

Take it away

CAB evidence on the DWP third party deductions scheme and financial inclusion

Summary

HM Treasury has proposed to extend the Department for Work and Pensions' third party deduction scheme to debts to private sector and third sector lenders where normal repayment arrangements have broken down.¹ The proposal forms one of a number of recommendations to improve access to affordable credit.

The facility for direct deductions from benefit for debts and ongoing commitments has been and remains essential for many benefit claimants to prevent repossession and homelessness, safeguard supplies and enable them to pay, and their creditor to receive regular, if small, payments towards their debts and avoid further debt recovery action and transaction costs such as counter fees.

Benefit levels are low and cannot sustain substantial deductions from essential living expenses. There is no overall cap on the value of deductions for debts and ongoing commitments that can be made from one person's benefit. There needs to be a fine balance between access to a scheme which manages indebtedness and the need to leave people with adequate basic income.

Whilst the total number of third party deductions has fallen since 1997, the proportion of income support claimants with one or more deductions from benefit has risen substantially and is now 45.6 per cent. This shows that there is a continuing need for the scheme. Although the introduction of direct payment of benefit into bank accounts provides an alternative method of paying debts by direct debit or standing order, third party deductions from benefit are still going to be needed, particularly by those whose benefit is paid into a Post Office card account or by cheque.

Access to the third party deduction scheme could reassure lenders that they will be able to lend to more people on low incomes at better rates of interest. It could also reassure the consumer that if they do fall into arrears they can avoid formal debt recovery action and costs via the scheme.

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Key points

The case for review and revision

The benefits from which deductions can be made are set at a subsistence level. For some groups, such as single adults, benefits have not risen adequately or in line with benefits for families with children in recent years. The level of benefit is intended to cover subsistence costs such as food, heating, clothing and shoes. At present whilst the scheme aims to help people manage their debts, it does not always prevent hardship because there is no overall cap on the number and value of repayments.

There are already at least eleven types of debts that could be repaid by deductions from benefit, for debts and ongoing costs. Rates of repayment for each are varied and can be high – ranging from £2.80 to £5 per week. Additionally current consumption charges can be estimated for commitments such as fuel and water. Further deductions can also be made from benefit to repay social fund loans and benefit overpayments. The amount that can be deducted to repay all types of debt should be reviewed so that an amount for debt repayment is distributed equitably between all suitable creditors, giving greatest priority to essentials. We believe that payments of as little as £1 per week ought to be accepted for all debts.

It is currently possible for almost all of a claimants' weekly income to go towards debts. Claimants have little control over the use of their benefit to repay debt – consent is only required where the total of deductions exceeds 25 per cent of benefit. Citizens Advice has always argued that claimants should be given more control and choice.

In contrast some benefit claimants cannot get third party direct deductions at all because they are not receiving a qualifying benefit. Citizens Advice would like to see all benefits and tax credits should brought into the scheme.

Claimants can receive a poor service from the DWP and their creditors in terms of regular statements and information about their debt repayments giving them limited opportunity, if any, to vary and reschedule payments.

Reform of the social fund is needed to extend social fund loans to those in low paid work or in receipt of other benefits and to increase the number of grants. We consider that reform of the social fund would be a more significant means of widening access to affordable credit than allowing lenders access to the third party deduction scheme.

Potential problems with adding credit loans to the third party deduction scheme

Potential problems with credit loans coming on board are:

- More claimants than now could have insufficient money to live on weekly.
- Where the claimant has other debts, lenders might be unable to secure direct payments because of the many other debts being deducted.
- Interest could continue to accrue on the account. As a result the debt would continue to grow rather than being progressively paid off.
- There is a risk that DWP frontline staff will be unable to administer the scheme, particularly if they are required to decide entry to the scheme on the basis of whether the lender has lent responsibly.
- There may be a reduced chance for claimants to get independent money advice on dealing with all their debts and maximising income.

Terms of access for credit debts

Citizens Advice considers that the terms of access to the DWP third party deduction scheme for any credit loans should be:

- All claimants with multiple debts should first have access to independent advice on the debts to help them make equitable payments to all their creditors and identify strategies for managing the debts in other ways. The provision of advice should be integral to the resourcing of the scheme and properly funded.
- The loan product would have to be on a pre-approved list and lenders would have to sign up to a list of conditions to offer such loans.
- Ongoing interest and charges should be frozen, and any court action to recover the debt should be stopped when the claimant is accepted onto the scheme.

Introduction

The DWP's third party direct deduction scheme allows people in receipt of income support, income-related jobseekers allowance and guarantee pension credit to have money deducted from their benefit and paid directly to repay debts and in some cases to pay for ongoing bills. The fact that deductions from benefits are in place often has the effect of persuading the creditors not to take enforcement action. The basic rules of the third party direct deduction scheme are explained in an annex to this briefing.

Citizens Advice last examined the third party deduction scheme in 1993. At the time we wrote *Make or Break?*, use of direct deductions was increasing. Citizens Advice Bureaux were frequently reporting that their clients were left with inadequate income to live on after deductions.²

Since 1997 there has been reduction in the total number of third party deductions, but as a proportion of income support claimants the number having deductions to pay debts has risen substantially.

There has been a decrease in numbers of deductions for fuel and water, mortgage interest, and community charge. Deductions from clients on income support for council tax have risen, as have deductions to recover fines, social fund loans and recovery of benefit overpayments.

There could in future be less of a need for a third party deduction scheme from benefits. Recent government moves to switch payment of benefit from order book and girocheque to payment into an account means that more people who rely on benefits could manage their income and debts by setting up direct debits or standing orders from their bank account to repay their creditors. In particular, fuel customers can access preferential payment tariffs if they pay their bills by direct debit. At the beginning of January 2005, the

DWP had received over seven million bank account details for direct payment of benefit to commence.³ Other changes have called into question whether third party deductions should continue for some debts, particularly for water charges where there has been a ban on domestic disconnection of supply for debt since 1999.

Nevertheless, CAB evidence shows that the most vulnerable continue to need access to the scheme. The 4.7 million people who so far have asked to open post office card accounts and those who cannot open or operate any kind of account for payment of benefit will not be able to set up direct debits and standing orders from this account to pay their debts. Even those whose benefits are paid into bank accounts may prefer to have deductions from their benefits to pay their debts if their bank account is overdrawn. Our evidence also shows that many other vulnerable clients, who may have mental health problems, addictions, or simply a very low income, find it helpful to have money deducted at source in order to help them to budget whilst meeting commitments and reducing arrears. The scheme can help clients to avoid debts escalating to the point where bailiffs are involved. For example:

A CAB in North-East Wales reported that a single man with mental health problems receiving incapacity benefit and income support was facing

repayments to bailiffs of £20 per week for council tax arrears. The bailiffs had refused to consider a lower repayment. The local authority was asked to take the debt back and collect the arrears using direct deductions from benefit.

The government also appears to regard the scheme as a method for recovering its debts. For example piecemeal changes have been made in March 2003 for deductions for child support maintenance and from December 2004 higher deductions have been permitted for magistrates' court fines.

The existence of the scheme is also important in the context of the current government initiatives to tackle overindebtedness. In 2004, the Government issued a cross-departmental action plan on planned and ongoing initiatives to tackle debt.⁴ The strategy includes action to develop financial capability; to ensure access to affordable credit; to promote responsible lending; to ensure that arrears are tackled before court action; to ensure access to debt advice and to resolve arrears disputes in court effectively and quickly. Access to the DWP's third party deductions scheme is relevant to this agenda. Access to the Third party deductions scheme could prevent court based debt recovery action being taken.

Citizens Advice considers that it is vital that the third party direct deduction scheme should continue to allow

Third party deductions from benefit 1997-2004		
	Aug 1997	Aug 2004
Income support	1,613,000	1,394,000
% of IS claimants with deductions	28.8	45.6
Jobseekers allowance	378,900	123,000
% of JSA claimants with deductions	25.1	16.4
Pension credit	–	224,000
% of PC claimants with deductions	–	7.6

Source: DWP Quarterly Statistical Enquiries, 2004

Deduction by type – income support claimants

Type of deduction	August 1977	August 2004	Average amount of weekly deduction August 2004
Electricity	39,000	17,000	£11.90
Gas	114,000	22,000	£10.65
Water and sewerage charges	144,000	92,000	£7.36
Mortgage interest	278,000	104,000	£32.45
Council tax	111,000	180,000	£2.78
Fines	14,000	21,000	£2.78
Social fund loan recovery	567,000	734,000	£11.14
Overpayment recovery	102,000	125,000	£6.32

Source: DWP Quarterly statistical enquiries, 2004

individuals access to a scheme to manage multiple debt problems. However, the scheme does need to be reviewed. Evidence from Citizens Advice Bureaux suggests that the current third party deductions scheme is in need of reform even if it was not extended to deductions for other debts.

This report is divided into two sections:

- Problems with the current scheme and the need for review.
- In that context, whether it would be feasible and desirable to extend the current third party deduction scheme to permit deductions from benefit for credit debts and for credit commitments which are not in arrears.

Third party deductions scheme – the need for review

Deductions from benefit represent a mixed blessing for CAB clients receiving benefits. On the one hand, the facility for payment of fuel, water, housing costs, fines or to repay social fund loans, for example, represents a helpful

budgeting tool to repay debts. Those whose main income is derived from means-tested benefits would find it harder to make regular repayments if the third party deduction scheme were not available. Citizens Advice Bureaux have been able to intervene on behalf of vulnerable clients faced with debt enforcement by helping to arrange direct deductions from benefit. As such the scheme prevents people falling into deeper poverty, by arranging limited repayments.

Equally though, benefit income is very low. A young single adult under age 25 might receive £44.05 per week in Income Support, £55.65 if aged 25 or over. The same rates apply for people receiving Jobseeker's Allowance. Deductions from these amounts leave clients with less money than the minimum amount the government says they need to live on. Bureaux frequently report clients left with just £10 or £20 per week to buy food and other essential items after benefits are reduced.

DWP research has shown that direct deductions to repay social fund loans are seen as advantageous by people with budgeting

loans. However, if people stop receiving benefits that qualify for the deduction scheme there can be “delays and difficulties in recovering outstanding amounts and can be a worry for claimants.”⁵

The current third party deduction scheme needs reviewing for three main reasons:

- Deductions cannot be made from tax credits, yet benefit payments for people with children are transferring to tax credits.
- The range of benefits that qualify for the deductions scheme is too restricted, and is not available to many people on low benefit income who might be helped by the scheme.
- Claimants have inadequate controls over the numbers and amounts of deductions that can be made from their benefit.

The current scheme provides a clear statutory framework for deductions. Annex 1 gives more details.

Those excluded from the scheme

There are large groups of benefit claimants excluded from access to the third party deductions scheme. New claimants no longer get income support for children, and instead receive child tax credit. Large numbers of people currently receiving income support for their children are due to transfer to child tax credit when the Inland Revenue’s systems are ready to cope with the transfer. It seems inequitable to bar people receiving child tax credits, who are often still on low incomes, from the deduction scheme. Those who are most likely to be affected will have other income, such as wages from part-time work, or child support maintenance:

A CAB in Kent reported that an unemployed single mother with three children was having difficulty keeping up repayments of council tax arrears. The client was due to transfer to child tax credit, leaving her receiving income

support less than 50p, so she could not arrange a deduction.

A CAB in Cambridgeshire reported that a lone parent lost her entitlement to income support when the benefit for her children started to be paid by child tax credit. This was due to the amount of maintenance she received. As a result the client could no longer have deductions from her benefit for her water debt and current consumption and was accumulating further arrears.

There are many people receiving benefits which are paid at roughly the same level as those benefits eligible for the third party deductions scheme, which are outside the scheme. Incapacity benefit is paid at £55.90 per week, at the lower rate for a person under pension age. Many people receiving incapacity benefit have incomes the same or very close to people on income support or jobseekers allowance. In contrast, people receiving pension credit are eligible to apply for deductions, yet pension credit is significantly higher than income support (£105.45 a week for a single person, £160.95 for a couple). There is inconsistency in the scheme which should be ironed out.

A CAB in South-East Wales reported that a man with mental health problems, and receiving incapacity benefit, had substantial water and gas arrears, and rent arrears. Because the client was not receiving income support the third party deductions scheme was not available to him.

A Northamptonshire CAB reported that a man with mental health problems had rent, council tax and water arrears, and was receiving incapacity benefit and disability living allowance, and therefore could not arrange direct deductions. The client’s mental health problems meant he had difficulty budgeting, and the client had defaulted on repayment

arrangements and was facing court action for repossession.

A West Midlands CAB reported that a woman suffering from depression had multiple debts including council tax arrears which were being recovered from income support. The client then moved onto higher rate incapacity benefit, which meant she was no longer entitled to income support and deductions stopped. As a result the client's debts had spiralled again.

It is not uncommon for people with health problems to move between income support/jobseekers allowance and incapacity benefit. This causes disruption where direct deductions have been in place. For this reason the government should review the range of benefits eligible for the direct deductions scheme.

A Hampshire CAB client receiving help for drug or alcohol problems was receiving incapacity benefit or jobseekers allowance depending on his condition. Direct deductions for council tax arrears could only be made when the client was receiving jobseekers allowance. As a result the client was threatened with proceedings for the council tax arrears.

Social fund loans can be deducted from the majority of social security benefits. In August 2004, 734,000 people on income support were repaying a social fund loan, with an average deduction of £11.14. DWP research has shown that families with children, including lone parents, are much more likely to be repaying a Social Fund loan than those without children. More than a third of families with dependent children on Income Support were repaying a loan compared with only eight per cent of those without children.

We conclude that the third party deductions scheme should be made available to a wider range of benefit and

tax credit recipients. In particular the scheme needs to be extended to recipients of incapacity benefit and tax credits. In our experience, the people receiving these benefits may suffer hardship because they cannot access the scheme.

Changes to the scheme

There have been a number of recent changes affecting the scheme. For example, the facility to repay water debts was introduced in order to safeguard against disconnection from water. Now, disconnection from water is no longer possible, so the original reason for the deductions has gone. There is still a compelling argument to retain water as a deduction, because people are still liable to pay and will face greater costs if they do not pay.

Other changes to the scheme, to allow deductions from non-resident parents on income support for child maintenance, and to allow deductions to repay magistrates' court fines, have recently been introduced, to meet particular policy objectives, but without reviewing the coherence of the scheme as a whole.

Deductions for child support were introduced in order to require non-resident parents on income support or jobseekers allowance, and most recently pension credit, to pay a minimum contribution of £5 towards child support liability. Most recently, similar rules were introduced for court fines. When introduced the amount that could be deducted for fines was £2.80 a week, in line with most other deductions, but from April 2005 this amount will rise to £5 a week. The Courts Minister noted that the policy intention was that "no-one is above the law. The increase in deductions from benefits makes it very clear that fine default will not be tolerated under any circumstances"⁶

This means that an increasing range of debts now have recourse to the scheme. There is also a trend towards higher deductions to

reinforce policy objectives. Because the rules of the scheme state that the minimum amount of benefit after all deductions is only 10p per week, in practice clients can be left with almost no income at all.

A North London CAB reported that a single woman with health problems compounded by drug and alcohol addiction was overpaid income support as a result of failing a medical assessment. The client was also repaying social fund crisis loans. From her weekly benefit of £55, the client was repaying £25 for loans and overpayments, and was also having a deduction made for council tax. After paying rent and electricity meter charges, the client had about £10 a week to live on.

A lone parent sought advice from a CAB in Derbyshire. She had been in dispute about her bill with her fuel supplier for some time. Although the client had asked energywatch to take up her case, the fuel company pressurised her to accept deductions of £27 per week from her benefit to pay the debt. The client told the CAB that as a result she was experiencing financial difficulties and had had to borrow from a moneylender to make ends meet.

Citizens Advice believes that the following areas of the scheme need to be reviewed:

- The priority of debts list – in particular whether water should be a lower priority now that disconnection for non-payment of domestic supplies are not possible.
- The amount that can be deducted to repay all types of debt should be reviewed so that an amount for debt repayment is distributed equitably between all suitable creditors, giving greatest priority to essentials. We believe that payments of as little as £1 per week ought to be accepted for all

debts, whether they be fuel or court fines.

- The minimum amount of benefit following deductions needs to be increased to ensure that benefit claimants do not suffer undue hardship.

Control over deductions

Claimants have inadequate controls over the use of their benefit to repay debt – consent is only required where the total of deductions exceeds 25 per cent of benefit. Some deductions can be made without the claimant's consent at all. This can cause hardship:

A woman in receipt of income support because she was unable to work had third party deductions from her benefit for a social fund loan and water debts, reducing her benefit by nearly £15 per week. The client sought advice from a Staffordshire CAB about a letter recalling her order book for an additional £5 per week to be deducted for child support maintenance to her ex-partner. With the further reduction in income, the client felt that she would no longer be able to afford to have her child to stay during the holidays.

In contrast, deductions for council tax arrears cannot be made until the local authority gets a liability order. As a result the debt increases, because court costs are added. This results in hardship for those people who could benefit from access to the third party deduction scheme to pay their council tax debts:

A Staffordshire CAB reported that a recovering heroin addict was in receipt of reduced rate income support whilst appealing a capability assessment for incapacity benefit. The client found it difficult to pay his council tax debt from his reduced income of £35 per week, but he could not access the third party

scheme because the local authority had not obtained a liability order yet. The client's only options were to pay monthly by direct debit or by swipe card at the post office. The client did not have a bank account and would find it difficult to make monthly payments from such a low income.

A woman on jobseekers allowance contacted a CAB in Greater Manchester to arrange direct deductions from her benefit to pay a council tax debt of £155. When the CAB phoned the council, they refused as there was no liability order in place. Taking liability order proceedings against the client would increase the debt by a further £50.

Deductions for rent arrears can only be made where the claimant has arrears equal to four weeks' gross rent. However as people on income support, income-based jobseekers allowance or pension credit are entitled to full housing benefit, the amount of rent they owe is likely to be small, perhaps a few pounds per week for water charges and heating costs where these are included in the rent but not controlled by housing benefit. So four weeks' gross rent could represent many weeks' missed payments for many tenants on means-tested benefits. Not unsurprisingly some social landlords take arrears action after quite a short period of no payment, often the amounts involve are very small but they are still less than the qualifying amount to have a direct deduction from benefit. The only consequence of this barrier to the scheme seems to be to increase the debts of claimants by court costs and put their tenancy at risk.

A CAB in Essex reported that a woman suffering from alcohol addiction sought advice about an eviction warrant for rent arrears of £177. The CAB negotiated with the local authority to suspend the warrant. However, they were unable to arrange for direct deductions from the

client's income support to pay the debt as the rent arrears totalled less than four weeks' gross rent. The client was very worried that she could face eviction again if she could not make regular repayments.

A specialist CAB debt advice service in Yorkshire reported that a single man on a drug rehabilitation programme on income support had to pay £5.50 each week towards water rates, heating charges and a tenant's levy from his income support as these charges were not covered by housing benefit. The client had paid this sporadically and rent arrears had accrued. The Local Authority took the client to court for possession when the arrears reached £125. The client wanted direct deductions from his benefit but this was not possible until his rent arrears reached 4 times his gross rent – a total of £177.

Citizens Advice considers that the rules of the third party deduction scheme should be revised to ensure that:

- the claimant's consent is required for all deductions.
- deductions for council tax arrears can be made before a liability order is made.
- deductions for rent arrears can be made earlier, for example when the landlord issues a notice of seeking possession, the first step to taking court action for possession.

Quality of DWP information provided to claimants on the third party direct deduction scheme

Claimants can receive a poor service from the DWP in terms of regular statements and information about their benefits and debt repayments giving them limited opportunity, if any, to vary and reschedule payments. In many of the cases reported by bureaux, no

statements have been sent and the claimant only finds out by accident that they have repaid their debt:

A CAB in Yorkshire reported that a woman on income support sought advice when she received a letter from the DWP telling her she would have to pay the remaining balance of £11 rent arrears to her housing association landlord as there was no need for her to remain on direct deductions any more due to the small amount owed. The client was angry that deductions had been made from her benefit without her consent or knowledge. When the CAB investigated, the adviser found that the client was entitled to full housing benefit from the inception of her new tenancy and had never actually been in arrears.

Problems also arise when claimants switch from one means-tested benefit to another. Deductions are stopped and have to be requested again. For some CAB clients this means that they can face enforcement action for the debt in question:

A Bedfordshire CAB client on income support had deductions from his benefit to pay council tax arrears. When the client reached the age of 60, he claimed pension credit and the deductions stopped. As a result the council enforced the council tax debt by sending in bailiffs. Fortunately the CAB was able to persuade the council to take the debt back from the bailiffs and request deductions from the client's pension credit entitlement.

Citizens Advice considers it is essential that the DWP provide better information to claimants having deductions made from their benefits to third parties. This should include regular statements to claimants of the amounts deducted and payments made to third parties. The DWP should give claimants with third party deductions who

stop claiming qualifying benefits clear information about dealing with their debts. This should include how they could get their direct deductions reinstated should they be switching to another qualifying benefit, and how to set up direct debits from a bank account should they be coming off benefit entirely.

Reform of the social fund

The Treasury's financial inclusion report sets out the government's announcements in the Pre-Budget report to abolish the double debt rule for social fund budgeting loans, reduce the maximum loan repayments on social fund loans and a substantial increase in the social fund loans budget. It also mentions that the government is still considering wider reform of the social fund to ensure greater financial inclusion.

Citizens Advice considers that it is essential for the government to undertake wide-ranging reform of the social fund in order to widen access to affordable credit. In our 2002 report, *Unfair and underfunded*, we argued, amongst other things, for social fund loans to be extended to those in low paid work or in receipt of other benefits and to increase the number of grants. **Reform of the social fund could be a more significant means of widening access to affordable credit than allowing credit unions and other lenders access to the third party deduction scheme.**

We now go on to consider the viability of the Treasury's proposal to extend the scheme to cover credit debts.

Should the current third party deduction scheme be extended to cover credit debts?

The relevant paragraph in the Treasury's financial inclusion report reads as follows:

“The Government also intends to explore commercial mechanisms that allow loans to be made to those on low incomes, at lower rates of interest than found in the alternative credit market on a national scale. The aim would be to reduce some of the increased costs and risks of lending to vulnerable groups. The Government is therefore considering arrangements whereby in certain circumstances, private and third sector lenders could apply for repayment to be made by deduction from benefit where normal repayment arrangements have broken down. There are similar arrangements for managing arrears of, for example, fuel bills. This facility would be subject to criteria designed to ensure that it is only available where loan products are appropriate and provided in a responsible manner. The Government will seek responses from private and third sector lenders, possibly working together, by 31 January 2005. The costs and benefits of this scheme for lenders and borrowers would be evaluated.”⁷

Citizens Advice considers it vital to ensure access to affordable credit. Our client group are particularly poor and often find it difficult to access cheap or even affordable credit. For example:

A CAB in Kent reported that a lone parent on income support had received an offer for a £200 loan and for shopping vouchers with the invitation to ‘give your family the fun-packed Easter they deserve’ and to ‘shop ‘till you drop’’. She did not take in the fact that the APR was 177 per cent. She was repaying a home credit loan at £35 per week from her benefit income.

An unemployed man with mental health problems did not want a Staffordshire CAB to report the criminal activities of a loan shark to the police or trading standards, even though the loan shark had taken his benefit books, had

assaulted him and continued to make further threats of violence. As a result the client was short of cash for himself and his family and was considering committing suicide.

For clients in situations like these, measures to improve access to affordable credit are beneficial. The Treasury argues that access to the third party deduction scheme would allow lenders to extend affordable lending to a greater number of people on low incomes, in the knowledge that access to the direct deduction scheme would guarantee payment in cases of default.

In order to evaluate whether this is a viable and feasible proposal, Citizens Advice considers that the Treasury and the DWP should explore the following issues:

- The impact on the current third party deduction scheme if it was expanded to include deductions for credit debt.
- Access to independent money advice.
- Whether clients would have enough available income.
- Whether the scheme would need to be extended to those on other benefits.
- Whether DWP frontline staff would be able to easily administer an expanded scheme.

Impact on current direct deduction scheme if deductions for credit debts were introduced

The introduction of deductions for credit debts would change the nature of the direct deductions scheme, which so far has been aimed at repayment of priority debts: those debts where enforcement for non-payment could lead to loss of the debtor’s home, liberty or fuel supply. Generally, negotiations with priority creditors are conducted on an individual basis, and the third party deduction scheme can be a useful way of managing some debts for eligible clients, particularly deductions for rent arrears, where social

landlords and courts have been happy to accept repayments based on the third party direct deduction figure for arrears repayment. The 2002 OFGEM and energywatch code of practice on fuel debt also requires fuel companies to ask their customers if they are on benefit, and if so set payments at no higher than the fuel direct rate, unless the customer insists on paying more.⁸

However the Treasury's proposal would extend the third party direct deduction scheme to creditors whose only method of enforcement is to obtain a county court judgment – i.e. non-priority creditors. Both credit union loans and unsecured debts to other private sector lenders are considered by money advisers to be non-priority debts. This means that payments to these debts can only be afforded after an individual has enough money to survive and pay current essential commitments. **Citizens Advice therefore considers that if loan arrears were to be included in the third party deduction scheme, they should be bottom of the priority list of debts.** The repayment of credit debts is not as important as paying those debts where non-payment would lead to loss of home, liberty or fuel supply.

The need for independent money advice

Access to independent money advice can help people manage multiple debt. For example:

A man who had given up work due to physical and mental health problems sought advice from a CAB in Surrey about debts to four creditors totalling £8,000 and housing problems. One of the creditors had obtained a county court judgment for repayment of the debt by instalments of £25 per month. As the client had no income at the time, he had already missed three payments. In addition, he was being harassed by his landlord who was demanding that he did not claim housing benefit, which he needed to do in order to pay his rent. At the time of seeking advice, the client's

creditors were making frequent demands for unaffordable repayments. The stress of dealing with these demands was making his already poor health even worse.

The CAB helped him sort out his problems by:

- ensuring first of all that he could afford to eat and pay his rent by claiming income support and housing benefit. The CAB managed to persuade the local authority to backdate his housing benefit claim as he had been intimidated by his landlord into not making an earlier claim.
- helping him resist the unrealistic demands for payments from his other creditors whilst they were trying to sort out his benefits.
- establishing that the client had no available income and that token repayments to his four non-priority creditors would be appropriate.
- applying to the court to vary the repayments on the county court judgment to £1 per month.
- negotiating reduced repayments of £1 per month with his other three non-priority creditors. All but one of the creditors accepted. The remaining creditor – a building society – insisted on repayment of the debt in full, or they would take court action. Nevertheless, the client continued to pay them £1 per month.
- making an application for housing as homeless to the local authority when his landlord harassed him into leaving his home – this entailed much detailed work as the council had to be persuaded that it was not reasonable for the client to assert his right to remain in his home before his tenancy expired due to the threats

and behaviour of his landlord. Eventually the Local Authority offered him suitable alternative accommodation, which he now occupies.

The CAB commented that none of this would have been possible for the client to do on his own due to his continuing health problems, especially as each of these issues were complicated and needed specialist advice.

One year after he first came to see the CAB, the client was well enough to take a Christmas job, to test out whether he would be able to maintain regular full-time employment. He was, and is now working full-time again and has increased his payments to each of his creditors accordingly.

Citizens Advice is concerned that access to the third party deduction scheme for some credit lenders could make it difficult for people with multiple debts to manage all their commitments equitably. For example, if one of the creditors in the case study above had had access to the direct deduction scheme, it might have made it difficult for the client to maintain regular repayments to his other creditors. In other cases where there is little hope of the debtor's personal and financial circumstances improving, the best option for dealing with all their debts might be bankruptcy or the government's proposed "no income no assets" bankruptcy.⁹

Citizens Advice considers that before direct deductions are made from benefits all claimants with multiple debts should first have access to independent advice on the debts to help them make equitable payments to all their creditors and identify strategies for managing the debts in other ways, including obtaining charitable funds or seeking relief (bankruptcy or the proposed no income no assets bankruptcy). Citizens Advice

considers that the provision of advice should be integral to the resourcing of the scheme and should be properly funded. This is desirable now and should be a requirement of any wider expansion of the scheme.

Would clients have enough available income?

In *Make or Break?*, we highlighted our concerns that many CAB clients were living on less than the state safety net due to the number and amount of deductions from their benefit. These concerns remain, particularly if the rules on the amounts to be deducted are not reviewed. The government has already recognised that current Social Fund repayment rates often cause hardship and proposes to reduce them.

The current third party deduction scheme mainly covers the income-related benefits: income support, income-based jobseekers allowance and pension credit. **In general, these people are likely to be on the lowest incomes and have little or no income to repay credit debts once they have paid their essential commitments.**

Early indications from analysis of the income and expenditure of nearly 600 people seeking debt advice from bureaux in February 2004 suggest that 40 per cent of clients on income support were unable to make offers of repayment to their non-priority creditors.¹⁰ The average available income to repay non-priority debts of these clients was only £13 per month. There is a real danger that by allowing some non-priority creditors access to the direct deduction scheme, more people will face hardship.

Whilst it may be realistic to expect claimants of income-related benefits to pay £2.80 per week towards priority debts, it is not for credit debts. It is CAB experience that clients on means-tested benefits are often unable to make pro-rata repayment arrangements to non-priority credi-

tors. Token offers, often no more than £1 per month to each creditor, are very common, although often creditors want more:

A CAB in Cleveland reported that a single woman in receipt of incapacity benefit had negotiated and paid token offers of £1 per month to all her creditors. When one of the creditors passed the debt to a debt collection agency, the client began to get phone calls stating she had to pay £10 immediately by debit card and then pay £25 per month. The woman found the calls very frightening because the company told her that she would be hearing from their solicitors if she did not pay up. In desperation she paid the £10 and set up a direct debit for £25 per month to the debt collection agency.

A man visited his local CAB after a credit card company continued to charge him late payment fees. The client, who was on income support, married, with four young children, had no savings or disposable assets and could not make an offer of repayment. The fees were totalling almost £80 a month and together with interest he was expected to pay over £180 per month.

Simply adding some new debts to the third party deduction scheme might increase the number of claimants with virtually no weekly income. This might also fail to achieve the Treasury's policy objectives, because in practice credit lenders would be unable to secure direct payments because of the many other debts being deducted, and the levels of those payments for debt and current consumption. **If the DWP third party deduction scheme is to be extended to other debts, Citizens Advice considers that it is vital that the government ensures the amount and priority of deductions for these debts is reasonable in the circumstances.** This means reviewing the whole of the existing scheme and the amounts that can be paid for

both debts and current consumption or commitments.

Would the scheme be limited to income-related benefits only?

In the current third party deduction scheme, with a few exceptions¹¹, deductions for debts can only be made from income support, income-related jobseekers allowance and pension credit. As our evidence in the first part of this report shows, claimants of other benefits would benefit if the third party deduction scheme was extended. If the intention behind the Treasury's proposal is to ensure that credit unions can expand in the knowledge that repayment of loans can be guaranteed from those on low incomes, then it makes no sense to limit the scheme to means-tested benefits only.

Whether DWP staff would be able to easily administer the scheme

The Treasury report says that they would need to develop criteria to access the scheme which would be designed to ensure that it is only available where loan products are appropriate and provided in a responsible manner. Citizens Advice agrees that these principles are important. All too often in our debt work CAB advisers see the consequences where people take out inappropriate credit, or where they are pressurised to enter into credit agreements which they cannot afford. The following are only a few recent examples:

A woman in receipt of income support went into her bank to negotiate an overdraft. She came out of the bank with a £4,000 loan and a credit card with a £1,000 limit, even though the bank was aware of her low level of income. The client sought advice from a CAB in Cornwall when the debts had grown so large she felt that the only way of getting out of debt was to petition for bankruptcy.

A Devon CAB had helped a client on income support obtain a refund of payment protection premium which had been mis-sold. When the client went into the bank branch to finalise the refund, the bank staff told her not to have any further dealings with the CAB, and tried to persuade her to take out another loan which she did not need or want or could afford. The bank even persuaded her to take out life insurance so that she could support her children after her death.

Citizens Advice agrees with the Treasury that lenders who do not lend responsibly or who offer unfair credit products should not be able to access the third party deduction scheme. However we consider that frontline Jobcentre Plus and Pension Service staff could find it almost impossible to decide whether products are appropriate and whether the money was lent responsibly. DWP staff would need to be very skilled, and would require information about the borrower's personal circumstances at the time the loan was taken out. This is likely to be information that the borrower may not be able or willing to give them. Such a requirement could make the administration of the third party deduction scheme more onerous and complex for frontline DWP staff.

Furthermore these rules would add to the complexity of the benefit system at a time when the DWP have announced substantial cuts in the number of their staff. **Citizens Advice believes that in reality these criteria would be hard for DWP staff to administer unless lenders were required to sign up to a scheme to offer approved products in an agreed way. DWP staff could then check the product against a centrally approved list.**

In order for this to happen, the Treasury needs to set out criteria for appropriate products sold responsibly. **Citizens Advice considers that the lender must sign up to the following principles:**

- Simple terms and conditions, so that the product is easy to understand.
- Check the borrower's ability to repay by checking whether they can afford to repay the loan from their income after meeting all their existing household commitments, including any other credit agreements.
- Agree not to charge any interest when third party deductions commence.
- Agree not to pursue court recovery action for the debt which will only add to costs before having sought direct deductions.
- Charge only simple interest if the borrower falls into arrears with the loan.
- Agree to abide by the Office of Fair Trading's Debt Collection Guidance when contacting debtors in arrears.

Should the third party direct deduction scheme be extended to allow deductions from benefit for loans not in arrears?

It is understandable that the Treasury might consider extending the DWP direct deduction scheme to credit unions/third sector lenders and possibly other providers of consumer credit. This could reassure lenders that they will be able to secure repayment and thus extend a loan at a better rate of interest than the consumer could get on the open market. It could also reassure the consumer that if they do fall into debt they will have access to a simple scheme to make payments and avoid formal debt recovery action and costs.

As such creating the conditions for easier access to cheaper borrowing might reduce the risk of default – although other factors are likely to be important, in particular the consumer's financial skills and overall level of income. However it is debatable whether a scheme providing payment only in default will be significant in achieving better access to affordable credit. A recent report by the

Joseph Rowntree Foundation advocates that the government should explore whether the direct deduction scheme should be extended to loan repayments where the borrower is not in default.¹²

Such a facility could be helpful for those people who need access to cheap credit but have not been able to open or use any kind of bank account and therefore make repayments by direct debit – i.e. those people who have opted for their benefit to be paid into a Post Office card account or who need to be paid by cheque.

However such a move would be fraught with difficulties. It would fundamentally change the nature of the current third party direct deduction scheme, which is targeted at those with arrears, rather than those with just budgeting difficulties. It would also be completely unfair to extend the scheme to credit commitments which are up to date without also allowing deductions for ongoing priority commitments which are not in arrears.

There would also be practical difficulties for the lender in obtaining from the borrower or the DWP sufficient information to make a lending decision and to get direct deductions

for the loan from its inception. The lender would have to get proof that the borrower was in receipt of benefit and check whether they would have sufficient income to make the repayments and pay their essential commitments. This would also involve checking whether the borrower has any other deductions for any other debts from their benefit – information which would have to be provided by overworked local Jobcentre Plus or Pension Service offices.

Citizens Advice believes that the government should take a very cautious approach to extending the third party direct deductions scheme to credit commitments which are not in arrears. **If the government considers that such an initiative is key to ensuring greater access to affordable credit, Citizens Advice considers that it is essential that benefit claimants can also obtain deductions from benefit for ongoing priority commitments which are not in arrears, and that there are sufficient safeguards in place to ensure that benefit claimants do not suffer undue hardship if deductions for new credit loans were to be made from their benefit**

Annex 1 – Third party direct deductions – current rules

What deductions can be made?

- Housing costs paid direct to the lender under the DWP's mortgage interest payment scheme
- Other housing costs
- Rent arrears
- Residential accommodation charges
- Hostel payments not covered by housing benefit
- Fuel
- Water charges
- Council tax
- Community charge
- Magistrates court fines
- Child support maintenance

From which benefits can deductions be made?

Normally deductions for all the above can only be made from income support (IS), income-based jobseekers allowance (JSA) and pension credit (PC).

Deductions from contribution-based jobseekers allowance can be made in some circumstances:

- For all debts listed above if there is an underlying entitlement to income-related jobseekers allowance;
- For council tax, community charge, fines and child support maintenance where there is no underlying entitlement to income-related jobseekers allowance.

Recently the deductions for child support maintenance have been revised to permit deductions from other benefits including incapacity benefit and retirement pension.

Agreement to deductions

The DWP can make third party deductions without the claimant's consent for the following debts:

- Community charge or council tax
- Magistrates court fines
- Child support maintenance
- Current housing costs
- Current mortgage interest
- Nursing home charges or hostel charges

For other debts, the DWP must have the claimant's consent if the total to be deducted exceeds 25 per cent of her/his IS/JSA applicable amount or 25 percent of her/his PC minimum guarantee before housing costs

What can be deducted?	
Type of debt	What can be deducted
Housing costs paid to mortgage lender	Current weekly housing costs allowed in IS/PC/JSA claim only
Other housing costs	Current weekly costs
Rent arrears	Current weekly water, fuel and service charges plus £2.80 per week towards the arrears
Fuel	Estimate of current consumption plus £2.80 per week towards the arrears for each fuel bill
Water charges	Estimate of current charges plus £2.80 per week towards the arrears
Council tax	£2.80 per week towards the arrears only
Magistrates court fines	£5.00 per week towards the arrears only unless the £5.00 deduction would bring the total deduction for court costs and certain other arrears to more than £8.40 per week. In these circumstances £2.80 per week towards the arrears only
Child support maintenance	Ongoing liability only

Maximum deductions

The DWP must leave the claimant with at least 10p entitlement to income support, jobseekers allowance or pension credit per week.

Where the claimant has more than one debt

Although deductions can be made under the third party scheme for more than one debt, the maximum which can be deducted from benefit for arrears and child support maintenance ongoing liability is £8.40 per week (three times the £2.80 deduction). If the total amount of deductions for arrears would exceed £8.40 per week, deductions are made in a set order of priority:

1. Housing costs not covered by the mortgage payment scheme
2. Rent arrears and related charges
3. Fuel charges
4. Water charges
5. Council tax and community charge arrears
6. Magistrates court fines
7. Child support maintenance

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- 7 Paragraph 4.26, *Promoting financial inclusion*, HM Treasury, December 2004
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- 9 Proposed in "*A choice of paths*" Department of Constitutional Affairs consultation paper, July 2004
- 10 Citizens Advice will publish this analysis later in 2005.
- 11 See annex
- 12 *Affordable credit* – Elaine Kempson and Sharon Collard, Joseph Rowntree Foundation, February 2005

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