The impact of independent debt advice services on the UK credit industry

This research explores the financial impact of debt advice on creditors. It fills a gap in research, much of which has, to date, focused on the benefits to consumers and society. Decisions on the future scale, structure and funding of debt advice need to be based on comprehensive evidence of its impact, and this study is a first step towards that.

Key findings

The current funding model for independent debt advice relies heavily on public funding, with significantly less financial input from creditors. Nevertheless, creditors as a whole are supportive of the role of most independent consumer debt advice and many acknowledge that they benefit from it, although they are unable to quantify that benefit.

Existing research from the UK and US is not definitive in demonstrating the scale of benefits that creditors derive from independent debt advice, although several studies do indicate outcomes that lead to an improvement in recovery rates experienced by creditors.

A model was developed by the project team to test whether debt advice leads to better outcomes for creditors when compared to other pathways to the resolution of defaults. Based on limited data gleaned from a number of sources, it compared the percentage of debt recovered from individuals receiving independent debt advice to the percentage that creditors might expect to receive in the absence of such advice. The results indicate that creditors in total might improve the amount they recover by £1 billion (or collectively, £1,100 per advised individual), where independent advice is given.

Key conclusion

Freely available data is insufficient to provide a definitive measurement of debt advice impact on creditor outcomes. However, when measured against even the most costly form of advice (face-to-face), the uplift in recovery of debt and the reduction in costs modelled for this project suggest that creditors do benefit financially from debt advice. This implies there is a self-interested business case for further creditor funding of debt advice. The research found strong reluctance amongst creditors to move towards a statutory levy on the industry such that it may be more constructive, in the first instance, to seek to build on and extend voluntary scheme like Fair Shares.
Policy context

Despite reductions in the availability of credit, levels of personal debt in the UK remain close to an all-time high at just under £1.5 trillion. In response to current 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.

The funding of independent debt advice has been the subject of several reviews and research studies over the past 20 years. Whilst several have investigated the benefits to consumers and society, no detailed studies have examined the financial benefits to creditors. Given that any decisions on the future scale, structure and funding of credit advice should be based on comprehensive evidence, this research set out to contribute to filling the gap.

About the study

This study, by Jackie Wells, John Leston and Mary Gostelow, focuses on the impact that independent consumer debt advice has on creditors. As a first step in a new field, inevitably the quantitative findings and modelling are not definitive.

The study is based on: a review of literature and research data; interviews with private creditor firms, debt advice agencies and other relevant stakeholders; challenging and refining the hypothesis that debt advice leads to positive outcomes for creditors; and 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 utility companies. It did not consider the impact on public sector creditors such as local authorities.

The provision of debt advice

The provision of debt advice is fragmented, with a complex patchwork of not-for-profit and private organisations. 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. Many 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’.

The demand for debt advice

Both need and demand for debt advice remain high, with demand not fully satisfied by current provision. Around 2.0 million to 2.5 million households are in arrears with bills or credit payments, and an estimated 3.6 million households may be in danger of falling into arrears. 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.

The impact on creditors

A mixed picture emerges from the British and US studies that have sought to identify the impact on creditors of debt advice. Several studies indicate outcomes that lead to an improvement in levels of losses among creditors. However, overall, the results of existing research are not definitive in demonstrating the benefits that creditors derive from independent debt advice.

To assess the impact of debt advice on the creditor market, a hypothesis was developed for testing during the research and to form the basis of the modelling of 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 the first order effects of improved recovery rates and lower costs.

The model was built upon very limited published data and incorporates a number of explicit assumptions. It is hoped it will encourage dialogue, challenge and further research. It 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 between two scenarios: (1) the percentage of debt recovered where individuals in arrears receive independent debt advice (based on the current experience of individuals receiving independent debt advice); and (2) 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).

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.

Although robust data from creditors on their administrative costs of recovery from debtors was unavailable, anecdotal evidence suggests that these costs are also reduced by the provision of independent debt advice. These savings are due to a reduction in chasing customers in arrears; an overall reduction in the need to spend time understanding the customer’s financial position; and reduced costs in pursuing customers through the courts.

The only data on creditors’ arrears administration costs that were available, 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 figure of 5 per cent is applied to the estimated £24.7bn owed by those customers who seek debt advice, then the cost of debt recovery amounts to £1.3bn, or more than £1,100 per customer (typically spread across several creditors). This per customer average is more than four times the cost of face-to-face advice (£265 per customer), 26 times the cost of phone based advice (£51) and 83 times the cost of web based advice (£16).

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 is likely that creditors make some cost savings.

**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 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

When measured against even the most costly form of advice (face-to-face), the uplift in recovery of debt and the reduction in costs modelled for this project suggest that creditors do benefit financially from debt advice. This supports a case for further creditor funding of debt advice.

This research found a strong reluctance amongst creditors to move towards a statutory levy on the industry, particularly in the light of other new taxes and costs being placed on the sector. However, the commitment to the current Fair Shares scheme suggests that a voluntary scheme can be made to work.

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

Whilst exploring the financial benefits to creditors of debt advice proved challenging, the research should provide a stimulus to further discussions between the advice sector, public sector funders and creditors.

Further information

This summary and the full report, *The Impact of Independent Debt Advice Services on the UK Credit Industry* by Jackie Wells, John Leston and Mary Gostelow, are available in print and as a pdf from Friends Provident Foundation (foundation.enquiries@friendsprovident.co.uk and www.friendsprovidentfoundation.org).

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