SURVIVING THE

WILDERNESS

THE LANDSCAPE OF PERSONAL DEBT IN THE UK

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Action for Warm Homes

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Introduction

As is the case with so many areas of modern life, low-income and vulnerable households are disproportionately affected by personal debt. “The poorest 10% of households have debts three times bigger than the value of the assets they own, while the top 10% have total wealth – property, pensions, and other assets – worth 35 times larger than their debt” (BBC, 2019).

Manageable levels of personal debt are not cause for major concern. As debt levels become unmanageable, with unrealistic repayment plans, and are taken out for spending with no lasting value, a household may be moving into ‘problem debt’ (Experian, 2019). Defined as being unable to pay debts or other household bills, problem debt is closely related to many wider problems in people’s lives, including “financial exclusion, family breakdown, and poor physical, and mental, health” (Citizens Advice, 2016).

Personal debt levels in the UK have fluctuated significantly in recent years, yet in early 2020 household debt was reported to be 31% higher than the peak before the 2008 financial crisis (TUC, 2020). It has been widely acknowledged as a precarious position, both for lenders and borrowers, with increasing concerns about the economic impacts of the global Covid-19 pandemic. “It is clear, that the UK is now in the largest recession on record”, almost 3.7 times larger than the 2008 financial crisis (Office for National Statistics, 2020). But what does this mean for the personal debt landscape, and what can be done to mitigate the impacts?

Following on from the June 2020 NEA policy paper “The Gathering Storm: Utility Debt and Covid-19”, this paper provides an evidence synthesis of personal debt, both prior and post the Covid-19 outbreak, with a focus on the shift from consumer debt, such as loans and credit cards, to household debts, such as arrears with utility providers, offering a comparison of known debt levels in energy, water and local government. It aims to alert policy makers to the consequences of negative budgets and problem debt, proposing a definition of ‘severe indebtedness’ for utilities to consider in their debt management practices, whilst identifying further areas of best practice which can be replicated across different sectors. The paper concludes with a series of recommendations which can be applied across all sectors to mitigate the impacts of personal debt and arrears following the pandemic and avoid low-income and vulnerable householders falling deeper into financial difficulty.

These recommendations include bringing forward the long-awaited ‘Breathing Space’ legislation and proposing Government contributions to utility debt matching schemes, alongside changes to industry-level guidance and collaboration to help the greatest possible number of households in problem debt at the earliest opportunities.

Key Recommendations

1. Government should bring forward Breathing Space and extend the respite period offered
2. The UK Government should make contributions for payment matching schemes
3. Consistent ‘Ability to Pay’ and debt collection principles should be implemented across all utilities
4. Opportunities for maximising data sharing should be explored, including utilising existing mechanisms, such as building on the Priority Services Register and acting on powers within the Digital Economy Act, to ensure that support is offered to customers moving into financial difficulty at the earliest possible opportunity
5. All companies should consider how a single definition of ‘severe indebtedness’ can ensure customers are treated fairly

The personal debt landscape

When the 2008 financial crisis broke, the UK entered its deepest recession since World War Two and personal debt played a significant role in the depth of the crisis. An over-reliance on unsecured credit, such as credit cards and loans, meant that people were living far past their means; it was clear overspending was not sustainable. Once people started to change their spending habits, the economy took a substantial hit in the sudden drop in spending, causing businesses to close and unemployment rates to rise. The UK fell into recession and a decade of austerity measures followed. But what does the personal debt landscape look like now?

Personal debt prior to the outbreak of Covid-19

A 2018 report, from a study conducted by the Institute for Fiscal Studies (IFS) and the Joseph Rowntree Foundation (JRF), looked at unsecured debt in the UK, with a primary focus on problem debt and low-income households, stating it is "crucial to distinguish between the occasions when debt is a problem and those when it is not" (Hood, et al., 2018). Their study analysed unsecured household debt with repayments which were not income-contingent, therefore excluding mortgages (as they are secured against the property) and student loans (as the lowest-income households do not make repayments).

Their report found:

- Around half of households in GB in 2012-14 had some unsecured consumer debt, with 10% of households holding over £10,000 of such debt

- Those with lower incomes are less likely to hold any unsecured debt, but are more likely to be in 'net debt', with unsecured debts of greater value than their financial assets

- Being in arrears on debts or other payment obligations (e.g. utility bills) is highly concentrated amongst the lowest-income households – 16% of those in the lowest income decile are in arrears compared with just 1% of those in the highest decile.

The statistical bulletin for 'Household debt in Great Britain: April 2016 to March 2018' studied the sixth round of the Wealth and Assets Survey, stating "given that total debt for the lowest total wealth decile is three times more than the value of total wealth… it is unsurprising that households in the lowest wealth decile are more likely to be experiencing problem debt" (ONS, 2019).

The European Quality of Life Survey (EQLS) has gradually asked respondents about more types of arrears. In 2003 and 2007 it included utility and rent or mortgage arrears. In 2016 arrears from payments related to telephone and internet bills were added. Each addition has revealed considerable proportions of the population with these arrears (Eurofound, 2017).

This pattern correlates with a report released by the Money Advice Trust – 'A decade in debt'. This reported on trends seen at National Debtline in the decade following the 2008 financial crisis.

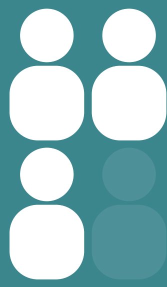
"Ten years ago, a typical caller to National Debtline was struggling to pay credit cards, personal loans, or perhaps a mortgage. Today, callers are struggling with smaller but trickier debts – often arrears on everyday household bills" (2018).

Problem debt

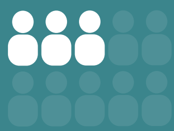
Defined as being unable to pay debts or other household bills, problem debt, or over-indebtedness, is a serious issue in the UK, with the Money Advice Service (MAS) estimating that 8.3 million people were over-indebted in 2018, and "22% of UK adults have less than £100 in savings, making them highly vulnerable to a financial shock such as job loss or large unexpected bills" (National Audit Office, 2018). The National Audit Office (NAO) report acknowledges that "HM Treasury (HMT) has overall policy responsibility for personal debt and has high-level objectives in two areas: preventing problem debt from occurring… [and] minimising the impact of problem debt".

In their 'Statistics Yearbook 2019' the debt charity, StepChange, reported on personal debt in the UK, stating that in one year, 635,091 new clients contacted them with problem debt; "one new client every 49 seconds" (StepChange, 2020a).

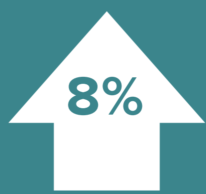
Some of StepChange's key statistics are:



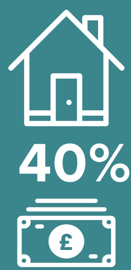
Three quarters of new clients say a life event or income shock such as experiencing an illness, a reduction to their income or unemployment was the main reason for their problem debt



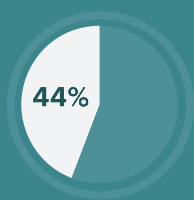
Three in ten clients had a negative budget at the time of advice



The average unsecured debt per new client at the time of advice is £14,129 – a rise of 8% since 2016



40% of new clients report to be in arrears with at least one household bill at the time of advice, with the average amount of arrears being £2,137.



44% of clients are in a vulnerable situation in addition to their financial difficulty.

2020 – the impact of Covid-19

"The implicit assumption is that the latest data gives good information about the current situation" (Matejic, 2020). Every time we open a data set, or a research paper, it is based on data that is, technically, already out of date. And yet, we can usually use this to identify emerging trends, and possibly guess where something new is heading based on assumptions made from past experiences. This has always been the case because analysis takes time. But, for possibly the first time, our current circumstances do not allow us that luxury. The world has been hit by a global health crisis, forcing nation-wide lockdowns, and effectively shutting down economies.

Since the start of lock-down in the UK:

- Over 3.2 million individuals[1] have submitted claims for universal credit;
- Over 9.6 million jobs[2] were furloughed through the Government's job retention scheme; and
- Over 1.9 million requests were made for mortgage payment holidays and a further 1.7 million requests made for payment breaks on credit cards and loans[3].

The coronavirus crisis has been unprecedented, and the long-term impacts remain unknown.

Attempts have been made to understand the impact of the Covid-19 crisis on household incomes and expenditure through nationwide surveys and economic data analysis. The Resolution Foundation has produced a report which analyses the YouGov online coronavirus survey responses to consider the early impacts of the crisis on living standards with a focus on incomes and consumption (Brewer & Gardiner, 2020). As can be seen in Figure 2, households in the bottom income quintile prior to the coronavirus crisis were more likely than the top income quintile to experience furlough, job losses or reduced hours, to have concern about their family finances and to feel that their ability to manage financially had worsened.

Conversely, households in the top income quintile were more likely to have seen reduced outgoings, to have seen their income remain the same or even increase during the crisis, and were over three times as likely to have a strengthened financial situation than those in the bottom quintile. Research undertaken by Wales Fiscal Analysis at Cardiff University shows that the "highest-earning decile of workers in Wales were 3.3 times as likely to work from home than the lowest-earners" (Rodriguez, 2020). Assuming this is broadly representative of all four UK nations, this suggests that lower earners will have been less able to manage to work during an imposed lockdown.

Percentage of households by income quintile indicating how COVID-19 has impacted their family finances (Resolution Foundation, 2020)

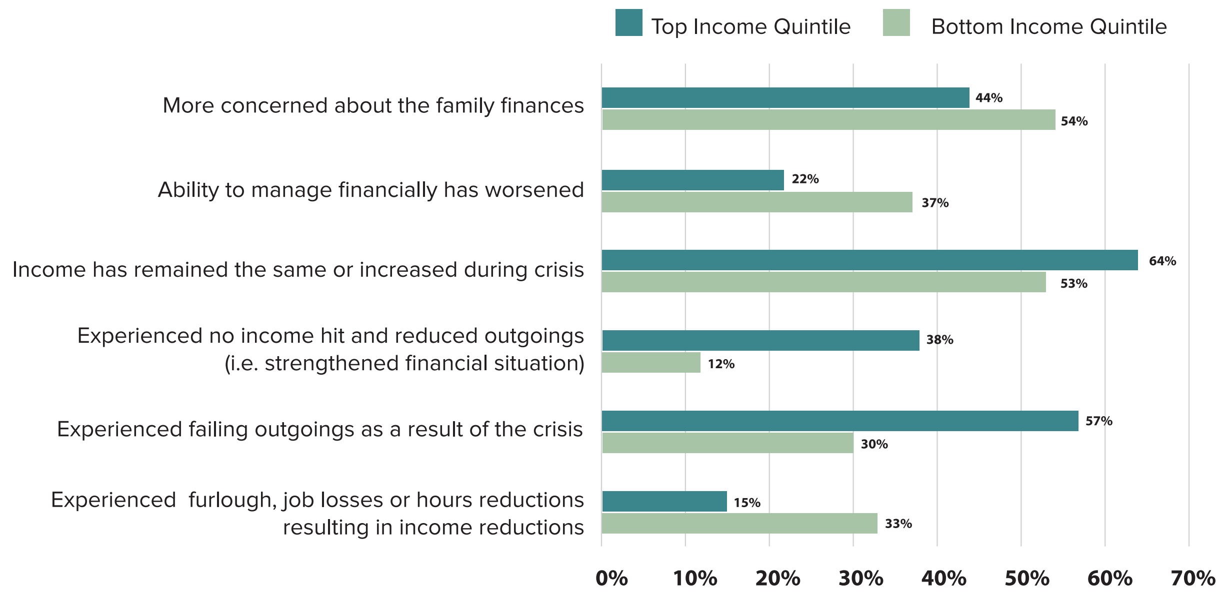


Figure 2 – Some initial results from the Resolution Foundation analysis of the impacts of Covid-19 on family finance (Brewer & Gardiner, 2020)

1. 16th March to 23rd June 2020 (Department for Work & Pensions, 2020)
2. As of 2nd August 2020 (Gov.uk, 2020)
3. As of 5th August 2020 (Money Saving Expert, 2020)

John Fairhurst, Executive Director at PayPlan (one of the UK's largest providers of free debt advice), has expressed concern at the number of calls being received from salaried professionals on high incomes, saying "They will be well above the benefits threshold, but their costs are way out of step with their new, reduced income… Three-month mortgage and credit-card holidays can provide temporary relief, but if they can't find a new job with a similar level of pay then hard choices lie ahead" (Cook & Barrett, 2020).

But the disproportionate effect on low-income households means that the both the incidence and severity of poverty may increase due to the pandemic, as those previously close to the poverty line may have moved into poverty under the Social Metrics Commission measure, and the depth of poverty for those already under the line will be increased due to job losses and reduced hours or pay (Social Metrics Commission, 2020).

In June 2020, StepChange, outlined the need for a financial recovery strategy for households to prevent a coronavirus household debt crisis. They estimated that "4.6 million people negatively affected have accumulated £6.1 billion of arrears and debt, averaging £1,076 in arrears and £997 in debt per adult affected", something which is "likely to increase substantially before the lockdown is fully phased out" (StepChange, 2020b). In October 2020, Citizens Advice estimated "6 million UK adults have fallen behind on at least one household bill during the pandemic, including: 3.4 million on mobile phone or broadband, 3 million on water bills, 2.8 million on energy, 2.8 million on council tax, and 1.2 million on rent", an estimated total of £1.6 billion in household arrears (Carr, 2020).

Acknowledging that short-term, temporary measures have been put in place to support people experiencing financial difficulty as a result of the crisis, StepChange highlighted the risks of the time-limited nature of these measures, of the impact of accumulated debt and of the ongoing support required once the crisis is 'over'. They outline three priorities for a financial recovery strategy:

1. Households struggling with arrears and debt should be provided with strong protections against housing insecurity and unaffordable repayment demands;

2. Households negatively affected by coronavirus should be provided with grants to address arrears and debt accumulated to pay for essentials during the crisis; and

3. The government should ensure the social safety net is a source of financial resilience for struggling households.

Negative Budgets

> *"A negative budget is where each month someone's income doesn't cover key living costs. This is typically identified through the debt advice process using a tool called the Standard Financial Statement" (Citizens Advice, 2020)*

The Office of National Statistics found that, in the financial year ending 2017, the lowest earning decile had expenditure higher than their disposable income; "households in the bottom income decile spent, on average around £12,800… while their average income, as measured with Living Costs and Food Survey data, was only about £5,000. This is consistent with the findings from other studies, showing relatively high levels of expenditure at the bottom of the income distribution" (ONS, 2018).

The issue of households not having enough money to meet their living costs is a growing one. Citizens Advice reported the number of people they help with debt who have negative budgets growing from 32% in 2016/17, to 38% in 2018/19, with the depth of the income deficit increasing from £167 to £203 in the same period. "This means that on average, those struggling with a negative budget had £203 more going out than they had coming in as income that month" (Matin & Lane, 2020).

In the same report, Citizens Advice also found that 4 in 5 of the people they help are close to falling into a negative budget, meaning they have less than £100 a month left after living costs.

The impact of the Covid-19 crisis on household finances is likely to have significantly increased the number of households experiencing negative budgets. Between March and May 2020, the number of employees on payroll fell by 612,000 workers (2.1%), the number of weekly hours worked in the same period dropped by 9% (94.2 million hours) and a quarter of the UK workforce (9.1 million workers) were being paid (in part) through the Government's job retention scheme potentially receiving only 80% of their usual wages and a sign that many job losses are yet to come (BBC News, 2020).

The latest UK household savings ratio, defined as "the percentage of disposable income that is saved", is 5% (4.2% lower than the average over the past 54 years of 9.2%). Although not yet an all-time low (as recorded in 2017), a savings ratio this low can indicate:

- An unbalanced economy, with an over-reliance on consumer spending;

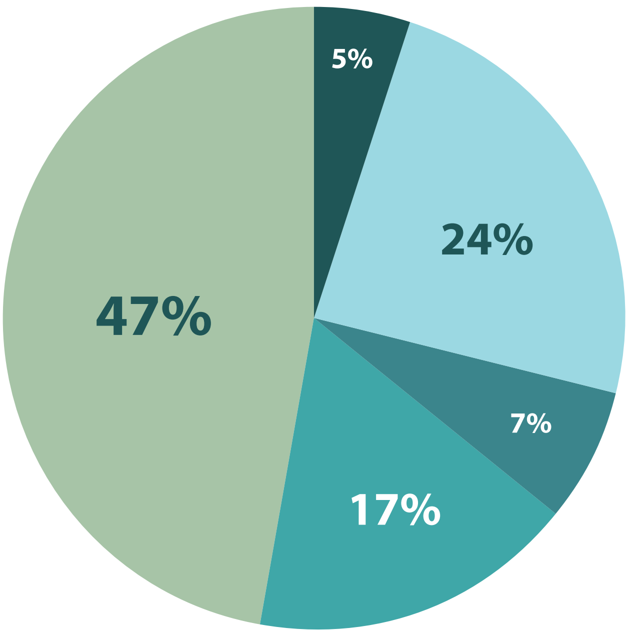
- A build-up of personal debt; and

- A current account deficit (Pettinger, 2020).

In 2018-19 "12.8 million households (46% of the total) had either no savings or less than £1,500 in savings" (The Money Charity, 2020). While it is believed that a short-term reduction in income is unlikely to result in a similar drop in expenditure, these figures show that a short-term reduction in income is not sustainable – a household cannot survive on a negative budget for long.

Of the c.14 million people identified by StepChange (2020b) as having been negatively affected financially by the pandemic, just under half (6.7 million, 47%) feel they are coping with their new financial situation and expect they will continue to do so for the remainder of the year. Figure 3 shows the segmentation for the remaining 7.5 million people surveyed.

Number of people negatively affected financially by Coronavirus



700,000 In problem debt pre-crisis **(5%)**

3,400,000 In financial difficulty pre-crisis **(24%)**

970,000 Newly struggling **(7%)**

2,400,000 Growing financial fragility **(17%)**

6,700,000 Coping (not yet showing signs of financial distress) **(47%)**

Figure 3 – StepChange segmentation of people negatively affected by Covid-19 financially, by relative financial fragility and potential pathways (2020b)

Breathing Space

In February 2020, HM Treasury confirmed the introduction of a 60-day halt to enforcement action and interest freeze for people with problem debt known as 'Breathing Space' (HM Treasury, 2020). This new initiative is due to be introduced in May 2021 and has been well received by debt advice agencies and charities supporting people in financial difficulty. The period of 60-days will be mandated to allow people in problem debt time to seek professional debt advice and agree a long-term solution to their debts.

A similar procedure has existed in Scotland since 2004, known as a 'Statutory Moratorium', which allows six weeks' protection from creditors. As part of the coronavirus response in Scotland, MSPs unanimously passed an extension to this 'breathing space' period to six months, allowing people in debt significantly longer to find a long-term plan for managing their debts. It also removed the limit of one application for a statutory moratorium in a twelve-month period (Scottish Government, 2020).

In the remainder of the UK, while mortgage companies, other lenders, and some utility companies are offering payment holidays to customers, interest is still accruing on the outstanding balances and the impact of this accumulated debt may be significant to those accessing the payment breaks once their repayments start again.

In our paper 'The Gathering Storm – Utility Debt and Covid-19', NEA recommended that Government should bring forward the Breathing Space legislation, ahead of the 2021 roll-out, recognising the unprecedented financial situations households are facing as a result of the pandemic.

Government and Utility Debts

Debts with more serious consequences are referred to as 'priority debts'; while they may not be the largest debts, or have the most expensive interest rates, the consequences of not paying them can be serious (Money Advice Service, 2020), and may include:

- Bailiff visits;
- Court summons;
- Disconnection of service(s);
- Bankruptcy; and
- Repossession.

Debt advice often suggests that priority debts should be paid first given the seriousness of the consequences. "Once you've got your priority debts under control, you should look at all your other debts. They're non-priority debts because the problems they cause are less serious" (Citizens Advice, 2019).

In the cases of Government and utility debts, council tax arrears and arrears in gas and/or electricity bills are classed as priority debts, as they can result in imprisonment and disconnection, respectively. Domestic water supply cannot be disconnected – "in the face of other household bill increases, and limited sanctions for non-payment, customers in financial difficulties often see their water bill as a low priority. They will pay other bills such as energy, satellite TV or credit cards first" (Ofwat, 2010) – water bills are therefore often one of the first essential household bill customers default on.

In a cross-government report, the NAO set out to identify the scale and nature of problem debt in the UK, highlighting a change in consumer behaviour with an increasing proportion of people seeking help with debts to government or utility providers and a decreasing proportion of people seeking advice related to consumer credit in the same period (National Audit Office, 2018). Their report also outlined inconsistencies in the availability of data on debt across sectors.

Focusing on the change in proportions of people presenting with each type of debt, the NAO provided estimates of the debts owed in 2018, estimating that at least £18 billion was owed to the government and utility providers. This included benefit and tax credit overpayments and advances.

For the purpose of this paper, any figures related to overpayments have been removed as the individual does not necessarily have control of these 'debts'. The resulting 2018 estimates can be seen in Figure 4.

While policymakers often focus on mortgage or consumer debts with financial institutions, debt problems in low-income groups often relate to non-payment of utility or telephone bills, rent, taxes or fines, debts with friends, or healthcare costs. Policymakers interested in early intervention should not overlook this. (Eurofound, 2020)

Estimates of debts owed to government and utility providers (NAO, 2018)

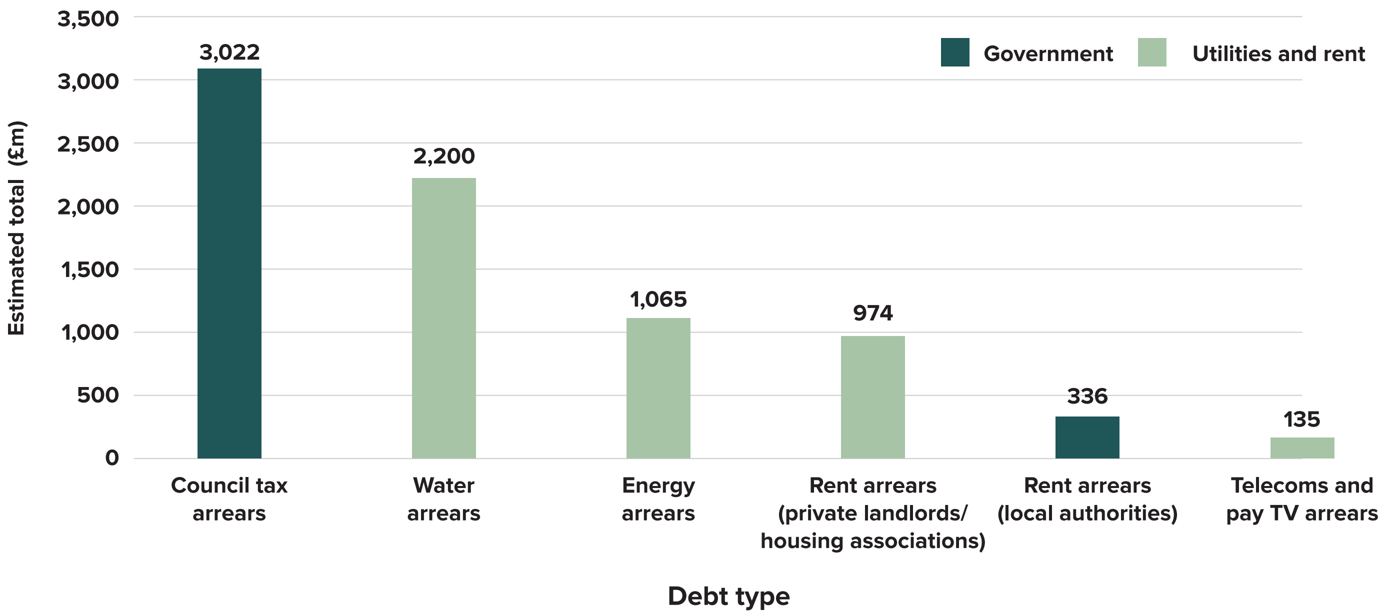


Figure 4 – National Audit Office estimates of debt to government and utility providers (2018)

The graph illustrates that more than half of government and utility debt is due to council tax and water bill arrears, with over £3 billion and £2.2 billion being owed to each sector, respectively. Energy bills follow with just under £1.1 billion owed. The figures quoted are cumulative and therefore will include arrears of previous years and not just arrears accrued during the reporting year.

For comparative purposes, NEA analysis in Table 1 shows:

- The number of households who would need to pay nothing in one year to accumulate a total debt of that size
    - This shows that, in 2017/18, the level of debt in the water sector was the equivalent of almost 5.6 million households not paying their water bill in one year, whereas the equivalent in energy was just under 900,000 households.
- The estimated total debt as a proportion of 2017/18 potential sector income
    - Conversely, this looks at the household population sizes in 2017/18 for each of the three sectors (Council tax is England only, Water is England and Wales, and Energy is GB) and multiplies it by the average bill for the same year to give a figure for 'potential sector income'. The estimated totals of debt are then shown as a percentage of this figure.
    - This shows that the energy sector debt as a proportion of 2017/18 potential income is significantly lower than the other two sectors at 3.4%. Council tax debt was 8.37% of potential income in that year, whereas water was almost a quarter of the total potential income for 2017/18.

Debt	Estimated total (£m)	Avg. 2017/18 bill (£)	Required no. of households paying £0 in 2017/18 to accumulate total debt	Estimated debt as a proportion of 2017/18 potential sector income
Council tax arrears	**3,022**	**1,591**[4]	**1,899,434**	**8.37%**
Water arrears	**2,200**	**395**[5]	**5,569,620**	**23.19%**
Energy arrears	**1,065**	**1,184**[6]	**899,493**	**3.40%**

Table 1 – Estimated government and utility provider debt compared to 2017-18 average bills

It is worth noting that each sector may have different definitions of when money outstanding becomes arrears. For example, an unmeasured water bill is technically due in advance on 1st April each year, but the payments are spread across the year. Different methods of payment or credit agreements will impact on the point at which missed payments are treated as 'arrears' and this needs to be considered by each sector and organisation when assessing levels of debt.

The following section of this paper takes each of these sectors in turn, identifying areas for potential improvements and examples of best practice which could be replicated across the other sectors.

Availability of Data

As highlighted by the NAO, the availability of data differs substantially between sectors.

Council Tax

On an annual basis, the Ministry of Housing, Communities and Local Government report the collection rates of council tax in England.

This is "the amount of council tax collected by 31st March shown as a percentage of the total amount that local authorities would have collected if everyone liable had paid what they were supposed to" (MHCLG, 2020).

The accompanying data tables show the outstanding arrears as a total and an amount per dwelling.

Water

Personal debt figures in the water industry are only occasionally published by Ofwat; the most recent publications are 'Affordability and Debt' (2015) and 'Vulnerability Focus Report' (2016), though personal debt levels in the water industry were briefly referenced in the PWC report 'Retail Services Efficiency Benchmarking' (2017).

Energy

Ofgem publish 'State of the Energy Market' on an annual basis, which includes figures on personal debt levels, reporting on the total number of customers in debt to their supplier since 2006, and the number of customers making repayments for arrears since 2012.

These topics are explored further in the annual report 'Vulnerable Consumers in the Energy Market'. Additionally, Ofgem release a series of data tables as part of their annual company performance reporting which outlines the levels of debt by each supplier.

4. "Band D council tax is the standard measure of council tax" and in 2017-18 the average for Band D council tax in England was £1,591. (Department for Communities and Local Government, 2017)
5. Household water and sewerage bills for 2017-18 (Water UK, 2017)
6. Average dual-fuel energy bill for a typical consumer with the large suppliers in 2018 (Ofgem, 2019a)

To make it easier to identify trends in debt, sectors should publish consistent, comparative data at least annually. This will ensure there is a continuous focus on improving household debt and arrears by each sector. Additionally, where possible, data should be presented by nation or by region to allow for regional differences to be addressed and for application of devolved policy where applicable.

Debt guidance and 'Ability to Pay' principles

To ensure debt collection practices and payment arrangements are fair to all customers, each sector has published guidelines and/or principles for companies to follow. The following table looks at each sector's guidance to identify areas of best practice and potential improvements.

Council Tax	Water	Energy
Guidance to local councils on good practice in the collection of Council Tax arrears (2013)	**Dealing with household customers in debt: guidelines (2015)**	**Ability to Pay Principles (2019)**
Guidance seems overly focused on the enforcement of debt collection, particularly in relation to bailiffs, with limited guidance available prior to this stage. Best practice is identified with the specified minimum number of statutory communications prior to further action.	Guidance appears to be very extensive and thorough, but this could be considered negatively as there is a lot of text to read through. It highlights some areas of best practice which are not captured in the other guidance principles, such as the need to comply with the Equality Act and the FCA Good Practice Handbook. Also specifies a minimum length of time before a reminder can be issued.	Guidance is simple and concise - easier to read and understand the principle without having to trawl through long documents. Identified best practices are mainly around the staff involved in managing debt and relevant customer relationships, and in the ongoing monitoring process to ensure it is fit-for-purpose and trends are identified.

Learning from Ofgem's 'Ability to Pay' principles, it is important that guidance is concise and easy to understand, with a clear focus on the customer. Additional process documents accompanying the overarching principles could then be provided to give further detail where required. All guidance should comply with already existing best practice(s), including the FCA Good Practice Handbook and the Equality Act (as highlighted in the water industry principles). A consistent approach across sectors would make it far easier for customers to understand the debt collection process and would offer the opportunity to address issues holistically instead of each bill being considered in silo.

It is also worth noting, that following a consultation in August 2019, Ofgem has announced they will incorporate the ability to pay principles into the Supplier licence conditions (Ofgem, 2020). This is in response to concerns that not all suppliers were applying the principles consistently when setting up repayment plans. The changes to licence conditions will be in place from 15th December 2020 and should be considered best practice as suppliers will be accountable under licence for the consistent application of these principles.

Third Party Deductions

The third-party deductions scheme is managed by the Department for Work and Pensions (DWP). It allows payments to be made to certain creditors directly from a benefits payment, helping customers who have issues with budgeting.

"The types of debts covered by the scheme are rated in a priority order. This reflects the degree of risk to the individual or their family by the enforcement action that may result from non-payment:

1. Housing costs for specific mortgage arrears
2. Miscellaneous accommodation costs; care homes, private hospitals
3. Hostel charges
4. Rent arrears, including service charges
5. Mains fuel costs; gas and electricity
6. Water charges; water then sewerage if two debts
7. Council Tax and community charge arrears
8. Fines
9. Child Support Maintenance under the old scheme
10. Refugee integration loans
11. Eligible loans." (Department for Work and Pensions, 2019)

Water and Fuel Direct numbers are decreasing year-on-year, and yet they offer a service which can help customers who struggle with budgeting, guaranteeing payment to the service provider.

Raising awareness of this scheme and encouraging new applications would help ease the range of pressures that indebted customers on benefits face which can prompt serious implications on mental and physical health.

Additionally, we saw the decision made to temporarily suspend benefit deductions for new and existing recovery during the coronavirus response period.

Although only for a limited time, this pause may have caused some issues for claimants of Universal Credit who rely on the third-party deduction scheme to pay their essential outgoings.

The pause in payments, alongside the increase in Universal Credit allowances for all, may have led to claimants believing they have a higher level of disposable income, when in reality the additional money was only temporary and some bills were going unpaid.

This may have caused a number of families significant issues when payments were reinstated, and further issues when the temporary increase to Universal Credit is removed.

Council Tax	"The third-party deduction scheme is designed to protect claimants in receipt of benefits. It is used when a claimant has arrears of essential household outgoings and has failed to budget for these bills. Other methods to recover the debt must have been tried, for example negotiating different ways of paying and managing bills. There must be a threat of enforcement action before consideration is given to applying for a deduction. The billing or levying authority may request deductions for arrears of Council Tax covered in a liability order in England and Wales and a summary warrant or a decree in Scotland." (Department for Work and Pensions, 2019)
Water	"Water Direct is another scheme operated by companies which some customers can find helpful to their budgeting. It allows companies to arrange to take payments direct from a customer's benefits before they are paid. Customers generally have to be in debt for an arrangement to be set up. Limits apply to the amount which companies are permitted to collect from benefits. By the end of 2018/19, 185,491 customers were paying water charges by Water Direct. This was down by 7% on the previous year (199,229), reflecting the fact that companies now offer a wider range of alternative support schemes that can often offer better support and more effectively meet individual customer circumstances." (CCW, 2019)
Energy	"Fuel Direct is a budgeting scheme that lets money be deducted directly from a customer's benefits to pay off a debt or energy use to a supplier. A fixed amount (in nearly all cases £3.70 (Gov.uk, 2020)) is taken directly from the customer's weekly benefits by DWP and paid to the supplier to help clear a debt. There has been a decline in the number of customers paying via Fuel Direct since a peak in 2011. The numbers of customers have reduced from around 39,000 electricity customers in 2011 to around 27,000 in 2015 and around 42,000 gas customers in 2011 to around 26,000 in 2015." (Ofgem, 2016)

Debt Recovery Processes and Third-Party Agents

In some cases, organisations may need to resort to debt recovery processes via a third-party agent to recover outstanding arrears. Recognising reports of harassment and sometimes illegal practices, regulators have set out specific standards for companies using third-party agents to ensure they are reputable and treat customers fairly.

Bad debt has an impact on both the customer and the organisation holding the debt. It risks failure of the supplier, and increased costs for all customers through a 'bad debt charge', which includes customers in debt. It is therefore understandable that companies and sectors need to have a defined approach to the later stages of debt collection and enforcement, with consideration to the support customers may need throughout all stages. We have outlined the cycle of debt in utilities in the 'Recommendations and next steps' section of this paper, which illustrates the impacts of debt on both customers and suppliers.

In the case of council tax collections, the impact of the bill for the full year becoming due after non-payment following a missed instalment reminder could be significant. Within energy and water, non-payment leads to discussions around reducing payments to make them more affordable, perhaps by spreading them out over a longer time, or by making smaller, more frequent payments based on what the customer can afford.

<table>
<tr><th>Council Tax</th><th>Water</th><th>Energy</th></tr>
<tr><td rowspan="2">Under The Council Tax (Administration and Enforcement) Regulations (1992) a taxpayer has the right to pay by instalments. If the instalment is missed, a reminder noticed is issued. If the missed instalment is not paid within seven days of this notice then the remaining council tax for the entire year becomes due.

This could have a significant impact on households with temporary financial difficulties. Failure to respond to reminder notices, or defaults on payment arrangements will result in the Council applying for a liability order to be issued. This gives the Council powers to make deductions from earnings via the debtor's employer or from benefits. If no payment arrangements are made, or no contact made with the debtor, the debt is passed to the Council's external civil enforcement agents. Future payments made will be applied to the enforcement agent's fees first before being applied to the debt, and if payment is made directly to the council the agent has the right to continue the enforcement action for their fees incurred.</td><td>Principle Five of the 2015 guidelines outlines the requirement for engaging a reputable company who abides by industry code of practice and the FCA handbook for debt recovery processes. It is specified that "the potential consequences of having their debt managed by a third party should be no more severe than if the service was provided directly by the company" (Ofwat, 2015).

There is a requirement for regular and effective communication systems to be in place to allow water companies to obtain access to the customer's details and agreements should they be approached directly by the customer or a third party acting on their behalf, such as debt advisers.

For companies with billing arrangements via the local authority, any debt is subject to the local authority collections processes.</td><td>Ofgem have pushed companies to reduce disconnections because they are in debt. In 2018 there were only six disconnections for debt, compared to 30,000 in 1998 (Ofgem, 2019b). Under the Gas Act (1986) and the Electricity Act (1989) suppliers have the right to pursue a warrant for a pre-payment meter to be fitted on any premises in an attempt to collect outstanding debt.

Although there is reference to use of external debt collection agencies (DCAs) in a number of historic documents by Ofgem, we have not found any published principles or requirements on suppliers when engaging or instructing external DCAs to collect outstanding energy debt.</td></tr>
<tr><td colspan="2">Unlike with council tax, energy and water companies do not have the powers to force entry to a property. Customers can still communicate directly with their energy or water company as the debt is not solely owned by the DCA.</td></tr>
</table>

Similar practices for council tax should be encouraged, as the impact of a large demand for payment can worsen financial situations, and directly impact on the customer's mental health.

Customer Communications

A minimum standard of customer communication is vital to keep customers adequately informed of their place in the debt cycle, and to allow customers the opportunity to correct genuine errors. Guidance provided by regulators sets out the minimum standards expected for customer communications in each sector, but these could be more consistent across different sectors.

While a minimum of three separate statutory communications by local authorities can be considered best practice, it is worth noting that each of these communications could appear negative and/or threatening to the householder receiving them. In what may already be a stressful and challenging time, softer messaging, particularly in the early stages of arrears, may be more likely to engage the household and could lead to improved outcomes for both the customer and the organisation collecting the debt.

A consistent approach across all sectors which considers not only the number of contact attempts, but also the tone and methods used in communication, would be

<table>
<tr><th>Council Tax</th><th>Water</th><th>Energy</th></tr>
<tr>
<td>Under the guidance, local authorities are expected to provide clear information about the enforcement process to all residents, particularly those in arrears. Prior to enforcement, "a bill payer should receive at least three statutory communications before further action is taken:

1. Reminder for payment
2. Court summons
3. Notification that the liability order has been granted and unless the amount owing is paid, bailiffs are likely to follow" (Ministry of Housing, Communities and Local Government, 2013).</td>
<td>Principle One of the guidance focuses entirely on communication with customers falling into debt. Communication should:

• Be proactive
• Be made as early as possible
• Give reasonable time to pay before reminders are issued
• Always set out what actions are taken if the customer does not respond
• Use a variety of methods to establish contact
• Take into account any special requirements of the customer, complying with the Equality Act
• Not be oppressive, misleading, or threating; and
• Should conform to good practice, including that set out in the FCA handbook.</td>
<td>Principle Two of the Ability to Pay Principles outlines the requirement for proactive contact with customers, whilst Principle Five covers the clarity of those communications. Companies are required to:

• Make early contact to identify payment difficulty
• Regularly review methods of proactive contact
• Use every opportunity to gather information about a customer's situation
• Provide clear communication explaining:
  ◆ How much the repayments are
  ◆ When the debt will be repaid; and
  ◆ What to do if they experience difficulties
• Explicitly explain to PPM customers that debt will be recovered regardless of usage.

Additionally, the supplier licence conditions outline the requirements to offer multiple methods of payment (suitable to the customers' individual circumstance) (SLC27) and specific standards of communication under the standards of conduct (SLC0).</td>
</tr>
</table>

valuable to customers, and would make it easier for those falling into hardship to manage timescales for addressing their debt issues.

Another point to consider is the number of communications a household in financial difficulty may be receiving from multiple suppliers/organisations. Recognising that households do not tend to struggle with one bill in isolation, customers will need to make contact with each organisation in turn, often needing to provide detailed financial information in every interaction, which can cause significant mental stress and anxiety.

One potential solution to this could be to develop a mechanism to sharing a financial vulnerability 'flag' with other utility companies once a company is aware of financial difficulty. This could utilise the already existing Priority Services Register and would allow companies to be proactive in their communications with customers, perhaps offering support at an earlier opportunity and therefore reducing the accumulation of debt. This would also offer an opportunity for 'enhanced needs pathways' for those with multiple vulnerabilities as financial vulnerability could be viewed alongside the other circumstances which may make a customer vulnerable.

Support services

Services offered across the different sectors vary quite significantly. Opportunities exist for sectors to make support services more consistent, particularly in directly comparable sectors such as energy and water.

<table>
<tr><th>Council Tax</th><th>Water</th><th>Energy</th></tr>
<tr>
<td>If struggling with the monthly council tax payment, households may be able to access some support:

• Spread payments over 12 months instead of the default 10 to reduce the monthly payment

• Be assessed for a 'council tax reduction' of up to 100% dependent on individual circumstances including where you live, your income, how many children and adults live with you, and other circumstances

• Receive a 'one-off discount' determined by individual local authorities</td>
<td>If a customer is struggling to pay, water companies offer:

• The WaterSure scheme which "enables water suppliers to cap bills for low income customers using a lot of water for essential family or health reasons" (CCW, 2020)

• Company specific 'social tariffs' which offer reduced bills to low-income households meeting specific eligibility criteria

• Payment holidays, offering a break from monthly payments to give customers time to deal with their specific circumstances

Additionally, for customers in debt, many companies have specific 'debt matching' schemes which clear any outstanding debt after an agreed payment plan has been maintained for a specified period of time. The plans often quoted as best practice are:

• For the initial 6-12 months, for every £1 the customer pays the company pays £1 too

• From 6 months (or 12 depending on the company) until the end of the agreed period (usually two years), for every £1 the customer pays the company pays £2

• At the end of the agreed period, providing the payment plan has been maintained, any remaining debt is written-off.</td>
<td>To help customers manage their bills, energy suppliers offer:

• Payment by instalments

• Alternative plans or tariffs

• Tips on saving energy to reduce your bills

• Installation of a prepayment meter (PPM) to help with budgeting

• Fuel Direct to take payments directly from benefits.

Additionally, low-income householders may be eligible for the Warm Home Discount (WHD) which offers a rebate of £140 off their energy bill. Some energy suppliers (through charitable trusts) offer grants specifically for their customers to help their financial situation. British Gas Energy Trust is the only one open to anyone to apply – you do not have to be their customer, though their website does states that the "majority of the grant budget is designated for British Gas customers" and encourages customers of other suppliers to approach their customer service teams in the first instance (British Gas Energy Trust, 2020).</td>
</tr>
</table>

The debt matching schemes offered by some water companies should be considered best practice, and other sectors should seek to implement similar support. While payments to the water company may be lower, a customers' ability to pay is considered, and the agreement, with the incentive of debt clearance, encourages positive payment relationships and offers relief from debt. As debt levels increase due to the economic impacts of Covid-19, it is possible that the resources available to companies to support at this level may become exhausted, and other funding avenues should be explored.

The powers within the Digital Economy Act offer energy and water suppliers direct access to DWP data for the purposes of assisting people living in fuel and water poverty. It is important that suppliers make full use of these powers to ensure they can directly target support services to those most in need, reducing the need for awareness raising and removing the requirement for a customer to actively apply to their supplier for help.

Severe Indebtedness

In 2018, the Money and Pensions Service (MaPS) published a technical report focused on levels of over-indebtedness in the UK, defining over-indebted individuals as those who "find keeping up with bills and credit commitments a heavy burden or have fallen behind on, or missed payments for bills/credit commitments in any three or more months out of the last six months" which they state do not need to be consecutive (CACI, 2018). In 2018, they estimated 8.9 million adults in the UK were classed as 'over-indebted' (17.2% of the adult population). The highest levels of over-indebtedness were estimated to be in London, where 22.5% of the adult population met the definition.

Indebtedness as defined by Winckler (2014) is the result of a combination of circumstances, events and behaviours. The term 'over-commitment' was previously used synonymously with over-indebtedness, and was described as arising either "from sudden shocks to expenditure or income flows" or cumulating over time, noting that it "can arise for any household in any income bracket, but some might be more at risk than others" (European Commission, 2008). The Covid-19 crisis has created a series of events and circumstances which, for many, have resulted in sudden shocks to income. While for some the crisis has significantly changed expenditure, the hardest hit are those who were already living on low-incomes, as can be seen in Figure Six; "the weighted average median pay in the five hardest-hit sectors is around £10.60 per hour; for the five least affected sectors, it is around £14.60 – or nearly 40 percent higher" (McKinsey & Company, 2020).

As those impacted financially by coronavirus, including the 3.2 million new claimants of Universal Credit, adapt to the reality of their new financial situations, for many, the likelihood of meeting all their previous financial commitments is unlikely. Difficult choices will need to be made to make cut backs, and some households may find themselves 'juggling' their essential bills, choosing to miss a payment in order to get by, possibly doing so for the very first time. As time passes, these households are likely to meet the definition of 'over-indebted'.

But utility companies aren't well placed to see the overall picture of a household's financial situation. They may see a missed payment on a bill one month, but the next month is paid on time. Over time, the missed payments start to accrue, leading to debts that become unmanageable for the household when added to debts held elsewhere. While a

pattern may emerge, or payments come to an abrupt stop, the account held with the utility is only one bill of many for the household, all of which have become a struggle due to their change in circumstances.

While utilities should always be encouraged to use all available data to understand a customer's situation, which may include Credit Reference Agency data, one possible solution to this issue is not to consider if a customer is 'over-indebted' but to consider if they are in 'severe indebtedness' with that provider. While there is no formal definition of severe indebtedness, it could be defined as the point where the debt owed to a single provider exceeds the annual cost of the service provided. As an example for the water industry, if based on the average 2020/21 combined water bill in England and Wales (Discover Water, 2020), a customer would be in severe indebtedness if their debt exceeded £397. Companies could measure the debt accrued against the customer's annual cost to monitor the severity of their financial situation introducing interventions at specific intervals to proactively offer support. Regulators could also place specific targets against companies to reduce the incidence of severe indebtedness given the associated reduction in bad debt this would make.

Distribution of jobs at risk by hourly paid band (% of all jobs at risk)[7]

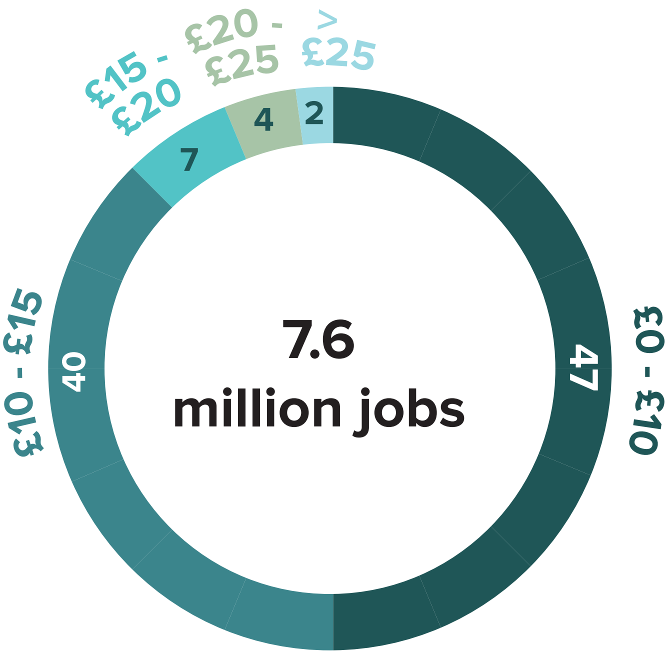


Figure 5 – McKinsey & Company (2020). Data Sources: Office for National Statistics; US Bureau of Labor Statistics; McKinsey Global Insititute Analysis; McKinsey Analysis

7. Jobs that are at a high risk of furloughs, layoffs, or reductions in hours in pay during periods of high physical distancing. Excludes occupations where no pay data were available

Recommendations and next steps

An unexpected change in circumstances can have a dramatic impact on household income. For many, the Covid-19 crisis has resulted in significant income-shock, and, in a very short space of time, households previously managing their finances now find them a struggle. For these millions of people, their personal finances have been hit hard and hit quickly, and no-one knows when their situations will improve.

More than ever before people are looking for support with paying their essential household bills, and yet these bills are likely to be increasing due to additional usage of energy, water, telecoms, and others, at home. As we move towards the colder months, and experience further local, and possibly national, lockdowns due to the second wave of Covid-19, these situations are likely to worsen rather than improve.

As has been shown in the direct comparisons within this paper, across the three sectors explored in detail, there are many areas of best practice which should be replicated across all three sectors wherever possible. Common approaches to debt management can help customers to know what to expect at all stages of the process, and how to navigate the support options which may be available to them.

Reducing utility debt has significant benefits for both the supplier and the customer, and both have an active role to play in breaking the cycle. Figure 6 illustrates NEA's interpretation of the cycle of debt in utilities. It shows how a change in customers' circumstances can lead to increased debt, poor supplier outcomes and wider economic impacts, culminating in increased bills for all which adds once again to the affordability issues experienced by many.

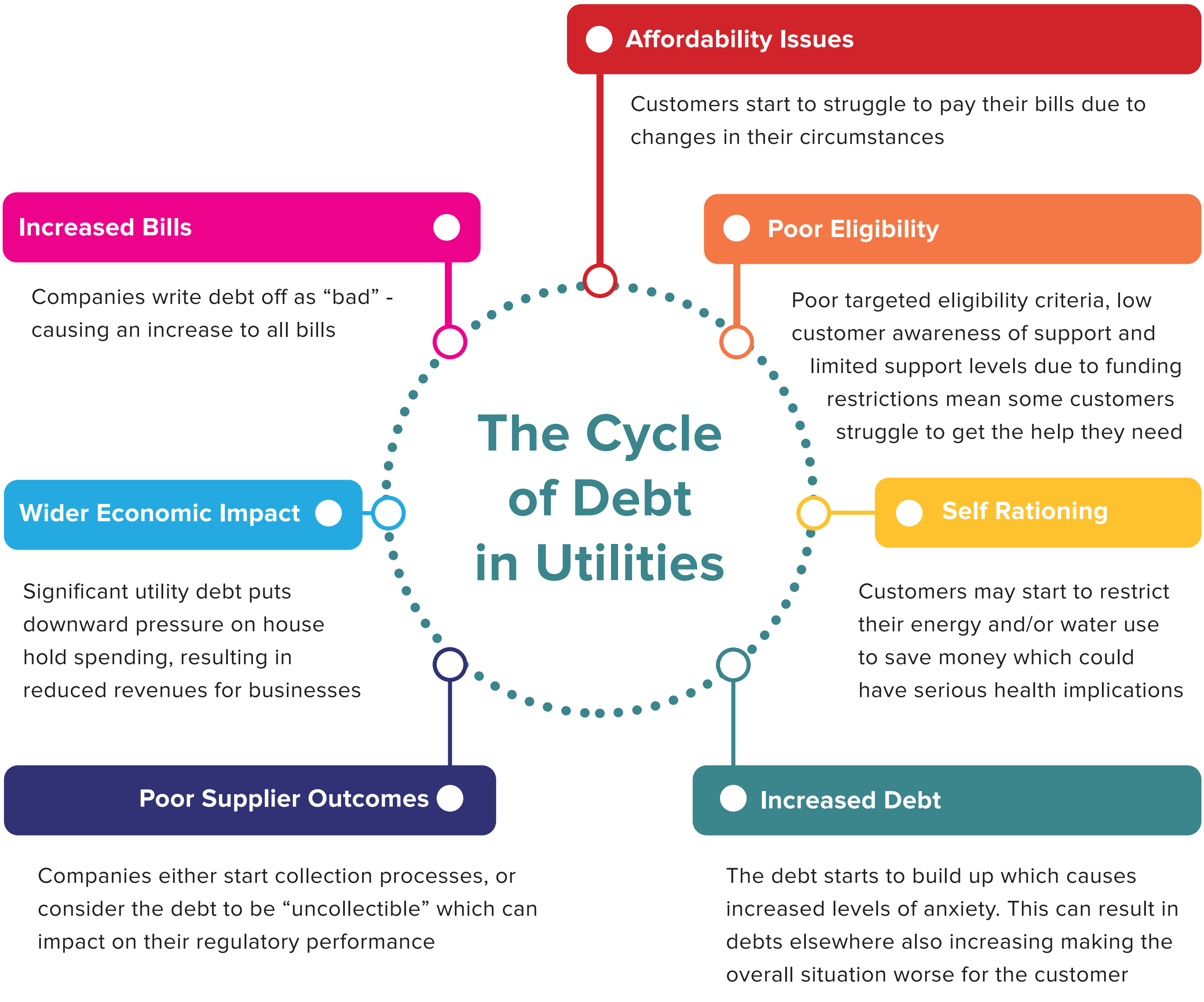


Figure 6 – Illustration of the Cycle of Debt in Utilities

As the longer-term impacts of the crisis are realised, and the depth of the resulting economic recession understood, action should be taken to ensure the households most adversely affected are adequately supported.

1

Issue: Breathing Space is due to be introduced six months after the end of current Government support schemes when unemployment rates and financial difficulty is expected to rise significantly due to income pressures and accumulated debt.

Recommendation: Government should bring forward Breathing Space and extend the respite period offered.

The long-awaited Breathing Space initiative due to be introduced in May 2021 is welcomed by many debt charities and consumer organisations, but the current launch date won't offer protection to those impacted with job losses or reduced income once the Government Job Retention scheme ends. Households with pre-existing debts may lose the ability to make payments towards those debts, and would benefit from Breathing Space being brought forward to allow them time to find a suitable debt management plan and alternative source of income without their debt worsening. This could be done in line with the end of the job retention scheme, to ensure that those who lose their jobs as a result of furlough ending have the respite period needed to get their finances in order.

Additionally, the current respite period of 60 days should be extended to be in line with the Scottish Government model of six months, which could be done on a temporary basis to cover the economic recovery period, which the Bank of England do not expect before the end of 2021 (Reuters, 2020). This would provide additional relief to thousands of households impacted by the resulting jobs-crisis by freezing their debts while they attempt to find alternative employment.

Bringing the timescales for Breathing Space forward would provide Government with a vehicle to simultaneously release a package of support measures which could further reduce debt and support those negatively impacted by the crisis.

2

Issue: Levels of utility debts are rising significantly due to the ongoing income pressures many households face as a result of the pandemic. These debts place significant pressure on both households and companies, and can result in future bill rises to pay for costs associated with writing it off to bad debt.

Recommendation: The UK Government should make contributions for payment matching schemes.

Utility debt accumulated during the crisis, because of payment holidays and reduced payments, will still be owed by customers to their suppliers. With other pressing financial commitments and reduced incomes due to job losses, this becomes a serious issue for consumers and can significantly increase stress and anxieties. If households go into winter with energy debt, they may choose to self-ration their energy usage during cold months, which could lead to significant health implications, and in extreme cases, premature mortality.

Recognised as best practice, some companies across the water industry offer payment matching schemes, whereby outstanding debt is written off after an agreed time providing all agreed payments have been made. This is currently funded by the water companies. As a minimum, Government should encourage the consistent adoption of this best practice across both the water and energy sectors.

Accelerating repayment of utility debts reduces the pressures on customers and reduces the likelihood of self-disconnection or self-rationing, in turn reducing the pressures on health and social services. It also reduces the risk of future bill increases occurring through write-offs to bad debt (the current cost of bad debt on a water bill is estimated to be £21 per year). There is therefore a case for Government to make contributions towards payment matching schemes in order to accelerate repayment of utility debts. This would require an impact assessment to develop the finer details but could be delivered through existing services such as Fuel and Water Direct.

Outside of the direct impacts of the Covid-19 crisis, identified best practice should be replicated wherever possible across all sectors, and cross-sector collaboration should be encouraged to reduce the touchpoints customers seeking support are required to make, and to apply consistency to their debt practices.

3

Issue: Each of the three sectors explored within this paper follow different principles and guidelines for debt management. This can become confusing for customers, making it difficult to understand and manage their debt journey across multiple sectors.

Recommendation: Consistent 'Ability to Pay' and debt collection principles should be implemented across all essential household bills.

As debt levels rise, essential service regulators should work together to establish and implement 'ability to pay' principles within sector specific licence conditions. This must include how suppliers will support customers to access professional debt advice so that customers can check benefits entitlements before debt repayment plans are agreed or signpost appropriate income maximisation services when repayment plans are reviewed.

Each of the current guidance and principles documents should be thoroughly assessed to ensure best practice is correctly identified and shared across sectors. As is the case with the guidance in energy and water, these principles should be consistent across all Local Authorities to ensure that debt collection practices are fair.

4

Issue: There is no current mechanism to share data across all sectors to provide an indication of financial difficulty. This limits a sectors' ability to respond quickly to need and offer appropriate support.

Recommendation: Opportunities for maximising data sharing should be explored, including utilising existing mechanisms, such as building on the Priority Services Register and acting on powers within the Digital Economy Act, to ensure that support is offered to customers moving into financial difficulty at the earliest possible opportunity.

Supporting households with their finances at the earliest opportunity can reduce the overall cost to serve that customer, as it removes the need for more resource-intensive collections procedures further down the line. The difficulty is often recognising who needs an early intervention.

Although not always the case, as previously outlined, water bills are often one of the first to be defaulted on, as the consequences for doing so are lower than other commitments. If payment is not made after a specified time period following a reminder, or if through interaction with the customer it is understood that they are unable to make payment, then this default could be considered the first sign of financial difficulty. Data sharing opportunities should be explored to notify other sectors of financial difficulty, allowing them to proactively offer support at an early opportunity and possibly preventing the customer falling into deeper financial difficulty. This notification could be initiated by whichever organisation notices the issue first – the first default may not always be to the water company.

Further data sharing opportunities should also be explored to support customers in this way. Where customers are identified as being eligible for support for social tariffs (in water) or Warm Home Discount (in energy), a financial vulnerability flag could be shared notifying the other sector, and allowing them to make proactive contact with the customer. This would reduce the need for the customer to make contact with multiple organisations, often having to provide the same detailed level of financial information when explaining their situation, which could therefore reduce pressure on their mental health and anxieties.

As we highlighted in this report the Priority Services Register can be adapted and, as referenced in our previous report 'Water Poverty: The Consistency of Social Tariffs' (2020) the powers within the Digital Economy Act must also be acted on, as both provide clear mechanisms to quickly identify need and offer appropriate support. This may also include opportunities to share an indicator for eligibility for energy and water efficiency measures, which can also reduce customer bills.

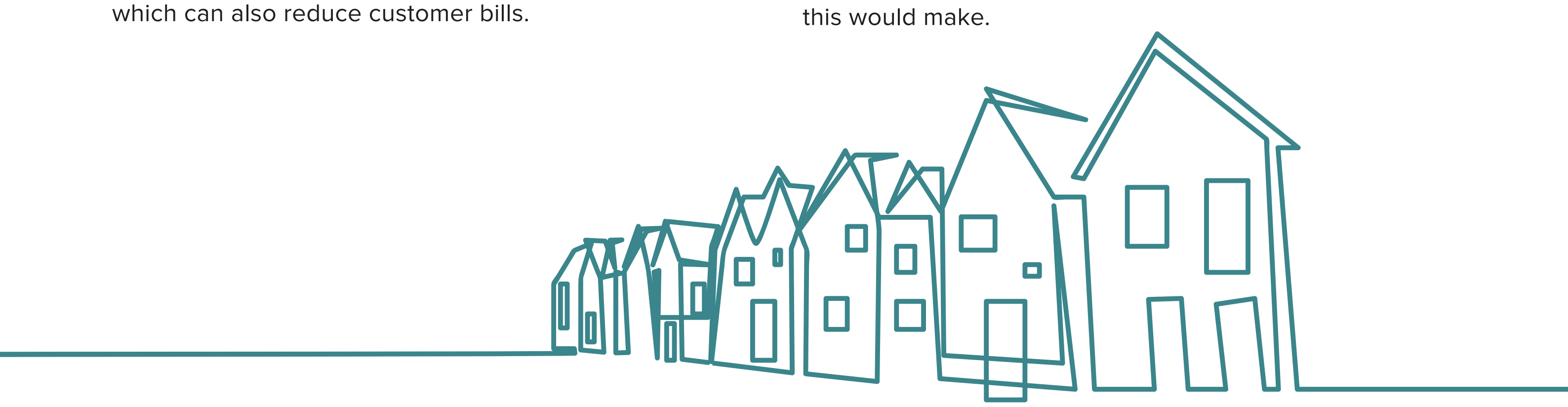
5

Issue: With increasing numbers of individual households falling into debt with their essential household bills, both prior to and post-Covid, it is becoming more challenging for companies to prioritise debt assistance. They also have a limited view of the overall financial situation of a customer and are therefore unable to determine if the customer is 'over-indebted'.

Recommendation: All companies should consider how a single definition of 'severe indebtedness' can ensure customers are treated fairly.

As utilities are not best place to understand an individual customer's overall financial situation, they find themselves unable to determine is a customer is 'over-indebted'. Adopting a formal definition of 'severe indebtedness' as the point where the debt owed to a single provider exceeds the annual cost of the service provided, would allow companies to measure the debt accrued against the customer's annual cost to monitor the severity of their financial situation.

Further investigation could be made by the companies using current or future data of their customers' means to indicate whether they are "can't pay" or "won't pay". Further customer segmentation would allow companies to use this information to better target support, and this could also offer the 'flag' needed for data sharing with other sectors/organisations (as detailed in recommendation four). Companies should then introduce interventions at specific intervals to proactively offer support. Regulators could also place specific targets against companies to reduce the incidence of severe indebtedness given the associated reduction in bad debt this would make.



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