of default have led to higher provisions for bad debt and higher write-offs as well as higher costs in chasing defaults, factors which affect shareholder returns and the price and availability of credit for all customers.
- Whilst there are some signs of improvements in default rates in 2010 and the debt crisis has not been as great as some anticipated, the expectation of higher interest rates, uncertain employment prospects and high levels of inflation suggest that this position could easily reverse.
- Whilst the use of debt advice is principally affected by levels of over-indebtedness and economic conditions, the rise in debtors having a multiplicity of creditors has changed the landscape for debt recovery and further fuelled the demand for debt advice.

Consumer borrowing patterns

The current economic crisis began in the US in 2006 and started to affect UK markets in 2007. Prior to the crisis, at the end of 2006, levels of personal borrowing in the UK exceeded £1.25 trillion. Levels continued to rise during 2007 but levelled out between 2008 and 2010 at just under £1.5 trillion, as the 'credit crunch' took hold, with unsecured debt representing approximately 15 per cent of all personal debt.

Bank of England data puts the average household unsecured debt at £8,716 excluding mortgages, and £57,444 including mortgages. However, these figures divide the total debt by the total number of households rather than simply those households with debt. Research by YouGov, however, puts the proportion of households with unsecured debt at 70 per cent, which would imply an average of £12,500 for those with debt (Department for Business, Innovation and Skills 2010).

As the economic crisis took hold and levels of unemployment rose, the landscape for mortgages and consumer credit shifted:

- More households began to show signs of increased financial stress (Department for Business, Innovation and Skills 2010).
- The number of people seeking help from debt advice agencies started to rise very substantially, although agencies report that levels did not reach forecast levels due to continued low interest rates.
- Banks and other lenders moved from a focus on promoting consumer credit to one of managing defaults.

One of the reasons put forward for debt advice demand levels not reaching the high levels forecast by some is a fall in the levels of lending to individuals, particularly credit card lending. Figure 2 illustrates how net lending on credit cards in particular has been negative for many months in 2009/2010 as individuals seek to pay down their debts and the availability of credit has been constrained.

Mortgage lending is also down from its pre-credit crunch levels. Net lending levels have remained positive but were significantly lower throughout 2009 and to date in 2010 than in 2007 and 2008 (Bank of England 2010a).

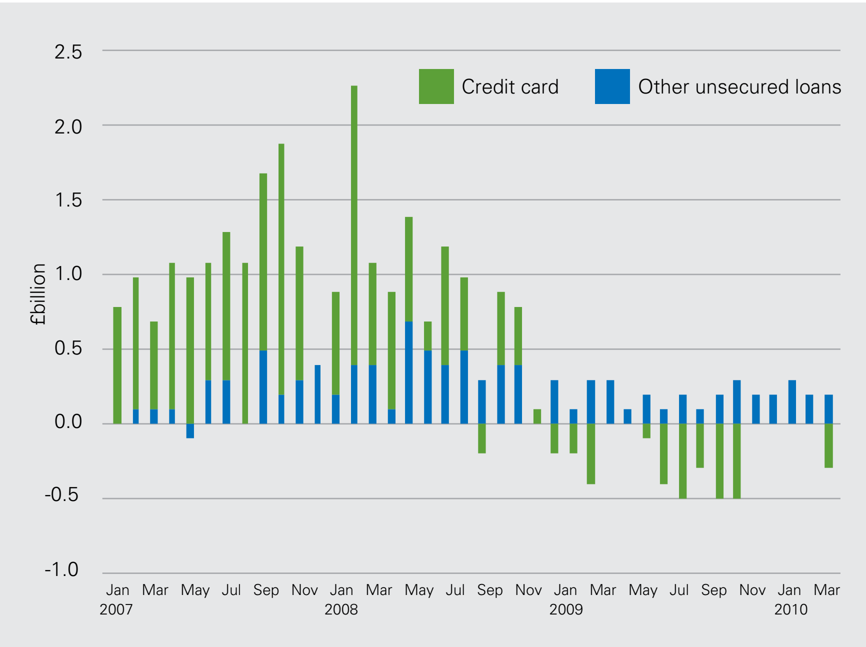

Figure 2
Trends in net lending to individuals (consumer credit) January 2007–April 2010. Levels of lending have fallen since 2008.

Source: Bank of England (www.bankofengland.co.uk).

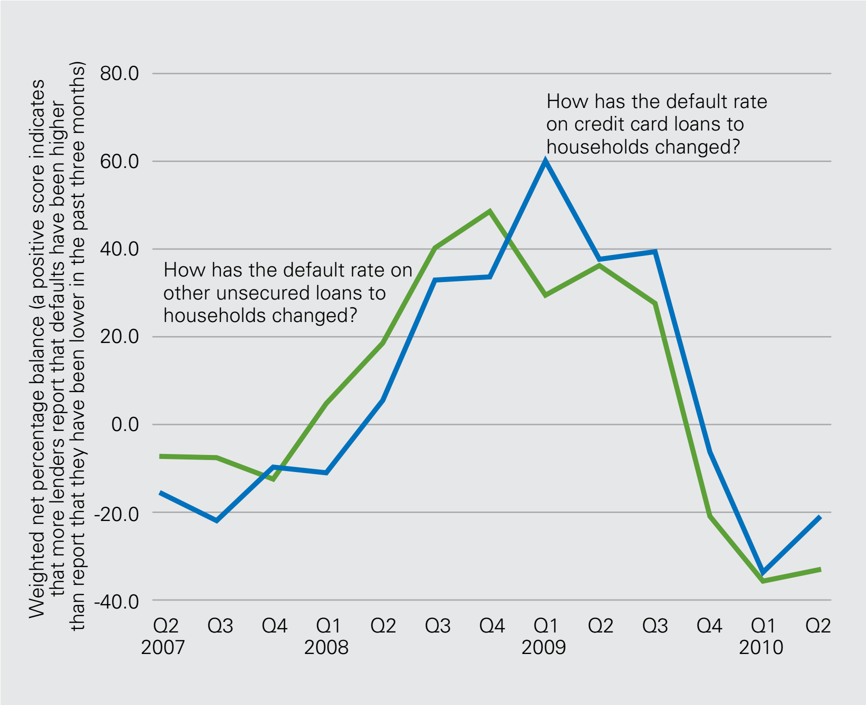

Figure 3
Trends in default rates on unsecured credit. Creditors report improvements in default rates.

Source: Bank of England (2010b).

Trends in defaults and arrears

In its July 2010 survey of credit conditions, the Bank of England reported that creditors' experience of defaults on unsecured lending had improved again in quarter two 2010 after two earlier quarters of improvement following a gloomier outlook during most of 2008 and 2009 (Bank of England 2010b). Default rates were expected to fall further in the next quarter of 2010, but concerns were expressed about the prospects of further deterioration should economic conditions worsen, including impending increases in interest rates.

Data on mortgage arrears (where arrears amount to more than 2.5 per cent of balances) reveals that recent rates have remained between 1 per cent and 2 per cent of households with mortgages. Possessions by lenders also remain low, at less than 0.5 per cent. Continued low interest rates have helped to prevent a repeat of the higher levels of arrears and possessions that occurred in the early 1990s and have kept possession rates lower than the 4 per cent forecast by the Council for Mortgage Lenders in 2008. Government measures to encourage forbearance on the part of lenders and the codes of practice applied by the FSA have also helped to keep the number of possessions low. However, research conducted for the Department for Communities and Local Government revealed quite clearly the very significant impact that a small increase in interest rates and a reversal of forbearance policies could have on mortgage arrears and repossessions (Aron and Muellbauer 2010).

Another indicator of the cost of over-indebtedness to creditors is the level of write-offs by lenders (these data do not include all creditors). Write-offs occur where a bank deems a loan or other credit to be unrecoverable and decides to remove it from the asset side of the balance sheet.[5] These data reveal a sharp rise in write-offs in the first three quarters of 2009 with a fall in the final quarter and in the first quarter of 2010 (Figure 4).

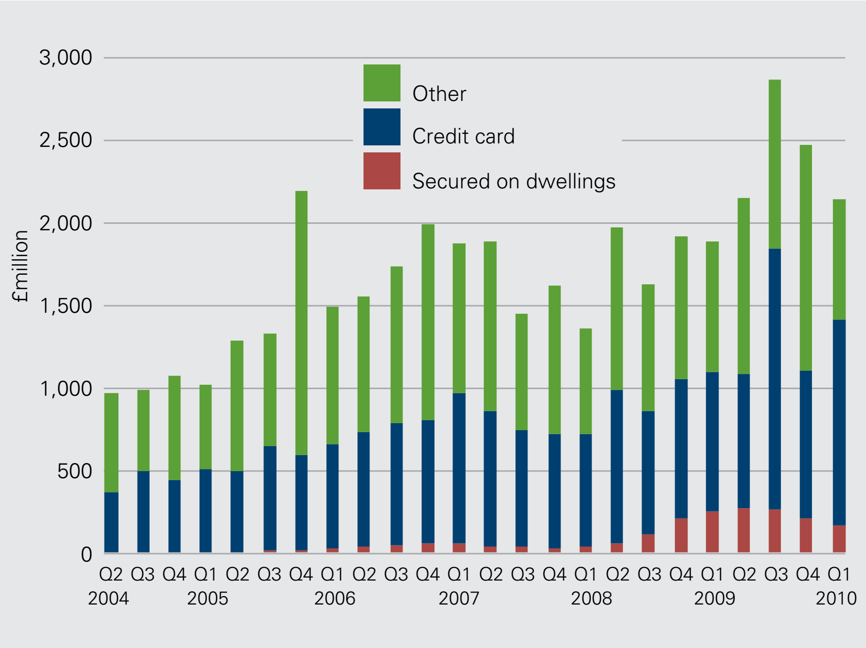

Figure 4
Levels of write-off by financial institutions against individual lending. Write-offs peaked in Q3 2009.

Source: Bank of England Statistics, Table c2.1: Write-offs and other revaluations of loans by monetary financial institutions.

Default rates and write-offs affect creditor profitability and have an effect on:

- shareholder returns;
- interest rates charged on credit to other customers;
- creditors' willingness to lend; and
- the ability of creditors themselves to borrow.

Trends in insolvency and court actions

Further evidence of a shift in levels of personal debt can be found in the data on insolvency in England and Wales (similar trends are evident in Scotland but different systems apply) and levels of county court judgments (CCJs).

As Figure 5 reveals, not only did the level of individual insolvencies rise steeply during the second half of the 2000s, the pattern of insolvency has also shifted from full bankruptcy proceedings being dominant until the 1990s when individual voluntary arrangements (IVAs) were first introduced as an alternative to bankruptcy and, more recently, the introduction of debt relief orders (DROs). We examine these different approaches to debt resolution further in Chapter 5 of this report.

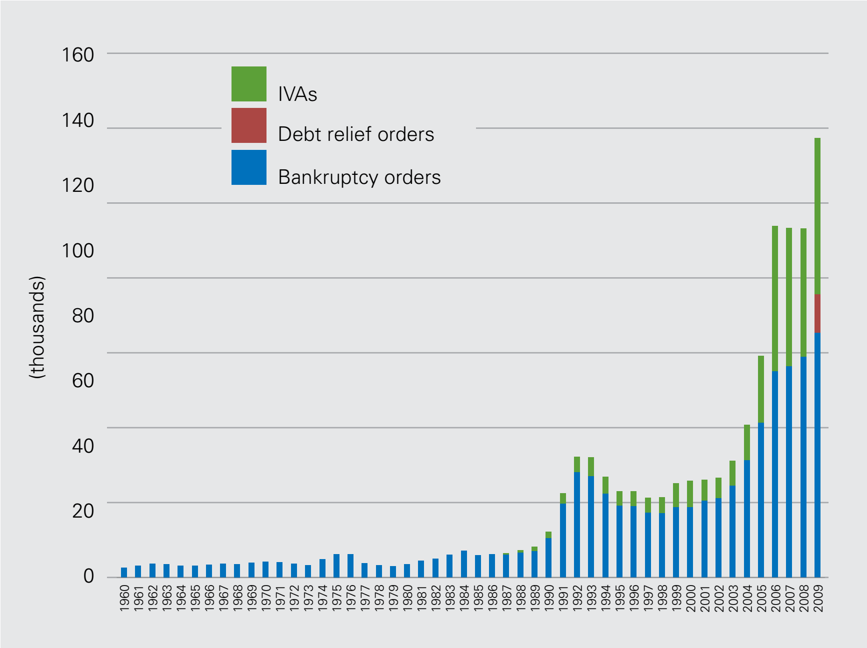

Figure 5

Trends in insolvency (England and Wales). The number of personal insolvencies has risen, year on year, since 1998.

Source: Ministry of Justice (2010) Court Statistics Quarterly April to June 2010.

The number of county court judgments made against individual debtors has fallen during 2009 and 2010 from higher levels in 2008, as shown in Figure 6. However, with more than 600,000 judgments made in 2009, the cost of chasing debts through the courts remains high and gives rise to costs for creditors as well as debtors.

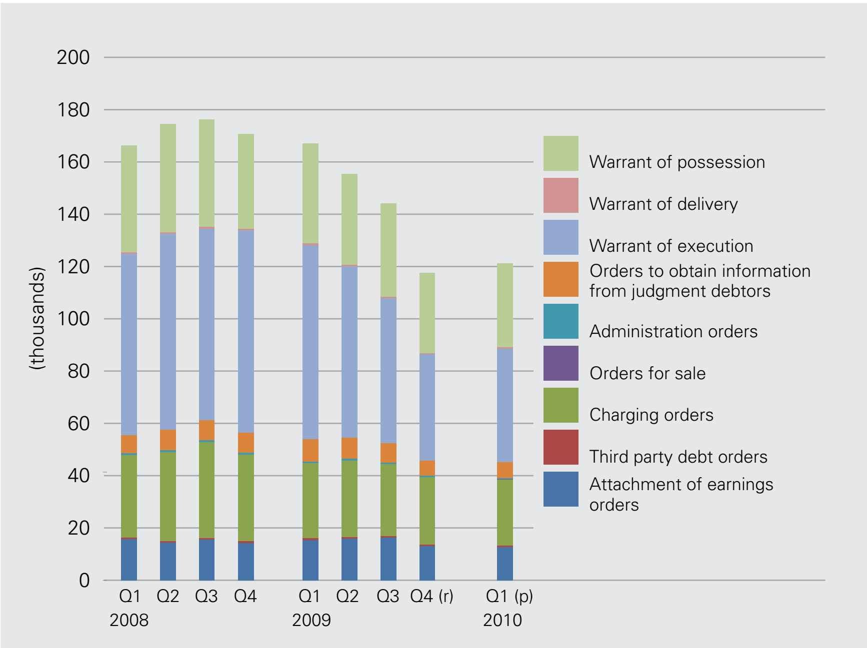

Figure 6

Number of warrants and orders in county courts (includes some cases that do not relate to personal debt). There was a steady decline in county court judgments during 2009.

Source: Ministry of Justice County Court (Non-Family) Statistics, Q1 2010.

Future prospects

The immediate prospects for levels of over-indebtedness and therefore demand for debt advice remain uncertain at this early stage of implementation of the coalition Government's fiscal and monetary policy. However, forecasts published by the Bank of England (Bank of England 2010c) point to expectations of:

- growth in GDP, at levels of 2–3 per cent per annum for the next three years;
- inflation levels above the Government's target of 2 per cent;
- interest rates rising throughout 2011 to 1.7 per cent and through 2012 to 2.8 per cent from the current low level of 0.5 per cent.

In addition, the Office for Budgetary Responsibility (OBR) has forecast that employment in the public sector could fall as a result of spending cuts and that unemployment is likely to continue to rise during 2010.

Taken together, these forecasts suggest that individuals' difficulties in servicing debt will increase during 2010 and 2011 as rises in inflation, unemployment and interest rates squeeze household spending.

Changing patterns of credit

While the use of independent debt advice is driven in the main by levels of over-indebtedness and by changes in economic conditions, usage is also being driven by a fundamental shift in the profile of credit used by consumers.

It is difficult to identify when exactly the recent trend towards increased multiplicity of creditor began but it is generally held that for most of the middle to end of the twentieth century, individuals in the UK tended to owe money to only a limited number of creditors. This has not always been the case. In earlier times, individual shops and suppliers gave credit and money lenders and pawnbrokers played a role in financing consumption. Individuals may have owed money to several shops and other suppliers and lenders at any one time. The shopkeeper, supplier or lender that shouted loudest or was most important (e.g. the landlord) got paid, others may have had to wait longer for payment. The courts have a long history as the last resort for creditors seeking repayment of debts. As far back as the fourteenth century, records are said to show that unpaid debts made up a significant proportion of cases at the county court (Burton 2007).

During the second half of the twentieth century, the trend was for most credit to be lent by an individual's bank so that individual retailers and suppliers did not have to. There were undoubtedly efficiency gains in this shift since most credit relationships were one-to-one. Most consumers tended to owe money to just one or two lenders, with the courts continuing to play an important role in enforcing debt repayment.

Now, once again, many consumers owe money to many different creditors and the creditor who shouts loudest or is most important (e.g. mortgage lender) often gets priority. This return to a multiplicity of creditors has reintroduced inefficiencies into the system and has contributed to the need for independent debt advice.

Chapter 3
The supply of debt advice

SUMMARY

This chapter describes the provision of debt advice and the debt advice service models, and changes taking place in the regulation and professionalisation of debt advice. We consider how creditors' views on debt advice have changed and the benefits and challenges of debt advice in the eyes of creditors. Key findings include:

- Debt advice is, ideally, a comprehensive service aimed at helping clients to address their debt and associated issues and to avoid similar difficulties in the future.
- The supply of debt advice services is highly fragmented and diverse and the distribution of clients between services is not optimal; both of these aspects make working with the sector less cost-effective for creditors than it might be.
- Creditors are generally supportive of debt advice and recognise that it delivers benefits to them. They particularly appreciate its role in encouraging dialogue between creditors and debtors.
- The scale of benefits derived by creditors from independent debt advice varies according to the client base of debt advice organisations, the efficiency of systems, the consistency, quality and objectivity of advice given, and the degree of follow-up with clients.
- In spite of increased regulation and professionalisation of the sector, creditors believe that considerable scope exists for further improvement, particularly among smaller fee-based organisations.
- The supply of debt advice remains inadequate for the level of demand and its distribution is sub-optimal.

What is debt advice?

This report is concerned with independent debt advice; it excludes both debt 'counselling' services delivered by or directly on behalf of creditors, and generic financial advice ('money guidance') offered by FSA/CFEB (see page 15).

The *Debt Advice Handbook* (Child Poverty Action Group 2010) describes debt advice as a series of tools and strategies used to help clients by:

- enabling them to maximise their income;
- explaining the implications of non-payment of each debt and on this basis deciding which are priorities;
- assisting them to plan their budgets;
- helping them choose a strategy (usually to reduce or stop payments) that will minimise the effects debt has on their financial, social or medical wellbeing by giving them impartial, independent and confidential advice that enables them to make an informed choice about the options available to them;
- preserving their home and fuel supplies;
- providing advice or representation with the implementation of whatever strategy is chosen.

In addition, some advice services also facilitate the administration of debt repayment by receiving payments from their clients and then distributing those to creditors; usually referred to as debt management plans (DMPs).

The debt advice landscape

The independent debt advice sector comprises a fragmented and complex patchwork of many different types of both not-for-profit and private agencies (see Table 1). This in itself is perceived as a disadvantage by some creditors.

Not-for-profit agencies include public sector (e.g. local government) and charitable organisations, although the latter are typically supported by a mixture of private and public funding. In addition to the leading organisations such as Citizens Advice Bureaux (CAB, or Citizens Advice), there are also many smaller organisations (mainly charities) serving discrete areas, such as the Bristol Debt Advice Centre (geographic area) and Age UK (specific age group).

Private sector debt advice organisations comprise free-to-customer and fee-based companies. The free-to-customer options include Legal Services Commission funded services delivered by solicitors and also organisations such as the Consumer Credit Counselling Service (CCCS, a charity) and Payplan (a commercial organisation), which cover their costs via optional 'Fair Shares' payments from the creditor organisations to whom they channel repayments.[6]

Table 1
Independent debt advice landscape.

<table>
<tr><td>Not-for-profit agencies</td><td colspan="2">Private sector agencies</td></tr>
<tr><td colspan="2">Free-to-client</td><td>Fee-paid</td></tr>
<tr><td>Public sector (e.g. council advice services)

Charitable organisations (e.g. Citizens Advice)</td><td>Solicitors (funded by the Legal Services Commission)</td><td>Solicitors, accountants, banks, financial advisers, etc.</td></tr>
<tr><td colspan="2" rowspan="3">Fair Shares-funded commercial organisations (e.g. Consumer Credit Counselling Service; Payplan)</td><td>Large, established debt management firms

(e.g. members of Debt Managers Standards Association or Debt Resolution Forum)</td></tr>
<tr><td>Smaller, newer debt management firms</td></tr>
<tr><td>Claims management firms</td></tr>
</table>

Fee-based debt advice services are typically associated with debt management companies, but they also include accountancy firms, solicitors and banks. Among fee-paid debt management firms, creditors broadly identify three different types:

- Large, well-established organisations such as Gregory Pennington and Baines & Ernst, who are typically members of one of the two leading trade associations. Generally these services are well-regarded and viewed as essentially similar to those of the 'Fair Shares' funded agencies.
- Smaller, and often newer, organisations. While some of these are considered professional by creditors, their reputation is more mixed.
- Claims management companies. These are a relatively new phenomenon and concentrate on seeking to identify if specific credit agreements are legally unenforceable. Although they may position themselves as offering debt advice, creditors do not accept that they are doing so or are acting in the interests of their clients.

The use of fee-based firms by consumers appears to be increasing. Payplan suggest that around two-thirds of DMPs are now fee-based compared to half of DMPs five years ago (Fairhurst 2010).[7] Various reasons are given for this:

- DMP firms spend a lot of money on advertising, so consumers are more aware of them than the free alternatives.

- Consumers want the problem to go away and are not price-sensitive with regard to how that is achieved.

- Consumers prefer low monthly payments, regardless of the fee.

Individual creditors reported finding themselves dealing with a large number of different debt advice organisations (up to 1,400 quoted by creditors interviewed for this project). A credit card company interviewed estimated that they dealt with about 300 advice organisations in a year but that around 80 per cent of cases were accounted for by about 20 of these. Another creditor mentioned that they dealt with a similar number of agencies.

It also emerged that debt advice agencies become involved with a significant proportion of delinquent accounts; estimates given by different creditors were 30 per cent, around 40 per cent and as high as 60 per cent.[8]

Debt advice service models

Debt advice organisations provide their services in a number of ways: face-to-face, telephone, over the Internet or through distributing written material. One or more of these may provide the ‘right’ service model for consumers.

Different models lead to different outcomes for creditors. To simplify the options these delivery methods have been categorised as three service models:

- Self-help is the provision of information without advice for those who feel confident in dealing direct with their creditors and tend to have levels of income that enable them to repay their debts in part or full. Outcomes for creditors are likely to include rapid repayment of debt or direct contact and negotiation of repayment terms by customers.

- Assisted self-help will benefit those who need some advice and guidance in dealing with their debt problems. They will usually have an interview with an adviser and are then given a self-help pack, and the individual takes responsibility for negotiating with their creditors. Outcomes may include debt management plans, assistance towards insolvency solutions or direct negotiation of repayment terms.

- Full assistance (typically face-to-face) will be required by those who are not financially confident, have complex debt problems and/or have low incomes and so may require more holistic support including income/benefits maximisation, and support with negotiating with creditors for rescheduling of debt.

There is no formal process to direct consumers to the ‘right’ service for their debt advice needs. For the funders of debt advice, ensuring that consumers receive the right level of help is critical to the efficiency of the service provided.

Debtors may move between these service models, either of their own volition or through informal triage arrangements, such as those organised between creditors and debt advice agencies or between debt advice agencies.

Despite these practices, there is concern among agencies and creditors alike that some debtors do not end up at the most appropriate advice source and that, as a consequence, the sector is not as efficient or cost-effective as it might be. For example, recent high levels of demand for advice are reported to have resulted in some debtors opting for fee-paid advice solely as a result of unacceptable waiting times to access free-to-client options.

There were suggestions from interviewees as to how the allocation of clients to appropriate advice forms and/or providers might be improved. One participant commented that the establishment of a single 'gateway' to advice had been discussed in the past and that, although no progress had been made, there might be merit in such an arrangement. He envisaged such a system drawing on multiple information sources regarding the debtor's situation, such as credit rating agencies and HMRC, while creditors would freeze recovery action and interest and charges for a period. Other comments included:

> 'We will give customers details of three to four free debt advice agencies to speak to or will put them through direct to Payplan, if they agree.'
>
> 'The collections team will direct financially distressed clients to free debt advice agencies.'
>
> 'People who need face-to-face advice will be referred.'
>
> (Debt advice agency interview)[9]

Creditor perspectives on debt advice

The interviews conducted for this report indicate that creditor attitudes to debt advice are influenced by their experience of debt advice organisations and the net benefits that they feel their firm derives from their activities. Overall, interviewees had a positive attitude to debt advice but they did also raise some negative points.

Favourable attitudes

The single most important benefit of independent debt advice for creditors is that it encourages debtors to make contact with them and so to begin to tackle the issue.

> 'With defaults, the issue is getting hold of the customer. So if a customer is talking to a third party that's a bonus for us; any form of customer contact is better than no contact.'
>
> 'They get the client to contact the creditors; they don't encourage debtors simply to try to get out of their debts so "you do get offers".'

> 'Money advice can help someone who wants to sort their problems.'
>
> 'All debt advice bridges the gap between debtors and the banks, which is invaluable.'

Other benefits of advice identified by those we interviewed:

- Advice helps to reduce the cost of chasing defaulters (unanswered/ignored telephone calls, letters) and delays the use of more expensive debt collection options such as CCJs. It is worth noting that among those interviewed it was not company policy to use CCJs, other than as a last resort.
- It provides the creditor with information through the Common Financial Statement (CFS) or equivalent, which gives them a better understanding of what they can/will accept as a reduced repayment and is more efficient.
- It puts the creditor on a more equal footing with other creditors, through pro-rata payments, rather than the uncertainty of not knowing where they are in the priority of debts to be repaid.
- It provides the interpersonal and legal skills to propose a solution, which the creditor firm does not have and would be reluctant to incur the cost of providing.
- It assists the creditor in differentiating between 'can't pay' and 'won't pay' customers by providing a holistic view of the debtor's circumstances. A number of creditors, e.g. utilities, will not have the systems/processes to enable them to make this distinction or to understand the level of multiple debts that the customer might have. The holistic view will help the creditor to decide on the most cost effective method of debt recovery.
- It takes the emotion out of the issue.
- It provides comfort in knowing that the debtor's income is likely to have been maximised.

> 'It is helpful where each individual advice agency tends always to use the same format of documents, etc. – so we know that it will be comparable and we know where to find things – this is much easier than dealing with hand-written information from individuals. Even easier if they use the CFS.'
>
> 'They have the advice skills and legal knowledge.'
>
> 'They can offer advice – we cannot advise – we are in a collections environment and we do not have complete knowledge of the debtor's circumstances.'
>
> 'Debtors [often] don't want to deal with their banks, and banks don't have the resources to do the hand-holding.'

Negative aspects

Creditors also identified some important negative features of debt advice.

Not all creditors felt that the generally adopted 'pro rata' approach to making payments was fair; for example, it was sometimes viewed as benefiting those who undertook 'riskier' lending and charged higher interest rates and/or the minority who declined to freeze interest and charges. Added to this there was also a feeling that there could be bias towards these same creditor categories during the period that payment arrangements were in place; debtors might request a rebalancing of payments to those accounts where the outstanding balance was not reducing (e.g. as a result of added interest) while debt management companies might pay more to those creditors who threatened action, which might result in the collapse or inequality of a debt management plan.

Some creditors emphasised that the involvement of a third party could result in significant and important communications delays in resolving arrears issues.

> 'The amount of time from the initial call to/from the debtor to the Income & Expenditure statement coming in can be very lengthy – e.g. there may be 10 creditors and the agency needs to get details from them all before it can produce a statement and offers – so it could be three months or more before we get any payment, and even then the first two months might go to the advice organisation. But the accounts might have been 120 days in arrears before this process starts – so by the time money comes in the debt may have been sold on.'

> 'Having a third party involved can introduce delay and a blockage – for example, regulations means that we are obliged to go through the agency even if a situation is urgent.'

> 'Our debt management team still want to be able to talk directly to the customer; it is more efficient.'

Some interviewees expressed concern about the lack of regulation of advice agencies, which they saw as at worst allowing some unacceptable practices and, more widely, contributing to an overall lack of consistency in how they operated.

The major concern, although not strictly a criticism of the advice agencies per se, was the generally late stage at which debtors tended to involve them; it was widely agreed that the benefit from advice would be increased significantly if debtors could be persuaded to involve them sooner.

Creditor attitudes to specific types of advice organisation

Creditors differentiated quite clearly between different types of independent advice organisations and the advantages and disadvantages each brought them.

CAB and other not-for-profit agencies

As the largest not-for-profit advice provider, comments were made most frequently about the CAB. Its major contribution to delivering advice, particularly to more vulnerable consumers, was recognised and appreciated. The CAB was also well regarded by creditors for, generally, advising their clients to try to meet their obligations and not just to look for a quick way out, in stark contrast to claims management companies. Another agency, Christians Against Poverty, was praised even more for this. When compared with fee-paid services it was also felt that the CAB tended to be more thorough in differentiating between priority and other debts and less likely to skew payment offers towards creditors who might threaten to sue.

Another benefit of the not-for-profit sector, compared with fee-paid options, was that they were seen as better at providing holistic support and, in particular, maximising debtors' income.

> 'Everyone appreciates the role of charitable debt advice.'
>
> 'We get a lot out of our relationship with the CAB.'
>
> 'So, if people have been advised, it gives us confidence that they will have had their income reviewed and maximised – many of the advice agencies are aware of benevolent funds, etc., that may be able to assist as well as having the expertise to ensure that all available benefits are claimed. We do not have this knowledge, so this can increase the returns to us.'

Nevertheless, in terms of the CAB's potential to deliver direct benefit to them as opposed to its clients, creditors were less positive in their assessment. Issues mentioned included:

- The relatively low income of the CAB's client base meant that, typically, they were unable to deliver much in the way of repayment.
- One creditor mentioned that restricted CAB opening hours could result in delays in gathering important information.
- The processes and procedures of some CAB were described as 'antiquated and inconsistent'; one creditor commented, 'They will virtually always write rather than phone; they post in income and expenditure statements.'
- The lack of structured debt management plans added to the administration costs for creditors.

Inevitably, there was also diversity in the attitudes and approaches adopted by different CABs, including a feeling that, in some cases, individual CABs and some other not-for-profit agencies tended to display a bias against creditors. It was said that CAB offers 'can be erratic', and it was suggested that CAB tended not to pay attention to whether the debtor had any equity in their property that could be used to help fund, for example, full and final settlements.

> 'Many of the offers are £1 per month and about half of them break. If they do break then we have to do the running around and contacting, whereas with the fee-paid sector we simply have to get on to the agency.'

> 'While the CAB would advise on the income and expenditure statement, in the end they send in what the client wanted...about 10 to 20 per cent of CAB statements/offers "deserve further investigation".'

> 'Sometimes they are not looking for an exit route; they seem to think that debt problems can be resolved by reducing the amounts owed, not suggesting things like selling your house, need to trade down, etc. Not helping the debtor to make tough choices and making them aware that they can't have it all, that is, the Sky sub, the mobile phone contract, the cigarettes and the house. Debt advice should be making them aware that some tough lifestyle choices have to be made to reduce the debt.'

Fair Shares-funded and larger, established fee-paid agencies

Creditors generally did not differentiate between the Fair Shares-funded agencies and the larger, more established fee-paid agencies. Views tended to be quite favourable regarding both of these.

A major advantage offered by them, from a creditor perspective, was that, in contrast to much of the not-for-profit sector, they tended to be very efficient and up-to-date in their procedures and communications. Examples cited were the wider use of email, the provision of income and expenditure statements in spreadsheet formats that sometimes could be dropped straight into the creditor's own systems, the use of BACS to make token or debt management plan payments, and the provision of regular statements on payments made and balances outstanding for all of the clients of the creditor whose repayments they were managing.

> 'The larger, fee-paid organisations are also quite innovative in how they communicate with us – e.g. web portals; spreadsheets; electronic faxes.'

> 'There are very good fee-charging firms who provide good advice and are looking after the customer.'

> 'With CCCS and Payplan you have someone who is more committed to resolving their debt problems. You have someone who has made the effort to pick up the phone rather than wander into their local CAB.'

> 'The fee-paid services are more scientific and consistent in calculating what to offer, and their offers tend to be a little higher than those from free services.'

There were further cost-saving benefits to creditors from the fact that these agencies often took full responsibility for trying to ensure that their clients' plans did not 'break', as they had a vested interest in the sustainability and longevity of repayment arrangements; creditors knew that the larger fee-paid and the Fair Shares agencies would work to sustain payment plans so the task of chasing missed payments could be passed to them.

One creditor who was interviewed also suggested that clients of the Fair Shares organisations tended to be more committed than many of those of the not-for-profit agencies.

Interestingly, conflicting views were found as to whether the fee-paid agencies delivered greater amounts to creditors than the not-for-profit sector. Against this, a fee-paid advice agency estimated that they tended to offer lower monthly payments but as a result of greater longevity delivered more overall.

Inevitably, the main downside stressed by creditors was that the funding of Fair Shares and fee-paid agencies alike was seen as coming from a pool of money that could have been allocated to greater repayments, and the costs of advice were sometimes viewed as excessive.

One creditor interviewed argued that it was unfortunate that creditors felt unable (for reputational and regulatory reasons) to signpost clients to reputable fee-paid services. It was felt that the larger fee-paid services provided a service equal to that of free services and that, were referrals made to them, their charges could be reduced to reflect lower lead generation costs.

> 'I think we tend to offer/ask debtors to pay a bit less; but it means that our longevity tends to be better so we get more in the long run by allowing debtors a "modest but adequate" budget. I estimate that over the lifetime of a DMP our plans will deliver about 20 per cent more to the creditors than a CCCS/Payplan.'
>
> (Fee-paid advice interview)

> 'Fair Shares costs and/or fees – these are amounts that could have been coming to us.'

> 'We worry that some charge very high fees and are concerned about "churning" of customers from DMP (after the agency has taken the first three months' payments), then default and they shift the customer into IVA and take another fee. This behaviour clearly is not good for creditors.'

Smaller fee-paid debt management and claims management companies

Whilst they recognised that some smaller debt management companies were professional and sought to act in their clients' interests, creditors were generally more negative about the role they played; they were criticised in particular for perceived poor customer service.

> 'You can see that the firm just wants to disburse the money so that they can get their commission.'

> 'Little effort is made in completing [financial statements].'

> 'We have concerns about behaviours of some fee-based firms. Attitudes vary

> according to whether the agency is just doing admin versus really managing the client; the former is not really adding value, particularly if they are taking large fee for doing little. Also, there are too many fee-paid firms to deal with.'

There was a feeling that some fees were excessive and that the trend towards higher up-front fees made it more likely that unscrupulous agencies would take the set-up fee and then not work to ensure that payment plans lasted. Such outcomes were very negative for creditors who may have frozen fees and charges whilst receiving none of the plan payments in the first two or three months.

Creditors also feel there is insufficient regulation of the fee-paid sector. Another complained about the regulation process from the creditor perspective.

> 'Creditors are lobbying hard for fee-based firms to tidy up their acts. There is a need for a single regulator. The OFT is not really a regulator, just an enforcer responding to complaints.'

> 'If we are unhappy with how an agency is behaving it can take a lot of work/time to investigate and prepare a reference to OFT or BBA.'

Finally, and unsurprisingly, creditors saw no merit in claims management companies. They perceived them to be acting against the interest of creditors and debtors alike. From a creditor perspective, they were viewed as seeking to exploit loopholes and, unjustifiably, denying them access to some enforcement rights. From a debtor perspective, they might take an upfront fee only to find that they could not assist. Even if they did manage to render the debt unenforceable through the courts, that did not remove the problem for the debtor since the creditor could still chase payment and the default remained on credit records.

Trends in creditor attitudes

Overall, creditor attitudes today are more positive than they were in the early 1990s. Twenty years ago, although there was support for debt advice services and their value to creditors was recognised, 'their real value is that they are used by some people who think we will be aggressive and the CABx act as a moderating influence' (Lawson 1989); a number of creditors in that period viewed money advisers as 'an unnecessary stalling device which prevented them from pursuing money through their own internal procedures' (Mannion 1992). In the same period, some creditors felt that debt advice services were 'lacking in uniformity and pulling in different directions' (National Consumer Council 1992a).

Today, the debt advice sector is considered more professional and the positive attitudes of creditors indicate that debt advice is better regarded. As a result, creditors are more welcoming of the services offered by debt advice agencies and recognise their value.

These changing attitudes in part reflect a number of initiatives and activities that have taken place or been built upon to improve the quality of advice, make the industry more professional and improve the dialogue between creditors and advice agencies. These include:

- qualifications such as National Vocational Qualifications (NVQs) in advice and guidance, Institute of Money Advisers (IMA) Certificate in Money Advice Practice and Debt Solution Forum's Certificate in Debt Resolution;

- professional standards as defined by the Institute of Money Advisers, Debt Solution Forum, Debt Managers Standards Association;

- the Common Financial Statement (CFS), a budgeting tool used by many advice agencies and other third party organisations to make debt repayment offers on behalf of clients. Creditors will know that offers are made by independent money advisers, based on expenditure within trigger figures following guidelines;

- CASHflow, an assisted self-help debt advice resource, launched nationally in March 2010. It works by supporting clients to make repayment offers directly to their creditors with assistance from a money advice agency;

- use of technology to provide debt calculation/advice tools such as CCCS's 'Debt Remedy', Citizens Advice online 'Adviceguide' or software packages to assist advisers such as Liquid Advice or DebtPro;

- process changes to increase efficiency such as Citizens Advice's 'Gateway' to identify those with immediate needs;

- the continued work of organisations such as Money Advice Liaison Group (MALG) to promote better communication, best practice and professionalism about creditors, debt advice agencies and other related stakeholders.

As a consequence of this more favourable assessment and the increasing interaction between creditors and debt advice agencies, several creditor firms have set up debt management teams separate from their debt collection activities. These teams deal primarily with communications with third party advice agencies. The reasons given for this development vary:

- Some teams have been set up in response to an increasing number of requests from debt management companies who wanted a named individual that they could deal with in the creditor firm.

- Other firms are said to have undertaken a business case analysis that proved that it was efficient to invest in a dedicated team.

Scope for further improvements

In their interviews creditors also indicated actions debt advice services could take to further help their firms:

- greater use of BACS for payments, which is more cost efficient for creditors;
- greater use of email rather than the postal service to deliver Common Financial Statements;
- use of spreadsheets that can be easily slipped into their own system;
- a consistency in the definition of 'fair expenditure', as this would make it easier to evaluate the repayment offers made;
- like CCCS and Payplan, other free-to-customer debt advice agencies could look to provide the client with an exit strategy from their debt problem instead of 'thinking that debt problems could be resolved by reducing the amounts owed'.

Adequacy of current levels of supply

Several commentators have expressed recent, strong concerns that their available capacity is already insufficient to meet demand. Moreover, they expect that demand to continue to grow, at least in the short to medium term, given the typical time lag between economic deterioration, such as increases in unemployment or part-time working, and consumers eventually seeking advice.

- CAB point to their experience of a time lag in demand following the economic downturn of the 1990s (Edwards 2003: 5).
- A recent report by Legal Aid Services also points to a substantial increase in demand for debt advice (Pleasence and Balmer 2009: 18–19).

Advice UK revealed a wide range of examples of unmet demand and strain on the advice network (Advice UK 2009). Examples drawn from several of its member agencies included:

> Clients must wait on average 4.56 weeks for a debt appointment.
>
> 21.8 per cent of clients attending morning drop-in sessions were turned away in February 2009 – this has been attributed to decreasing capacity in other local agencies.
>
> Waiting times have increased to over 3 weeks from about 1 week for an appointment. Some agencies are only seeing people with priority debts.
>
> Presently we are holding appointments until April where possible or giving people

> other choices (e.g. National Debtline) where the need is more urgent.
>
> Getting difficult to get through to the major telephone debt agencies such as National Debtline and CCCS.

In the longer term, high levels of demand are still expected as a result of the trend for individual debt cases to be more complex, outstanding arrears greater and the recovery responses of creditors faster and less forgiving. This is expected to be so even if total debt levels fall as a combined result of consumer retrenchment and more cautious lending practices.

Capitalise reports similar strains from agencies in London and also highlights the impact of growing complexity and changes in creditor behaviour (Capitalise 2009). It describes the impact of increased complexity as follows:

> While the rise in the level of priority debts is making the need for face-to-face debt advice more pressing, clients are also presenting themselves with an increased number of individual debt issues, making each advice process more complex and time-consuming. Given the constrained capacity of debt advice services in London, this trend increases the time constraints on debt advisers and reduces their ability to see the growing number of people coming for advice. Sometimes people do not get all the help they need, as debt advice agencies balance the demand and complexity with the requirements of their funders to see targeted numbers of people.

Finally, the same report records the changes in creditor behaviour agencies have seen, which again adds to the amount of resource they need to allocate to each case:

> Debt advice agencies have observed creditors reacting to the debt crisis by passing on more cases to debt collection agencies and taking a less conciliatory stance towards their debtors by resorting to county court action or bailiffs or possessing some of the clients' assets. This pressure on debtors is increasing their need to be supported to negotiate with creditors in order to preserve their livelihoods.

Chapter 4
The demand for debt advice and its outcomes

SUMMARY

This chapter examines the overall demand for debt advice, explores who does and does not seek advice and reports on what actions are taken following advice. Key findings include:

- Up to 5.5 million households are either currently in arrears (2 million) or are at risk of falling into arrears in the near future if economic conditions change for the worse (3.5 million).
- Each household falling into arrears has multiple types of credit arrangements and an even greater multiple of creditors.
- Approximately 2 million consumers per annum access debt advice, with the number rising in recent years. However, not all of these are currently in arrears; half are struggling but not yet in arrears.
- Of the 2 million individuals currently in arrears, only around half have sought independent debt advice, with many of the remainder avoiding contact with creditors.
- Most of those who use debt advice and who are in arrears have been in arrears for some time and across multiple creditors. Most are on low incomes but a significant and growing minority are higher earners.
- There appear to be few attitudinal or demographic differences between those in arrears who use advice and those who do not; however, advice users typically have more and larger debts and are more likely to have been chased by their creditors.
- Those who receive debt advice are satisfied with the advice they receive and tend to follow the advice given. This includes cutting back on spending, contacting their creditors, and taking out a debt management plan or seeking insolvency solutions. Many report a drop in level of contact and chasing by creditors and that they have avoided creditors taking legal action.
- Research also suggests that, in some cases, advisers also undertake a lot of tasks on their client's behalf (many of them potentially beneficial to creditors).

Consumers in arrears or in danger of going into arrears

Recent surveys have estimated the number of consumers/households in arrears:

- The 2008/09 YouGov DebtTrack survey recorded 3 per cent of respondents stating they had 'fallen behind with *many* bills or credit commitments', and a further 4 per cent had 'fallen behind with *some* bills or credit commitments' (quoted in Department for Business, Innovation and Skills 2010). Taken together, this gives a total of 7 per cent of consumers currently in arrears. Based on an estimate of c.26 million UK households,[10] this implies that just over 1.8 million households are in arrears on '*some*' or '*many*' commitments.

- Results from the Wealth & Assets Survey indicated that 10 per cent of all households, approximately 2.6 million if applied to the UK, were in arrears on at least one non-mortgage commitment (Office for National Statistics 2010).

- Bank of England research conducted in 2009 reported that 11 per cent, equivalent to around 2.9 million households, either 'had fallen behind on some or many payments' or 'kept up with bills and credit commitments but had a constant struggle' (Bank of England 2009).

Overall, therefore, the available data point to there being in the region of 2.0–2.5 million households who are in arrears with bills or credit commitments.

Arguably, the YouGov survey also provides an estimate of the numbers who may be in danger of falling into arrears. In addition to the 70 per cent who indicated current arrears on some or many bills, a further 14 percent stated that they 'were keeping up with bills and commitments but finding it a *constant* struggle'. This represents another approximately 3.6 million households.

Consequently, taking the widest interpretation of a 'target audience' who, from a creditor perspective, might benefit from debt advice, a total emerges of around 5.5–6.0 million households.

Demographic profile

The YouGov DebtTrack survey confirms the widely observed pattern that those in arrears are strongly over-represented among those on low incomes, living in rented accommodation, especially social housing, and where one or more adults in the household are unemployed or long-term sick/disabled. Nevertheless, it also emerged that a sizeable minority (close to one fifth) of those in arrears were households with incomes above £30,000 per annum, while more than a third were likely to have some, although typically small, equity in their homes. These are likely to offer greater potential for 'recovery' from a creditor perspective.

Selected details of the demographics and usage of credit products of those in arrears or in danger of going into arrears, compared with the total population, are included in the Appendix.

Demand for and users of debt advice services

The YouGov survey found that just fewer than 5 per cent of households had used debt advice services in the preceding six months, equating to around 1,250,000 users.[11] It also confirmed that those facing the greatest debt problems were the most likely to avail themselves of advice services, as shown in Table 2.[12]

It is unsurprising that those with the greatest debt issues (who represent 3 per cent of the population) are more likely to use advice services (39 per cent of them used debt advice in the past six months). Nevertheless, the data in Table 2 also draw attention to the fact that it is still

Table 2
Users of debt advice.

Arrears status	*Proportion of total population (column percentage)*	*Proportion of this group having used debt advice services in the preceding six months (row percentage)*	*Total number (based on c.26m households)*	*Proportion of all advice users (column percentage)*
Keeping up with all bills/credit commitments, but it is a struggle from time to time.	35.6	3.1	287,000	23
Keeping up with all bills/credit commitments but it is a constant struggle.	16.0	9.6	399,000	32
Falling behind with some bills/credit commitments.	4.2	24.2	264,000	21
Real financial difficulties and fallen behind with many bills/ credit commitments.	3.0	38.5	300,000	24
Total			1,250,000	

only a minority of those in arrears who had accessed advice within the last six months. Also, as a result of the distribution shown above, it was the case that just under half (45 per cent) of advice users were currently in arrears; the remainder were struggling but had not yet fallen behind with payments.[13]

These data also show that approximately three out of four of those who were already behind with *some* commitments and around six out of ten of those behind with *many* commitments had *not* used advice services in the previous six months. The combined total of these (c.1.3 million)[14] was broadly similar to the total number (c.1.25 million) of all advice users in the same period.

Debt advice services used

Data from the YouGov survey confirmed that the Citizens Advice Bureaux are the most widely used debt advice service. The proportions of debt advice users citing each of the leading providers are shown in Table 3. Data from the advice services themselves tend to confirm this ranking.

Extrapolation from these numbers, and the shares recorded by the YouGov survey, generally point to around 2 million debt advice users a year, compared with YouGov's estimate of 1.25 million unique users in six months. This estimate is broadly in line with that of Gillespie and Dobbie, who suggested there were around 1.3 to 1.4 million users per annum of free debt

Table 3
Debt advice services used.

Advice organisation	*Proportion of those seeking advice using each agency* *(%)*
CAB	31
CCCS	21
National Debtline	16
Money advice services	10
Other advice centres	9
Insolvency service	6
Payplan	5
Bank manager	5
Independent financial adviser	4
Professional insolvency practitioner	3
Local council	3

advice (excluding fee-paid services and Internet-only and telephone-only services other than National Debtline) (Gillespie and Dobbie 2009). There are no definitive estimates of what proportion of advice users opt for fee-paid rather than free-to-client services.

Table 4

Credit products used by those in arrears and using debt advice.

	Total population (%)	*Keeping up with all commitments/ bills but it is a constant struggle (%)*	*All those in arrears, whether or not sought advice (%)*	*In arrears and had sought advice in previous 6 months (%)*
Mortgage	37	35	31	40
Secured personal loan	5	10	11	15
Unsecured personal loan	20	30	37	58
Authorised overdraft	37	51	46	59
HP agreement	3	5	4	14
Car finance loan	9	8	9	16
DSS/Social Fund loan	2	5	10	7
Loan from friend/ family	7	12	26	29
Catalogue	14	25	28	37
Home collected loan	2	2	14	10
Pawnbroker	0	1	2	2
Student loan	13	13	9	11
Payday loan	1	1	4	5
Store card – balance not paid off	11	15	16	22
Credit card – balance not paid off	44	54	56	68
None of these	28	16	10	5
Average number of product types (excluding mortgages)	1.7	2.3	2.7	3.5

Profile of debt advice users in arrears

Information on the credit products used by those in arrears who had sought advice revealed that typically:

- They are using a wide range of types of credit; they are also using significantly more sources of credit than either the total population or all those in arrears (i.e. advice-seekers and others combined).

- They have significantly higher levels of ownership of a variety of unsecured debt and are high users of less formal or mainstream credit agreements such as payday loans (5 times the population penetration), home collection credit (5 times), HP agreements (4 times), family and friends (4 times), social fund loans (3.5 times).

Details of the proportions that used each product type are outlined in Table 4. The mean household income of those having sought advice was £23,600 per annum, with 28 per cent below £11,500 pa and 38 per cent above £25,000 pa.

Levels of indebtedness among those in arrears who had used advice services averaged £16,700 but with 28 per cent owing more than £20,000; 26 per cent owing more than 140 per cent of their annual household income; and 27 per cent with arrears representing more than 100 per cent of their household income (Table 5).

Data specifically from CCCS highlight the dominance of credit cards and unsecured loans in the profile of non-priority debts among those seeking advice. Together these two categories accounted for 85 per cent of CCCS clients' debts; also, in terms of average size of debt they dwarfed all others; mean sizes of debts were £13,109 for credit cards and £13,800 for unsecured loans, while the range for all other unsecured credit categories was between £1,300 and £5,300.

A similar profile emerged from the first wave of the YouGov survey (July 2008). The average amounts owed on a range of unsecured debts (among those with that type of debt) by those who had received advice are shown in Table 6.

Timing and reasons for using debt advice services

There is surprisingly little survey evidence as to why consumers choose to seek help from debt advice services. However, one theme to emerge strongly is that, typically, problems often have to reach crisis point before individuals take the plunge, while advisers and creditors alike believe outcomes would be much better if help were sought earlier. For example, a Ministry of Justice survey found that:

> most respondents (65 per cent) had been *experiencing their current financial difficulties for at least a year*, including 11 per cent who had been experiencing these difficulties for more than five years. Only four per cent of respondents said that they had been experiencing financial difficulties for less than three months.
>
> (Williams and Sansom 2007: 27, emphasis added)

Table 5
Profile of debt among those in arrears seeking debt advice.

	In arrears and had sought advice in previous 6 months
Household unsecured borrowing	
Mean amount	£16,700
Up to £4,000	23%
Over £4,000 to £10,000	24%
Over £10,000 to £20,000	24%
Over £20,000	28%
Household borrowing (excluding mortgage) as % of income	
Up to 30%	34%
Over 30–60%	20%
Over 60–140%	21%
Over 140%	26%
Amount in arrears as % of household income	
Up to 10%	30%
Over 10–50%	32%
Over 50–100%	11%
Over 100%	27%

The report went on to comment

> It is notable that *many respondents do not seem to have sought advice when their problems first surfaced*, as almost half (47 per cent) of those who had been experiencing financial difficulties for more than two years had sought advice less than three months ago.
>
> (Williams and Sansom 2007: 27, emphasis added)

A qualitative longitudinal study commissioned by Friends Provident Foundation also highlighted the strong tendency for debt clients to delay before seeking advice. It commented that '[t]he only interviewees who sought advice as an initial or early option were people who had previously sought advice' (Orton 2008: 30).

It went on to state that,

> The real issue was *how long it was before people sought advice;* some did so before there was an absolute crisis but other interviewees talked in terms of having

Table 6
Average debt levels for those with each product and receiving debt advice.

Type of debt	*Amount of debt (£)*
Unsecured personal loans	9,373
Credit card balances	9,172
Car loans	5,460
Hire purchase agreements	2,881
Home collected loans	1,750
Mail order credit	1,637
Authorised overdrafts	1,592
Store cards	1,308

> reached a point of 'desperation' and 'hopelessness', and for them it was the intervention of a third party that was often critical.
>
> (Orton 2008: 31, emphasis added)

This survey also provides some insight into what had caused delay amongst those who, eventually, decided that they would seek advice after all. The barriers they mentioned included:

> ignorance of available services; nervousness about approaching an advice provider when people had little idea what to expect; and debt advice being a last resort. Seeking advice can be difficult when it is seen as representing failure, meaning the person could no longer manage their own finances and was unable to cope.
>
> (Orton 2008: 31)

Finally, CCCS confirmed that it was their experience that clients tended to have struggled with financial problems for some time before coming to them; they estimate that almost two-thirds (62 per cent) of their clients have had debt problems for a year or more before coming to them.[15]

Reasons for not using debt advice services

The most frequently mentioned reasons given by those who were in arrears but had not used advice is either that they are confident they do not need assistance or simply that they have not got around to it. Results from the YouGov survey are shown in Table 7.

A survey conducted by ComRes on behalf of R3 showed a similar pattern. Respondents who were in financial difficulty and had not contacted their creditors were asked why they had not contacted anyone for help. The responses are shown in Table 8.

Table 7

Reasons for not using debt advice among those in arrears (YouGov).

Reasons given for not using debt advice	*Proportion giving this answer among consumers who were in arrears but had not used advice (%)*
Do not need advice	25
Not got round to it	14
Have received advice previously and know what to do	13
Received poor advice in the past and do not want to return	10
Got advice elsewhere (e.g. via a website/friend/relative)	9
Know advice is available but do not know how to contact providers	8
Unaware such services were available	5

Source: Aggregate results from four waves of the YouGov DebtTrack survey (June 2008 to February 2009).

Table 8

Reasons for not using debt advice among those in financial difficulty (ComRes)

Reasons given for not using debt advice	*Proportion giving this answer among consumers who were in arrears but had not used advice (%)*
I don't think the problem is big enough to need help	44
It's a short-term problem	25
It's easier not to think about it	21
I don't know where to go for help	21
I can't afford help or advice	20
I'm worried about what people will think	14
I'm scared about the effect on my family	11
I don't trust anyone to help	11
I'm afraid of being made bankrupt	9
Other	3

Source: R3 2010.

Trends in the demand for and use of debt advice

No long-term surveys were identified that had measured trends over time in the demand for and use of debt advice services. However, information from the main agencies confirms that:

- the number of users has grown significantly in recent years;
- the scale of the problems they face is increasing;
- some changes have been noted in the profile of debt advice users.

Trends in the number of debt advice users and severity of their problems

Evidence provided by or about the agencies include:

- CAB reports that its number of debt advice clients has doubled in the past decade (Citizens Advice 2009).
- The National Audit Office (2010) states that debt advice providers funded by government over-indebtedness strategy programmes reported a 28 per cent increase in the number of clients making contact, in a single year between July 2008 and July 2009.
- CCCS reported 335,323 calls to their helpline in 2009. This represented a 32 per cent increase over the 2007 level (CCCS 2010a).
- The Scottish CAB further reported that the mean size of client debt had increased from £13,380 in 2003 to £20,193 in 2008, and the mean ratio of debt to income has worsened in the same period since debts have grown faster than incomes (Citizens Advice Scotland 2009).
- The Scottish CAB reports sizeable increases between 2003 and 2008 in the proportion of its debt clients with particular types of debt. Examples include credit cards (up from 55 per cent of clients in 2003 to 69 per cent in 2008), unsecured loans (up from 53 per cent to 65 per cent), overdraft (25 per cent to 44 per cent) and mail order/catalogue credit (19 per cent to 30 per cent); as a consequence, the average number of types of debt per client had increased from 2.74 to 3.70 (Citizens Advice Scotland 2009).

Trends in the profile of debt advice users

There appear to be mixed trends in the profile of debt advice clients and in their ability to repay. CCCS has seen a small trend towards clients with slightly higher incomes (the proportion earning £30,000 and over among their clients has increased from 8.4 per cent in 2007 to 12.0 per cent in 2009). At a recent BBA conference they commented that one of the big changes has been an increase in male, white collar unemployed and underemployed seeking help. They have also seen a decline in the average size of debts and, recently, a slight fall in the number of consumers seeking help because credit has become harder to obtain. However, at the same time, they are finding that fewer of their clients can sustain a debt management plan and that, in around one-third of cases now, they can only advise those seeking help to attempt to increase their income; this proportion has grown from 2 per cent in 2007 to 33 per cent in 2009 (CCCS 2010b). Similar changes were reported in 2009 (Gillespie and Dobbie 2009). Taken together these trends suggest:

- More higher income consumers are being drawn into debt problems.
- Consumers are making some efforts to reduce their debt exposure and/or are finding it more difficult to access credit.
- Surplus income available to make repayments on arrears is being squeezed by other costs rising faster than incomes, for example energy price increases.

Comparing users and non-users

A key problem in measuring the impact of debt advice services is the question of how those who were advised would have behaved in the absence of that advice. It is possible, for example, that those who seek out advice might not be typical of all those facing debt problems. They might be naturally more organised or 'activist' and, consequently, likely to have taken steps to repay their arrears; in that case it would be misleading to attribute all of any reduction in their debts to the impact of debt advice.

The 'ideal' way to assess this issue would be via a random controlled trial. Unfortunately, there have been almost no such studies on the topic of debt advice.[16] However, by comparing the profile of those who have, and have not, used debt advice services some insights may be gained into whether or not users are somehow different to the total universe of those in arrears.

In the YouGov sample of those who were in arrears, few significant differences either in demographics or attitudes emerged between those who had sought advice in the past six months and those who had not (although those who had not sought advice includes both those who have never sought advice and those who have sought advice but longer ago than six months). This was in sharp contrast to a comparison from the same survey between all those in arrears and the rest of the nationally representative sample; here, those in arrears (advice-seekers and others combined) recorded very different attitudes to money and also were concentrated in particular demographic groups.

By contrast, the only relevant demographic differences that emerged between those in arrears having been advised and those who had not been were that the former were slightly more likely to be living in social rented accommodation (27 per cent compared with 23 per cent), and to be unemployed (10 per cent against 6 per cent) or disabled/long-term ill (22 per cent compared with 16 per cent).

On attitudes to money there were essentially no major differences between those in arrears who had recently been advised and those who had not. Details are shown in the Appendix.

The only area of significant difference to emerge between those who had sought advice and those who had not was in the level of use of some (although not all) financial products and in current levels of debt/arrears.

Those in arrears who sought advice were more likely to be using, for example, unsecured personal loans (used by 58 per cent of advice seekers against 34 per cent of those not seeking advice), mail order credit (37 per cent compared with 29 per cent), store cards (22 per cent compared with 13 per cent) and credit cards (68 per cent compared with 58 per cent). Full details of differences in products used and in levels of debt and arrears between the two groups are shown in the Appendix.

The likelihood of having sought advice, however, was strongly associated with the extent to which the household had been involved in creditor action. In the YouGov survey, two-fifths (39 per cent) of those who had been involved in one or more of bankruptcy, IVA, CCJ or a DMP had sought advice on debt in the preceding six months. Among all households in structural arrears (more than three months behind in payments), 18 per cent had sought advice, compared with 9 per cent of those who were less than three months in arrears and less than 5 per cent across the total population.

Overall, these data on the differences between advice-seekers and others do not make the case that the former are more activist and, consequently, more likely to repay their debts anyway; however, neither can they prove that no such difference exists.

Advice outcomes

It is unlikely that debt advice will have a real impact on debtor behaviour (and so potentially on creditor outcomes) unless debtors feel satisfied with the service they have received, they receive objective advice and act upon the advice they have been given. In fact, evidence points strongly to users of debt advice being almost universally favourable towards the service they have received and there have been high levels of action based on the advice given.

Satisfaction with advice services

For example, the NAO survey conducted by Opinion Leader found that 50 per cent of users felt the face-to-face advice they had received had exceeded their expectations, while a further 37 per cent stated that it had met expectations; 92 per cent said they would recommend the service to a friend and 97 per cent had found it helpful.[17] Similarly, a customer satisfaction survey for National Debtline reported that 95 per cent of callers from 2008 who were surveyed reported that they were satisfied, 75 per cent had been extremely satisfied with the advice received and 85 per cent would recommend the service to others experiencing debt problems.[18]

Overall, there is little doubt that free debt advice services are generally well received by clients using them.

A similar picture emerges for fee-paid services provided by members of one of the two leading trade associations, Debt Managers Standards Association (DEMSA), which represents around 70 per cent of the industry's turnover. Results from their 2009 customer satisfaction survey showed that 58 per cent of respondents rated the service received as 'excellent' and a further 21 per cent classified it as 'good'.

Following advice received

Available survey evidence shows high proportions of clients claiming that they have followed the advice they were given. NAO investigated whether or not consumers acted on the advice they received from the government-funded services they were evaluating. They found 'almost everyone given advice by any of the three advice agencies whose clients we sampled had taken that advice' (National Audit Office 2010). Their results showed, for example, that the proportions who claimed to have followed the advice they were given were 98 per cent for CCCS users, 95 per cent for users of the BIS-funded face-to-face advice schemes and 88 per cent for National Debtline.

Actions taken as a result of advice

The YouGov survey asked participants who had received debt advice what actions they had taken *as a result* of the advice received. Obviously, it is not possible to know what steps might have been taken in the absence of advice. Nevertheless, the high proportion of those who did act, and the nature of the steps taken by them, suggests that the advice process had some impact.

The steps attributed specifically to advice received are shown in Table 9. The actions likely to have the greatest impact on creditors are the high proportions that went on to contact their creditors and also the significant numbers who had implemented bankruptcy or an IVA or a DMP. In particular, a number of creditor organisations interviewed for this study emphasised that encouraging debtors to make contact with their creditors was probably the most important outcome from their perspective.

Table 9
Actions taken by those receiving advice.

	Total (%)	*Keeping up but a constant struggle to do so (%)*	*Falling behind on some commitments (%)*	*Fallen behind on many commitments (%)*
Cut back on spending	59	57	55	64
Drawn up a budget plan	53	51	42	62
Taken out a consolidation loan	8	14	9	3
Contacted creditors	52	33	49	69
Enquired about a DMP	26	15	20	40
Enquired about an IVA	11	8	6	17
Enquired about going bankrupt	10	7	10	13
Took out a DMP	21	12	15	34
Took out an IVA	3	4	0	4
Went bankrupt	1	0	0	3
Done nothing so far	9	12	13	4

Where the YouGov survey *was* able to compare between those who had received advice and those who had not, it found some evidence of a difference in the proportions taking less specific actions, although the quantum of change may have been more significant. Those who had been advised recently were more likely to say that they had reduced spending across a number of categories. They were also likely to have taken a second job. It is also of interest that those who had *not* recently been advised were slightly more likely to have used savings or borrowed more on overdraft or credit cards to address their financial position (Table 10).

Clear differences did emerge, however, in the relative proportions stating they had adopted bankrupt, or taken out an IVA or DMP, as shown in Table 11. As might be expected, those who have recently received advice were considerably more likely to be using a DMP than those who have not recently received advice or have never sought it.

Table 10
Differences in actions between those taking advice and those not.

	Proportion taking action among those who had recently received advice (%)	*Proportion taking action among those who had NOT recently received advice (%)*
Taken an extra job	12	7
Not taken a holiday	66	62
Reduced spend on food	82	74
Changed supermarket	39	32
Cut back on oil/gas/electricity	61	58
Used car less	50	45
Went out less	70	72
Spent less on take-aways/alcohol	65	66
Spent less on shoes/clothes	78	76
Spent less on ‘nice to haves’	76	75
Cut back on spending on the family	60	58
Used money from savings/investments	16	28
Borrowed on overdraft	38	43
Borrowed more on credit card	33	36
Re-mortgaged	5	4
Asked friends/family for help	46	42
Cancelled TV subscription	27	23
Not paid bills until final demand	66	64
Cut back on birthday/Christmas presents	68	59
Cancelled mobile phone subscription	8	10

Table 11
Structured solutions already used by those taking and not taking advice

	Recently received advice			*Have not recently received advice*		
Have already adopted	*Not fallen behind but constant struggle (%)*	*Falling behind on some commit-ments (%)*	*Fallen behind on many commit-ments (%)*	*Not fallen behind but constant struggle (%)*	*Falling behind on some commit-ment (%)*	*Fallen behind on many commit-ments (%)*
DMP	41	38	55	6	10	28
IVA	8	5	8	2	4	3
Bankrupt	6	5	7	2	2	4

It also emerged from the YouGov data (four quarterly waves aggregated from 2008–09) that those who had received advice in the previous six months were considerably more likely to have contacted all types of creditor than were those who had not received advice. Among those who were more than three months in arrears on different types of bills/commitments, the proportion that had made contact with the creditor concerned is shown in Table 12.

Table 12
Contact with creditors.

Proportions of those in arrears by three months or more who had made contact with the creditor concerned in the past six months	*Those who had received advice in the past six months (%)*	*Those who had not received advice in the past six months (%)*	*Difference (%)*
Gas	84	72	12
Electricity	88	73	15
Water	84	60	24
Mortgage	92	82	10
Rent	81	73	8
Council tax	64	54	10
Credit cards	64	52	12
Store cards	65	43	22
Personal loan	91	74	17
Other debts	84	66	18

This pattern was also found by the Department for Business, Innovation and Skills. Their survey reported that:

> the likelihood of having contacted creditors was somewhat higher for the small group who had sought professional advice on debt (59 per cent), compared with those that had not sought advice (37 per cent).
>
> (Department for Business, Innovation and Skills 2010: 35)

A similar result was recorded by a pilot study into the impact of debt advice specifically from not-for-profit advice agencies. This commented:

> The results indicate that, following advice, clients were more likely to take action to try to resolve their debt problems themselves. For instance, more clients had contacted creditors themselves following advice, whereas few had done this at the point of advice.
>
> (Williams and Sansom 2007: iii)

A Legal Services Commission report highlighted the difficulties that debtors tended to find in trying to tackle their problems prior to receiving advice:

> For the most part, the approaches used by clients to try and cope with their debt problems prior to contacting a debt outreach project offered a temporary stop-gap. Most clients had tried to negotiate with at least some of their creditors to reduce payments or to arrange to make up missed payments. Few had reached any agreement with their creditors themselves.
>
> (Buck et al. 2009)

Other actions resulting from advice including adviser interventions

Another finding to emerge is that advisers tend not only to stimulate greater action from their clients; they also undertake a lot of tasks on their behalf (many of them potentially beneficial to creditors) and also seem to reduce the need for creditors to take some actions, again potentially beneficial to the latter. Quite detailed evidence of these impacts is available from the Ministry of Justice survey (Williams and Sansom 2007). This study is striking in terms of how strongly it reveals that generally actions were taken by advisers on behalf of their clients, rather than by the clients themselves. This represents a clear contribution from the advice process in advancing the progress of debt resolution. The report comments:

> the onus is on advisers to plan and carry out most of the specified actions. For instance, 71 per cent of advisers had planned or actually worked out a budget plan on behalf of respondents compared with only three per cent of respondents who planned to do it or had done it themselves. The results were similar for actions such as negotiating to reduce payments or to freeze interest rates on debts, where 55 per cent and 46 per cent of advisers respectively had planned or actually done these things compared with only four per cent and two per cent [respectively] of respondents [who had done these things themselves].
>
> (Williams and Sansom 2007: 55)

Evidence also emerged that sometimes the intervention of advisers was necessary to bring credibility to debtor offers; in some instances, creditors would accept an offer made via an adviser that they had previously rejected when made by the debtor directly. This may imply that creditors trust many (if not all) advisers and so are benefiting through their intervention as it helps streamline their own decision-making. Previous qualitative research funded by Friends Provident Foundation found that 'some interviewees expressed frustration that advocacy was required to persuade creditors to accept offers that the interviewee had already made' (Orton 2008: 35).

Turning to the reduction in creditor actions, at the time of receiving advice respondents from the Ministry of Justice research were asked which creditor actions they had been threatened with and which had actually happened to them since the beginning of their current financial problem. Details in Table 13 indicate a high level of creditor activity aimed at achieving repayment of arrears. However, the project report noted that in this study 'most clients had been to the agency for advice before' (Williams and Sansom 2007: 55); consequently, the levels of creditor activity reported will overstate the typical level experienced by clients at the point they initially opt to receive advice. In addition, the survey was largely conducted among face-to-face crisis debt advice services likely to attract those facing more severe debt issues.

However, in the follow-up stages of the research, debtors reported that the effects of the advice given had included significant reductions in the impact of creditor actions and, therefore, almost certainly in the overall level of creditor action and associated costs (Table 14). These last data suggest strongly that debt advice brings about a change in the balance between creditor-led and debtor-led actions that lead to resolving debt defaults.

Table 13
Creditor actions.

	Has happened (%)	*Threatened with (%)*
Received letters/phone calls	89	
Involvement of a debt recovery agency	65	59
Legal action to recover debt	23	53
CCJ	21	35
Disconnection of gas, electricity or landline	15	21
Action by bailiffs	13	32

Table 14
Impact of advice on creditor actions – selected effects of advice given.

	6 months after advice (%)	*12 months after advice (%)*
Avoided legal action or further legal action	75	70
Avoided action or further action by bailiffs	74	41
Stopped unreasonable harassment from creditors	70	59
Stopped letters/phone calls from creditors	69	64
Prevented a possession order being made	67	34
Prevented/helped with other enforcement procedures	66	39
Avoided a CCJ	62	30
Helped avoid eviction	61	31
Avoided disconnection of gas, electricity or landline	56	25

Chapter 5
Approaches to managing consumer default

SUMMARY

In this chapter we examine further the different approaches open to creditors and customers in managing arrears and defaults. Key findings include:

- Creditors employ a number of proactive and reactive techniques in managing accounts in default.
- Where customers fail to respond to communication and attempts to recover debt, recourse to the county courts can be the only option for creditors, although creditors claim to be using this action less in recent years.
- Creditor-led court actions may give rise to several hundred pounds of additional cost but may result in creditors being repaid in full or part.
- Many of those in financial difficulty find it difficult to deal with their creditors, either because they cannot bring themselves to contact creditors or because creditors do not respond to their request.
- Debt advice can lead to different outcomes for customers and creditors, with the potential for different costs and recovery rates.

Management of arrears can be achieved through either creditor actions or debtor actions; the latter often done with help of independent debt advice. The different approaches give rise to different costs for creditors and their customers and potentially change the profile of recovery for creditors.

Creditors' management of arrears

Recent years have seen lenders put in place new measures for dealing with customers who find themselves unable to deal with their debts, either as a result of voluntary codes such as the Lending Code (British Bankers' Association et al. 2009) or FSA regulation of the mortgage market. Many lenders have moved away from aggressive approaches to managing defaults, but advice agencies continue to report differences in approach between creditors. Citizens Advice reported in February 2010 on a number of measures of best practice that it believes can improve recovery rates for creditors (MacDermott 2010), including:

- setting the right organisational culture, including adopting a flexible approach that responds to an individual's circumstances;
- achieving the right motivation for debt collection staff with incentives that relate to the sustainability of solutions;
- developing clear communications that encourage customers to engage in the process;
- providing information and support;
- being willing and able to maintain and develop best practice, including the development of feedback loops between advisers, customers and internal staff.

Creditors have a number of tools at their disposal to manage defaults. On a proactive basis, more credit rating data and formulae are being developed to target lending more effectively. Some creditors may also vary their pricing (typically interest rates) to take account of differences in the probability of customer default. If the customer does default, the creditor may already have 'recovered' some of the costs that it expects to incur as a result of future possible defaults. If the customer does not default, the relationship has proven profitable for the creditor and the customer has improved their credit rating.

However advanced these proactive tools become, they cannot always identify customers who may, at a later date, find themselves in financial difficulty. Several creditors are now applying more sophisticated analysis of customer data to try to identify those most at risk of default before arrears arise.

Once customers are in default and arrears start to build up, cases are typically dealt with by standard processes involving letters and phone calls to the customer. In many cases, customers

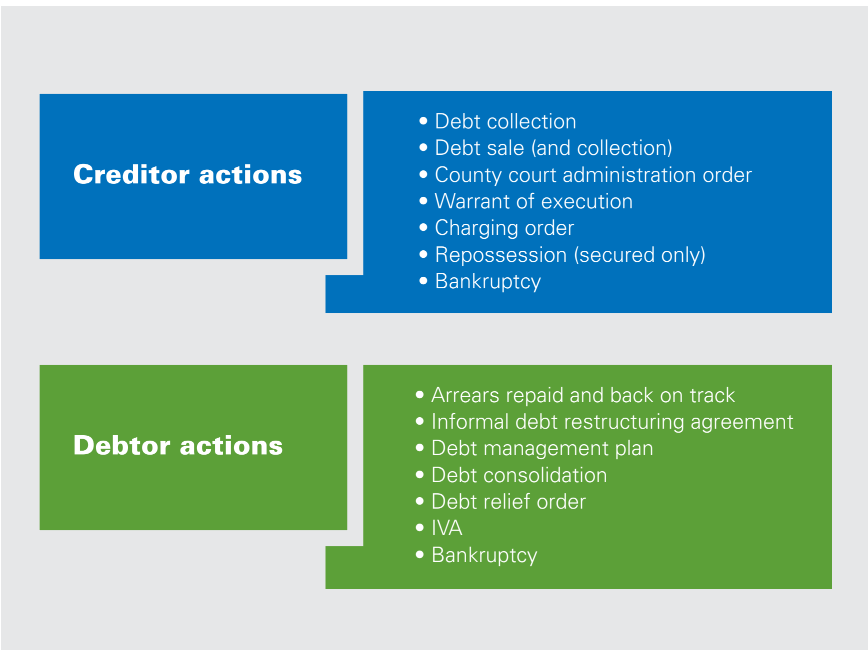

Figure 7
Debt recovery solutions: debtor or creditor initiated.

remedy the situation and return to standard repayments. In other instances, customers agree a revised repayment schedule with their creditor(s) without recourse to independent debt advice. Some creditors introduce or recommend the client to independent debt advice at this stage of the process. Research suggests that very few customers seek independent advice at this stage of the process. However, where they do, costs that would otherwise have been incurred in later stages of the recovery process will have been saved.

Where arrears move beyond a certain period (which may vary by creditor and type of credit), creditors transfer customers to debt collection departments. These may be internal departments; subsidiaries, sometimes operating under a different brand; or external agencies appointed by creditors to collect their debts for them. These teams are naturally focused on recovering the maximum amount of debt for the creditor and may be incentivised on the amount recovered. Once customers are transferred to one of these teams, they will be pursued actively for repayment with the ultimate sanction being a claim being made by the creditor for an order or warrant through the county courts. Some debt collection teams are encouraged to suggest to clients that they seek help from an independent debt advice organisation.

Once debt collection procedures have been initiated, customers come under more pressure to remedy their situation, including the threat and use of court action to reclaim the debt. In some cases, the threat alone can be enough to encourage the customer to enter into negotiations with individual creditors or to seek advice. Where creditors are made aware that advice is being given, they will normally call a halt to any further proceedings until it becomes clear whether agreement on repayment can be reached. Interest and further charges may also be frozen, an action which is helpful to the customer but either reduces profitability for the creditor or leads to higher charges for other customers. The direct costs of debt collection such as staff time, phone call and external agency fees, are therefore borne by the creditor but, again, ultimately feed through to higher charges for other customers and/or lower profitability. Ofwat report that that the costs of debt recovery and write-offs adds about £12 a year to every household bill (Ofwat 2010).

However, some customers continue to avoid contact with creditors (for reasons outlined below) and, in some cases, with debt advice agencies. In these cases, creditors are left with initiating court action as their only remaining option. Claims for personal debts are usually put before the county courts. In 2009, just under 1.5 million 'money claims' were presented to the courts in England and Wales, although not all of these involved personal debt. Many of these cases will not reach court since creditors and their customers are given a chance to reach agreement before this happens (through pre-action protocols). Once again, this stage of the creditor process may trigger the customer to seek help from a debt advice agency. The advice may or may not be able to forestall or reverse the court process by helping the customer reach an agreement with creditors. However, even at this stage of the process, some customers still fail to seek advice.

In 2008 (latest annual figures from Registry Trust), the number of judgments against individuals reached over 800,000 (81 per cent of all of the county court judgments in the year). These claims represented amounts of £2,938 million or an average of around £3,600 per customer (Registry Trust 2009).

Among those that do reach court, the first action of the courts will be to order the customer to repay the debt either in instalments or in one lump sum. If the customer fails to do so, the creditor can go back to court and seek a warrant or further order. The courts issued more than 688,000 orders or warrants during 2009 (once again, not all of these relate to personal debt). The main options open to creditors, where they believe that customers can repay some or all of their debt, include:

- Warrants of execution, which allow for goods owned by the customer to be sold to repay the debt. This may involve the appointment of a bailiff to seize goods. Forty per cent of all orders and warrants issued in 2009 were of this nature.

- Possession orders, where creditors with secured debt are permitted to repossess property and sell it in order to recover debts. Not all possession orders are acted on by creditors. One quarter of all 2009 orders and warrants were possession orders.

- Charging orders, where the unsecured debt is secured against the person's assets, typically the equity they hold in their home. Ultimately, the creditor may be able to seek a court order for the sale of the property (although the number of these remains very low). Almost one in five orders and warrants issued in 2009 involved charging orders.

- Attachment of earnings, where the courts require payments to creditors to be deducted by the individual's employer and paid directly to the creditor from the individual's pay. Ten per cent of all 2009 orders and warrants were for an attachment.

- Administration orders, whereby the courts take on a role similar to that of a debt management company and distribute a debtor's payments across his or her creditors. Where the courts agree to act in this way, 10 per cent of each payment is taken by the court to cover costs, which does not reduce the debt owed but may ultimately affect the amount recovered by the creditor. In practice, very few administration orders are implemented by the courts.

As reported earlier, levels of warrants and orders fell during 2009 from higher levels in 2008, but overall they rose again slightly in the first quarter of 2010.

Where creditors are unable to recover debt in any of these ways, or where customers have defaulted on judgments, creditors may then petition the courts for bankruptcy (debtors may also petition for bankruptcy of their own accord – see below).[19] The number of creditor-led bankruptcies has been falling in recent years, whilst the number of debtor-initiated bankruptcies has been on the rise.

In all cases where court action is taken, the court costs and sometimes the creditor's legal costs are added to the customer's debt. Costs vary according to the level of debt and the way in which the claim is made. Based on the average amount claimed of £3,600, costs to initiate a CCJ would amount to approximately £100. Possession orders cost £100 or £150 depending upon the process. Further fees are then payable by the creditor to list the case and for hearing fees. Tracking fees vary between £35 for very small claims to £200 per case for fast-track and multi-track claims. Hearing fees may reach £1,000, but for a typical case could be in the order of £100. Creditors submitting a bankruptcy order will be charged £190 and may incur listing and hearing fees in addition. Pursuing an average amount of £3,600 through the courts might give rise to costs of several hundred pounds, all or just some of which might be recovered from the customer.

The customer may also be liable to pay bailiff costs, and in some cases may continue to accrue interest after a judgment. All of this can add considerably to the debt owed by the customer but does not necessarily result in the creditor recovering all of those costs. In cases where courts judge that actions have been taken too early, in situations where the customer has offered to make a reasonable payment or where the customer clearly cannot pay, the court may decide not to assign the creditor's costs to the customer.

Creditors may also find that court solutions do not lead to full repayment of all capital and interest outstanding. Some of the debt may, in the end, be written off.

Debtor-led solutions

Around 2 million households currently find themselves struggling with debt. In many cases they find themselves unable to resolve the issue directly with their creditors, either because they feel unable to deal with their creditors or because their creditors will not agree terms with them.

Research into the behavioural economics of engagement with debt (Summers et al. 2005) has shown that reasons for consumer lack of engagement with creditors include:

- a failure to see contact with creditors or debt advice as normal social behaviour (norms);
- anticipation that they will regret contacting their creditors or advice agencies more than they will regret failure to contact (anticipated affect);
- a belief that they are incapable of dealing with the situation (self-efficacy);
- a belief that contacting creditors or advisers will be difficult, e.g. long waits for calls to be answered (perceived behavioural control);
- a belief that events are outside of one's control (locus of control);
- a perception that they are not responsible for their debt position or for sorting it out (attribution style);
- adopting an avoidance style – 'head in the sand' behaviour (coping styles);

- a belief that the benefit of engaging does not outweigh the losses incurred by not engaging, in part framed by the belief that creditors might not act to regain the debt owed (loss/gain framing);
- a belief that if they do nothing, their debt will go away (optimism);
- the sense that waiting for things to get worse is somehow better than engaging (procrastination and hyperbolic discounting);
- hiding from the threat of further action from creditors due to fear (fear-control response).

Whatever the root cause, many of these individuals avoid or totally ignore early calls from creditors to repay debts or, worse still, borrow more to pay off those creditors that shout most loudly. Borrowing from Peter to pay Paul is a common feature of the behaviour of these customers.

Advice agencies also report that, even where customers are proactive in approaching their creditors, they are in some instances rebuffed. Some creditors will accept solutions proposed by a debt advice agency that are identical to solutions presented directly by the customer but previously rejected by the creditor.

Another reason for lack of engagement between customers and creditors given by some of those interviewed related to the nature of the people employed by creditors to collect debts. Creditor staff employed to manage customer relationships or collect arrears may be incentivised on the value of the debt recovered. Several of those interviewed for this project expressed the view that individual creditor organisations do not typically employ the type of individuals who can deal proactively with this type of customer.

> Front line agents are focused on collecting debt and are not trained (generally) to deal with clients who are in distress. The competencies required to deal with distressed customers are different to those required to collect debt, so if banks want to help those in debt, they need to recruit different people.
>
> (Industry body interview for this research)

Moreover, where customers have multiple debts, it can prove difficult or inappropriate for one single creditor to try to deal with the issue. Some creditors are now actively recommending that such customers seek the help of independent debt advice agencies, typically free-to-customer agencies.

Where customers do seek the help of an independent debt advice agency, a number of different solutions become available to them. In some cases, debt advice can lead to customers getting back on track. In others they may employ solutions that lead to more structured repayments where all or some of the outstanding debt is repaid. In some cases, only insolvency solutions are available.

Solutions available to a customer will vary according to the level of debt, the surplus income available to the customer and the assets owned (particularly where the customer is a homeowner). Debt advice agencies and the Money Advice Trust have suggested that the range of solutions is incomplete and complex and that some customers cannot be offered any solution because they fall through the gaps created by current solutions.

The main customer-led solutions are outlined below.

Individual negotiations with creditors/debt repayment plan

Although these solutions are available to customers without the aid of a debt advice agency, customers often report that the help given by the agency (whether self-help packs, online support, phone or face-to-face advice) helps them overcome their fears and the difficulties of dealing with creditors, and confirms that dealing with creditors is a social norm (norms, self-efficacy, perceived behavioural control and locus of control barriers identified above).

The use of standard forms such as the sample letters and the Common Financial Statement (CFS) ease the process and should ensure that creditors respond in a consistent manner to offers made by customers. Agencies may help customers through the process of negotiation. They may also help clients maximise their income through claiming benefits or advising them to sell assets, putting them in a better position to either repay their debt or offer creditors token payments whilst they get their finances in order or seek new employment.

From a creditor perspective, rescheduling arrangements may not result in recovery of 100 per cent of the debt, including arrears, future interest and charges being repaid, and some write-off may occur. Interest and charges will, in many cases, be frozen. The need to resort to the courts, along with the associated costs, should be eliminated, and the creditor's own debt collection department's activities can be put on hold. However, some replacement costs may arise for creditors in handling individual restructuring cases or in dealing with the debt advice agency.

The extent to which this solution is employed varies from agency to agency. Longitudinal customer research by National Debtline (NDL) suggests that 70 per cent of their recent customers contact their creditors after dealing with NDL, that 80 per cent of these (56 per cent of customers) are successful in coming to an arrangement with creditors and that 90 per cent of these (just over half of all users) keep to their agreements. Some of the remaining half will go elsewhere for solutions, such as DMPs or IVAs.

Citizens Advice customers, particularly those given full face-to-face support, are unlikely to be able to pursue this option, in part because they have a different income profile and in part because they tend to be less confident in being able to deal with their creditors.

Among CCCS customers, the 30 per cent for whom CCCS were unable to recommend a structured solution and the 5 per cent who meet their payments may have found themselves in a position of having to carry out the negotiations with their creditors.

Where voluntary agreements are put in place and fail, they may be followed up by a more structured DMP, some form of insolvency, or by creditors pursuing debts through the courts.

Debt management plans (DMPs)

Where customers have multiple unsecured debts, typically in excess of around £5,000, and surplus income over expenditure, they may be advised to resolve their debt issues through a DMP. Some debt advice agencies operate their own DMPs whilst others refer to external organisations.

DMPs involve a single payment being made to an organisation that manages DMPs, who then distribute payments to individual creditors. Companies that manage DMPs fall into two categories: fee-based agencies, where the customer pays a fee that is deducted from their payments; and free-to-customer agencies where the whole of the payment is passed across to creditors, some of whom pass back a Fair Shares payment to the agency. From the perspective of creditors, there may be a considerable difference in the amount that they recover through different types of DMP company, depending upon:

- whether they participate in the Fair Shares scheme. If they do, they receive in net terms 90 per cent of the amount paid through CCCS and Payplan. If not, they receive 100 per cent of their share;

- the amount that is deducted in fees by the fee-based DMP companies. In many cases, this amounts to more than the 10 per cent paid to CCCS/Payplan, but the fees are paid by the customer in addition to repaying the full debt so the costs to the creditor are lower than under Fair Share payments. Market data on fees is not available but some of the larger DMP companies publish rates of 15 per cent or more of the monthly payments, plus an initial fee equal to the first one or two months' payments;

- whether realistic payments have been set up that the customer can sustain. Sustainability of DMPs almost certainly varies by type of company, but no published data is available.

Where payments are made in bulk by the DMP company, DMPs should be more efficient for creditors than one-to-one negotiations with clients. Efficient systems are required on the part of the debt management company (DMC) for this efficiency gain to be realised.

Whilst most creditors now accept DMPs as a valid form of debt repayment, albeit that they may receive back less than 100 per cent of the full debt, including interest due and charges, there remain some differences in approach between creditors. Debt advice agencies report that some creditors continue to renegotiate higher payments within a short time of a DMP being set up, which can result in the DMP collapsing for all creditors. Customers may also prefer to pay a disproportionate amount of their repayments to creditors that do not freeze interest and charges in response to a failure to reduce the amount they owe on these accounts. In either event, some DMP creditors may benefit more than others.

At present, the establishment of a DMP does not protect the customer from actions by a creditor and may not be binding on creditors if they are not being paid in full.

The Government has recently consulted on whether a statutory alternative to DMPs should be put in place. At the time of writing, the consultation had been closed but the policy response had not yet been made. Were statutory plans to be implemented, this would change considerably the DMP market.

Token payments

Whilst not technically a final solution, making token payments is an interim solution employed by debt advice agencies for those customers who appear to be having temporary problems with repayment of debt. Token payments per creditor can be as low as £1 per month but are often £5 per month. Token payments are agreed for a relatively short length of time and are then typically followed by one or more of the creditor- or debtor-led solutions.

Debt relief orders (DROs)

For those customers with unsecured debts of less than £15,000, who are not homeowners, who have very few other assets and who have no prospect of repaying their debts, DROs offer a low-cost form of insolvency. Costs to the debtor are £90, compared with costs of £510 for bankruptcy. Debts are generally written off in their entirety after a year and creditors are prevented from taking any further action. For creditors, the loss is 100 per cent of the debt owed. For debtors there are restrictions placed on further borrowing for a year and the existence of the DRO is placed on a public register, which will affect future credit ratings and ability to borrow.

Individual voluntary arrangements (IVAs)

Subject to agreement by creditors with more than 75 per cent of the debt owed, IVAs are a form of insolvency open to those who have surplus income or assets but who are unlikely to be able to repay their debts in full. Anecdotal evidence suggests that creditors get back between 30–40 per cent of the debts owed under IVAs, and that average (mean) debts under an IVA are just under £60,000 (CCCS 2009). Where the customer owns equity in their home, this will typically be included as an amount that can be repaid to creditors. The costs of insolvency are carried by the customer and paid to the insolvency practitioner who administers the scheme. The benefits for creditors lie in the opportunity to reclaim a reasonable level of debt without resorting to their own court actions and the transfer of costs from the creditor to the debtor (although this will reduce the amount of debt that can be paid off).

Bankruptcy

Where other routes to repaying debt are exhausted, customers can initiate their own bankruptcy proceedings. Creditors are repaid some of the outstanding debt from the sale of any assets or surplus income (for up to three years), with the remainder written off. Fees of

£510 are paid by the customer (thus reducing the amount available to the creditor) but are cheaper than creditor-initiated bankruptcy.

Impact of debt advice on outcomes

The availability of debt advice and a range of associated debtor-led solutions have changed the landscape for debt recovery for creditors. Debt advice can lead to different outcomes that may, in turn, lead to different recovery rates for creditors and a transfer of some costs from the creditor to the customer. However, the picture is far from simple due to the ability of creditors to pass on some or all of the costs of creditor-led actions to their debtors.

In the next chapter we examine in more detail whether creditors recover more from customers who seek debt advice than they would were debt advice not available, and whether there are cost efficiencies and savings for creditors through the application of debt advice.

Chapter 6
The impact of independent debt advice on creditors: Research studies

SUMMARY

This chapter seeks to understand whether the impact that independent debt advice has on creditors can be measured using existing research. Key findings include:

- Very few research studies have been conducted into the impact of advice from a creditor perspective, and several of these are not UK studies. Even fewer studies have been structured in such a way as to show robustly the true impact of advice.
- Some of the research does point to positive outcomes for creditors, for example, in the form of lower levels of debt following debt advice, but overall the research results are not definitive.
- A limited UK-based study showed a greater improvement in debtors' own assessment of their debt situation among those taking advice compared to those who did not, but no measurable improvement in their arrears.
- A US study found that advice led to a substantial reduction in debt among those using the service but attributed some of the improvements in creditworthiness among those using advice to motivational or other characteristics of those using advice.
- Another US study showed that a credit card company experienced significantly lower losses with customers using debt management plans compared to those not doing so, and that the difference was approximately twice the level of Fair Shares contribution made by the creditor.
- A comparison of a sample of recent UK users of debt advice with a sample that either had not received advice or had not received it recently, revealed those receiving advice having lower debt levels and those without advice having higher debt levels over the period.
- A further UK study that tracked advice users revealed a 40 per cent reduction in the average amount owed to creditors, but a reduction in the amount paid to creditors over time.
- The case for debt advice in terms of improved creditor outcomes cannot be proven based on existing research.

Many studies have sought to measure the 'impact' of advice, usually from a debtor rather than creditor perspective. In terms of robustness of methodology, the rank order is:

- random trials where debtors are allocated to an advice (treatment) or control group on an unbiased basis;
- studies that compare outcomes for those who have received advice with similar groups of those who had not received advice, but where access to advice is not based on random allocation;
- studies that report on outcomes for those who have received advice but provide no 'counter-factual' in terms of outcomes for those who have not received advice.

Findings from studies with a 'control' group

Department for Constitutional Affairs/National Debtline study: a UK study

Few random controlled studies have been conducted. The most ambitious UK attempt was the trial that formed part of the Department for Constitutional Affairs' 'Impact of Debt Advice Research Project' (Legal Services Research Centre 2007). The study involved 402 participants, all of whom had debt problems about which they had not sought advice. Half of the participants, chosen at random, were offered advice via National Debtline, while the remainder were not. However, the 'explanatory power' of the study was reduced by:

- general sample attrition;
- the take-up of the offer of free advice was quite low (35 per cent);
- a proportion (10 per cent) of the 'no advice' control group in fact accessed advice independently.

The likelihood of identifying any impact from advice was possibly also reduced by the decision to use a telephone-based service rather than potentially more intensive face-to-face support.

The key positive finding was that there was a statistically significant difference between the treatment group and control group in the proportion of debtors who regarded their situation as *improved*. At a 20-week follow-up interview, 47 per cent of those who were offered advice reported a change for the better, compared to just 37 per cent of those in the control group.

However, other results failed to show statistically significant differences between the treatment and control groups. After 20 weeks, 35 per cent of the treatment group were debt-free but so were 37 per cent of the control group. Comparative figures for those who had reduced arrears were 50 per cent against 42 per cent.

Overall, the report concedes that 'the control trial provided no direct support for the proposition that advice leads to a significant reduction in levels of debt' (Legal Services Research Centre 2007: 18).

However, it must be recognised that there is a danger of a 'false negative' from this study due to the issues identified above that reduced its planned 'explanatory power' and also its limited time-scale with a single 'after' interview conducted less than six months later. The report further argues that:

> the fact that the assistance provided to advice agency study clients[20] (in contrast to control study participants) commonly involved direct negotiation with creditors over repayment and interest levels, something that clients much less frequently undertook on their own, suggests that the help they received should have at least facilitated debt reduction.
>
> (Legal Services Research Centre 2007: 20)

It goes on:

> The control trial focused on a limited advice service, provided from a remote location and aimed at helping people to help themselves…It could have been argued that even more positive results would have flowed from the random control trial had a more proactive advice service been studied.
>
> (Legal Services Research Centre 2007: 20)

The impact of credit counselling: two US studies

The US study that incorporated a control group approach, although not random allocation, was *The Impact of Credit Counseling on Subsequent Borrower Credit Usage and Payment Behavior* (Elliehausen et al. 2003). It examined the impact of one-on-one counselling delivered by five non-profit agencies to approximately 14,000 clients during a five-month period in 1997. Credit bureau data provided objective measures of credit performance for these clients over a three-year period following the initial counselling session, as well as for a large comparison sample of individuals with risk profiles and geographic residences similar to the client group in 1997 but who were not identified by the five agencies as having been counselled.

The report concludes, 'This study demonstrates, for the first time, that one-on-one credit counseling has a positive impact on borrower behavior over an extended period' (Elliehausen et al. 2003: 31).

It found that borrowers who had been counselled subsequently enjoyed better credit ratings and that across a broad range of specific credit characteristics (e.g., number of accounts with positive balances, total debt, revolving debt, bank card percentage utilization), counselled clients experienced improvement relative to the comparison group. Also, delinquency experience (as measured by the reduction in 30+ and 60+ day delinquencies) after three years was substantially better for counselled clients, relative to the comparison group. A later analysis of the same study concluded that:

> On seven different measures of borrower credit performance, including an overall index of creditworthiness, the borrowers who received credit counseling improved their profile and performance over the subsequent three years, relative to borrowers with similar initial credit profiles who did not receive counseling. Statistical analysis to correct for borrower self-selection into counseling revealed that much of the improvement was attributable to motivation or other unique characteristics of the group of borrowers who chose to seek counseling. This was especially true of the observed change in borrower credit scores. But *across several specific measures of credit usage (e.g., total debt, total active accounts), counseling itself was associated with substantial reduction in debt and improved account usage measured three years later.* Moreover, it appears that the counseling experience provided the greatest benefit to those borrowers who had demonstrated the least ability to handle credit at the outset.
>
> (Elliehausen et al. 2007: 27, emphasis added)

Another, relatively simple, US study compared outcomes between two sets of cardholders at a large chain store. One group enrolled in debt management plans and the other did not. The make-up of the two groups was controlled to include similar distributions of credit scores. The chain lost money on both groups of accounts, but it lost 32 per cent less on the accounts in debt management plans. Taking into account Fair Share payments to the credit counselling organisations the chain's net losses were 17 per cent lower in the advised group (cited in Hunt 2005).

Findings from a study comparing separate samples of advice users and non-users

Such studies can provide a prima facie case that those who receive advice may perform better in reducing their financial problems than those who do not receive advice. However, in the absence of a robust control group methodology, it is not possible to be certain that all, or even part, of any difference can be attributed to the impact of the advice; it may reflect a selection effect rather than a treatment effect.

The YouGov longitudinal study[21] provides some evidence of different outcomes between those who had received advice at some point during the study and those who had not. Thus there are some indications from this study that the over-indebted consumers who had received debt advice performed somewhat better in improving their financial position than did those who had not receive advice.

The mean (based on the mid-points of ranges) amount of unsecured borrowing was measured at each of the four research waves. The trend in the results is shown in Table 15.

Table 15
The impact of advice on levels of debt.

Mean level of unsecured borrowings at:	*Received advice*	*Not received advice*
Wave 1 (June 2008)	£12,443	£8,579
Wave 2 (September 2008)	£12,985	£8,785
Wave 3 (November 2008)	£12,532	£9,207
Wave 4 (February 2009)	£11,872	£9,322

The mean indebtedness of those who had not received advice during the relevant period increased by 8.7 per cent, while amongst those who had been advised it reduced by 4.6 per cent. Had those who had been advised also increased by 8.7 per cent, their mean debt at the end of Wave 4 would have been £13,525 rather than £11,872. This difference in performance of £1,635 is equivalent to 13.3 per cent of the initial mean borrowings of £12,443.

Findings from studies of users of debt advice alone

Studies of the experience of users of debt advice alone are able to show whether their debt position improves following advice. What they cannot do, of course, is:

- compare the experience of advice users with similar non-users and, consequently, provide insight into how much of any improvement might have occurred even in the absence of advice;
- demonstrate causality, i.e. provide an estimate of the extent to which improvements among advice users were a direct consequence of the advice received.

One UK evaluation study reports sizeable impacts, including relative to the cost of providing the advice. The Money Advice Outreach Evaluation (Smith and Patel 2008) sought to measure the impact of several outreach projects. It reported data on 5,863 closed cases, the mean debt of which was £7,675. It found that the average pilot programme cost per closed case was £454 and that the average length of staff time committed to closed debt cases was around four and a half hours (263 minutes). Key outcomes measured for closed cases were as shown in Table 16.

The mean level of debt reported by the advice agency study clients was observed to fall from £18,780 at the time of the advice, to £11,195 one year later, a fall of 40 per cent. Some of the fall can be attributed to repayments made by debtors (a positive outcome for creditors) and some to write-offs by creditors (a negative outcome). Six months after advice, 59 per cent of debtors said that they owed less than they had when they first received advice and this grew to 67 per cent after 12 months.

Table 16
Outcomes for those using money advice.

	Percent of closed cases
Payment plan	35
Debt written off	9
Client represented in court	5
Increase in annual income	8
Referral to other advice/support	5
Client opted to use IVA	4
Client became bankrupt	5
Avoidance of threatened loss of home	5
Securing lump sum (including back payment)	4
Avoidance of threatened utilities disconnection	3

A tangential benefit also was a sharp reduction in the number of debtors who did not know how much they owed; this fell from 20 per cent at the point of receiving advice to only 5 per cent a year later, suggesting that they were better placed to address their problems.

However, an interesting outcome was that there was a decrease in the average amount being paid to creditors. Before receiving advice the average was £97 per month; six months later it was £70 per month and a year later, £69 per month. The reason for the decline is not reported but may be linked to some debtors having their debts written off or to customers establishing more sustainable repayment plans. Also linked to this was a sizeable increase in the proportion of respondents who said they found paying what they owed less difficult; one year after being advised, 56 per cent said that they found paying what they owed less difficult.

Chapter 7
Quantifying the impact of debt advice on creditors: A model

SUMMARY

In this chapter we examine and seek to quantify the effect of independent debt advice on the creditor market. Key findings include:

- Existing evidence suggests, but does not prove, that debt advice leads to improved outcomes for creditors, particularly around recovery rates and administration costs.
- While data to test this is in short supply and fragmented, we have built a model to test the impact on recovery rates that will nevertheless require further refinement and challenge in order to improve its robustness.
- The model suggests that creditors benefit from the delivery of independent debt advice in the form of higher recovery rates, with benefits ranging from £173 million to £2.1 billion. When looked at on a per individual basis, creditors (as a whole) are estimated to receive between £100 and £1,300 more in repayments, depending upon the assumptions made.
- Creditors are also thought to gain through reduced administration costs. Extrapolating from admittedly very limited data, debt advice would have to reduce creditor costs by 40 per cent to show a positive benefit for creditors after the costs of face-to-face advice, but considerably less than this if other forms of advice were provided. This benefit excludes any benefits from higher recovery rates.
- Taken together, the findings of this research and modelling would appear to provide considerable support for the hypothesis that 'The use by the over-indebted of crisis debt advice leads to better outcomes for creditors when compared to other pathways to resolution of defaults'.

The theory of improved creditor outcomes

In assessing the impact of crisis debt advice on the creditor market, we developed a theory, or hypothesis, to test during our research and to form the basis of our modelling. In developing this theory we have sought to simplify what is a very complex model of behaviour on the part of creditors, the over-indebted in general, users of debt advice in particular, and debt advice itself.

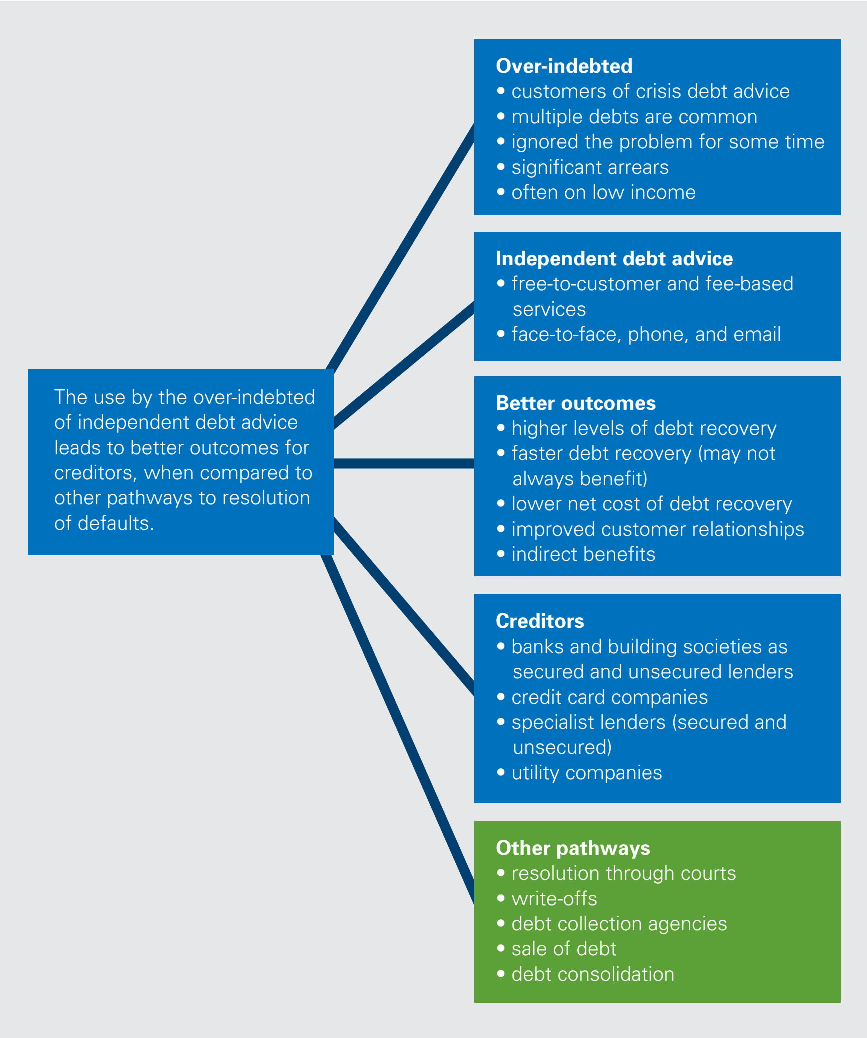

Figure 8
A theory of improved creditor outcomes.

The theory that this research project set out to test can be described as follows:

> The use by the over-indebted of crisis debt advice leads to better outcomes for creditors when compared to other pathways to resolution of defaults.

Figure 8 provides further definition around the theory and in particular sets an initial view of what might constitute better outcomes for creditors.

The initial theory rests on a number of assumptions that were being tested through this research, including assumptions about the characteristics of individuals who use debt advice; the outcomes from those advice services; the different outcomes that would arise if that advice were not available; and the behaviour of creditors in the absence of such advice. We explore each of these below.

The hypothesis asserts that, in net terms, outcomes for creditors are improved by the provision of independent debt advice. Better outcomes could arise in a number of ways. The first order effects would seem to be improved recovery rates and lower costs:

- If the provision of independent debt advice leads to customers repaying more of their original debt, interest and charges than would otherwise occur, creditors should find themselves with lower levels of provision for bad debts and lower levels of write-off.

- Some outcomes for creditors and debtors can give rise to higher costs than other outcomes. In particular, solutions that involve resorting to the courts appear to give rise to higher costs (some of which will be borne by the creditor) than solutions that lead to customer-led insolvency solutions.

The analysis below concentrates on the first order effects. However, there would also appear to be potential for second order effects for creditors, namely:

- An improvement in the provision for bad debt should reduce the burden of risk-based capital required under Basel II, thus freeing up capital for other uses.

- An improvement in relationships between creditors and their over-indebted customers could lead to a return to longer-term customer profitability and to wider improvements in brand image.

- Lower relative pricing for credit products could lead to improved competitiveness.

Modelling the outcomes for creditors – recovery rates

Model caveats

The model described below has been built upon very limited published data and incorporates a number of assumptions, which we have made explicit. We present the model not so much as a statement of what we believe the position to be, but rather, as an 'Aunt Sally' which we hope will encourage dialogue, challenge and further research.

The baseline results shown below are based on our best efforts but readers should not give any disproportionate weight to the baseline when comparing to the sensitivities.

In addressing the potential benefits below, we are mindful of the differentials that may exist between different creditors. It is often stated by debt advice agencies that those creditors who shout loudest or who have the more aggressive approaches to debt collection are likely to recover a higher proportion of their debts than those who do not. Whilst this behaviour does not necessarily affect the overall amount repaid, it can bring about differential effects between creditors. Whilst we do not model this effect below, we consider it among the overall conclusions of this report.

For the purposes of the modelling, we have focused on levels of unsecured credit. Debt advice agencies tell us that this is the main issue for the over-indebted and that arrears and defaults on unsecured credit far exceed those on secured debt (in large part because consumers themselves prioritise the payment of their mortgages over other debt).

Recovery rates on personal lending are important both for the profitability of the lender but also, for those businesses subject to Basel II regulations (Basel Committee on Banking Supervision 2006), for the calculation of capital requirements. Whilst we do not explore these regulations in detail in this report, we recognise the relationship between recovery rates and the calculations of credit risk. Any systematic improvement in recovery rates might be expected to lead to lower capital requirements for some creditors.

From the outset of the project, it was clear that there would be considerable limitations to testing the theory, not only because full data sets to support or challenge the underlying assumptions would not be available but also because of the absence of any data to support a counterfactual: what would have happened if independent debt advice had not been available?

One option is to compare what happens to those who are similar in profile to the users of debt advice and to examine what outcomes they experience. However, there are a number of reasons why individuals who look similar in other respects might still not act the same in any given situation. So, for example, an individual who currently uses debt advice might be more motivated to 'sort out' their debt situation than a similar person who does not currently use debt advice. Therefore, in the absence of debt advice, they would not act identically.

It is impossible to know for certain what the debt outcomes would be for individuals currently using crisis debt advice, in the absence of such advice. For the purposes of this research, we have assumed that those who receive debt advice, in the main, find a solution which is not creditor-led but that in the absence of debt advice, they would be less likely to find their own solutions and creditor-led actions would be more likely.

Model structure and assumptions

We have documented below details of the variables, data sources and assumptions made that inform the recovery model below.

The model has been constructed using two main scenarios. The first assumes that individuals receive independent debt advice with outcomes driven in the main by the debtor. The second assumes that independent debt advice is not available and that outcomes are driven more by creditor actions. Various sensitivities are then tested.

The key input variables that drive the model are:

- the number of individuals using independent debt advice services in a year;
- average levels of unsecured debt;
- the mix of solutions that are employed to repay/recover debt;
- recovery rates – assumptions about the percentage of debt (capital, interest due and charges).

The outputs from the model are:

- total amount owed by users of debt advice;
- total amount and percentage recovered in each scenario;
- net gain or loss to creditors of debt advice.

Users of independent debt advice

There is no single source of information about the number of users of independent debt advice in any one year. For the purposes of the model, we have excluded the users of fee-based debt advice. We have also adopted a conservative approach of focusing on those customers who are provided with advice, rather than the total number seeking help on debt issues. The number of 1.2 million users of free-to-customer debt advice is used for the modelling. The number was derived from several sources (all have been rounded to the nearest thousand):

- Citizens Advice report that they deal with approximately 600,000 debt queries a year, of which around 150,000–200,000 are serious issues. We have taken 200,000 as a conservative estimate of the number of individuals that are helped by Citizens' Advice. Were a much higher number taken, the impact on creditors would be considerably higher.

- CCCS reports that it received approximately 335,000 phone enquiries and 153,000 website queries in 2009. It goes on to record 121,000 individuals counselled by phone and 68,000 using the online debt remedy support. We have used the lower numbers.

- Payplan do not report any detailed numbers but are believed to help approximately 120,000 individuals (Gillespie and Dobbie 2009).

- National Debtline report receiving approximately 350,000 calls and advising 200,000 individuals. We have used the lower number.

- Other free-to-customer debt advice organisations (Advice UK, local authorities' advice services, LSC funded advice, and others) are estimated to advise a further 406,000 individuals on debt advice (Gillespie and Dobbie 2009).

- No data is available on the number of people advised by fee-based advisers, but on the basis of research analysed in Chapter 6 we have estimated that 100,000 are helped by such organisations.

Evidence from the YouGov survey suggests that the number of users of debt advice in six months is 1.25 million. In a year, this number would not be expected to double but could come close to 2 million. By modelling using 1.2 million we are potentially underestimating the number of users but are focusing on those who were advised/supported through a process rather than all of those who sought information. We are also conscious that the number of users may yet rise as interest rates rise and in time fall back again. We have therefore also modelled the impact using 2 million users and 0.5 million users (see sensitivities below).

Average levels of debt

We have compiled the average level of debt from data supplied by debt advice organisations and from other published data sources. YouGov and other research sources have been used to validate the assumptions. The weighted average unsecured debt level derived from advice agency data is £20,662.

The value of debt used approximates the amount of capital, interest and charges outstanding at the point of seeking debt advice.

- Citizens Advice reports that average debt levels among their customers are approximately £17,000.
- CCCS reports average debt levels of £24,000 whilst Payplan reports an average of £35,000 and National Debtline an average of around £20,000.
- We have assumed an average of £17,000 for all other organisations.

Data from the YouGov survey shows the average unsecured debt levels for those using advice at £16,700, which suggests that the weighted figure may be a little high. However, we are also minded that survey data may understate levels of debt and have therefore used the weighted average above.

In the 'no advice' scenario, we anticipate that customers will accrue higher levels of debt due to the absence of advice. However, in order to show the difference between the advice and no advice scenarios more clearly we have maintained the same level of average debt but have run a sensitivity with higher 'no advice' debt to show what difference this makes.

We have not been able to separate unsecured and secured debt in all cases and may therefore be overstating the level of unsecured debt. However, we have taken comfort from comments from a number of those interviewed that, looked at in the round, levels of unsecured debt far exceed secured debt (for those in difficulty).

We are conscious that levels of debt vary by the method of debt resolution followed. For example, average levels of debt for those pursuing bankruptcy are significantly higher than those using debt relief orders. We could find no comprehensive data to use to weight the results by these differences. Any future refinements to the model could seek to achieve this.

Methods of debt resolution – advice scenario

There is no single or comprehensive data on the routes taken by consumers to repay debt or creditors to recover debt. We have therefore compiled data from a number of sources, validated this against known totals where available and, where data are not available, have made certain assumptions explained below.

One important simplification of the model is that we have assumed in the advice scenario that only debtor-led solutions are employed, a view supported by National Debtline research, which suggests that the majority of clients follow the advice given. However, we recognise that, in practice, creditors may pursue some advised customers through other routes.

In the no advice scenario, we have allowed for a mix of some debtor and creditor solutions. We have assumed that without advice, token payments and debt management plans would not be available. Whilst we accept that this may be an over-simplistic assumption, at present it is a requirement of debt management companies to act in their client's best interests which implies that advice and DMPs are linked.

For the advice scenario, we have relied, in the main, upon data and other information supplied by the debt advice organisations. The main weakness of such data is that it is often based upon recommendations made to clients rather than final outcomes. Without long-term tracking of clients or longitudinal surveys, it is unlikely that any better data will be available.

Final outcomes may be influenced by decisions on the part of debtors, for example:

- Clients may be recommended and helped to negotiate directly with their creditors but may choose to follow or reject this recommendation.
- Some may follow the recommendation and repay all of the money owed, others may be unable to keep up payments and fall back on other solutions.
- Clients may break the terms of their DMP which can lead to revised terms being negotiated with creditors or creditor-led actions.
- Clients may be advised to use an IVA solution but may ultimately end up resorting to bankruptcy.

The final outcome for creditors as a whole may also be influenced by individual creditor behaviour. For example:

- Research by R3[22] suggests that some creditors continue to pursue customers who are subject to IVA or bankruptcy proceedings (R3 2010). Where this occurs, the final outcome for all creditors may be affected.
- Debt advice organisations report that some creditors continue to pursue customers who are seeking to repay through debt management plans, thus breaking the DMP process.
- Debtors are reported to respond more urgently to requests for repayment from creditors adopting a more aggressive approach to debt recovery than to those adopting

a more sympathetic approach. The former are likely to recover more, resulting in repayments being unevenly spread across all creditors.

The assumptions used in the model are based initially on the following data and assumptions:

- CCCS provides the most detailed analysis of recommendations made to customers. They divide these by phone-based advice and web-based solutions (web-based data reported in brackets below). We have adapted the data as follows:

  - 4.7 per cent of phone customers (15.4 per cent of online customers) are reported as meeting their payments. These are assumed to repay all of their arrears and debt and reinstate their regular payments. We assume the same outcome for the 1.9 per cent of CCCS customers (1 per cent) who are advised to realise an asset.

  - 33 per cent of customers (30 per cent) cannot be found a solution and are advised on how to increase their income (although in the future CCCS hopes to move many of these customers on to token payments). We have assumed that these clients have to find a way to negotiate directly with their creditors. As noted below, we adjust the recovery rate on this outcome to reflect the fact that a proportion of customers adopting this route appear to have little income with which to repay customers. The 5 per cent of CCCS customers (4 per cent) reported as having 'other' outcomes are also assumed to adopt DIY solutions.

  - 7 per cent of customers (1 per cent) are placed onto a token payment scheme. Whilst this is a temporary outcome, we have adjusted the recovery rate to reflect the fact that some customers will then move on to other solutions as their income position improves or stays the same (DMP, repayment of arrears, DRO, IVA, etc.).

  - 23 per cent of customers (30 per cent) start a DMP. Some will complete repayments through this mechanism, others will fail to repay all of their debts and reach a full and final settlement with creditors, others will find themselves moving on to other solutions. Research by R3 suggests that 30 per cent of current bankrupts and 30 per cent of current IVA debtors started in a DMP. Using this data and applying it to the current number of DMP customers (but ignoring the timing differences), we estimate that 8 per cent of DMP customers could ultimately move to an IVA and 4 per cent could move to bankruptcy. We reflect these differences in the recovery rate for DMPs (see page 86).

  - 6 per cent of CCCS customers (1 per cent) are directed towards a DRO, 5 per cent (9 per cent) are recommended to seek an IVA, 14 per cent (9 per cent) are recommended to initiate bankruptcy proceedings. We assume that these recommendations are adopted.

- In the absence of any equivalent published data, we assume the same outcomes for Payplan customers (phone-based outcomes only).

- National Debtline tell us that only 1 per cent of their customers are recommended an IVA and that 3 per cent are moved on to a DMP. The National Debtline model of supporting customers to help themselves leads to the vast majority of customers approaching their creditors themselves with a view to agreeing a revised repayment schedule. Although some may move on to other debt advice/debt management organisations, we assume a DIY solution for all remaining National Debtline customers.

- Outcomes for Citizens Advice customers are difficult to estimate. CAB have estimated that approximately 22 per cent of their customers could qualify for a DMP, although this solution is not currently offered through CAB. We have therefore applied this percentage to customers who negotiate directly with creditors. CAB has elsewhere estimated that 30 per cent of their customers could qualify for DROs (Citizens Advice 2009) – again, we have used this percentage to drive the number of DROs for CAB clients. This leaves 48 per cent of CAB customers to distribute between token payments, IVAs and bankruptcy. Since 58 per cent of CAB debt customers are reported to have no spare money (Citizens Advice 2009), some of whom are allocated to DROs above, we have decided to allocate the remaining 48 per cent as follows:

  - 10 per cent of clients to token payments;

  - 18 per cent to IVAs;

  - 20 per cent to bankruptcy.

- We have no data for the remaining free-to-customer organisations but, since many have a charitable structure similar to CAB and may attract a similar profile of client, we have allocated customers in the same proportions.

- Similarly, we have no data for fee-based organisations. However, we do know that these organisations only accept customers from whom they can generate a fee. We have therefore applied the following outcomes:

  - 95 per cent of customers are placed into DMP;

  - 5 per cent are placed into an IVA.

Having started with the data above, we have then sought to validate the results against known market data, in particular against insolvency data (Insolvency Service 2010):

- 11,800 DROs in 2009 and almost 12,000 in the first half of 2010. If annualised to take account of DROs not being available for the whole year in 2009, we might expect there to be in the region of 24,000 in a year;

- 47,641 IVAs set up in 2009;

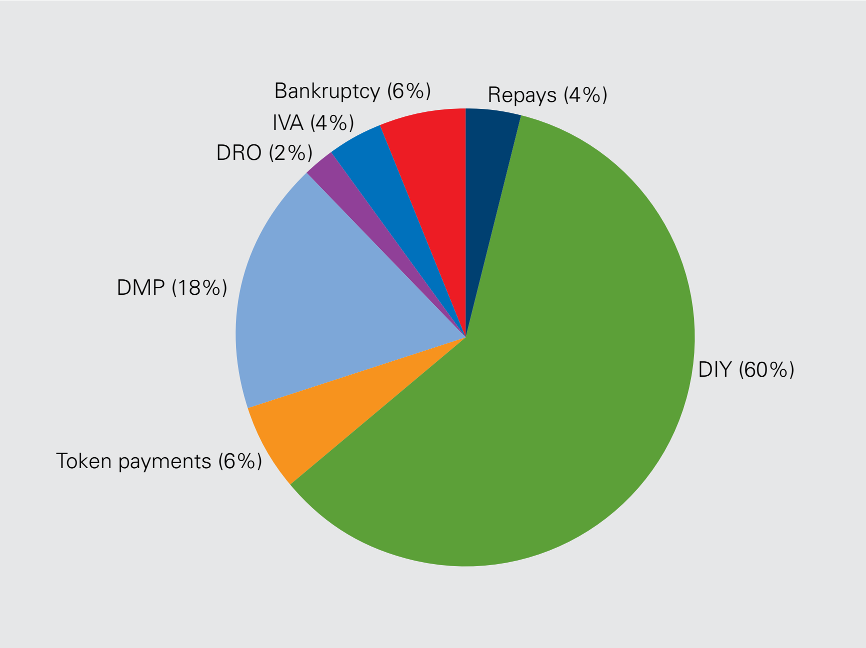

Figure 9
Percentage of outcomes for advice scenario.

- 74,680 bankruptcy orders in 2009, approximately 80 per cent of which are thought to be debt.

We have also reduced the proportion shown to be using DMPs on the grounds that not all will do so, and CCCS data supports this. However, the precise number of DMPs set up each year is unknown. Our model generates approximately 220,000 new DMPs, almost half of which are from fee-based organisations.

Where downward adjustments have been made, these have been reflected in upward adjustments to the proportion negotiating directly with creditors. The result of all of these assumptions generates the picture of debt outcomes for consumers who seek debt advice shown in Figure 9.

Methods of debt resolution – no advice scenario

Having established the outcomes for the advice scenario, we then adjust for a no advice scenario. Overall, we suggest a return to solutions that have become less popular with creditors and debtors alike. Creditors would become more dependent upon the use of debt collection agencies and, in the absence of advice, would likely demand higher performance levels from such agencies. Moreover, in the absence of debt advice, we have assumed that fewer customers would find their way to negotiating directly with their creditors and that those that do would leave it later in the process to do so.

Whilst in a no advice scenario creditors may find themselves having to put more pressure on customers to repay their arrears, overall we see this behaviour as counter-productive in achieving that aim. In this scenario we assume that, in many more cases, creditors will be left with little option but to resort to court-based solutions.

As mentioned above, we have not allowed DMPs and token payments as part of the no advice scenario. We have made the following additional assumptions:

- We have assumed that the same proportion of customers find their way to repay in full, although we assume that they repay 100 per cent since advice agencies will not be asking for charges and interest to be frozen.
- We have roughly halved the proportion of customers who find their way (without advice) to negotiating directly with their creditors; DROs; IVAs and debtor-led bankruptcy. We have no data on which to base this assumption.
- We have allocated the remaining 60 per cent of customers in the following way, although we would point out that we have no strong basis for this split other than evidence that creditors are seeking to avoid court actions and that debt sales are not particularly attractive or easy in the current market:
    - 25 per cent are passed to debt collection agencies or departments;
    - 10 per cent of cases result in charging orders being achieved;
    - 10 per cent of cases result in other court orders being achieved;
    - 10 per cent of cases lead to creditor-initiated bankruptcy;
    - 5 per cent of cases are sold.

We have adjusted for some of the key assumptions made here in the sensitivity testing described below.

Recovery rates

If little is published on outcomes from debt advice (from a creditor perspective), even less data are available on the percentage recovered through different solutions. The assumptions we have used in Table 17 have, wherever possible, been supported with published evidence, but in some cases have been based on anecdotal evidence passed on by those interviewed. We have noted in Table 17 the rationale behind each assumption.

Table 17
Assumptions used for creditor outcomes for unsecured debt.

	Percentage recovered	*Rationale*
Debtor-led actions		
Arrears and debt repaid	90	We have assumed less than 100% to reflect the freezing of charges and interest during periods of negotiation. (100% assumed in no advice scenario)
Debt restructured directly with creditor	55	National Debtline reported to us that their 2008 clients were expected to pay back approximately 55% of their debts (according to research conducted). Most of their clients negotiate directly with creditors. We have applied the National Debtline figure to all customers of debt advice.
Token payments	37	We have calculated this on the assumption that 10% recover and repay their debts, 30% end up on a DMP, 20% each end up with a DRO, IVA and bankruptcy. We have no basis for this split of final outcomes
Debt management plan	60	We have calculated this using CCCS data on DMPs. Based on the total owed by those on DMPs at the end of 2009, the amount repaid each year, and an eight-year average duration, we estimate that approximately 60% of the debt will be repaid. R3 data supports the view that around 60–70% is recovered under DMPs.
Debt relief order	0	Since DROs involve the writing off of all debt, we have assumed a 0% recovery rate.
IVA	30	Repayments in an IVA will depend upon an individual's ability to pay. 20% of IVAs are reported as failing. CCCS reported that for their IVA customers, lenders agreed to write off 57% of the debt. Other advice organisations reported between 20% and 50% recovery. R3 suggest that average IVA debt is £162,000 and that IVA users typically repay £347 per month, which implies a 13% recovery. We have erred on the side of CCCS data and used 30% as the average recovery.
Client-led bankruptcy	10	We have no figures for the recovery rates on debtor-led bankruptcy. The only data available on recovery rates found related to Scottish cases and included corporate bankruptcies. These data showed an average recovery rate of around 50%. We believe that the recovery rate from individual bankruptcies is considerably lower.
Creditor-led actions		
Pass to debt collection agency	40	Anecdotal evidence suggests that creditors receive between 10% and 50% back from debt collection agencies. We have chosen to use a percentage towards the upper end of that range.
Charging orders	90	Given the enhanced security, we assume that the majority of debt is eventually paid off.
Other court orders	35	Supported only by anecdotal evidence suggested by individuals interviewed or more informal discussions.
Creditor-led bankruptcy	15	Supported only by anecdotal evidence suggested by individuals interviewed or more informal discussions.
Sold on	10	Feedback from interviewees has suggested a low return for creditors selling on debt, ranging from 2p to 10p in the £.

Table 18
Model inputs for advice scenario (creditor outcomes for unsecured debt).

With advice	*% of arrears cases where debt advice received*	*% recovered (including arrears, late payment charges and other costs)*
Client-led actions		
Arrears and debt repaid	4	90
Debt restructured directly with creditor	59	55
Token payments	6	35
Debt management plan	18	60
Debt relief order	2	0
IVA	4	30
Client-led bankruptcy	6	10
Creditor-led actions		
Pass to debt collection agency		40
Charging orders		90
Other court orders		35
Creditor-led bankruptcy		15
Sold on		10

Model results – with advice scenario

The final inputs to the 'with advice' scenario are shown in Table 18.

The results for the scenario show that of the £24.7 billion of debt deemed to be owed by the 1.215 million using debt advice:

- £12.6bn is recovered;
- £12.1bn is written off; and
- creditors would on average, or overall, recover 51 per cent of the debts owed.

Table 19
Model inputs for no advice scenario (creditor outcomes for unsecured debt).

Without advice	*% of arrears cases where NO debt advice received*	*% recovered (including arrears, late payment charges and other costs)*
Client-led actions		
Arrears repaid and debt repaid	4	100
Debt restructured directly with creditor	30	55
Token payments		
Debt management plan		
Debt relief order	1	0
IVA	2	30
Client-led bankruptcy	3	10
Creditor-led actions		
Pass to debt collection agency	25	40
Charging orders	10	90
Other court orders	10	35
Creditor-led bankruptcy	10	15
Sold on	5	10

Model results – no advice scenario

In a scenario where no advice is available to consumers, it is likely that higher levels of debt would be accumulated before advice solutions could be found. It is also therefore feasible that recovery rates would be lower as a result. However, we have neither increased the amount owed nor reduced the recovery rates per action but have instead changed the mix of actions taken.

The inputs for the no advice scenario are shown in Table 19.

The results for the scenario show that of the £24.7 billion of debt deemed to be owed by the 1.215 million using debt advice:

- £11.3bn is recovered;
- £13.4bn is written off; and
- creditors would on average, or overall, recover 46 per cent of the debts owed.

Implications for creditors

The difference between the two scenarios suggests that creditors as a whole might recover *just over £1.2 billion* more where debt advice is given, than without it.

Allowing for the estimated £45 million already spent by creditors on Fair Shares payments, the creditors of an average debt advice customer collectively recover in excess of *£1,000 more per individual*. Individual creditors will typically gain less than this amount since individuals are typically in arrears to more than one creditor.

We have not factored in any time value of money to the calculation and accept that some of the repayments under debt advice may be realised some years out from the original default, which reduces the net present value of debt advice repayments against other outcomes.

However, the difference between the two calculations is significant and, moreover, exceeds by some margin the cost of even the most expensive forms of debt advice.

Sensitivity testing

The assumptions that underpin this model are, in a number of cases, unsubstantiated and open to and require further challenge. In order to address this challenge, we have shown what happens to the results if key assumptions are modified. We have run five different sensitivities, and for each we show how the results compare to the baseline results described above. The sensitivities are:

1. The assumed recovery rate for those negotiating directly with their creditors has been reduced from 55 per cent to 40 per cent in both scenarios. Advice ceases to be beneficial to creditors when this falls below 38 per cent.

2. The assumed recovery rate for those on DMPs has been reduced from 60 per cent to 40 per cent. Advice ceases to be beneficial to creditors when this falls below 31 per cent.

3. Creditors are more successful in recovering monies in the no advice scenario (or, as a result of less delay, they recover monies more quickly). The recovery rate on debt collection and court actions is increased by 30 per cent (other than charging orders).[23] Advice ceases to be beneficial to creditors when rates rise by more than 33 per cent.

4. Rather than increase the average level of debt in the 'no advice' scenario to allow for the time delay in creditors and debtors reaching resolution and the lower probability of creditors freezing interest and charges, we reduce the recovery rate for the 'no advice' scenario by 10 per cent.[24]

5. The proportion able to negotiate with their creditors in the absence of debt advice has been increased from 30 per cent to 60 per cent (and reduced the other actions proportionately). This requires creditors to be more successful in communicating with

debtors and takes no account of the likely delay and higher levels of debt that may accrue. Advice ceases to be beneficial to creditors when this rises above 68 per cent.

6 The proportion of individuals who succeed in repaying their debts in full is increased from 4 per cent to 10 per cent in the no advice scenario (which requires creditors to be more successful in encouraging customers to repay and that customers can afford to repay more than appears to be the case under the advice scenario). Advice ceases to be beneficial to creditors when this rises above 13 per cent.

7 We increase the number receiving advice to 2 million. Whilst this does not change the recovery rate or the difference per individual, it does affect the difference that advice makes to the creditor market.

8 We reduce the number receiving advice to 0.5 million. Again, this does not change the recovery rate or the difference per individual, but it does affect the difference that advice makes to the creditor market.

9 Finally, we have removed the customers and outcomes for fee-based advice organisations from the model on the grounds that creditors are unlikely to fund such organisations.

The results of the scenario are shown in Table 20.

Table 20
Results of sensitivity testing.

Sensitivity tests	*Recovery rate advice scenario (%)*	*Recovery rate no advice scenario (%)*	*Difference between scenarios £m*	*Difference per individual*
Baseline	51	46	£1,272	£1,047
Sensitivity 1	42	41	£178	£146
Sensitivity 2	47	46	£374	£308
Sensitivity 3	51	50	£121	£100
Sensitivity 4	51	44	£1,655	£1,362
Sensitivity 5	51	50	£279	£229
Sensitivity 6	51	49	£397	£327
Sensitivity 7	51	46	£2,122	£1,061
Sensitivity 8	51	46	£497	£994
Sensitivity 9	51	46	£1,163	£1,043

The results show that the model is highly sensitive to the assumed recovery rates and to the mix of outcomes but that any one assumption has to change quite substantially before debt advice does not deliver improved recovery rates for creditors. However, the results also reveal that excluding fee-based debt advice from the analysis makes little difference to the impact on creditors.

Modelling the outcomes for creditors – other costs

At the outset of the project, we envisaged being able to collect robust data from creditors on their administrative costs of recovery from creditors. Such data has proven to be unavailable to us. However, there is plenty of anecdotal evidence that creditor costs associated with debt recovery are also reduced by the provision of independent debt advice.

As noted earlier in the report, creditors themselves imply cost savings arising from:

- reduced costs for each creditor arising from the need to continue to chase customers in arrears;
- an overall reduction in the need to spend time understanding the customer's financial position – this cost saving would be magnified across the group of creditors, since the time spent understanding this is undertaken only once, rather than by each creditor independently;
- reduced costs in pursuing customers through the courts.

The only data on administration costs available to us, on which to base any estimate of quantification, is published by Ofwat (Ofwat 2010). They suggest that water companies spend £76 million pa on debt recovery (excluding write-offs) against debts of £1.4bn, so costs equate to 5 per cent of their debts.

If the same proportion of debt is applied to the £24.7bn used in the recovery costs model above as being owed by those customers who seek debt advice, we would find that costs amount to £1.3bn, or more than £1,100 per customer. This per customer average is more than four times the cost of delivering the most expensive form of debt advice – face-to-face (£265 per customer (National Audit Office 2010)), 26 times the cost of delivering phone-based advice (£51) and 83 times the cost of web-based advice (£16).

Face-to-face advice, whilst the most expensive, is also the most likely to replace the costs and activities of creditors in dealing with their customers (e.g. advisers are more likely to help complete the income and expenditure forms). For creditors to see a positive impact from debt advice and taking account of the cost of advice, creditor costs would need to be reduced by more than 24 per cent. Phone-based advice is less costly to deliver but perhaps also less likely to reduce costs for creditors. If by delivering phone-based debt advice, creditor costs were reduced by more than 5 per cent, they would see a positive impact, even after the cost of advice. For web-based advice, the figure is 1 per cent.

Whilst this project has not been able to quantify the cost savings to creditors of customers using independent debt advice, it would appear likely that creditors do make some cost savings.

Taken together with the improvements in recovery costs modelled above, there would appear to be considerable support for the hypothesis described at the start of this section of the report.

In the final chapter of this report we consider this finding in the context of the current funding of independent debt advice.

Chapter 8
Funding and cost of debt advice

SUMMARY

In this chapter we consider the funding relationship between creditors and debt advice organisations and draw together some initial thoughts on the future of funding. Key findings include:

- There is growing concern in the advice sector that its funding base is already unsustainable and likely to come under further strain as a result of cuts in public sector support.
- Not-for-profit services are predominantly supported from the public sector, with only minority contributions from creditors through Fair Shares and corporate donations.
- Whilst the modelling conducted for this project suggests a case for higher creditor contributions, there remain a number of issues that would require resolution in order for creditors to feel more willing to fund independent debt advice.
- Creditors generally recognise that they benefit from debt advice services but also see a number of barriers to contributing, including: perceiving the sector as fragmented and not as efficient as possible; and a feeling that, for several reasons, there is no direct correlation between support given and benefit to the individual creditor.

Current funding

Current funding for debt advice comes from a number of sources. Gillespie and Dobbie (2009) identified the following principle sources of funding for a sample of 'free-to-customer' money advice services:

- Around two-thirds of all funding of free-to-customer charitable debt advice services comes from central and local government in the form of grants from government (an estimated £106m–£109m).
- Approximately 19 per cent of funding comes from charitable donation from the lottery, and other charities.

- 3.3 per cent of the funding for debt advice (excluding Fair Shares payments) comes from the creditor industry or its charitable foundations.

- Around 10 per cent comes from other sources.

Funding is also derived from:

- The creditor industry, in the form of Fair Shares payments to certain debt advice organisations (mainly CCCS and Payplan). Fair Shares payments by the creditor industry are typically 10 per cent of the amount recovered but can be as low as 7 per cent or as high as 15 per cent.[25] CCCS estimate that Fair Shares payments provide their organisation with £25 million per annum and Payplan's parent company accounts for 2008 reveal £16 million in contributions from DMPs. Christians Against Poverty estimate that 6 per cent of their funding comes via Fair Shares payments from 22 organisations. We estimate that around £45m funding per year comes from Fair Shares payments.

- Customers who pay directly for debt advice through fees to DMP companies. Fee-based firms typically charge an initial set-up fee for a debt management plan with monthly charges. A number of companies will apply minimum and maximum monthly charges. During the past year average initial set-up fees have increased from £250 to £290 while the average monthly charge has risen from 15 per cent to 17.5 per cent (Collard 2009; Phillips 2010). It has been estimated that debt management plans will cost consumers £275m in upfront fees and charges in 2010 (Phillips 2010).

The concentrated, public sector funding base of many debt advice services has raised concerns about the adequacy, sustainability and fairness of the funding methods used. Specifically, it has been argued that without a more systematic and equitable means of funding debt advice, there is a danger that the current fragmented system of funding free-to-customer services could result in a duplication of effort among debt advice agencies, poor use of resources and a curtailment of the increased professionalism of debt advice.

Since the growth of debt advice services in the 1990s, the majority of funds for free-to-customer debt advice have come from government and local authorities. Creditor funding is currently limited to part-funding of National Debtline, voluntary contributions through Fair Shares payments and irregular charitable contributions.

Concerns about the future sustainability and volume of funding for free-to-customer debt advice services have been an issue since the 1990s. The Money Advice Trust was established in 1991 and it was specifically targeted to raise sufficient funds for money advice from the private sector. A report by National Consumer Council in 1992 referred to their earlier 1983 report, which stated that, 'the primary responsibility for funding money advice services must lie with central and local government. As creditors will also benefit [from money advice services], we hope that financial institutions may be willing to provide partial funding' (National Consumer Council 1983).

It was found that the private sector was reluctant to contribute. In response to this, the NCC consulted on the options for a statutory levy to fund advice services. But the need for secure funding for money advice services has not gone away. Government policy of 'encouraging contributions from the private sector has not resulted in sufficient funds being made available' (National Consumer Council 1992b).

Their suggested options received a mixed response and the proposals were not followed through as there was no consensus for a statutory levy at that time.

In the current economic climate and with talk about a double-dip recession these concerns have come to the fore again because:

- Funding from the Financial Inclusion Fund is currently due to end in March 2011. The future of continued funding for this project beyond March 2011 will depend on the outcome of the next spending review (House of Commons Committee of Public Accounts 2010) and the priorities of the new coalition government.

- Pressures on Government spending and the current programme of cuts (Fact Box 2010) makes the future for Government grants uncertain. During the previous recession, many voluntary organisations experienced a cut in central and local government funding. In contrast, to date during the latest recession Government has made an extra £10m available for Citizens Advice Bureaux to allow them to extend their opening hours and provided an extra £5.85m to National Debtline. However, such policies may not continue.

- When available, funding is typically short term for a period of one to three years and comes from a variety of sources; for example, in their 2008/09 annual report, Citizens Advice thank 62 donors, of which 18 are government or public bodies.

- In the medium term, charitable donations may be handed out in instalments rather than a lump sum at the beginning of a project. This would impact on cash flow and the flexibility of an advice service (Ministry of Justice 2009).

- In a 2009 survey, 60 per cent of business leaders polled predicted their organisation would reduce charitable giving, implying a 34 per cent cut (£500m) in the estimated £1.4bn per annum total charitable giving by British business (TSI Consultancy 2009).

Cost of providing debt advice

In their report, *Helping Over-indebted Consumers*, the National Audit Office (2010) states that telephone advice from National Debtline costs around £51 per person, face-to-face advice an average of £265 and Internet counselling and management averages £16 per person. CCCS estimate that their debt advice tool, 'Debt Remedy', costs £5.99 per client counselled (Foundation for Credit Counselling 2010). Advice and assistance that involves a greater level of support for clients, particularly if it concerns serious problems and is delivered face-to-face, will involve much higher costs as evidenced in the evaluation of the Legal Services Commission's telephone advice pilot. This pilot put the range of advice costs between £67 and £454, depending on the type of adviser, method of delivery and extent of advice and assistance (Pleasance et al. 2007).

Gillespie and Dobbie (2009) suggest that through the use of free debt advice services 1.1 million clients per annum are advised at a cost of around £160 million to £165 million, by an estimated 4,330 to 4,500 full-time equivalent advisers. They estimate that to reach a further 1 million people would cost around £220 million (4,340 posts).

The NAO (2010) and Gillespie and Dobbie (2009) analyses both suggest costs per advised customer that are significantly below the per customer benefits modelled for this research.

Creditor attitudes to funding debt advice

When asked about their current funding and support of debt advice agencies, interviewees were hesitant to provide information. Some of this reluctance might have arisen as interviewees did not wish to reveal the full value of defaulting loans. For example, among those who contribute to the Fair Shares agreement, the level of funding made to Payplan or CCCS could indicate the minimum total level of consumer loans that had defaulted, data which would be considered confidential.

Though support of free debt advice was considered commendable, there were no spontaneous expressions by creditor firms that free-to-customer debt advice (excluding CCCS and Payplan) should be retained at all costs.

> 'Everyone appreciates the role that they [charitable debt advisers] play.'
>
> 'If free debt advice services were in danger of being cut, it's logical that those who use the service would contribute but they are probably facing cuts also.'

Instead, creditors thought it more likely that one or both of the following might occur:

- Usage of CCCS and Payplan and/or existing or new fee-paid debt advice services would increase ('the market would create something', in the words of one interviewee) as it was thought that they would have or would develop the capacity to cope with more demand. This view is possibly a reflection of the creditor customer base of those interviewed as it is generally acknowledged that those who use CAB or similar charitable organisations are often from lower income groups.

- Some financial services creditors might set up their own advice arrangements.

Based on the comments made, both actual and inferred, it appears that some of the reluctance to discuss more sustainable funding of free debt advice is motivated by concerns that:

- Creditors perceive themselves as already 'paying quite a lot' to fund debt advice via a combination of Fair Shares and 'a considerable amount of funding' from corporate social responsibility budgets.

- There is going to be funding of generic financial advice via a levy and firms should not be expected to pay yet another levy specifically to support debt advice; instead, perhaps part of the levy already planned should be allocated to supporting debt advice.

- If extra funding obligations are imposed then that could quite likely result simply in cuts being made to existing voluntary contributions.

- Responsible lenders are supporting other lenders' poor practices (as one creditor put it, 'Why should I be paying for what is not my fault?').

- All those who benefit don't currently contribute to Fair Shares; there was a suggestion that Fair Shares arrangements should be reviewed, perhaps introducing arrangements where creditors who do not contribute are not paid back until those who do have been paid back in full.

- The present structure of the debt advice landscape is fragmented and complex and better value for money from contributions could be obtained if it were rationalised.

- The money received through debt advice agencies is cancelled out by the frozen interest and charges that the creditor could otherwise charge (though it could be argued that this is just 'paper money' as they are possibly unlikely to collect these charges as well as the original amount owed).

Creditors also made the specific point that the potential case for greater funding was weakened currently by the absence of clear evidence that its outcomes were to their benefit. In discussions it appeared that the motivation for providing funding was somewhat grudging and based on corporate social responsibility drivers and not at all based on a firm belief that they were benefiting from the services. One creditor remarked, 'it's hard not to participate in Fair Shares when the rest of the industry does'.

Conclusions on creditor funding

Creditor funding of independent debt advice is, at present, limited to:

- those organisations that operate free-to-customer debt management plans; and

- irregular charitable funding of other free-to-customer initiatives.

In total we estimate that creditor funding represents in the region of £45 million to £50 million pa, most of which takes the form of Fair Shares payments.

The quantitative analysis carried out as part of this project supports the case for further creditor funding of debt advice on the basis of benefits received (we imply no responsibility on the part of creditors for the difficulties encountered by consumers in this economic climate). When measured against even the most costly form of advice (face-to-face), the uplift in recovery of debt and the reduction in costs, each suggest that creditors benefit from advice.

Our limited research among creditors suggests that there remains a strong reluctance to move towards a statutory levy on the industry, particularly in the light of other new taxes and costs being placed on the banking sector. However, the degree of commitment to the current Fair Shares voluntary scheme suggests that a voluntary scheme can be made to work (both CCCS and Payplan have been able to increase their capacity in response to higher demand on the back of Fair Shares payments). The scheme benefits from clarity between the cost of the scheme and the benefits received by creditors (both repayment of debt and cost efficiencies gained through efficient systems). It is also seen as broadly equitable, albeit that some creditors do not participate and yet benefit. Removing such creditors from the scheme would appear at face value to make the scheme more equitable but would bring with it increased problems in sustaining DMPs.

However, the scheme is not without difficulties, most particularly in that:

- it only funds repayments that are made through structured DMPs and does not fund repayments through DIY arrangements or other debtor-led solutions;
- by definition, it does not fund the advice delivered by those agencies who serve those most in need of advice but are least able to repay their debts.

It was not the task of this research to suggest a new funding arrangement; indeed we found creditors, unsurprisingly, reluctant to engage in a discussion of future funding. However, it is clear from our research that any new funding scheme would need to engage all of the private sector creditor industry, clearly align costs to benefits and be equitable between creditors (although creditors may have different views on what constitutes equitable treatment). The difficulties in reaching an agreement, as set out clearly by NCC in their 1992 report on the funding of money advice services (National Consumer Council 1992a), remain.

Appendix
Profile of demand

This section contains additional, detailed information on the demand for debt advice and evidence of actions taken by debtors after receiving advice. It supplements the main report on: the demographics of those in arrears or in danger of going into arrears; the profile of debt advice users, overall and for the main agencies; differences in attitudes, levels of indebtedness and uptake of financial products between advice users and non-users; and differences in actions taken by the users of various advice services.

Demographics of those in arrears or in danger of going into arrears

Selected details of the demographics of those in arrears or in danger of going into arrears, compared with the total population, are given in Table A1.

Table A1

The demographics of those in arrears or in danger of going into arrears, compared with the total population.

	Total population (%)	*Keeping up with bills but it is a constant struggle (14% of households) (%)*	*Falling behind with some bills (4% of households) (%)*	*Fallen behind with many bills (3% of households) (%)*
Housing				
Mortgaged or owned outright	63	51	39	35
Social housing	11	20	34	34
Working status				
Unemployed/job-seeking	5	8	13	15
Not working – other reasons (e.g. housewife; disabled)	18	24	22	31
Household income				
Below £11,500	15	25	34	44
£11,500–£17,499	14	24	27	7
£17,500–£29,999	24	24	21	31
£30,000+	47	28	18	17

Those who have the greatest arrears problems are making above average use of unsecured loans; loans from friends and family; mail order credit and home collected credit. However, the penetration of authorised overdrafts and store and credit cards is not significantly greater among those in arrears or in danger of going into arrears than it is in the total population. Details are shown in Table A2.

Table A2 also reveals that those who are in arrears have significantly more types of credit sources/products than the average.

The same survey also found that those who were in arrears often had utilities or council tax debts. The proportions are shown Table A3.

Table A2

Types of credit used by those in arrears or in danger of going into arrears, compared with the total population.

Proportion with each credit category	*Total population (%)*	*Keeping up with bills but it is a constant struggle (14% of households) (%)*	*Falling behind with some bills (4% of households) (%)*	*Fallen behind with many bills (3% of households) (%)*
Mortgage	37	35	32	29
Unsecured personal loan	20	30	33	42
Secured personal loan	5	10	13	9
Authorised overdraft	37	51	48	44
HP agreement	3	5	3	6
Car finance loan	9	8	9	8
DSS/Social Fund loan	2	5	9	12
Loan from friend/family	7	12	27	25
Catalogue	14	25	25	32
Home collected loan	2	2	11	17
Pawnbroker	0	1	0	5
Student loan	13	13	9	8
Payday loan	1	1	1	9
Store card – balance not paid off	11	15	15	18
Credit card – balance not paid off	44	54	58	52
None of these (excluding mortgage)	28	16	9	12
Average number of product types (excluding mortgages)	1.7	2.3	2.6	2.9

Table A3
Proportion falling behind with household bills.

Proportion currently behind on utilities or council tax	*Total population (%)*	*Falling behind with some bills (4% of households) (%)*	*Fallen behind with many bills (3% of households) (%)*
Gas	3	18	21
Electricity	3	16	20
Water	3	20	26
Council tax	3	27	28

These data demonstrate that around half of those who are already in arrears are customers of credit card providers and almost as many have authorised bank overdrafts; in addition, over a third have unsecured loans and more than a quarter have catalogue/mail order credit accounts. Finally, around a fifth are behind with payments on utility or council tax bills.

Profile of debt advice users

The Wealth and Assets survey confirmed the finding that those facing heavier debt problems were more likely to have sought advice; the comparisons in that survey were that 31 per cent of those who currently found debt 'a heavy burden' had sought advice at some point, compared with 12 per cent of those who found debt 'somewhat of a burden' and 4 per cent of those to whom debt 'was not a problem at all' (Office for National Statistics 2006/2008).

A related YouGov longitudinal survey,[26] conducted among those who defined themselves as 'struggling' with debt, showed a similar result; it found that 20 per cent of this group had used 'professional' debt advice in the preceding six months.

A recent National Audit Office (NAO) survey, however, suggested wider use of 'advice' (National Audit Office 2010). This survey was also conducted only among those who perceived themselves to be struggling financially. However, it used a much wider definition of 'advice', including advice from friends and non-independent advice from creditor organisations and other financial institutions. Based on this definition, more than half of participants (59 per cent) said they had received advice. The NAO cautions, however, that using self-definition of those struggling with financial issues can be misleading; their analysis categorised around half of their sample as the 'worried well', namely those who on any objective measure were neither in arrears nor 'at risk' of falling into arrears. Nevertheless, this group accounted for a significant proportion of those who said they had sought advice compared with only just over a quarter of advice service users who were currently in arrears.

Profile of the users of different debt advice services

Data on the profile of the debt advice clients of the leading services are available from surveys, and from analysis by the agencies themselves. Not surprisingly, it emerges that the different providers tend to be working with somewhat different client bases.

According to the YouGov data, the CAB appears to attract the greatest proportion on low incomes. However, the CAB has a broadly even spread in terms of the severity of debt problems faced by its clients. By contrast, CCCS and National Debtline appear to be dealing with a greater proportion of those who are more severely indebted. Unsurprisingly, the Insolvency Service has a very different profile to the other agencies (Table A4).

Data on client profiles from the advice agencies themselves is shown in Table A5.

Turning to the relative role played by free and fee-paid advice services, the Wealth and Assets survey provides an insight into the relative use of these advice services categories by different segments based on debt burden (Table A6).

The NAO survey (Table A6) also reviewed which types of debtors used free and fee-paid services respectively. It showed that the 'badly hit' were more likely to have gone to a free debt advice service (20 per cent) than the 'worriers' (6 per cent); conversely, the 'worriers' were more likely to have used a fee-paid service (17 per cent) than did the 'badly hit' (10 per cent).

Table A4
Profile of debt advice clients by advice service (from survey data).

	Total	*Money Advice Service (%)*	*National Debtline (%)*	*CAB (%)*	*Insolvency Service (%)*	*CCCS (%)*
Age	(%)	(%)	(%)	(%)	(%)	(%)
18–24	4	0	2	9	0	0
25–39	30	25	44	26	35	28
40–54	35	34	33	30	41	42
55+	31	41	20	35	24	30
Social category						
ABC1	51	29	55	44	82	56
Employment status						
Unemployed	4	3	2	6	0	7
Disabled	22	21	16	34	12	14
Income		*(£'000)*	*(£'000)*	*(£'000)*	*(£'000)*	*(£'000)*
Median household income (£15.5 – 17.5K)		15.5–17.5	15.5–17.5	13.5–15.5	25–30	15.5–17.5
Financial position	(%)	(%)	(%)	(%)	(%)	(%)
Keeping up with bills but a struggle	33	24	18	32	11	16
Falling behind with a few	28	41	34	33	39	31
Fallen behind with many	39	35	48	35	50	53

Table A5
Profile of debt advice clients by advice service (from services themselves).

	CCCS (2009)	*CAB (2008)*	*Scottish CAB (2009)*	*National Debtline*
Average net income	£17,316	£12,252	£11,220	£15,600
Average debt	£24,274	£16,971	£20,193	£20,000
Average debt to average income ratio	140%	139%	180%	128%
Unable to offer any repayment to non-priority creditors	30%	58%		25%
Have more than £500 per month surplus		6%		
Able to repay non-priority debts in less than 10 years (among those able to make an offer)		44%		
Would take more than 100 years to repay non-priority debts (among those able to make an offer)		16%		
Average monthly surplus available				£197

Table A6
The relative use of advice services categories by different segments based on debt burden.

	Debt is a heavy burden (%)	*Debt is somewhat of a burden (%)*	*Debt is no problem at all (%)*	*Total (those who have ever sought advice because of debt) (%)*
Free advice agency	61	56	49	56
Fee-charging debt advice company	13	10	6	10
Insolvency practitioner	3	3	6	4
Accountant, bank manager or other financial adviser	22	27	32	27
Solicitor/lawyer	4	2	6	4
Friends/relatives	18	20	20	19
Other	10	6	6	7

Attitudes of debt advice users and non-users

The YouGov survey found virtually no attitudinal differences between those in arrears who had used debt advice in the previous six months and those who had not, as shown in Table A7.

Table A7

Attitudes of those in arrears who have and have not received debt advice in previous six months. Mean score based on +2 to –2 scale, where a positive score denotes agreement and a negative score shows disagreement with the statement.

	In arrears and received debt advice in past six months	In arrears and have not received debt advice in past six months
If I want something I am prepared to buy it on credit and think about how I will repay the money afterwards	(0.6)	(0.6)
I am prepared to spend now and let the future take care of itself	(0.8)	(0.7)
Companies lending money have only themselves to blame if people stop repaying	0.67	0.5
Borrowing has become a way of life	1.1	0.9
I would rather buy things on credit than save up	(0.7)	(0.7)
Buying things on credit does not feel like spending	0.2	0.0
Bankruptcy is now regarded as being socially acceptable	0.2	0.1
I would miss a payment on an existing financial commitment if it meant I could have what I wanted now	(1.0)	(1.1)
If lenders offer to lend me money I will take it	(0.5)	(0.7)
I am more of a saver than a spender	(0.7)	(0.6)

Differences in the uptake of financial products and scale of indebtedness

The YouGov survey allowed for investigation of whether there were any differences in the use of various financial products, and the relative levels of indebtedness between those who had sought advice and those who had not. Those who had taken advice overall used more products and were more heavily in debt (Table A8).

Table A8
Differences in the uptake of financial products between those who are in arrears and had sought advice and those in arrears who had not sought advice.

	In arrears and had sought advice in previous 6 months (%)	*In arrears and had not sought advice in previous 6 months (%)*
Mortgage	40	39
Unsecured personal loan	58	34
Secured personal loan	15	11
Authorised overdraft	59	58
HP agreement	14	8
Car finance loan	16	11
DSS/Social Fund loan	7	6
Loan from friend/family	29	20
Catalogue	37	29
Home collected loan	10	7
Pawnbroker	2	1
Student loan	11	11
Payday loan	5	2
Store card – balance not paid off	22	13
Credit card – balance not paid off	68	58
None of these	5	11
Average number of product types (excluding mortgage)	3.5	2.7

Table A9
A comparison of borrowing between those who had sought advice and those who had not. Those who had sought advice have significantly higher levels of debt.

	In arrears and had sought advice in previous 6 months	*In arrears and had not sought advice in the previous 6 months*
Household unsecured borrowing		
Mean amount	£16,700	£10,900
	(%)	(%)
Up to £4,000	23	44
Over £4,000 to £10,000	24	23
Over £10,000 to £20,000	24	18
Over £20,000	28	15
Household borrowing (excluding mortgage) as % of income		
Up to 30%	34	51
Over 30–60%	20	22
Over 60–140%	21	18
Over 140%	26	10
Amount in arrears as % of household income		
Up to 10%	30	51
Over 10–50%	32	24
Over 50–100%	11	10
Over 100%	27	16

Supplementary analysis of data from the Wealth and Assets survey also confirms the picture that those who have used advice have tended to have greater debts than those who have not. The mean level of unsecured debt was consistently higher among those who had used debt, for all levels of perceived debt burden (Table A10).

The NAO survey also identified that those most in debt (the 'badly hit') were more likely to have sought advice (20 per cent) than the so-called 'worriers' (7 per cent).

Table A10

Debt levels and attitudes of those who have, and have not, sought advice.

	Have sought advice (£)	*Have not sought advice (£)*
Debt currently a heavy burden	8,355	6,664
Debt currently somewhat of a burden	4,706	4,277
Debt currently not a problem at all	2,741	1,747
Total	5,454	2,692

Differences in actions taken by users of various services

YouGov provides a picture of some differences in actions taken by the users of various advice services (Table A11).

Table A11

Proportion of advice service users by actions taken.

	Total (%)	*Money advice service (%)*	*National Debtline (%)*	*CAB (%)*	*Insolvency Service (%)*	*CCCS (%)*
Cut back on spending	59	75	48	60	47	74
Drawn up a budget plan	53	57	55	59	29	67
Taken out a consolidation loan	8	10	2	6	12	2
Contacted creditors	52	29	55	61	47	69
Enquired about a DMP	26	35	34	24	19	40
Enquired about an IVA	11	17	11	11	29	14
Enquired about going bankrupt	10	10	14	10	25	12
Took out DMP	21	28	21	16	12	36
Took out an IVA	3	4	7	3	12	0
Went bankrupt	1	0	5	1	18	0
Done nothing so far	9	7	5	8	0	5

Notes

1 The debt counselling type services delivered by or on behalf of creditors and generic financial advice (money guidance) as offered by FSA/CFEB are excluded.

2 National Audit Office (2010) includes estimates of the average cost of delivering debt advice.

3 Secured creditors are those that have a legal charge over the property against which the loan/mortgage is made, with a right to repossession if repayments are not kept up. Unsecured creditors have no such charge on property but can apply to the courts for a charging order, which would make the debt secured against a customer's property.

4 Priority creditors are those whose actions could deprive individuals of their home, liberty or essential goods and services.

5 Creditors will also make provisions for bad debts (or non-performing loans) which are not included in the data for write-offs. These provisions relate to the creditors' expectation of default and future write-off.

6 Fair Shares are optional contributions made by creditor organisations in acknowledgement of the repayments they receive from clients who have been assisted by the debt advice organisation. Typical Fair Shares amounts are in the region of 10 per cent of repayments received.

7 However, there are other estimates that suggest the fee-paid share may be closer to 50 per cent; see R3 research (https://www.r3.org.uk/uploads/documents/Debt%20Management%20Plans_Feb%202010.pdf).

8 Creditor interviews, 2010.

9 Unless specifically stated as otherwise, all quotes in this section of the report are from interviews with creditors or trade associations.

10 *Social Trends* (Office for National Statistics 2010) estimates 25.2 million households in Great Britain and 0.7 million households in Northern Ireland.

11 This may be a slight under-estimate, as those who stated either that they 'did not have any bills or credit commitments' (3 per cent) or they 'were keeping up with all bills/

commitments without difficulty' (39 per cent) were not asked whether they had used such services; however, it is unlikely that many in these groups had done so.

12 YouGov data is used in tables in this section of the report, unless explicitly stated otherwise.

13 Other data from the survey suggest that some of those describing themselves as 'keeping up' may, in fact, have had arrears; possibly they may have been referring to keeping up with negotiated reduced payments. However, it is not possible to verify this or to estimate the number involved.

14 75.8 per cent of 4.2 per cent of 26.0 million households is 828,000 and 61.5 per cent of 3.0 per cent of 26.0 million households is 480,000; together these total 1,308,000 households in arrears who have not recently sought advice.

15 CCCS unpublished data.

16 Two such studies, one from the US and one from the UK, are reported on page 71.

17 Opinion Leader survey quoted in National Audit Office 2010.

18 Research conducted by Illuminas on behalf of National Debtline (August 2008).

19 Creditor-led bankruptcy can only be initiated where debts exceed £750.

20 The total research programme involved four studies, one of which was a longitudinal investigation of outcomes for a sample of debt advice users.

21 YouGov longitudinal study (June 2008 to February 2009) of households experiencing financial stress, reported in Department for Business, Innovation and Skills (2010).

22 R3 is the brand name for the Association of Recovery Professionals.

23 By way of example, recovery rates on debt collection in the no advice scenario increase from 40 per cent to 52 per cent (a 30 per cent increase).

24 Had we instead increased the amount owed, it would not have been possible to make a simple comparison of amount recovered, since the amount recovered and the amount unrecovered would both have increased.

25 Taken from creditor interviews conducted during May and June 2010.

26 YouGov longitudinal tracking study (June 2008 to February 2009) also quoted in Department for Business, Innovation and Skills 2010.

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