National Audit Office

Report
by the Comptroller
and Auditor General

Cross-government, HM Treasury

Tackling problem debt

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Report by the Comptroller and Auditor General

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Sir Amyas Morse KCB
Comptroller and Auditor General
National Audit Office

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The aim of this report is to evaluate and conclude on HM Treasury's overall approach to over-indebtedness, and how well it brings together government's and other stakeholders' various activities and interventions to meet its objectives.

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Key facts

8.3m

estimated number of over-indebted people in the UK

40%

proportion of reported debt problems in 2017-18 relating to debts owed to government, up from 21% in 2011-12

£248m

our estimate of the minimum annual cost to the public purse of the direct impact of problem debt on a person's likelihood to experience anxiety or depression or be in state-subsidised housing

£15 billion	total outstanding mortgage arrears in 2018
£18 billion	our estimate of personal debt owed to government, utility companies, landlords and housing associations; a minimum figure based on available data and research
4 in 10	estimated proportion of people in the UK who cannot manage their money well day to day
5,000	approximate number of consumer credit lenders regulated by the Financial Conduct Authority
600,000	estimated number of people who need debt advice but are unable to access it

Summary

1 Over-indebtedness, or problem debt, is when someone becomes unable to pay their debts or other household bills. Debt problems are detrimental to people's wellbeing, and can lead to higher use of public services such as mental health services and state-subsidised housing, with resulting costs to the public purse. Over-indebtedness also results in costs to the wider economy, for example through lost productivity or increased crime.

2 The Money Advice Service (MAS) estimates that 8.3 million people in the UK are over-indebted, and that 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. The ratio of unsecured debt to household income has been increasing since 2014.

3 HM Treasury (HMT) has overall policy responsibility for personal debt, and has high-level objectives in two areas:

- **Preventing problem debt from occurring**. HMT aims to help people manage their money by improving their financial capability, and coordinates government's work to ensure people can access useful and affordable financial services. The Financial Conduct Authority (FCA) regulates retail lending (including consumer credit and mortgages), and MAS coordinates the UK's financial capability strategy, which covers a large number of other bodies. HMT has oversight of both organisations.
- **Minimising the impact of problem debt**, by providing support to those who become over-indebted. MAS commissions free debt advice from the third sector. The FCA regulates debt collection among retail lenders and debt collection agencies, as well as debt advice organisations.

4 Other parts of government also play a significant role in meeting HMT's objectives, and their policies and interventions are interrelated. This makes delivering HMT's policy objectives challenging, requiring a coordinated approach to ensure that the actions or policies of one part of government do not negatively affect the work of another. In particular:

- the Department for Work & Pensions shares some responsibilities for financial capability and financial inclusion with HMT. It will be the lead sponsor of a new financial guidance body from January 2019;
- government policy decisions can impact on people's financial and debt situation, for example where they affect benefits or the affordability of utilities; and
- government itself is a significant source of personal debt, such as benefit overpayments or council tax arrears, and therefore has an important role in managing the impact of over-indebtedness. The Cabinet Office leads the government's work to improve debt management practices in government.

Scope of this report

5 We have previously reported on specific areas relating to personal debt, but have not examined government's overall approach or how the interdependencies between policy and delivery areas are managed. For example, previous reports have looked at regulating consumer credit, helping consumers to manage their money, or managing debt owed to central government. Public bodies have taken positive steps in response to recommendations in these areas.

6 This report aims to evaluate and conclude on HMT's overall approach to over-indebtedness, and how well it brings together government's and other stakeholders' various activities and interventions to meet its objectives. In particular, the report examines:

- whether HMT has appropriate mechanisms to identify the scale and nature of the problem it is seeking to address and organise government's response (Part Two);
- evidence on the effectiveness and coordination of government actions to prevent problem debt through improving people's financial capability and regulating consumer credit lending (Part Three); and
- the extent to which government as a whole adopts best practice in managing its own debtors, and supports over-indebted people more generally through debt advice and other protections (Part Four).

7 We considered personal debt within three broad categories: consumer credit and mortgages; utilities and private rent arrears; and debts to government (such as council tax arrears or benefit overpayments). This is because, while people can struggle with debts to multiple organisations at the same time, government oversight and intervention differs between the three categories.

Key findings

Identifying the problem and coordinating the approach to over-indebtedness

8 **HMT relies on many organisations to meet its objectives on problem debt, but there are weaknesses in its accountability arrangements for ensuring there is an effective and coherent approach**. HMT works closely with many organisations across government and the private and third sectors that have interconnected responsibilities. It exerts influence through a range of formal and informal relationships, including sitting on a number of boards and groups covering issues such as financial capability and debt advice. However, it does not have any formal mechanism or forum to bring issues together in a coherent way, ensure common understanding of priorities, or collectively hold delivery partners to account. It has also not articulated overall spending commitments, detailed aims or the outcomes it is seeking to achieve, or what data it will use to assess performance. The government previously had a formal over-indebtedness strategy, but HMT did not continue this when it took on policy responsibility in 2013 (paragraphs 2.3 and 2.4).

9 **People increasingly report problems with debts owed to government or utility providers, but HMT has limited insight into these areas**. Government needs to understand the scale and nature of problem debt to determine a sufficient and targeted response. It has detailed data on debts owed to retail lenders, such as mortgage arrears of around £15 billion in 2018. But it does not have complete data on all debts owed to government and utility providers (we estimate debts from arrears and overpayments to be at least £18 billion), where people are increasingly struggling. For example, the proportion of problems reported to Citizens Advice relating to government debts increased from 21% to 40% between 2011-12 and 2017-18, while for consumer credit it reduced from 52% to 33%. Of the four largest central government creditors we requested personal debt data from, two collect the data while the other two cannot disaggregate personal debt from overall debt data (paragraphs 2.5 to 2.9).

10 **Government has no estimate of the extent to which problem debt leads to increased use of public services, or the resulting cost to the taxpayer**. Understanding the impact of problem debt is important for policymakers across government, in considering the impact of policy design on over-indebtedness and the relationship between actions in one part of government and costs occurring elsewhere. Estimating the impact on and cost to public services of problem debt is complex, and government has not done this. Our modelling indicates that the direct effect of problem debt on an individual's likelihood to experience anxiety or depression or to be in state-subsidised housing results in an additional cost to the taxpayer of at least £248 million a year, and to the economy as a whole of around £900 million a year. We were unable to model other effects, including on employment and benefits, because of gaps in the data available (paragraphs 2.10 to 2.12).

Preventing over-indebtedness

11 MAS has improved coordination of interventions to raise individuals' financial capability, but its strategy does not involve all relevant parts of government and MAS does not yet know the strategy's impact.

- Financial capability – the ability of people to manage their money and handle periods of financial difficulty – in the UK is low. MAS estimates that 4 in 10 people in the UK cannot manage their money well day to day, while the Organisation for Economic Cooperation and Development (OECD) has found the UK to score below average in financial capability compared with other OECD countries (paragraph 3.5).
- MAS is responsible for improving financial capability, and recognises that to meet its aims it needs significant and long-term buy-in from other public and private bodies that also have responsibilities in this area. Since 2015, MAS has led a long-term strategy to bring together such organisations, in order to coordinate activities and build an understanding of which interventions are most effective. While this has improved coordination, participation in the strategy is optional. For example, the Department for Education, which is responsible for financial education in schools, is not involved at all, though both it and MAS recognised this as a gap they intend to address. MAS and two pensions guidance services will be replaced by a single financial guidance body from January 2019, which presents potential for a more robust approach, as it will have statutory responsibility to coordinate financial capability activities. However, it will not have additional formal powers to do so (paragraphs 3.4, 3.6, 3.7, 3.9 and 3.10).
- MAS does not yet know what impact its financial capability strategy is having. It has made good progress in identifying which individual interventions are most effective, and is now starting to evaluate the overall impact of the strategy so far (paragraph 3.8).

12 The FCA has taken action to improve responsible lending, but recognises that it has more to do to tackle persistent and unsustainable consumer credit debt. Affordability is a particular concern in unsecured consumer credit, where debt levels can escalate quickly due to high interest rates. The FCA has regulated consumer credit since 2014, for which it is accountable both to HMT and directly to Parliament. It seeks to ensure that firms lend money to individuals responsibly, to protect consumers from unaffordable credit, and that firms treat customers fairly. There are around 5,000 consumer credit lenders, and the FCA requires them to meet certain lending standards. The FCA has also taken action in specific areas of particularly high detriment, such as introducing a price cap on short-term high-cost credit. Fees and charges on a typical payday loan reduced from more than £100 to around £60, which the FCA estimates saves borrowers £150 million per year. However, the FCA recognises it has more to do on high-cost credit. Its 2018-19 business plan prioritises action to address issues in rent-to-own, home-collected credit, catalogue credit and unarranged overdraft fees (paragraphs 3.12 to 3.15).

Managing problem debt

13 **Evidence shows that good debt collection practice both benefits individuals and boosts collection rates.** Common best practice principles include timely assessments of vulnerabilities, affordable repayment plans, and signposting or referring people to debt advice. Research in 2014 estimated that tailored debt advice, support and affordable repayments saved creditors £82 million in a year from 110,000 over-indebted clients, an average saving of £750 per person. Lenders and debt collection agencies we interviewed also reported benefits from following best practice. By comparison, our modelling, based on a survey of debt advice clients, estimates that intimidating actions and additional charges were 15%–29% more likely to make debts harder to manage and increase levels of anxiety or depression (paragraphs 4.3 to 4.5).

14 **Government lags behind the retail lending sector in following good debt management practice.** Departments, agencies and local authorities are responsible for their own approaches to debt management. We found examples of good practice, but it is not adopted consistently. For example, established best practice in how to assess the affordability of repayments, promoted by MAS, is used by only 19% of local authorities and is not used as standard by government departments. Research in 2016 found that government bodies' debt management standards are considered by debt advisers to be frequently worse than other types of creditor. Debt advice clients' perceptions of whether they are treated fairly also lag behind retail lenders (paragraphs 4.6 to 4.8). We identified two particular areas that stakeholders highlighted as affecting the adoption of good practice:

- **A lack of data-sharing.** Because of IT systems and legal barriers to data-sharing, government cannot identify individuals who owe money to different departments, and in one department different debts within the same department. This risks poor value for money as there is nothing to prevent debt teams competing for repayments from the same person. The Cabinet Office is leading a pilot to identify a segment of debtors who owe money to more than one government organisation through the Digital Economy Act 2017, to support the case for more data-sharing to prevent debt (paragraphs 4.10 to 4.12).

- **Short-term incentives and funding pressures.** Our analysis of debt charity data found that people report more problems with debts owed to government as the fiscal year progresses, a pattern not observed with private sector debts. A number of stakeholders we interviewed considered that this could be affected by performance metrics (for example, in-year collection targets and league tables) and funding pressures at a local level creating incentives to pursue debts more quickly and aggressively than is best practice (paragraphs 4.13 and 4.14).

15 **The Cabinet Office's work to improve debt management across government is constrained by a lack of powers and gaps in participation at senior and local levels**. The Cabinet Office is responsible for promoting good debt management practice across central government. It created a forum in 2016 to examine government's practices and make recommendations to improve them, and in 2017 developed fairness principles aligned with established best practice. Group members consider that it has improved coordination of approaches. However, it does not monitor whether its recommendations are adopted. Furthermore, the group has no executive powers, direct involvement from senior officials (who provide oversight through a separate cross-government group) or representation from local government (paragraphs 4.15 to 4.18).

16 **HMT is developing proposals to strengthen statutory protections for those struggling with problem debts**. It is developing a proposed new scheme that would allow individuals with unmanageable debt to enter statutory protections from action by creditors and access a statutory debt repayment plan. Success will depend on the extent to which the new protections are used and the impact they have on outcomes, which HMT recognises it will need to consider when designing the scheme (paragraphs 4.22 and 4.23).

17 **There is a shortfall in the amount of debt advice available to support over-indebted people**. MAS spends £48 million a year on directly commissioning debt advice, funded by a levy on financial services firms. Other organisations and individuals voluntarily provide an estimated £148 million of further funding directly to debt advice bodies. MAS commissioned an independent review which published in 2018 and found that 600,000 over-indebted individuals were unable to access advice, and that capacity would need to increase by 50% within two years to satisfy demand (paragraphs 4.20 and 4.21).

Conclusion on value for money

18 HMT is taking a thoughtful and well-intentioned approach to excessive indebtedness. It recognises that this has significant damaging effects in terms of public and economic costs, as well as on individuals, although these are not quantified. The effort to provide support across multiple government actors has become more coherent in recent years.

19 However, the problem has not stood still. Utility providers and the public sector have emerged as major components of debt problems. The information available in these areas is, disappointingly, much less coherent or transparent than commercial debt information. There are also crucial areas, such as debt collection, where public oversight lacks impact. While recognising the positives, we conclude that HMT cannot promote improvement in the management of excessive debt as effectively as possible across a wide network without fixing the weak links. This leads us to assess that there is further to go before value for money is secured.

Recommendations

20 HMT should:

a Develop an accountability mechanism to ensure that government's policies on personal debt and related areas are delivered effectively and coherently. It could learn from examples such as the Department for Business, Energy & Industrial Strategy's Consumer Protection Partnership, which has improved coordination in a policy area facing similar challenges.

b Work with other parts of government to improve the quality and availability of data on the scale, nature and impact of personal problem debt.

c Set clear aims and performance measures for its policies, including the impact of the new statutory protections it is currently developing. It should consider how to measure the influence that government interventions have had on outcomes for over-indebted people.

d Work with Cabinet Office and others in government to examine fully whether government bodies have incentives to prioritise in-year debt collection over better collection overall, and consider how best to correct for any perverse incentives where appropriate.

21 Departments, led and supported by Cabinet Office, should:

e Ensure the Cabinet Office's cross-government work on debt management has the mandate and levers to prompt better practices in central and local government.

f Continue to explore how to improve data-sharing within government, to help tailor debt management approaches to debtors' circumstances, and avoid different parts of government competing with each other.