

CAN'T PAY OR WON'T PAY?

**A review of creditor and debtor approaches
to the non-payment of bills**

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Disclaimer

The views expressed are those of the authors and are not necessarily shared by the Department for Constitutional Affairs.

The authors

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EXECUTIVE SUMMARY

This research was commissioned by the Lord Chancellor's Department to explore the following questions that arose from the Report of the First Phase of the Enforcement Review:

- Why don't debtors pay?
- What features, if any, indicate a '*can't pay*' debtor?
- How effective are different bodies responsible for enforcement at identifying and responding to '*can't pay/won't pay*' distinctions amongst debtors?

The research was essentially qualitative and based on depth interviews with both debtors and creditors.

A typology of can't pay won't pay

It became clear that whether people pay their creditors is dependent on two factors: their *ability* to pay and their *commitment* to doing so.

Ability to pay

People owing money fall into one of three groups, according to their ability to pay. First there are those who have the money to pay when they fall into arrears and are still in a position to pay when their creditors reach the late stages of debt recovery. At the other extreme are people who do not have the money either when they fall into arrears or when their creditors seek to recover the money owed. In between is a third group, who are able to pay when they fall into arrears but, as a result of a change in circumstances, can no longer afford to do so when their creditors reach the late stages of debt recovery.

Commitment to pay

The situation with regard to the commitment to pay is more diverse.

The majority of people who fall into arrears with credit or household commitments have every intention to pay on time, but simply lack the money to do so. These include: people on low incomes who face unexpected expenditure; people who have had a sudden substantial fall in income leaving them unable to meet all their

commitments; and people with mental health problems which impair their ability to manage their finances. These are the archetypal '*can't pays*'.

Then there are three further groups of people who are not appropriately considered as either can't or won't pay, regardless of whether they have the money or not. They are: people who have a genuine dispute with their creditor and are withholding payment until the dispute is resolved, and people who are disorganised in their approach to bill payment. This leads to irregular payment of their bills and they often fall into arrears. The third group who should be considered neither won't nor can't pay are tenants taken to court for rent arrears where the main cause is an administrative failure in the payment of Housing Benefit by the local authority direct to the landlord.

That leaves four groups of people who have little or no intention of paying their creditors on time:

People withholding money on principle - These people do not routinely withhold payment of their bills but object to paying a particular bill out of principle. This is usually linked to the customer's belief that they are not receiving a satisfactory service or that they are getting poor value for money from their creditor. Examples of withholding payment on principle can be found across all bills, but it is most common for council tax and water bills. Multiple debt is not common among this group of debtors.

Ex-partners withholding payment - This group includes ex-partners who retain responsibility for paying some or all of their bills in their former family home but withhold these payments. Here multiple debt can be quite common.

People 'working the system' - These are people who deliberately and routinely wait until late in the debt recovery cycle before paying just about all their bills. Some will attempt to avoid payment altogether if they possibly can. These people usually have a long history of arrears and county court judgements on a variety of commitments.

People 'ducking responsibility' - This group of people have spent freely and owe very large sums in consumer credit – often owing many tens of thousands of pounds

on credit cards and other forms of unsecured credit. They blame the credit companies for having lent them the money and feel no responsibility for repaying the money they owe.

In each of these four groups who have little or not intention of paying, some people have sufficient money to pay their arrears and we have classified these as '*won't pays*'. Others do not have the ability to pay and we refer to these, as '*won't but can't pays*'.

Creditors' approaches to arrears management

Creditors adopt one of three approaches to arrears management and debt recovery: a holistic approach; a hard business approach; and a one-size-fits-all approach.

Holistic approach - Creditors adopting a holistic approach invest heavily in systems and staff to enable them to discover the circumstances of the people who fall into arrears and their reasons for not paying their bills. They then use this information to adapt their arrears management and debt recovery approaches. Their primary objective is to maintain the customer relationship, and they aim only to use the courts when they believe a customer has the ability to pay but is deliberately avoiding doing so. Throughout this whole process they endeavour to work closely with money advisers and go beyond requirements set out in industry codes of practice for dealing with customers in financial difficulty. The holistic group are, therefore, best able to identify can't from won't pays.

Hard business approach - Ensuring that any money is recovered at minimum cost is the main concern of creditors adopting a hard business approach to arrears management. The underlying philosophy of this approach is that if customers fail to make contact then they should be treated as won't pays. So these creditors are not proactive in trying to establish the circumstances of customers in arrears. Their debt recovery systems are intended to reduce company costs, and they avoid using any action where there is little chance of success. These creditors, by and large, work to the letter rather than the spirit of their industry code of practice on financial hardship, and often view money advisers as a hindrance to the arrears process. This group are less successful than holistic creditors at identifying can't from won't pay debtors.

One-size-fits-all - These creditors adopt a standard set of procedures for arrears management for all customers. Standard letters are issued at set time intervals, and debt recovery is seen as a continuation of arrears management. They have no systems for distinguishing can't from won't pays and often rely on the courts to provide background information on the circumstances of those who are in arrears.

All types of creditors are represented in the holistic and hard business approaches. These include: financial service providers, utility companies, local authorities and housing associations; priority and non-priority creditors; and creditors in both the prime and sub-prime credit markets. Those adopting a one-size fits- all approach tend to be drawn from a more limited range of creditors, including:

- Some telephone companies, who were interviewed before the Oftel guidance on debt and disconnection was published in October 2002.
- Some local authorities, who have yet to revise their approach following a Best Value Inspection.
- Some housing associations, whose code of practice does not include detailed guidance on dealing with tenants in financial difficulty.
- Some sub-prime lenders, especially those offering secured loans, who either are in breach of the industry code of practice or have not signed up to one at all. They differ from other creditors taking a one-size-fits-all approach in that they deliberately take a harsh stance on arrears, having lent purely against the equity in their home.

Which debtors is it appropriate for creditors to take to court?

Most people would agree that is appropriate for creditors to take court action against *won't pays* – that is people who have the ability to pay their arrears, but are withholding payment on principle, working the system or ducking responsibility for their debts.

Similarly there would be general agreement that it is quite inappropriate to initiate court proceedings against anyone who has every intention of paying but is unable to do so – the *can't pays*. Most would also believe that court action is inappropriate in cases of genuine dispute over payments, where people intend to pay but are disorganised in their approach to bill payment, and where the administrative errors with Housing Benefit payments have led to rent arrears.

The situation with regard to people who ‘*won’t but can’t pay*’ is more complex. Here the most sensible solution seems to be to pursue the debt once their financial circumstances have improved.

Whose responsibility is it to determine the circumstances of debtors and ensure that inappropriate cases don’t reach the courts?

Responsibility for ensuring that inappropriate cases do not come to court must rest with the creditor. At the same time, it is important to acknowledge customers’ responsibility to pay the money they owe when they have the money to do so, and the important role that independent money advisers can play.

Creditors adopting a holistic approach to arrears management and debt recovery have already developed systems to ensure responsibility when using the courts. Other creditors should be encouraged to do the same. Ways of achieving this include:

- *Industry guidance and codes of practice* All creditors ought to be covered by principle-based codes of practice, supplemented by detailed guidance on dealing with customers in financial difficulty. These should reflect best practice as illustrated by the holistic approach to arrears management as described in this report and compliance should be monitored by independent bodies.
- *Pre-action protocols* Creditors who decide to use the courts to enforce payment should be required to state in pre-action protocols that they have complied with their industry code of practice and guidance in the handling of the case.
- *Money advisers* Money advisers have an important role in helping to identify people who are unable to pay, and people with mental health problems. Yet the level of investment in money advice is far from adequate. The importance of creditors working with money advisers should be incorporated into industry codes of practice and guidance on dealing with customers in financial difficulty.

Which are the most effective methods of debt enforcement

There has been a general fall in the use of the courts by creditors. This almost certainly reflects changes in the way some creditors are approaching debt enforcement. They are undoubtedly consistent with the shift away from one-size-fits-all approach and particularly with the expansion of the holistic approach amongst creditors. These creditors take far fewer cases to court, and if they do so, usually apply for attachment of earnings orders in preference to warrants of execution.

There is a general feeling of dissatisfaction with the efficiency of warrants of execution among many creditors. This may also explain the fall in use of this method of enforcement.

Garnishee orders are not widely used. Indeed, none of the creditors who took part in this study reported using them. It may be the fact that they are usually preceded by an oral examination, which deters creditors from using this approach.

In fact, some creditors have taken a decision to use debt collection agencies in preference to the courts. This raises the need to ensure that such agencies work to the same high standards as the best practice in the credit industry. Draft guidance issued by the Office of Fair Trading, coupled with improvements in the code of practice issued by the Credit Services Association will go a long way to achieving this.

1. INTRODUCTION

This research was commissioned as a result of the Report of the First Phase of the Enforcement Review, which identified that,

... the system is not good at identifying which debtors have the ability to pay and which do not, so debtors may find themselves being pursued relentlessly for a debt that they have no means of paying. Equally, debtors who know the system's weaknesses are able to exploit them to avoid payment.

It was felt that the inability of the civil justice system to distinguish between debtors who won't pay and those who can't pay could potentially diminish the ability of the Review to achieve its stated aims. These were to make enforcement:

- More straightforward and understandable;
- Capable of delivering higher rates of recovery;
- Fair to both debtors and creditors, and particularly sensitive to those debtors who do not have the resources to pay; and
- Capable of delivering results more quickly.

Money advisers have, however, suggested that the First Phase Report is based on an apocryphal myth that there is a very substantial group of professional debtors who do not intend to repay their debts, even after a judgement has been made against them. The simple fact is that no one knows to what extent there are won't pays.

Furthermore, it was apparent from existing research that there is not a clear-cut distinction between can't and won't pay debtors and that more research was needed to explore this issue. This research project was, therefore, commissioned to clarify that picture within the context of debtors appearing in the civil courts.

Research aims and methods

The research was commissioned by the Lord Chancellor's Department to answer the following key questions:

- Why don't debtors pay?
- What features, if any, indicate a 'can't pay' debtor?
- How effective are different bodies responsible for enforcement at identifying and responding to 'can't pay/won't pay' distinctions amongst debtors?

In order to address these questions, the research had the following objectives:

- To identify and analyse the demographic characteristics of debtors who do and do not pay;
- To identify why debtors are willing or unwilling to pay, and which features of the debtor, the debt and the enforcement process influence such decisions;
- To investigate the enforcement practices of creditors, identifying why certain enforcement procedures are chosen and what mechanisms, if any, are in place to identify types of debtors and likelihood of recovery;
- To identify and analyse the extent and features of those who do not pay because, although they have the resources, they cannot accept the fact of their indebtedness; and identifying what factors, if any, would lead them to pay.

The information was gathered using qualitative research techniques, allowing an in-depth exploration of these complex and personal issues. Fieldwork took place from the end of May to the beginning of October 2002, and involved:

- The re-analysis of 49 qualitative interview scripts from past research projects with debtors;
- Fifteen semi-structured interviews with debtors;
- Ten depth interviews with representatives from trade associations and regulators and the analysis of guidance for debt recovery;
- Twenty depth interviews with staff in the debt recovery sections of ten companies; and
- Two depth interviews with money advisers.

We re-analysed 49 depth interview scripts, from four previous studies: *Water Debt and Disconnection*, 1995; *Gas Debt and Disconnection*, 1993; *Paying with Plastic*, 1994; and *Money Matters*, 1997. The scripts selected were all of people who had the money to pay the amounts they owed but had not done so. This work focussed particularly on identifying why they had not paid the money they owed and what factors distinguished them from others in these studies who were clearly unable to pay. From this a comprehensive model of consumer behaviour was derived, mapping can't pay/won't pay profiles.

To test the customer model derived from the secondary analysis, a further 15 depth interviews were carried out with debtors against whom enforcement action had been taken. A credit card and utility company provided the sample. Both companies had a

policy of only taking action against debtors that they believed were in a position to repay the money owed. Contacting these debtors proved extremely difficult. Forty per cent of those we attempted to contact had moved from their last address known to the creditor, and there was also a very high level of non-contact after six or more calls (20 per cent). Most of those we interviewed were only contacted after many attempts to do so.

The interviews, which lasted between an hour and a half and two hours, covered a range of topics. These included: money management and attitudes to bill payment; factors leading to arrears; arrears history across all bills and credit commitments; the process of negotiating arrears with creditors; and the experience of court and debt collection agencies. The interviews were challenging and often required a good deal of probing and double-checking to elicit a clear picture of people's motivations with regard to paying their creditors.

Depth interviews were also carried out with ten representatives from trade associations and regulators. The following issues were explored during these interviews: the use of policy and guidance on debt recovery; typical industry structures and approaches to arrears management across their industry; views on good and poor practice; and thoughts on can't pay/won't pay as a workable definition. Existing guidance on debt recovery was also analysed.

The information collected from the interviews with trade associations and regulators was used to inform the selection of companies, which were chosen to reflect different approaches to debt management and included: two credit card companies; two loan companies; two mortgage lenders; two local authorities; and two utility companies. In each pair of creditors we interviewed one that we believed made every effort to distinguish between can't pay and won't pay debtors and one that did not.

The interviews with debt recovery staff in these companies focussed on: their arrears management and debt recovery procedures and how decisions are made about the method of debt recovery employed in different circumstances. They also explored creditors' views on what distinguishes a debtor who won't pay from one who can't

pay – which was compared with the range of circumstances identified from the research with debtors.

Finally, we interviewed two money advisers to obtain their perspective on the reasons why people do not pay even though they have the resources to do so.

At the outset, the study was intended to be a feasibility study for more extensive quantitative research. However, it soon became apparent that this would be highly problematic and, at the same time, that the qualitative research was providing a large amount of valuable information in its own right – these issues are discussed further in Appendix 1.

Structure of the report

In Chapter 2 we explore the reasons why people fall into arrears, concentrating particularly on people that might be considered won't pay. From this analysis we develop a map of can't pay won't pay.

Chapter 3 begins with an overview of industry codes of practice and guidance on dealing with customers in financial difficulty. It then reviews three rather different approaches to arrears management and debt recovery adopted by creditors.

Finally, Chapter 4 draws together the conclusions of the research and assesses the policy implications.

An overview of the feasibility of conducting further quantitative research is included in Appendix 1. Appendix 2 provides further details of industry codes of practice and guidance on dealing with customers in financial difficulty.

2. A MAP OF CAN'T PAY WON'T PAY

The great majority of people who fall into arrears with their household or credit commitments do so because they are in financial difficulty – resulting from a change in circumstance or living long-term on a low-income. Only a minority of people might be considered won't pay, although the proportion generally increases across the debt recovery cycle and is highest among those facing court proceedings. But this varies greatly between creditors and across the economic cycle.

In practice, however, the distinction between can't and won't pay is far from clear-cut and actually encompasses both the *ability* and the *commitment* to pay the money owed. People vary both in their ability to pay at the time court proceedings are initiated and also at the time when they ran up the arrears. They also vary widely in their commitment to paying their creditors.

In this chapter we attempt to unpick these different components to provide a map of can't pay won't pay.

Reasons for arrears

All surveys of people in financial difficulty have shown that changes in circumstance are the main cause of arrears on credit or other household commitments (see for example, Berthoud and Kempson, 1992; Ford, Kempson and Wilson, 1995; Herbert and Kempson, 1995; Rowlingson and Kempson, 1993). Indeed this was also recognised by the creditors we interviewed.

In a recent study of over-indebtedness for the Department of Trade and Industry half of households with current arrears had actually experienced a drop in income in the past 12 months. The riskiest events were redundancy, relationship breakdown and giving up work through ill-health, with a drop in wages not far behind (Kempson, 2002).

This was reflected in the reasons people gave when asked why they had fallen into arrears; more than four in ten attributed them to a drop in income – mainly through redundancy (Table 2.1).

Table 2.1: The reasons for arrears on household bills and credit commitments

	<i>Column percentage</i>
Loss of income	42
<i>Redundancy</i>	18
<i>Relationship breakdown</i>	6
<i>Sickness or disability</i>	6
<i>Other loss of income</i>	12
Low income	15
Over-commitment	9
Increased/unexpected expenses	11
Overlooked or withheld payment	12
Third party error	6
Debts left by former partner	2
Other reason	3
<i>Base: all in arrears in past 12 months</i>	208

Source: Kempson (2002)

Relationship breakdown was a cause of arrears in around one in twelve cases – either through a drop in income or because an ex-partner had left debts behind when they moved out (Table 2.1). In fact, half of the people who had separated from a partner in the past twelve months had fallen into arrears with one or more of their commitments. However, as earlier research on mortgage arrears has shown, in about half of cases the arrears pre-dated (and may well have contributed to) the relationship break-up; in the other half they followed it (and presumably were a consequence) (Ford et al, 1995).

A further 15 per cent of householders said that they had fallen into arrears because their incomes were low (Table 2.1). Again this confirms earlier research, which has found that low income was often the cause of arrears on household bills such as water and fuel and that many people were not claiming the social security benefits to which they were entitled (Herbert and Kempson, 1995; Rowlingson and Kempson, 1993).

In a quantitative survey, you would not expect people to give reasons that were critical of themselves, but rather to look for some external cause. Even so, one in ten said that their difficulties stemmed from over-commitment (Table 2.1). And one in

eight of said that they had either overlooked or deliberately withheld payment (Table 2.1), indicating at best a degree of disorganisation and at worst a deliberate attempt to 'work the system' (Whyley, Kempson and Herbert, 1997).

A minority (6 per cent) said that their arrears had been caused by an error made by their creditor that they were disputing.

Other research has shown that rent arrears are often caused by an administrative failure in the payment of Housing Benefit by the local authority direct to the landlord (Blandy, Hunter, Lister et. al., 2002). The Survey of English Housing, 2001 found that more than a third (35 per cent) of all social tenants said that problems with Housing Benefit was a reason for them being in arrears.

Pulling these findings together, it is clear that the great majority of people who fall into arrears do so because they cannot afford to meet all their commitments. This was well-recognised by most creditors. But a minority of people in arrears, at least one in eight, were clearly able to pay but had not done so – either because they were disorganised or because they were withholding payment.

At the same time it is clear from earlier research, that the proportion of people who have not paid although able to do so is generally greater at the later stages of debt recovery. But this varies greatly by creditor (Whyley, Kempson and Herbert, 1997). As we shall see in the following chapter, some creditors make great efforts to establish contact with customers in arrears and set up repayment plans that take account of their circumstances. Wherever possible they avoid taking court action against people who are in difficult financial circumstances. At the other extreme there are creditors that have no systems in place to discover why customers have fallen into arrears, and consequently they summons many people facing financial difficulties.

Previous research also shows that the proportion of won't pays is influenced by other external factors. First, the proportion varies across the economic cycle. So in times of recession the proportion of people who have fallen into arrears because they are unable to meet their commitments increases sharply. During periods when the

economy is buoyant, the level of arrears falls along with the proportion of people who are unable to pay.

Secondly, the proportion of won't pays is higher for some types of commitment than it is for others. The commitments that tend to be afforded the lowest priority are council tax, water bills and credit cards. Council tax and water bills have a high proportion of people who object in principle to paying, while credit card companies are seen as lending money irresponsibly and so able to wait for their money. The attitudes to these creditors are highly susceptible to media coverage. For example, there was a wave of antagonism towards water companies in the mid-1990s when the media were regularly running stories about the large salaries they paid to their staff at the same time as water charges were increasing quite markedly (Whyley, Kempson and Herbert, 1997).

Distinguishing can't pays from won't pays

At the extremes it is easy to distinguish between people who can't pay and those who have set out not to pay. The first group includes, for example, people who have lost their jobs and been unable to keep up with commitments that were perfectly manageable while they were working. The second would include people who could afford to pay but took a principled stand against the poll tax and withheld payments as part of their protest at the introduction of the new tax.

In between, things are much less clear with, for example, some people on state benefits also withholding poll tax payments because they objected to the tax.

In fact, most creditors felt uncomfortable with a simple dichotomy between can't and won't pay, recognising that it was something of an over-simplification. They did agree, however, that people who are trying to avoid payment are disproportionately found among those who cannot be contacted and also among those who pay at the last possible minute to avoid being taken to court or having their account passed to a debt collection agency.

Part of the complexity lies in the fact that there are two quite distinct components to the can't pay won't pay divide. First, there is the *ability* to pay the money owed and secondly the *commitment* to paying.

Ability to pay

People at the late stages of debt recovery fell into one of three groups according to their ability to pay their creditors:

First there were people who had the money to pay when they fell into arrears and were still in a position to pay when their creditors reached the late stages of debt recovery. At the other extreme were people who did not have the money either when they fell into arrears or when their creditors sought to recover the money owed.

In between these there was a third group of people who had been able to pay when they fell into arrears but, as a result of a change in circumstances, they could no longer afford it when their creditors reached the late stages of debt recovery.

Commitment to paying

As we have noted above, many people have every intention to pay bills and credit commitments on time, but their circumstances force them into arrears. They include:

- People who had got into difficulty through living on a low income for long periods of time and had faced unexpected expenditure.
- People who had had a sudden large fall in their income, leaving them over-committed.
- People with mental health problems that impaired their ability to manage their finances.

These three groups are the archetypal can't pays. It should be noted that some of these people can, on occasion, look like won't pays because they repay the arrears in full when they receive a court summons. In reality, they will have raised the money by borrowing (commercially or from family or friends).

In contrast, there are people for whom the commitment to paying creditors is a major reason for their arrears. They include:

- ‘*Payment withholders*’, people who did not routinely withhold all their bills but either objected to paying a particular bill on principle or were in dispute with their creditor.
- ‘*Working the system*’, people who routinely waited until late in the debt recovery cycle before paying just about all their bills.
- ‘*Ducking responsibility*’, people who had spent very freely and owed very large sums in consumer credit. They blamed the credit companies for having lent them the money and felt no responsibility for repaying the money they owed.
- ‘*Disorganised*’, who, unlike the previous three sub-groups, were not deliberately delaying payment, but were so disorganised that some bills got paid on time, while others did not.

These four groups can be found among people of all incomes and with quite differing abilities to pay. It is quite clear that those who withhold payment, work the system or duck responsibility would be considered won’t pay if they have the money to pay the money they owe their creditors. It is less clear how to categorise them if they lack the money to do so. It is also not entirely clear whether those who are disorganised should be considered as won’t pay even if they *are* in a position to pay the money they owe.

In the sections that follow we consider these issues in more detail.

Payment withholders

People withheld payments for a variety of reasons. They included people who objected to paying the Council Tax or water charges or who had been unable to reach an agreement with their creditor and so stopped paying altogether. Most of these people only routinely withheld one or two of their bills. But they also included ex-husbands who had left their wives to repay their debts. They included people of all incomes and ages except those in their early twenties or over seventy (Table 2.2).

All the creditors recognised this group – although in most instances they said it is very small and tends to be people who are in dispute over payments or disputing a claim on payment protection insurance. Creditors differ greatly in the proportion of people they summons who have a dispute of this kind. At one extreme, some suspend the

arrears recovery process while they sort out the dispute; at the other as many as five per cent of people taken to court could have a genuine dispute over payments. This is discussed in more detail in the following chapter.

Withholding payment on principle

Only two creditors – a water company and a local authority Council Tax department – acknowledged having customers who withhold payment on principle.

*We have groups of people who will [withhold payment] because their street is being dug up, because their dustbin wasn't emptied, because they haven't got children so they don't go to school... or they make a reduction, they reduce what they pay.... Then there's the groups who feel they're contesting the legislation... 'why do they have to pay 50% when the place is empty?'.
Local Authority Council Tax department.*

But both creditors said that the proportion of people withholding money on principle had fallen in recent years.

Table 2.2: Typology of customers who had the money to pay but had not paid

<p>Payment withholders</p> <ul style="list-style-type: none"> • Default bill is a low priority • Not paying on principle or because in dispute • Found in all demographic groups, except the very young and very old. 	<p>Disorganised bill-payers</p> <ul style="list-style-type: none"> • No systems for money management • May work away from home • Not deliberately delaying payment • Tend to gravitate to direct debits • Found among all demographic groups
<p>Working the system</p> <ul style="list-style-type: none"> • 'Better in my account than theirs' • Laid back approach to bill-payment • Detailed knowledge of creditors' approaches to arrears • Often big spenders • Do not worry about being in arrears • All age groups except the very elderly • Single men or male money managers in couples • Self-employed 	<p>Ducking responsibility</p> <ul style="list-style-type: none"> • Credit card companies are irresponsible • Owe large amounts on credit • Live life to the full and big spenders • Disorganised money management • All age groups except the very elderly • Either owner occupier couples • Or young singles living with parents

Norma and Neil were typical of those who objected to paying water bills in the mid-1990s. At that time water bills were rising steeply and the press was reporting the large salary increases being paid to water company bosses following privatisation. Neil was a self-employed builder, his wife worked part-time. Together they had an income, in 1996, of approximately £17,000 a year, but they were comfortably well-off, as they owned their four bedroomed house outright and had low outgoings. But there was just one bill that Neil felt strongly that they should not have to pay - his water bill. He recognised that the water company had to incur the cost of maintaining water purity but felt that, despite an increase in his bill, there had been no improvement in the service. At the same time he felt that the increase was due to the high salaries of company executives.

Over the past ten years it's tripled... because they pay exorbitant salaries to people who are directors. You can't pay millions of pounds in salaries when you are supposed to be running a community service. They earn as much in a day as I earn in a year and I'm expected to boost their salaries up. They're not particularly clever people they just happen to be big names who've got themselves into a cushy number.

Neil was eventually disconnected and had no problem finding the full amount to clear all his arrears.

Although adverse publicity about water companies has abated there are still people who object to paying for water. Sarah, for example, was 26 and a lone parent on benefits. She objected to paying for water, and had not paid her latest bill. Sarah had many views on why she shouldn't have to pay this bill, these included: the prices were too high for lone parents; that water was a necessity so '*why should you have to pay*'; and she felt the service and the water quality was poor anyway. Because of these beliefs Sarah said she would only pay her water bill when she got a summons. Sarah only took this extreme stance for her water bills. Despite living on a low income, she was not in arrears with her other utility bills, and was a careful budgeter.

Others, like Jack and Pam were prepared to make a stand beyond the court summons. They said they would even be prepared to go to prison for non-payment. They threw away all correspondence from the water company.

I don't agree with it. It's a natural resource. You don't pay for air; you shouldn't have to pay for water. I'll never pay a water bill as long as I live. I'll go to prison first. They're not going to get a penny out of me.

Poll Tax evasion was also widespread in the early 1990s and a long-term effect of this has been to legitimise the non-payment of Council Tax. Jan and Colin had a modest income of £19,600 a year. Colin was a lorry driver and Jan was a part-time cleaner. Jan was very systematic in her approach to bills, she wrote everything down, knew when each of them was due, and tried to save up to pay her bills promptly. However, Jan '*despised*' paying Council Tax bills because she could see no personal benefit for this payment despite the fact the bill was very high.

I didn't want to pay it because I can't see what they're doing for me. It's not paving outside my house. They don't come and sweep the front of my house. Or the houses in the roads where we live. I think I'm like everybody else despising that.

Jan had a history of not paying her Council Tax. Two years previously she had been to court and had set up a payment plan after bailiffs visited her house. Despite this earlier experience, Jan had stopped paying her Council Tax bill again, and had not paid for six months, because of her strong views.

Disputed payments

Disputes over bills and failed payment arrangements are the most common circumstance where payment is withheld – sometimes with justification, sometimes not. Most creditors felt that these cases ought not to reach the late stages of debt recovery, although they admitted that they can sometimes slip through. As we discuss in the following chapter, they differed greatly in their ability to identify and weed out such cases.

Fraser, for example, worked away from home a great deal and objected to paying estimated gas bills. He had only recently moved house and the bills were based on the consumption of the previous owners. He could well afford them as he was a free-lance avionics consultant earning about £50,000 a year. But he refused to pay as the gas supplier would not accept his meter reading.

A common area of dispute was between private landlords and their tenants. Tim's water arrears stemmed from a time when he sub-let his flat for three years and the tenants did not pay the water bills. He felt that he should not have to pay the outstanding arrears but eventually drew the money out of his savings after the water company had taken him to court.

In other instances disputes arose over the level of payment of arrears. Susan and Brian were in their late twenties and their problems started after the birth of their first child six years previously. Susan had always planned to go back to work after her maternity leave, but her baby was diagnosed with cerebral palsy, and this was no longer an option. Until this date both Susan and her husband had worked full time and were financially stable. However, they found it difficult to adjust to their drop in income and fell into arrears with a number of commitments.

They had negotiated affordable payment plans with all but their water company and kept to these payments. They had made every effort to negotiate a payment plan with the water company, and for some time sent them what they could afford. Unfortunately the company refused to accept this offer.

They just won't accept anything that you offer them. And I'm sending them cheques on a regular basis and they started sending them back saying we're not accepting these because we want more than that. They actually started sending cheques back that I was sending them.

Because they felt that the creditor was being completely inflexible they stopped making payments all together,

We thought, 'Well at least you're getting something. Surely something is better than nothing'. But when that continued, in the end I said ' Well what's the point in struggling, we'll just leave it', and they might come round to think, 'Well yes it's better to get something rather than nothing'.

Bills not paid by ex-partners

As we noted above, relationship breakdown is a fairly common cause of arrears and in some cases, like Sandra, these arise as a direct result of an ex-partner deliberately withholding payment of bills he should have been paying.

He was going down the pub and I got into mega problems because I had all these letters saying, 'Why haven't you paid?' and he was ripping them up and throwing them away so I end up having bailiffs and all here demanding it. It was an absolute nightmare. So I had to get myself back on my feet and start paying it off.

Sandra was in arrears with her gas, electricity and water. She repaid the gas and electricity in instalments, but was taken to court for her water arrears, and paid part of it in a lump sum by selling a household item, and the rest in instalments.

Working the system

This group was considered by the majority of creditors to be the largest group among debtors who have the ability to pay. And they generally considered them to be 'playing games' with their creditors. The exceptions were the two mortgage companies for whom this was less of a problem.

Most creditors felt able to identify them from their pattern of waiting until the last moment to see what action will be taken against them and then generally paying quickly to avoid a court hearing or having their account passed to a debt collection agency. On occasion, though, they miss the deadline and they lose the 'game'.

There are those who are 'credit-aware', those who know the game... I mean some customers will treat [the default notice] as a reminder... They know how to play the game, know the score, know the rules. Bank 1

There are a core of customers who pay as late as they can and they make a kind of sport of this, sort of optimise the cash flow. Utility company 2

One creditor had, in fact, developed score cards to predict this pattern of behaviour and identified that it was more common among men than women and also among the self-employed. This was confirmed by our interviews (Table 2.2). They tended to be people who spent freely and felt their creditors could wait to be paid. In contrast to others, most of people working the system had a long history of arrears and were in multiple debt.

Most had no intention of reaching the summons stage, merely to keep the money in their own bank account for as long as possible. But they did end up in court for a number of reasons. Some were away from home and others were disorganised about bill payment and missed the last opportunity to pay and avoid a court hearing.

There was, however, a small group of people who will avoid paying altogether if they can. Nick and Giles were prime examples. Nick was a lone parent and was fairly well off, earning over £50,000 per year. But he had a lavish lifestyle that necessitated high expenditure on childminding and taxi fares so that he could socialise every day after work.

I don't drink that heavily, just beer. I play hard in that I have a high-pressured job and I socialise for a couple of hours after work before I collect the kids. That is my social life.

Paying bills did not fit his lifestyle and he owed £27,000 in mortgage arrears, as well as £15,000 to the bank. He also had gas and electricity arrears, and had not paid his water rates.

It's not that I chose not to pay. I just haven't bothered – not even considered it... I ignore them... I leave them to the last minute, which is a habit I've got into... don't like paying bills.

Nick was also quite calculating in the way he dealt with creditors. Like others who worked the system, he had acquired a detailed knowledge of creditors' arrears management practices and the best ways of stalling them.

I did go and arrange a [gas] Budget scheme... Really that was just a sort of holding them up process because I had them going for about another eight months.

Despite making this arrangement he did not make any of the payments and deliberately waited until the last minute and planned to contact his gas supplier to try and win some more time. Unfortunately he forgot.

When I knew they were one hundred per cent serious that they were going to cut me off on a particular date, I intended to contact them and then forgot it. If I had just rung them and said 'OK, look I want a key meter instead of disconnection', I would have got a key meter... I was playing it to the last minute and then forgot on the vital day.

Even then Nick still thought he could escape payment.

I don't know whether I'll be here three months from now, so there was no point in me paying a £900 bill... there are ways of being un-locatable.

Giles also worked the system with expertise. Giles was 40 and lived with his second wife and child in France and Kent. He was a self-employed property developer. Although he was well off, he had still managed to build up arrears that totalled £16,000. He was six months in arrears with his mortgage owing £10,000 and was also

£6,000 in arrears with his credit cards. Giles's self-employed income was variable and because of this he had developed a belief that if he had the money he would pay, but if he did not his creditors could wait. He sometimes waited up to two years before he contacted a creditor.

Giles had been working the system for over two decades and was also aware of many of the creditor approaches to debt recovery. This informed both his approaches to bill paying and the way he dealt with companies when in arrears. This was true of the way he had been handling his credit card payments over the past years.

They will take anything in full and final settlement, the more you owe then the easier it is to do it, take a round figure, I have done this three or four times. If you owe them £5,000 I guarantee you will probably get off with a one off payment of £3,000... and they will always take it, it means they can write it off, the agency gets to collect their fee straight away, you know [if they accept] £30 a month by the time six months has gone you have moved addresses and God knows what, it is cheaper for them to take what they can in a lump sum. I have had a great game with that lot. So that's what you've got to do, it is no good owing them £600 it has to be nearer £6,000.

He also failed to pay utility bills, because experience had shown that these creditors were often powerless to recover the money owed from absentee landlords.

I have got flats in London and I rent them out and I have seen electricity companies still chasing it after two years, they find it very difficult to cut people off these days.

Giles never worried about his arrears because he knew he would always be in a position to pay them off.

Both Nick and Giles had above average incomes. However there were also people who worked the system who were on more modest incomes.

Wayne was 36 and lived with his wife and two children. Although his income dropped when he had to leave work a year previously because of health reasons, in fact he was already in arrears before that time. But his problems worsened once he was on benefits. He had arrears with his gas (£40), electricity (£100), water (£70) and credit card (over £1,000). He knew that it was possible to buy time by making offers of payment to his creditors.

If you owe money to a company, they would much rather you abide by their terms and what they want you to pay, but at the end of the day, if you come back to them and say well I can't afford that but I can afford this, they're not gonna want to pay for court costs and that sort of thing knowing very well a judge is going to say you've got to pay fifty pence a week or something like that... Generally they will accept y'know, as and what you can offer them.

Wayne's situation was exacerbated by his disorganised approach to bill payment and money management,

I do find that sometimes I get more bills come through one month than the next, sometimes they all get cluttery 'cos they sort of clutter up.

However, like many were working the system becomes a way of life, Wayne was resistant to direct debits, which would restrict his ability to work the system.

Well it suits me [to pay by credit transfer] because it gives me more control. And I think when you're trying to pay off bills, sometimes direct debits aren't a wise idea because as I say if you haven't got enough money in the bank one month to cover it, you end up costing yourself more money. So if you do it by [credit transfer] it's a lot easier because you actually be in control of when you pay it em, rather than you could be if you used direct debits.

Being in debt and working the system had become a way of life for Wayne. He did not worry about it as he felt he would pay it off when he had the income,

I don't let it get to me too much because I always think, I'll pay this when I can afford to, so you know, I don't sort of over worry about it too much you know, to that extent, 'cause I know I'll pay it. I'm, not the sort of person who doesn't pay bills but I know I will pay them when I get the money.

Nick, Giles and Wayne had always worked the system and were determined to avoid paying altogether if they could. Neither court action nor having their debts passed to a debt collector seemed to worry them.

Edith was somewhat different. She had first fallen into arrears when she split up from her husband, leaving her to care for her granddaughter alone. She started to juggle bills and work the system in order to make ends meet.

You have to get food and then the next thing you have got a bill to pay so you never, being one parent, you have never got enough money for other things. I mean if my granddaughter wants something, I have got to juggle around go short on food or that, or buy less food.

At first she was living on Income Support, but when she reached 60 she started to receive a state pension and found a part-time job in a factory, which also opened up eligibility for Working Families Tax Credit. Her weekly income had more than

doubled to £10,900 a year. Despite this increase in income she had two court summonses for non-payment of water and Council Tax. She still routinely missed payments, usually during expensive times like Christmas or for holidays. It was during these times that Edith set her own payment parameters for bills, viewing delayed payment as a sort of loan.

I preferred the holiday, I knew that when I came back after a fortnight that I could pay it because my wages would be in you see.

Unlike Nick, Giles and Wayne she was not trying to avoid payment entirely and was quite worried when she was taken to court.

Ducking responsibility

People ducking responsibility had spent very freely, running up very high credit commitments, with large balances on a number of cards and loans. Having done so, they criticised the credit companies for having lent them the money and felt that they could wait for payments if need be. Arrears on household bills were rare amongst this group.

They were of all ages except people aged over 70 and young people under 25. They tended to be in white-collar work and were either owner-occupiers or, if young, living in their parents' home (Table 2.2).

While most creditors recognised the existence of this group, only the credit providers said that they were directly affected. And in all cases they thought that the group was growing in size. In part, they attributed this growth to the setting up of fee-charging debt management companies, who advertise for people to contact them if they feel that they have over-stretched themselves with borrowing. But they also acknowledged that the credit industry itself must accept some of the responsibility.

It makes me wonder how they get that much... the husband's and wife's joint earnings may be £30,000, their total debt [on consumer credit] may be, say, £70,000... they may have eight or nine different credit cards. How did they get them if they're only earning that? Now is that a case of a card issuer not being a responsible lender or have they put false information on their application forms? Credit card company 1

Indeed, recent research has shown that part of the problem lies in the practice of raising credit limits on credit cards and overdrafts without first checking at a credit reference agency (Kempson, 2002).

Some of those ducking responsibility for their credit commitments could easily have repaid the money they owed. Laura and Martin were both teachers and their annual household income was £55,000. They were extravagant and liked to spend heavily on holidays and celebrations. Paying their credit cards was a low priority and they had a '*sod it mentality*', missing payments and going over their credit limit to support their extravagant lifestyle. They owed approximately £4,500 on three cards, all of which had been cancelled by the card companies. Laura and Martin believed that banks are '*greedy*' and out to make as much money as possible from their customers. Consequently they felt no guilt or responsibility for their debt, and were in no hurry to repay it.

Other people, however, had built up large credit commitments that had become beyond their ability to pay following a drop in income. Frank was 59, had recently separated from his wife, and had moved out of their family home to rent a room from a friend. By training Frank was a legal executive but had been made redundant 14 years ago, and became self-employed. This business was never really very successful, and in the final four years he said it was only bringing him an income of £8,000 a year. The business eventually folded in August 2001 and Frank started to claim Jobseekers' Allowance.

Frank had always lived beyond his means and his attitude to credit companies dated back over 25 years, when he had a regular income, but still got into problems servicing his credit commitments. In the past he had left a large sum of money outstanding on a credit card for ten years. When he did eventually pay it off the company immediately issued him with a new card. This incident contributed to Frank's belief that credit companies were irresponsible and he could build up large commitments even when he knew that he would probably struggle or find it very difficult to repay. Over time this attitude had hardened.

Yes in my own case it made me, I'm not sure if irresponsible is the right word, but less responsible I suppose I should say because you know basically I don't care a damn now, whereas I did before, I thought it was important, if you owed money you paid it and things like that and now alright, I will do it but I'm not that bothered about it, in fact nothing bothers me.

He also felt that they made a great deal of money through his interest payments and bank charges over the years.

Frank owed approximately £52,000 in credit commitments. This included £18,500 on three credit cards, three loans totalling £27,000 and an overdraft of £5,000. He felt his debts were out of control, and had stopped making all payments.

I am in a totally impossible situation you see, until I get a job or get some work you know or something turns up it is totally impossible for me to even contemplate paying off what I owe or even keeping up with current payments and I am past the stage now where I worry about people phoning I mean when people phone and say well look can you make a payment I simply say no, I mean what can they do, you don't normally go to prison in this country for owing money.

Frank was not overly worried about his debt as he knew that his creditors were limited in what they can actually do to recover it. He believed that they would probably not take him to court as it would be 'good money after bad', and they would not recoup their court costs.

Fatemeh's situation was similar to Franks. She and her husband had run up large credit commitments while she was married, but since her divorce she was living on a very low income and had continued using her credit cards. Unlike Frank, poor mental health contributed to her financial difficulties. She owed a total of £28,000, which included two credit cards and an overdraft, and her bank account had been suspended. She was registered disabled because of her mental health problems and received £210 a week in benefits.

She successfully negotiated credit card repayments of £1 per month, with the help of a money advice agency. She kept to this agreement for 12 months but had not made any payments for the past six months. This was because she felt that her creditors were partly to blame for getting her into debt as they had regularly raised the limits on her cards and she resented the fact that they had taken away the service she valued.

The credit card companies they say you owe £3,000 you've got to pay £3,000, I haven't got it, where am I going to get it? I've been using this facility for the last couple of years, I've been paying you, you've been increasing my limit, that's fine, now I haven't got the money to pay you, you'll have to bend a little bit... They take away the credit card, fine, you don't even get what I can afford to pay you, at the moment I can't. People have to help each other, the credit card companies have enough profit out of everyone.

She felt no responsibility for the money she owed – she blamed her ex-husband and the credit card companies. In fact, her financial difficulties were largely caused by over-spending while she was married, and were compounded by her mental health problems.

Disorganised

Unlike the previous four sub-groups, these people were not deliberately delaying payment; they fell into arrears through poor money management and disorganised bill payment. Some bills got paid on time whilst others did not.

Without exception, all the creditors interviewed recognised this group of people and some went on to sub-divide it into those who are regularly away from home and those who have limited budgeting skills. If creditors' arrears management procedures were more efficient, these people would not reach the late stages of debt recovery.

However, one creditor said that, even with their very sophisticated management information systems, it was often quite difficult to distinguish people who are disorganised from those who deliberately work the system. In practice disorganised bill-payers pay erratically – sometimes late, sometimes on time; whereas payment withholders consistently wait until the last minute.

Disorganised bill-payers could solve many of their problems by setting up direct debits or standing orders to pay their bills. Creditors recognised this and said it was why they promoted payment in these ways. In fact, having got into financial difficulty, most people in this category had taken steps to make bill payment more routine. This included setting up direct debits; budgeting ahead and setting money aside for bills; and the installation of pre-payment meters for fuel.

People who are disorganised are to be found in all income groups, including those with sufficient money to meet their commitments and those without.

Simon, Sandra and William were all fairly comfortably off but all were totally disorganised when it came to managing their finances. Simon was typical of many young people when they first set up home independently

It was just that I wasn't used to budgeting. I've never really had to deal with bills and everything else... I was renting a place before, that was the first time I had lived on my own and it came as a shock every quarter. It took me a while to adjust. Before that I used to spend money and whatever and then when the bills came in it was a big shock to me until I got myself used to this way of just putting money aside every week.

Simon's poor money management skills quickly led to arrears with his telephone and gas bills and his telephone was cut off. He also exceeded the credit limit on his credit card and fell into arrears with his payments. The credit card company passed his account to a debt collector. Being in debt had forced Simon to reappraise his situation and set up a separate account for bill-payment.

It forced me to think about tomorrow instead of just living for today. I can cope with it now because I know all the bills are paid, the money is in the account ready for all the bills... It stops temptation and that way, when the bills come in, I don't have to struggle for a month whereas I maybe would have to use a whole month salary up and then I've got no money left.

In contrast, Sandra, aged 55 and William, aged 70, had continued to be disorganised all their lives. Sandra attributed some of her disorganisation to the fact she worked shifts.

I've got a mind like a sieve to be honest. I'm sort of coming and going out on shifts. If you're on nights sort of one day goes into another and before you know it's late again... If I'm busy things come through the post and you forget and put it in the bin.

This had led to her receiving a court summons for water arrears although her other commitments were all up-to-date.

William, a retired university lecturer, had always been disorganised with bill payment. His electricity supply was disconnected while he was on honeymoon. This pattern of disorganisation and missing bills had continued throughout his married life and into retirement. William admitted that his problems were caused by his 'lazy' approach to bill payment.

Well the wobbles probably come because I am lazy. And/or preoccupied with other things and I just have to make catch up every so often, it is as simple as that.

So far we have looked at people on above-average earnings. There are also disorganised people among people on benefits or in low-paid employment. Most people living on low incomes for long periods struggle to meet all their commitments, but they differ in the priorities they set. Some put money aside for their bills as soon as they receive their income and live on whatever money they have left; others give bills a lower priority than their family's day-to-day needs and, consequently 'rob Peter to pay Paul'. This constant juggling inevitably leads to arrears, unlike disorganised people on higher incomes who can often avoid falling into arrears.

Mapping can't pay won't pay

In previous sections we have shown that in understanding the divide between can't and won't pay, it is important to distinguish between the ability to pay and the commitment to do so. Table 2.3 brings these two elements together.

From this we can see that some categories of people should not even be included in the can't pay won't pay divide. These are the people who have fallen into arrears because they are disorganised and those who have a genuine dispute with their creditor – whether they have the money to pay or not.

Equally it is quite clear that people who fall into arrears purely as a result of a change in circumstance or long-term low income are can't pay as, in both instances, they have never had the money to pay the arrears but always had the intention of doing so. People with serious mental health problems that impair their ability to manage money ought also to be considered as can't pay regardless of their income.

Table 2.3: A map of can't pay won't pay

	Has money to pay	Had money to pay when fell into arrears, not now	Did not have money to pay when fell into arrears
No intention to pay			
Withholding on principle	Won't	Won't/ but can't	Won't/ but can't
Withholding – dispute	--	--	--
Withholding – ex-partners	Won't	Won't/ but can't	Won't/ but can't
Working the system	Won't	Won't/ but can't	Won't/ but can't
Ducking responsibility	Won't	Won't/ but can't	
Intend to pay			
Disorganised	--	--	--
Change in circumstances			Can't
Long-term low income			Can't
Mental health problems	Can't	Can't	Can't

Key  = should not be considered either can't or won't pay

That leaves people who withhold payment as a matter of principle; ex-partners who withhold payment; those working the system; and people ducking responsibility. All these are won't pays – irrespective of their income. Although those without the money to pay might be more appropriately called '*won't but can't pay*'. Whether it is appropriate for creditors to pursue the money such people owe if they are on low incomes and unable to pay is another matter and one that we discuss further in subsequent chapters.

3. ARREARS MANAGEMENT AND DEBT RECOVERY

Over the 1990s there was a significant shift in the approaches taken by creditors to arrears management and debt recovery. In part, this was stimulated by a growing body of evidence – from researchers and money advisers – that many people fall behind with the payments on their commitments because of a change in their financial circumstances. Moreover, the evidence showed that many people who are in financial difficulty find it difficult to face up to the situation and bury their heads in the sand. Until then, many creditors had assumed that customers in default did not make contact because they were deliberately avoiding payment. Consequently, creditors' arrears management practices often reinforced customers' views that there was little point in contacting their creditors unless they could afford to pay all the money they owed (see for example Rowlingson and Kempson, 1993). In contrast, most creditors now acknowledge that many people fall into arrears through a change in circumstances that results in a struggle to make ends meet.

Reflecting this change in perception, the 1990s saw the development of industry codes of practice and guidance, which cover the handling of customers in arrears and debt recovery. These cover most major creditors – including credit companies, utilities and housing associations. Since 2000, local authority services have a duty to review their services over at least a five-year period and the Audit Commission undertakes Best Value Inspections.

At the same time, some creditors have used developments in information technology to develop very sophisticated systems that enable them to identify different categories of customer and tailor their arrears management and recovery systems accordingly.

Despite these developments creditors still differed in their ability to distinguish between different categories of customers as they move through the arrears management and debt recovery processes. At one extreme some creditors had procedures in place from the point where their customers first fell into arrears right through to the final stages of debt recovery. These creditors used the courts least and the customers they took to court included a relatively high proportion of people

attempting to avoid payment. At the other extreme there were creditors that had no real systems for identifying the circumstances of the customers that were in arrears. Consequently, they made heavier use of the courts and the large majority of the customers they took to court were in financial difficulty.

Industry codes of practice and guidance

All sections of the credit industry are now covered by codes of practice, issued by trade associations. These include the *Banking Code* (for lending other than mortgages by banks and building societies); the *Mortgage Code*; the Finance and Leasing Association's (FLA) *Consumer Code of Practice*; and the Consumer Credit Association's *Code of Practice*, which covers the home collection credit industry. All have sections covering companies' dealings with people who fall behind with payments. In addition, detailed guidance on dealing with customers in financial difficulty has been issued to supplement the *Banking Code* and the *Mortgage Code*. (See Appendix 1 for further details).

Compliance with the *Banking Code* and the *Mortgage Code* is monitored by independent bodies – the Banking Code Standards Board and Mortgage Code Compliance Board. These Codes are also used by the relevant Ombudsmen. There is no independent monitoring of either the FLA *Consumer Code of Practice* or the Consumer Credit Association's *Code of Practice*.

The utility companies are also now covered by Codes of Practice, albeit on a rather different footing. Here the regulators – Ofwat, Ofgem and Oftel – have issued guidance rather than codes of practice. In the case of Oftel the guidance was only issued for the first time in October 2002.

The Ofgem and Oftel Guidance requires companies to produce their own Codes of Practice, which include sections covering dealing with people who are in financial difficulty. These Codes must be submitted to the regulator for approval and companies must monitor their own observance of their Code of Practice. (See Appendix 1 for further details).

In contrast, the Ofwat *Debt Recovery Guidelines* set down broad principles for dealing with people in debt, accompanied by detailed guidance on best practice. Companies' policies and practices are audited by WaterVoice (customer service) committees, who visit companies and examine the records of customers in arrears and report to Ofwat.

(See Appendix 1 for further details).

The Housing Corporation has issued a regulatory Code, with accompanying Guidance for housing associations, which reflect the Corporation's regulatory powers. This Code is wide-ranging and it has little to say on the matter of rent arrears other than a statement in its guidance on management that '*legal possession of a property is sought as a last resort*'.

The situation with regard to local authorities is rather different. The Local Government Act 1999 brought in a duty of Best Value for all council services, which came into force in 2000. This requires local authorities to carry out fundamental Best Value reviews of all their services and expenditure over at least a five-year period and also to publish a Performance Plan. The Audit Commission's Best Value Inspectorate audits these Performance Plans as well as carrying out an inspection of all fundamental reviews. Reports of these reviews are published on the Commission's website.

Avoiding arrears and risk management

Most of the above codes and guidance include sections that relate to avoiding arrears and risk management. Guidance issued by all three utility regulators refers to offering frequent payment options to help make quarterly and half-yearly bills more manageable. Previous research has shown that this can go some way to reducing the level of arrears (Herbert and Kempson, 1996; Rowlingson and Kempson, 1993). The Ofwat and Ofgem guidance go furthest, each requiring companies to provide for weekly, fortnightly and monthly payments - in cash as well as by cheque or direct debit. And the Ofgem *Guidelines* also require companies to tell customers who are in financial difficulty how they might reduce their bills by the more efficient use of gas and electricity.

Best Value inspections of local authority rent and Council Tax departments include the extent to which they offer a range of payment methods that are appropriate to the needs of their customers.

For the credit industry, risk management relates to a full assessment of a customer's ability to pay before the decision to lend them money is made. All four industry Codes – *The Banking Code*, *The Mortgage Code*, the FLA *Consumer Code of Practice*, and the Consumer Credit Association's *Code of Practice* give a commitment that all lending will be 'subject to an assessment of the borrower's ability to pay'. This point has been picked up by the Department of Trade and Industry Taskforce on Over-indebtedness, who have recommended that these sections of the Codes should be strengthened.

In recent years fuel and telephone companies have also begun to screen customers to assess their credit risk – either checking at credit reference agencies or using credit scoring. They then use a variety of procedures to minimise their credit risk, the most common of which are security deposits or conditions relating to supply (eg pre-payment meters for fuel or a bar on outgoing telephone calls). Both the Ofgem and Ofwat guidelines set standards for such procedures.

Arrears management

Most codes and guidelines advocate that companies should make early contact with customers when they fall into arrears, to discuss the options for settling their arrears (Of tel, the Housing Corporation and the FLA are the exceptions). The *Mortgage Code* goes further than this and advocates that companies should seek a meeting with borrowers 'to discuss the situation and examine ways to resolve the problem'. While the Ofwat Guidance is quite specific about the tone and content of communications.

In three documents, stress is laid on taking a holistic approach to customers' problems, to identify those in financial difficulty and tailor debt recovery procedures accordingly. The Statement of Practice accompanying the *Mortgage Code* says that lenders should try to work out the best repayment option for individual borrowers. Recent guidance issued under the *Banking Code* goes further and advocates that lenders should look at the overall situation of borrowers to identify those in financial

difficulty. But it is the Ofgem guidelines that go furthest. Fuel companies are required to describe in their codes the procedures they have for distinguishing between customers in difficulty from others in default. It also states that companies should be sympathetic to the welfare of the family as a whole.

All the codes and guidance stress that companies should be willing to set up repayment plans with customers. And most go on to say that the plans should be realistic and sustainable, taking into account the customer's ability to pay (again Oftel, the Housing Corporation and the FLA are the exceptions). This is a major step forward as, in the past, repayment plans were often set at levels that customers could not afford, resulting in court action that could have been avoided.

The *Mortgage Code* Statement of Practice sets out forms of forbearance that lenders might consider in order to recover the money owed. The *Banking Code* indicates that lenders might consider writing off a debt for a customer whose financial circumstances are exceptional and unlikely to improve. If this is requested by the customer or their adviser, the lender must give reasons if they refuse.

The Ofgem guidance recommends that if the customer is in receipt of Income Support or Jobseekers' Allowance companies either apply for Fuel Direct, where payments toward fuel arrears are deducted at source, or set up a repayment plan where repayments do not exceed the level of deduction under Fuel Direct.

All the codes and guidance (except that issued by the Housing Corporation) advocate that companies should be willing to work with money advisers who are acting on behalf of customers who are in arrears. They also give the names and contact details of the main organisations able to help – citizens' advice bureaux, money advice centres, National Debtline and the Consumer Credit Counselling Service.

Best Value inspections in local authorities assess the procedures they have for managing arrears, including the extent to which they offer money and debt advice and assistance with claiming social security benefits.

Debt recovery

Guidance issued under the *Banking Code* and the *Mortgage Code* explicitly states that court action should be a last resort, when all other attempts to recover the money owed have failed. Moreover, mortgage lenders have given an undertaking to the Government not to seek possession from any borrower who is in receipt of Income Support or income-related Jobseekers' Allowance.

The new guidance under the *Banking Code* says that lenders should only take a customer to court where they do not co-operate and a repayment plan cannot be developed. Lack of co-operation would include not making contact and unreasonable demands from the customer – for example for a debt to be written off or repaid over a very long period of time, even though they could afford to make reasonable repayments.

The Consumer Credit Association, whose members seldom use the courts, includes within its *Code of Practice* a clause requiring members to take a customer's circumstances into account before determining whether to enforce an agreement.

The guidance issued by utility regulators does not mention court use although it is implicit in the revised guidance Ofwat has issued to water companies that they will make every endeavour to set up realistic and sustainable repayment plans before taking a customer to court. The Guidance does, however, require companies to make it clear to customers what court action might be taken, the process involved and any consequences that might ensue.

Best Value inspections of local authorities include their use of the courts and of debt enforcement.

Overview of company approaches to arrears management and debt recovery

Research in the early part of the 1990s identified some fairly significant differences in the ways that creditors within the same industry handled arrears management and debt recovery (Ford, Kempson and Wilson, 1995; Ford and Kempson, 1997; Herbert and Kempson, 1996). At that time, most lacked sophisticated systems that would enable them to identify the reasons why individual customers had defaulted. Even so, they differed greatly in the approach they took to customers in arrears. Some subscribed to a ‘short, sharp shock approach’ to arrears management and recovery, believing that the majority of people were trying to avoid payment. They saw using the courts as an integral part of the arrears management process. They moved swiftly to taking court action and, consequently, summonsed large numbers of people who were in financial difficulty following a change in circumstance. At the other extreme, some creditors had fairly relaxed approach to arrears management – often allowing their customers to run up considerable debts before they took legal action.

Compared with the situation in the early 1990s, some important differences now stand out ten years later. First, commercial creditors have become more sophisticated in the systems they use for reducing risk and especially for arrears management and debt recovery. Secondly, rather more creditors combined sophisticated business systems with a holistic approach to their customers.

The other notable point is that, on the whole, local authorities were often much less sophisticated in their arrears management and recovery – at least in part through lack of resources. Compared with the commercial creditors they had been able to invest far less money into the development of their systems of arrears management and, consequently, they were much less able to distinguish between customers in different circumstances. The recent introduction of Best Value inspections have also played a part in increasing the accountability of local authorities for the management of arrears practices.

Even so, it was clear that creditors still differed markedly both in their ability to distinguish between different categories of customer and in the approaches they took to arrears management and debt recovery. This applied across all types of creditor,

(including priority and non priority creditors), and was confirmed by the interviews with money advisers. As far as we could establish, this applied to both prime and sub-prime credit markets.

On the whole, creditors fell into one of three categories that were not linked to the particular industry they were in. First there were those who adopted a holistic approach to their customers and made every attempt to identify the reasons why they had fallen into arrears from the outset. They had usually invested a good deal of time and money into the systems they operated and these were also under fairly constant review. They made least use of the courts and made every attempt only to summons people who they had every reason to believe were trying to avoid payment.

Other creditors took a hard business approach to arrears management and debt recovery. Like the first group, they had often invested in sophisticated computer systems but these were designed primarily to save the creditor money and not to develop a customer responsive approach. Typically they only sought to distinguish between different categories of customer at the debt recovery stage.

Finally there were some creditors who had little or no ability to distinguish between different categories of customer and operated a one-size-fits all approach to arrears management and debt recovery. They were the heaviest users of the courts and summonsed large numbers of people in financial difficulty.

These three approaches are summarised in Table 3.1 and expanded in the sections that follow.

Table 3.1: Approaches to arrears management and debt recovery

Holistic approach	Hard business approach	One size fits all approach
Provisions of codes/guidance exceeded	Follow the letter not the spirit of codes/guidance	No/only recently published codes/guidance
Adapt payment methods to customer needs	Determine payment method to suit own needs	Standard payment methods
Holistic approach to customers	Little attempt to ascertain customers' circumstances	No real ability to determine customers' circumstances
Customer segmentation to ensure fair and reasonable treatment of customers	Customer segmentation to save costs	No customer segmentation
Welcome assistance of money advice agencies	Money advice agencies seen as a hindrance	Variable approach to money advice agencies
Litigation seen as a failure	Litigation seen as part of debt recovery	Litigation seen as an inevitable final stage
Aware that many customers are unable to pay	Place greater emphasis on won't pay	Least informed understanding of can't/won't pay

Holistic approach

Creditors that adopt a holistic approach to customers who fall into arrears are typically enthusiastic supporters of codes of practice and guidance and normally exceed their provisions. Their aim is to maintain the customer relationship, by taking steps to avoid arrears, to recover arrears through payment plans in all cases and avoid court action whenever possible. Consequently, their account management, arrears management and debt recovery procedures are all quite sophisticated and designed to reflect the circumstances of individual customers as far as possible.

Account management

The holistic approach tends to start with a view that the level of arrears can be reduced by offering appropriate payment methods. These creditors use behavioural scoring, computer models of customers' payments on their accounts, and write to those who might be helped by a change in payment method. For example, they typically identify people who fall into arrears through disorganised money management through their erratic payment history. Through correspondence and telephone contact they both encouraged and assisted them to move onto direct debit payments.

Creditors, such as the utility companies and local authorities, that would normally issue bills quarterly or half-yearly, recognise the importance of offering customers on low incomes the option of paying weekly, fortnightly or monthly and also of paying in cash either at a post office or PayPoint outlets.

Where there is a clear dispute about an account they will suspend the arrears management and debt recovery procedures while they try to resolve the matter. Consequently such cases should not come to court as a matter of routine.

Indeed, their management information systems are highly sophisticated, with staff encouraged to record any potentially useful information that they gather in the course

of contact with customers. This information is then used to determine the approaches to be used should the customer fall into arrears.

Arrears management

Three things distinguish creditors that adopt a holistic approach to arrears management.

First, they have invested considerable sums in management information systems that enable them to differentiate between different categories of customers and tailor their arrears management procedures accordingly.

We used to have a one-size-fits-all approach, where it was a bit like a sausage machine. You know debt went in one end, and you cranked the handle, and something came out the other end. But what we said was, that it's important to differentiate between our customers. So we put in some technology, which enables us to segment our customer base. And that really determines the approach we take to recovery. Utility company 1

In practice, this means that those with a previously good payment history may receive an additional letter reminding them that they have missed a payment. While at the other extreme, customers that repeatedly pay at the latest possible minute to avoid court action are put through an accelerated arrears management procedure.

Their arrears management systems are subject to constant review, using a Champion Challenger approach. Revisions to procedures (challengers) are tested on a sample of customers to see if they deliver better results than the established procedure (the champion).

Secondly, in contrast to other creditors who manage the *accounts* that are held with them, those adopting a holistic approach take a wider view of their *customers* and stress the importance of managing the customer relationship.

...it's important that we take a customer view of [the situation] and manage the customer relationship and not just at account level... I think we're a bit more advanced than others so that if we get a customer who's in arrears on a loan then we look to see the relationship before we determine what we do in going forward, and we've got software to manage that... It depends on a variety of things. I mean, what is the customer relationship? How many products? Are they all performing together? How long has the customer been with us? Is there any history of non-payment? And that will determine the

strategy... We also score the customer as well. We have scoring software, which determines the route that account will take. Bank 1

This customer focus is reflected in their communications with customers. In all their correspondence they are at pains to stress that customers should make contact if they have had a change in circumstance or are experiencing financial difficulties and they have special telephone lines to facilitate this.

I mean if you look at it morally and legally then the onus is on the customer to do something about it, but... what we're trying to do is to create an environment in which the customer feels that they can telephone or write and get the matter attended to. So, I think if there's any onus on us, it's to do that, to present these channels that a customer can use and publicise them where there's a problem. Bank 1

While other creditors rely on letters at the early stages of arrears management, creditors adopting a holistic approach place greater emphasis on personal contact - usually by telephone. A telephone call not only conveys 'a greater sense of urgency', compared with written communications which are often ignored, but it also provides an opportunity for creditor and customer to discuss the reasons why payments have been missed.

They have invested considerable sums of money both in predictive dialling systems (where the telephone numbers of customers in arrears remain within the automatic dialling system for up to 25 days) and also in staff recruitment and training. This is, however, seen as a wise investment as it helps to maintain the customer relationship.

... it's very demanding on resources of course, but then again, we think it's an investment worth making, because... they're far more likely to progress far more satisfactorily throughout the whole of their mortgage life. Sub-prime mortgage lender 1

It's worth the additional investment in better telephony and better staff, or improved numbers of staff to actually generate that contact with the customer and resolve the situation. Credit card company 1

Even so, some customers cannot be reached by telephone despite considerable efforts. In these cases creditors have experimented with text messages, emails and tele-messages (a successor to telegrams).

Thirdly, when they make contact creditors adopting a holistic approach aim to identify why the customer has fallen behind with their payments, to set up a realistic

plan for repaying the money owed and to adjust methods of payment to reduce the likelihood of arrears in the future. Indeed, they will try to set up a payment plan in all cases and repeatedly offer to do so even at the very late stages of arrears management or debt recovery. They lay particular stress on setting up plans that are realistic and try to discover exactly what the customer can afford to pay. This is in contrast with other creditors who will usually accept any offer that is made by a customer – realistic or not.

We had gone through a number of years where we accepted any offer whatsoever that was made by the customer. And what we basically found is that it's just become unsustainable... And that is something we are moving away from now and we're getting into more negotiation rather than just accepting anything that the customer is offering. Credit card company 1

Moreover, they are willing to re-negotiate payment plans if they break down. Most creditors will place a limit on the number of times they are willing to re-negotiate, with the limit often being determined by the customer's circumstances. In other words, the aim is to retain a viable relationship with the customer wherever possible.

They also work closely with money advisers employed by citizens' advice bureaux, the Consumer Credit Counselling Service or other money advice agencies and accept the payment plans that they put forward for their clients. Furthermore, they are more prepared to adopt a more sympathetic approach to dealing with mental health problems. The input of money advisers is valued because they tend to see customers whose circumstances are the most complex and most difficult to unravel and because they help their clients to face up to their problems. This co-operation works in two ways. First, creditors often have special telephone lines for money advisers to use and, secondly, they will refer customers to a money adviser for more detailed assistance if they are in serious financial difficulty or have defaulted on several payment plans.

A minority of these creditors employ their own debt counsellors whose job it is to maximise customers' incomes, for example, by helping them to claim any benefits to which they are entitled, and work out a realistic budget to meet their out-goings. And some water companies have set up independent charitable trusts to which they refer people in serious financial difficulty. These trusts offer grants, to help people settle their arrears, as well as maintaining close links with local money advice agencies.

Debt recovery

Where a creditor adopts a holistic approach the court is used as a last resort and is seen as an admission of failure. Moreover, the courts are used very selectively. They recognise that it is pointless to take people to court if they have no money to pay and only do so if they know from previous contact that the customer is in work. They use 'debt surveillance' for customers on very low incomes and take no further action until the customer's circumstances have changed.

As noted above, it would be rare that a case would come to court if there was a dispute with the customer or a problem with payment protection insurance as they would '*bend over backwards*' to resolve it.

They also avoid taking action against people with previous county court judgements – in this case '*because we would be throwing good money after bad*'. For similar reasons they think twice before initiating court proceedings against people with whom they have been unable to make contact. Instead they use debt recovery agencies – often using an in-house team first before either employing an independent debt collection agency or selling the debts to them.

Hard business approach

The main concern of creditors adopting a hard business approach is to ensure that arrears are recovered at minimum cost. So the systems they have developed for account management, arrears management and debt recovery are designed to reduce costs to the company, with little consideration of customer need.

Consequently, they tend to comply with the letter rather than the spirit of the codes of practice or guidance that apply to them. Indeed, the arrears manager for a fuel company dismissed the Ofgem Guidance as '*completely irrelevant in the real world*' and said he found '*the regulatory corset to be constrictive rather than in any way helpful to the management of customers*'.

Account management

The aim of these creditors is to get as many of their customers onto direct debit as possible. Some, especially utility companies, use credit scoring and checks at credit reference agencies to determine the frequency and method of payment they will require as condition of accepting high risk customers. Where Codes of Practice or Guidance require them to make available options for frequent and cash payments they give these little publicity.

Disputes on accounts are often seen as ‘*a sham*’ and a way of avoiding payment. Consequently they will often press for payment.

Arrears management

These companies work from a premise that it is up to the customer to make contact if they are having financial difficulty and that many people claim to be in difficulty when they are not. Their views are summed up in the following two quotes.

Well, if you can afford to get into the agreement at the start then you convince us that your circumstances have changed and that means you can't afford it now... But unfortunately, there's too many people out there who try their damndest to pull the wool over our eyes and persuade us they haven't got anything, when they have. Bank 2

I've no objections to the vulnerable being protected, but I think it's too easy for people to pretend to be vulnerable and then to get away with being delinquent. I mean I guess my view is that being vulnerable is not an excuse for [your account] being delinquent. Utility company 2

Because of these attitudes, the early stages of arrears management tend to be rather mechanistic with considerable reliance on paper communication. Cost is given as the reason for not telephoning more customers at this early stage. Likewise cost also explains their reliance on general call centres for dealing with any contact initiated by customers. Even though they recognise the shortcomings of their approach.

Actually a lot of the damage that we do to ourselves is because we don't pick up on signals we get from the customer in the call centres and do the wrong thing. Utility company 2

Like companies adopting a holistic approach, some have developed behavioural scoring systems to determine the speed that customers go through the arrears management and debt recovery processes. In this case, though, the aim is to identify

those who are working the system and delaying payment until the last possible moment and to accelerate them through the process.

Because there is a heavy reliance on standard procedures, tweaked by computer-based scoring systems, there is little personal contact with most customers who fall into arrears. As a result, they know little about the circumstances of customers when they fall into arrears and they aim to get arrears repaid in the shortest period of time. Consequently they often set up payment plans without checking the customer's ability to pay. The customer's financial circumstances are only discussed if they (or their adviser) say that they need an extended period for repayment. Again they say that they have insufficient resources to do more, even though payment plans often break down.

They will only work with free money advice agencies with great reluctance and on the whole they see them as a hindrance rather than a help. Creditors commented on the time it takes to reach an agreed payment plan if this is negotiated by an advice agency. There was a recognition that people often pay the creditor who presses hardest for payment and that this is not always in the customer's best interest. Even so, this was the approach that they tended to adopt. These creditors were neither in a position to identify customers with mental health problems for themselves nor were they particularly understanding of clients from money advice agencies with enduring mental health problems.

Debt recovery

In contrast, creditors adopting a hard business approach have invested in the development of procedures for the later stages of arrears management and especially debt recovery. It is only quite late in the process that they attempt to distinguish between different categories of customer and to tailor their procedures accordingly. Again this is driven by cost considerations. A prime example of this is the use of 'litigation scoring' – that is, computer models to predict the likely outcome of court action – which for these creditors plays the same role as the personalised information collected by the creditors taking a holistic approach.

We're far better concentrating our resources on debtors where there is a prospect of recovery. If there's no prospect of recovery, what's the point?
Bank 2

For the most part, even these creditors try to avoid taking people on very low incomes (and especially those on Legal Aid) to court.

... generally speaking the starting point is: Is he a home owner? Does he have a job? And, if you know, he has both then we certainly pursue him. If he has one out of the two, we might stop and consider. If he's neither then there's a good chance that we won't pursue him. Bank 2

That said, they are far more likely to issue court summonses than creditors adopting a holistic approach. This is partly because of their deep scepticism about people claiming to be unable to pay and partly because they often lack any up-to-date information about the circumstances of the people who owe money to them. One arrears manager for a bank was issuing 800 claims a month, and said that they knew nothing about the circumstances of half of these people. Indeed he admitted that they referred to their legal recoveries section as '*the sausage machine*'.

One-size-fits-all approach

As its name suggests, this group of creditors has a standard approach to account management, arrears management and debt recovery. But it includes three rather different types of creditor.

First, there are the telephone companies, who have only had Oftel guidance on debt and disconnection since October 2002, and local authorities for whom Best Value Inspections were introduced in 2000. Creditors whose procedures fell short of the new guidance when it was introduced have yet to revise their one-size-fits-all approach. In time, they will gravitate towards either the holistic or the hard business approaches described above.

The second group consists of creditors for whom the relevant code of practice includes no detail on dealing with customers in financial difficulty – housing associations for example.

Indeed, a money adviser drew an unfavourable comparison between the arrears management and debt recovery practices of social landlords (including both local authorities and housing associations) and those of mortgage lenders. He attributed this to the lack of detailed guidance for social landlords along the lines of the Mortgage Code.

Finally, the third group comprises creditors who have not signed up to a code of practice at all or who are in breach of the relevant code of practice. This will include a minority of the sub-prime lenders and especially those offering secured loans. They differ from the previous two groups in that they have decided to adopt a harsh approach with anyone who falls into arrears, often with one eye on the equity in the customer's home.

Account and arrears management

All three groups of creditors have standard ways of billing and accepting payment and make no real attempt to provide payment methods that will contain the level of arrears.

Likewise, they have a one-size-fits-all approach to arrears management. This is generally based on a series of standard letters and notices, issued at set times. There is no attempt either at customer segmentation, so that all customers go through the procedure at the same pace. Neither do they try to contact customers by telephone to discover more about their financial circumstances when attempting to recover the money they are owed. They were the least able to identify and make appropriate arrangements for customers with mental health problems.

If payment plans are set up, it is at the instigation of the customer and the creditor makes little or no attempt to discover whether offers of payment are realistic. Relationships with money advisers vary. Some creditors see their intervention as helpful as it provides them with much needed information about customers' circumstances. Others are reluctant to co-operate at all.

Debt recovery

Debt recovery is generally seen as a natural continuation of arrears management. As a consequence of this approach, these creditors issue the highest level of summonses and many of the people they take to court are not in a position to pay the money they owe.

The representative of one local authority Council Tax department said that they generally wait for the court to carry out a full means enquiry. Even if someone offers a repayment plan, unless this is underpinned by a direct debit, they will go to court to get a liability order as ‘security’ because so many informal payment plans have failed in the past.

Another important consequence of the one-size-fits-all approach is the fact that both housing associations and local authority housing departments take large numbers of tenants to court even though their arrears have been caused by problems with Housing Benefit. In contrast to their counterparts who adopt a holistic approach, these landlords make no attempt to ensure that tenants in arrears are receiving all their benefit entitlement.

Changes in creditor approaches to arrears management and debt recovery

Interviews with creditors indicated that, in most cases, both arrears management and debt recovery had increased in sophistication in recent years. Many creditors had shifted away from the on-size-fits all approach and, as indicated above, those adopting a holistic approach were constantly refining their systems and procedures for arrears management.

Money advisers confirmed that commercial creditors are becoming more customer-focussed, making greater attempts to establish contact and set up payment plans and relying less on taking cases to court.

It's a more sympathetic approach... they are making it easier to identify within their own organisations, the ones who can't pay and the ones who won't pay... Fewer and fewer people are actually proceeding down the court option... They are far less threatening, far more customer-friendly, and telling people the options that are available to them. Money adviser

A recent survey of the changes in creditors' approaches to debt recovery resonates with this and indicates that, overall, there has been a shift towards the more holistic approach described above (Credit Management Research Centre, 2002).

The survey found that, over the late 1990s, there had been a shift towards greater customer care and away from a hostile approach to arrears management and debt recovery. A greater emphasis was placed on finding a solution to customers' debt problems as opposed to merely collecting the cash owed, with a trend towards creditors adopting a customer as opposed to an account profile. Creditors were offering a wider range of payment options as part of a strategy to minimise the risk of arrears. There had also been significant changes in the use of technology and computer-based scoring systems to guide both arrears management and debt recovery. Use of Champion Challenger approaches was also on the increase. Finally, there had been a reduction in the use of the courts – with an increase in debt surveillance, in-house debt collection and the sale of bad debt to independent debt recovery agencies (Credit Management Research Centre, 2002).

In other words, it would seem that there is a growing trend towards creditors adopting a holistic approach to arrears management and debt recovery – using the courts less and using them more selectively for cases where there is only a good chance of recovering the money owed.

Creditors' use and views of the courts

Many of the creditors interviewed said that the mere threat of court action is sufficient to prompt many customers to contact them for the first time and arrange a way of repaying the money owed.

The first letter we send for debt recovery has quite a big impact, because you're now saying to the customer, 'Look this is serious now, this is really serious and the consequence here is we're going to sue you'. And that tends to be quite a marker in getting people to respond. Bank 1

One mortgage lender, with a holistic approach, estimated that between 30 and 40 per cent of customers respond to the letter telling them they will be taken to court and a further 10 per cent do so when a hearing date is fixed.

Even so, all the creditors interviewed use the courts to recover money owed, although the two credit card companies rarely do so, preferring instead to use debt collection agencies. All but the local authority Council Tax department use the county courts; magistrates' courts are used by this department and also by one of utility companies to obtain warrants of entry.

Views of the court process

County court users complained of long waits for hearings and frequent adjournments although this varies considerably across the country – with London and other major cities being the worst. This is especially frustrating for the creditors who have adopted a holistic approach as it means that customers' arrears continue to rise needlessly.

The number of cases we get referred and adjourned, sometimes for what I consider to be frivolous reasons, is very frustrating. Certainly some of the inner London courts. You know the length of time we have to wait to get cases through there might be six months. And then to wait 6 months and then to get an adjournment is a bit frustrating. Especially when it happens three, four or five times... I mean it is eroding the equity in the property... The customer is less likely to come out... with any sort of cash in their hand... And that to me is crazy, because what happens is that we're back three, four or five times for the same situation. Nothing really changes. And at the end of the day it has just cost everybody a lot of money. It's also cost the courts far more cases than they need to have dealt with. Sub-prime mortgage lender 1

This mortgage lender could see little improvement, despite the changes introduced in recent years. The other mortgage lender that was interviewed, however, felt that things are beginning to improve.

It's early days, but there is some evidence that the courts and the district judges are more active in terms of having cases prepared in a way that will deliver quicker hearings and a more realistic outcome. There's some evidence of that happening. Mortgage lender 1

Many creditors also commented on the increasing costs of using the courts, saying that this is putting many off using the courts at all. This is confirmed by other recent research (Credit Management Research Centre, 2002).

Indeed, cost is one of the reasons why so many creditors have developed systems to determine which customers it is appropriate to take to court and, as importantly, those where there is little point because the chances of recovering the money owed are slight. Both the credit card companies interviewed have gone further still and use

debt collection agencies (both in-house and independent) in preference to the courts. Both felt that the average debt (around £1,500) is too small to justify the costs of taking court action.

Only a minority of the creditors interviewed commented on the recent changes to civil procedures, following the proposals made in Lord Woolf's report *Access to Justice*. Creditors are expected to take all reasonable steps to recover the money owed to them before they turn to the courts and to provide the courts with evidence that they have done so. Mortgage lenders¹, in particular, thought that these have led to a greater customer focus in the courts and have also stimulated creditors to adopt a more holistic approach to arrears management and debt recovery.

I think that the changes to the civil procedure rules that came about via Woolf have sort of tightened things up. Lenders have to be absolutely certain of their case, and the evidence being submitted, even to the extent now where, before signing off any documentation, an officer from the lender will have to sign a statement that all the information is correct. Indeed there's a criminal sanction attached to that if any of the information isn't seen as correct. That's definitely tightened things up. Sub-prime mortgage lender 1

As noted above, only two of the creditors interviewed used magistrates' courts: a utility company and a local authority Council Tax department. The local authority arrears manager, whose department issued very large numbers of summonses for non-payment of Council Tax, was quite critical of magistrates, saying that some were not even aware of the enforcement options available.

In fact we've had meetings where we've gone down and spoken to a group of magistrates just to sort of speak to them around recovery options we have. But sometimes they may be granting a liability order and they're not sure what exactly it means. So we do make the magistrates aware of the powers... the clerks are usually good and do advise. Local authority Council Tax department.

Enforcement

As other research has noted (Baldwin, 2003 forthcoming) obtaining a court judgement is, in many ways, the easy part. Enforcement, on the other hand, is a great deal more difficult.

¹ Housing cases are more likely to have a hearing, whereas most other cases will tend to go through as default hearings.

Most of the creditors who adopt a holistic approach hope to set up payment plans even after issuing a court summons. And to achieve this they spell out in detail the cost and other implications of enforcement in their communications with customers they take to court. Often this prompts people to make contact and agree a way of repaying the money they owe. If this can be done creditors do not usually seek to enforce the debt in other ways, although mortgage lenders will often seek a suspended possession order if a number of previous payment plans have been broken.

Where agreed payment cannot be reached creditors have several enforcement procedures open to them. All have recourse to warrants of execution (enforced by bailiffs), attachment of earnings (or social security payments), and charging orders. In addition, mortgage and other secured lenders and social landlords can apply for a possession order on properties where the loan repayments or rent is in arrears. And local authorities can apply to the magistrates' courts for committal summonses, if they have been unable to recover arrears on Council Tax.

In practice, warrants of execution are the most common form of enforcement, and are used in 85 per cent of cases enforced through the county court (Judicial Statistics: Annual Report 2001). The interviews with creditors, however, showed a growing disenchantment with warrants of execution and an increasing use of attachment of earnings, often backed up by charging orders. Although, as Table 3.2 shows only 77,876 attachment of earnings applications were issued in 2001, compared with 394,611 warrants of execution.

Table 3.2: Different forms of enforcement by debt

Warrants of execution against goods issued	394,611
Warrants of delivery of goods issued	7,799
Warrants of possession of land:	
Issued	133,500
Executed	65,699
Garnishee summonses issued	4,139
Charging order applications issued	22,098
Attachment of earnings	77,876

Source: Judicial Statistics, 2001

This was equally true of creditors who adopted a holistic and those taking a hard business approach to debt recovery. As noted above, both groups of creditors have implemented ways of identifying the circumstances of debtors to inform their choice of enforcement method. In both cases, their use of the courts has been informed by commercial considerations.

I would say that a lot of creditors are looking at court fees as being an investment not a cost. You know, there is a very different approach now... Many more of them have activity-based costs built into the system, so that they want to see an investment in cost delivering an income. If I've spent £100 on a court fee, I want to get it back. Bank 1

Warrants of execution

Warrants of execution enable creditors to recover the money owed through the use of bailiffs or a sheriff's officer. These officials have the right to seize goods belonging to the debtor and sell them to repay the money they owe, although in practice they rarely do so. More commonly, they offer a debtor a 'walking possession agreement', giving them more time to pay before specified goods are seized and sold.

Creditors have tended to be attracted to warrants of execution because they are much less complicated to administer than other measures and, unlike other methods of enforcement, do not rely on the creditor having details about the debtor's circumstances (Baldwin, 2003 forthcoming). Indeed, some commentators believe that they are used too frequently and in circumstances that make them inappropriate. In its Green Paper, the Government notes that it '*would like to see a system that encourages the use of the most appropriate method [of enforcement] rather than widespread use of distress [seizure of goods under a warrants of execution]*' (Lord Chancellors' Department 2001).

In fact, most of the creditors interviewed said that warrants of execution are no longer their first choice for enforcement. Experience has shown them that bailiffs are slow, expensive to use and not especially effective at recovering the money owed. In other words they are not a wise investment. Consequently many said that they had scaled back their use considerably in recent years.

What we tend to get is returns saying 'customer not willing to come to door'. Or 'I knocked on the door and there was no answer'. Or 'I knocked on the door and the person told me they weren't the plaintiff' Almost any excuse to

say 'well, I've tried and now I'll just bat it back'. Certainly the whole bailiff system is seen very negatively by users at the moment. Utility company 1 (who had recently conducted a major review of other company's debt recovery practices before revising their own).

I mean by the time you add it all up and take into account the costs associated with it, it wasn't – apart from any morals attached to it – this wasn't commercially a good idea. If we were aware that the customer had luxury goods [like a Porsche on the drive] we would step back and think about ... seizing those goods. But that would be a real exception. And nine times out of ten, 99 times out of a hundred, the situation doesn't exist. Bank 1

Only the local authority Council Tax department continued to apply for large numbers of warrants of execution – mainly because they usually know too little about debtors' circumstances to apply for an attachment of earnings or benefits.

Other recent research (Baldwin, 2003, forthcoming) confirms that creditors are becoming frustrated with warrants of execution.

Attachment of earnings

Attachment of earnings, where employers deduct payments of arrears to creditors at source from wages, has become the preferred method of enforcement for most creditors who continue to use the county court.

As noted above, commercial pressures, reinforced in some cases by the Civil Procedure Rules introduced in April 1999, have encouraged creditors to make greater efforts to ascertain the circumstances of debtors before they take them to court. Many now only initiate court proceedings for those who they know are in steady work and/or have equity in their homes – they do not summons out-of-work tenants. In such circumstances an attachment of earnings can ensure steady repayment of the money owed – especially when all previous attempts to set up payment plans have failed.

[Attachment of earnings orders] are the most productive...we should be suing people who have got [earned] income and if we get evidence of income this is the order we would use... if we don't get an instalment judgement then that's the sort of order we're aiming for. Bank 1

Only the local authority Council Tax department routinely sought attachments of benefits, where debt repayments are deducted at source from social security payments.

Creditors who spell out the implications of an attachment of earnings order in their communications with debtors often find that people respond with an offer of payment.

First of all many customers do not want their employer to know they're in debt. So that will prompt them to come back to us directly and set something up to avoid it. Utility company 1

Problems arise, however, where the creditor has been unable to make direct contact with the debtor and consequently knows little about their financial circumstances. In such circumstances, they can apply for 'an order to obtain information from judgement debtors' (formerly called an oral examination). Like creditors' own attempts to elicit information, these rely on the debtor's co-operation although ignoring them is a contempt of court. And, as in previous research (summarised in Baldwin, 2003 forthcoming), the creditors interviewed did not report much success with these orders.

...we find it extremely slow and quite expensive. The observation appears to be that the debtor gets away with ignoring the court for quite a long time until the judge gets upset and says 'enough's enough', most debtors will say 'I'll just ignore this paperwork and see what happens'. And I guess that's one of the reasons it's so slow. Utility company 1

In fact, it has been reported that three-quarters of defendants fail to attend these hearings, even though that puts them in contempt of court (Lord Chancellor's Department, 2000).

One creditor felt that the situation in Scotland was preferable, where sheriff's officers help to obtain information to inform the enforcement process.

[the Scottish system] is good for getting information. In Scotland, after the judgement, you have to serve what's called a charge, where the sheriff's officer formally calls on the debtor and tells them that a judgement has been granted, but the sheriff's officer, as part of that service, will also gather any enforcement information and recommendation. Bank 1

Charging orders

Charging orders, where a charge (effectively a mortgage) is placed against property owned by the debtor, make provision for the money owed to creditors to be repaid when the property is sold. As such it is a fairly long-term strategy and one that

creditors tend to use in conjunction with an attachment of earnings order to give them added security.

Charging orders do, however, have the further advantage for creditors of encouraging debtors to reach an agreement to repay the money they owe, as they are concerned about their credit rating.

Debt Collection Agencies

There is a growing trend among creditors to use debt collection agencies. Since the late 1990s many companies have set up their own in-house debt collection agencies that operate under a different name to give customers the impression that they are independent. They only pass to outside agencies cases where their own in-house team has failed (Credit Management Research Centre, 2003). This was reflected among the creditors we interviewed.

The two credit card companies interviewed routinely use debt collection agencies, in preference to the courts, in all but exceptional cases involving customers with very large balances, who are clearly working the system.

Among other creditors, debt collection agencies (both in-house and external) are frequently used in cases where the debtor is known, from credit reference agency checks, to have previous County Court Judgements.

Like letters regarding court action, the two credit card companies have found that letters telling customers that their account is being passed to a debt collection agency, and the impact this will have on their credit rating, prompt many people to make contact for the first time. One of the card companies that has a holistic approach estimated that around half of the people receiving these letters make contact and agree a way of repaying the money they owe.

Creditors' abilities to distinguish can't from won't pay

From the map of can't pay won't pay (Table 3.3) we can see that creditors using a holistic approach will make the most appropriate use of the courts to recover the money owed to them.


Through customer segmentation, personal contact and their desire to understand the circumstances of people owing money to them, they are able to identify people who can't pay and set up realistic payment plans. They are also able to weed out people who are in dispute over the money owed or who are disorganised.

Although they may occasionally slip up, they primarily take court action for debt recovery against won't pay debtors who have sufficient money to pay (column1). They use 'debt surveillance' for the 'won't but can't pays' (columns 2 and 3) only taking further action when their circumstances have improved.

Creditors adopting a hard business approach aspire to achieve the same outcomes but frequently fail to achieve these aspirations. Consequently, they tend to take more people to court as they are less able to weed out people in dispute, who are disorganised or who are can't pays.

Table 3.3: A map of can't pay won't pay

	Has money to pay	Had money to pay when fell into arrears, not now	Did not have money to pay when fell into arrears
No intention to pay			
Withholding on principle	Won't	Won't/but can't	Won't/but can't
Withholding – dispute	--	--	--
Withholding – ex-partners	Won't	Won't/but can't	Won't/but can't
Working the system	Won't	Won't/but can't	Won't/but can't
Ducking responsibility	Won't	Won't/but can't	
<i>Intend to pay</i>			
Disorganised	--	--	--
Change in circumstances			Can't
Long-term low income			Can't
Mental health problems	Can't	Can't	Can't

Key  = should not be considered either can't or won't pay

It is, however, the one-size-fits-all creditors who are the heaviest users of the courts and who will be taking action against all categories of defaulters regardless of either their ability or commitment to pay.

4. SUMMARY AND CONCLUSIONS

In Chapter 2 we developed a typology of can't pay won't pay, drawing together people's ability to repay their creditors and their intention of doing so (see Table 2.3). This showed that there is a large group of people who fall into arrears, solely through an inability to repay what they owe. In other words they would be considered as *'can't pays'*. They include people who have had a change in their circumstances leaving them with commitments they are no longer able to afford to pay. They also include people who have lived long-term on a low income who have faced some disruption to their finances, such as unexpected expenses or a disruption to their benefit payments. The third group of can't pays are people with enduring mental health problems that impede their ability to manage their finances.

Then there are two further groups of people who may well have the money to pay but are not appropriately considered as either can't or won't pay. First there are people who have a genuine dispute with their creditor and are withholding payment until the dispute is resolved. Such people are normally in arrears with only one commitment. Secondly, there are those who fall into arrears simply because they are disorganised about managing their finances. They have every intention of paying but their payments tend to be erratic and they frequently fall into arrears. Both groups will include people who are able to pay the money owed as well as those who are not.

In addition to these people, there is a third set of circumstances that should be considered neither won't nor can't pay. These are where tenants are taken to court for rent arrears that have been caused by administrative failure in the payment of Housing Benefit by the local authority direct to their landlord. Indeed, there is clear evidence that some landlords are taking tenants to court as a way of ensuring that the local authority reinstates Housing Benefit payments.

That leaves four remaining groups of people who have little or no intention of paying their creditors on time. In each group, some have sufficient money to pay, the *'won't pays'*; others do not and these we have called *'won't but can't pays'*.

The four groups include people who are withholding money on principle. This is most common for Council Tax and water, where a minority of people take a principled stand against paying at all. But withholding payment can occur for any bill where a small minority of customers consider that they receive poor service or poor value for money from their creditor. Multiple debt is unusual among these people.

Secondly, they include ex-partners, who retain responsibility for paying some or all the bills in the former family home but withhold payment. Here multiple debt can be quite common.

Thirdly, there are people who deliberately work the system and routinely wait until the latest possible moment before paying. Some will attempt to avoid payment altogether if they can. These are the people with long histories of arrears and County Court Judgements on a variety of commitments.

Fourthly, there is a growing group of people who have borrowed large sums of money in consumer credit - often owing many tens of thousands of pounds on credit cards and other unsecured credit. Having done so, they then blame their creditors for lending recklessly and feel no obligation to keep up-to-date with the repayments. We have described these people as ducking responsibility.

Chapter 3 concentrated on the approaches taken by creditors to arrears management and enforcement and their ability to identify types of debtor. This showed that creditors tend to adopt one of three approaches: a holistic approach; a hard business approach and a one-size-fits-all approach.

Creditors adopting a holistic approach have invested heavily in systems and staff so that they can discover both the circumstances of the people who have fallen into arrears and their underlying reasons for not having paid. They then tailor their approaches to arrears management and debt recovery accordingly. In doing so, they work closely with independent money advisers and exceed any provisions on dealing with customers in financial difficulty that are in the code of practice for their industry. Their over-riding aim is to maintain the relationship with their customers wherever possible and only take to court those they believe have the ability to pay but are

deliberately avoiding doing so. They are, therefore, in the best position to identify can't from won't pays.

In contrast, the main concern of creditors taking a hard business approach to arrears management is to ensure that any money they are owed is recovered at minimum cost. They are not pro-active in trying to discover the circumstance of the people owing money to them. Instead they believe that if they customers fail to make contact then they should all be treated as won't pays. So the systems they have developed are designed to reduce costs to the company, and avoid taking costly action to recover arrears where there is little chance of success. These companies usually work to the letter rather than the spirit of their industry code of practice on financial difficulties. They also frequently see independent money advisers as a hindrance rather than a help. As a consequence they are usually less successful at distinguishing can't from won't pays than creditors who adopt a holistic approach.

Finally, there is a group of creditors who have a one-size-fits-all approach, with standard procedures for arrears management and debt recovery that are applied to all customers, regardless of their circumstances or reasons for arrears. So they have standard letters that are issued at set intervals with debt recovery being seen as a natural continuation of arrears management. These creditors have no systems in place to distinguish can't from won't pays and often rely on the courts to help them uncover the circumstances of the people who owe money to them.

The holistic and hard business approach creditors are drawn from all types of creditor. This includes financial service providers, utility companies, local authorities and housing associations; priority and non-priority creditors; and creditors in both the prime and sub-prime credit markets. Those adopting a one-size-fits-all approach, on the other hand, tend to be drawn from a more limited range of creditors. They include:

- some telephone companies, who were interviewed before the Oftel guidance on debt and disconnection was published in October 2002.
- some local authorities who have yet to revise their approach following a Best Value Inspection
- some housing associations, whose code of practice does not include detailed

guidance on dealing with tenants in financial difficulty

- some sub-prime lenders, especially those offering secured loans, who are in breach of their industry code of practice or have not signed up to one at all. They differ from other creditors taking a one-size-fits-all approach in that they deliberately take a harsh stance on arrears, having lent purely against the equity in the home.

This analysis of debtors and creditors raises a number of important questions relating to use of the courts by creditors seeking to recover money owed to them:

- Which debtors is it inappropriate for creditors to take to court?
- Whose responsibility is it to determine the circumstances of debtors and ensure that inappropriate cases do not reach the courts?
- Which methods of debt enforcement are the most efficient ways of recovering the money owed to creditors and have the biggest deterrent effect on debtors?
- How might court procedures be improved?

Each of these questions is addressed in turn in this concluding chapter.

Which debtors is it appropriate for creditors to take to court?

Debtors that it is clearly appropriate for creditors to take to court are those who have the money to pay what they owe but are withholding payment on principle, working the system or ducking responsibility for their debts.

There are equally clear categories of people against whom it is quite *inappropriate* for creditors to initiate court proceedings for enforcement. Most obviously, they would include people we have called the can't pays; people who are not in a position to repay the money they owe and have fallen into arrears through no fault of their own. They will include people who have experienced a drop in income; those on low-incomes that have become disrupted; and people with enduring mental health problems that impair their ability to manage their finances.

It is also inappropriate for creditors to take to court people who have a genuine unresolved dispute over payments or bills (those who dispute payments as part of a regular game of playing the system are another matter). Similarly, people who are

disorganised about paying bills should not be taken to court but encouraged onto direct debits or standing orders.

Finally, it is indefensible for landlords to initiate court proceedings against tenants as a way of resolving disputes over Housing Benefit that should be being paid direct to them by the local authority. Indeed, some would go further and argue that tenants should not be taken to court while there is any unresolved disruption to Housing Benefit payments.

That leaves the grey area of people who we have called 'won't but can't pay'. That is people who are withholding payment, playing the system or ducking responsibility for their credit commitments, but do not have the money to pay. Many creditors (including those with a holistic approach to arrears management and those adopting a hard business approach) would argue that court action is pointless while someone lacks the money to pay. But they will pursue the debt when the customers' circumstances improve.

Whose responsibility is it to determine the circumstances of debtors and ensure that inappropriate cases don't reach the courts?

Responsibility for ensuring that inappropriate cases do not come to court must rest with the creditor. In doing so, it is important to acknowledge that the customer has a responsibility to pay the money owed where they have the means to do so and also that independent money advisers can play an important role.

To be fair, many creditors who adopt a holistic approach to arrears management and debt recovery acknowledge this responsibility and have put staff, systems and procedures in place that enable them to tailor their actions to the circumstances and payment intentions of the people who money to them.

The question then becomes how to encourage other creditors to do the same.

Industry guidance and codes of practice

Industry guidance and codes of practice have an important part to play. As we noted in Chapter 3, although the great majority of creditors are signatories to such guidance or codes of practice, the quality of the coverage and compliance is highly variable.

Information collected for this study would suggest that guidance and codes of practice are most effective where they set out the broad principles for dealing with customers in financial difficulty, accompanied by more detailed guidance about how they should be implemented in practice. This makes it more difficult for creditors to abide by the letter rather than the spirit of the documents. Moreover, it is clear that independent money advisers can make a valuable contribution to the drafting of the detailed guidance.

Such documents, however, have greatest impact where they are subject to independent monitoring - as with the Banking and Mortgage Codes and the Ofwat.

Debt Recovery Guidelines.

We would, therefore, propose that all types of creditor ought to be covered by principle-based codes of practice, supplemented by detailed guidance on implementation. The content of the codes and guidance should reflect best practice as illustrated by the holistic approach to arrears management described in this report. Compliance with these codes should be monitored by independent bodies. The recent decision by the Office of Fair Trading to establish a framework for the evaluation and accreditation of industry codes of practice is a welcome move in this direction. The Department of Trade and Industry should give also detailed consideration to the adequacy of existing codes of practice, as part of its review of the Consumer Credit Act. The findings and implications of this research should be drawn to their attention.

At the same time the Office of the Deputy Prime Minister and Housing Corporation should consider the implications of the research findings for housing associations and local authorities. The Housing Corporation Regulatory Code and accompanying Guidance has little coverage of dealing with tenants in financial difficulty. Nor does it deal adequately with handling cases where Housing Benefit has not been paid by the local authority. The situation with regard to local authorities is somewhat different.

Here there is no published code of practice, although local authority housing and Council Tax department arrears management and debt recovery practices *are* subject to independent review by the Best Value Inspections. It is clear from the reports of these inspections that current practices are highly variable. There is a case to be made for local authorities to have a code of practice and guidance on its implementation, in the same way as creditors in the commercial sector. This should, however, be a codification of the existing criteria used in Best Value Inspections.

Finally, creditors who decide to use the courts to enforce payment of debts should be required to state in pre-action protocols that they have complied with their industry code of practice and guidance in the handling of the case.

The role of money advisers

Many creditors and debtors would argue that independent money advisers have an important part to play in helping to identify people who are unable to pay. This view would be endorsed by many courts.

Money advisers can help to unravel complex cases of multiple debt and also to identify people facing mental health problems. Yet the level of provision of money advice across the country is far from adequate. In Scotland, the introduction of the Debt Arrangement and Attachment Act will lead to a considerable expansion in provision, by creating a greater role for money advisers. Under the Act, if a debtor negotiates repayment plans with their creditors with the help of an accredited money adviser, all further debt enforcement will be suspended while the payment plan is maintained. This has been fairly controversial, with some independent money advisers fearing that they may compromise their independence if they become accredited to act in this way. It would seem appropriate to wait and see the outcome of the new provisions in Scotland before any consideration is given to the introduction of something similar in England and Wales.

In Ireland there has been a rather different development. Here the government-funded Money Advice and Budgeting Service has set up a pilot voluntary agreement with the Irish Bankers Federation. This recommends that banks should work with money advice agencies to find ways of recovering the money owed to them, as an alternative

to using the courts. The pilot ran for six months from the beginning of May 2002 and the outcome is yet to be reported. If it proves to have been successful, it may be appropriate to promote something similar in England and Wales. Again this may best be incorporated into existing codes of practice.

The role of the courts

The courts can have an important part to play when creditors have failed, despite many attempts, to ascertain the circumstances of a debtor. Where creditors are unable to gain the co-operation of a debtor they can apply to the court for an Order to Obtain Information from Judgement Debtors (formerly known as Oral Examinations). On the whole, creditors did not report much success with these orders. Indeed it has been reported that three-quarters of defendants fail to attend these hearings even though it puts them into contempt of court (Lord Chancellor's Department, 2000). This will require further investigation as, unfortunately, neither the interviews with debtors nor those with creditors shed any light on why people do not attend.

Some creditors commented positively on the role played by sheriff's officers in Scotland, who call on debtors to tell them that judgement has been granted against them and, at the same time, gather any information that could help to inform the choice of method of enforcement. Creditors felt that similar provision might be considered for the bailiff service in England and Wales.

The Green Paper, *Towards Effective Enforcement*, proposes a new court-based method to enable effective enforcement - a Data Disclosure Order, which should assist creditors with recalcitrant debtors. This Order will seek information on judgement debtors who have failed to respond to the judgement or to comply with court-based methods of enforcement. Information will be sought from third parties to enable the creditor to make an informed choice about the means of enforcing a judgement. Information about the debtor will be sought, without their consent, from both private and public bodies who will have a legal obligation to disclose the information required.

Which methods of debt enforcement are the most efficient ways of recovering the money owed to creditors and have the biggest deterrent effect on debtors?

Although warrants of execution (enforced by bailiffs) are the most widely used form of enforcement by far, many creditors seemed dissatisfied with their effectiveness. As a consequence creditors with either a holistic or a hard business approach to arrears management and debt recovery are switching to applying for attachment of earnings orders instead.

This move away from warrants of execution is reflected in official statistics, which show an annual fall of 16 per cent to 394,611 in 2001 (Judicial Statistics 2001). In contrast, the number of attachment of earnings orders made for the repayment of debts rose by just over 18 per cent to 42,011. Both these figures need to be seen alongside a general fall in the number of enforcement applications made by creditors to the courts.

Data collected by the credit reference agencies, however, show that the level of consumer credit default has remained about constant. As a consequence, the shifts in use of the courts almost certainly reflect changes in the way some creditors are approaching debt enforcement. They are clearly consistent with the shift away from a one-size-fits-all approach and especially with the growing use of a holistic approach by many creditors. Such creditors take far fewer cases to court and, if they do so, almost invariably apply for attachment of earnings orders in preference to warrants of execution.

The Lord Chancellor's Department is proposing several improvements to attachment of earning orders. These include the introduction of a means of tracking debtors who do not inform either the court or their creditor when they change employer and the use of fixed deduction rates (similar to those used for Council Tax) to reduce the time to process the order.

Official statistics show that only 4,139 garnishee summonses were issued in 2001 and none of the creditors we interviewed said that they used them or volunteered any views on their effectiveness. Garnishee orders freeze the assets in a debtor's bank account and make provision for creditors to be paid directly from the account.

Debtors do have a right to attend court and apply for a hardship order if the freezing of their account would cause financial difficulties. However, as garnishee orders are normally preceded by an Oral Examination hearing it may be this that deters creditors who, as noted above, report only limited success with these hearings.

Debt collection agencies

We noted in Chapter 3 that some creditors have taken a decision to pursue the money owed through debt collection agencies rather than by means of the court. This raises the question of how to ensure that these companies work to standards that are equivalent to those required of creditors. Indeed, in November 2002, the Office of Fair Trading issued a press release noting that debt collection attracts the second largest number of consumer credit licensing complaints after the motor trade. This press release was issued at the same time as new draft *Debt collection guidance for consumer credit licence holders and applicants*, which is open for consultation until 21 February 2003. Based on consumer complaint information and evidence submitted by consumer bodies, this guidance aims to set out the type of behaviour that is likely to lead to action being taken by the OFT to refuse or remove a licence. It will also enable the OFT to take speedier action against those engaging in unfair practices.

In addition to OFT guidance, some industry codes of practice (for example the Banking Code) apply equally to third parties acting on behalf of creditors that are code subscribers. All codes should have this provision and this is a further point for the Department of Trade and Industry and the Office of Fair Trading to bear in mind.

Some creditors, however, sell on bad debts to debt collection agencies and in these circumstances agencies would presumably not be obliged to work to the creditor's code of practice. There is, however, a code of practice issued by the Credit Services Association (the trade association for debt collection agencies). The provisions of this code will need to be reviewed alongside creditor codes and also in the light of the OFT guidance once it is finalised.

Which enforcement methods have the greatest deterrent effect on debtors?

It was clear that for most recalcitrant payers who reach the late stages of the arrears management process a letter threatening either court action or transfer of the debt to a debt recovery agency is enough to encourage them to pay the money they owe.

However, for the hardened won't pays - those withholding payment on principle, playing the system or ducking responsibility - neither the threat of this action nor actually carrying it out has much effect. In such cases, the best creditors can hope for is to recover the money owed in the most cost-effective way possible.

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APPENDIX 1

FEASIBILITY OF FURTHER QUANTITATIVE RESEARCH

One of the key aims of the study was to assess the feasibility of carrying out further quantitative work on the numbers of can't pay and won't pay debtors within the processes for debt recovery.

Overall, experience on the feasibility study has led us to the conclusion that this would be a difficult task to undertake. It would require an interview survey as court records contain insufficient information required to distinguish between debtors who can't pay and those who won't pay. The sample would need to be selected from court records as only a minority of creditors would be willing to participate. But it is clear that it will be difficult to achieve an acceptable response rate. And while it is possible to identify approaches to payment using a qualitative approach, this will be more difficult in a structured interview. Each of these points is discussed in greater detail below.

Analysis of court records or an interview survey?

It is clear that the information needed to distinguish can't pay from won't pay debtors is largely either attitudinal or it relates to approaches to bill-payment and this information is not available from court records. Further quantitative work would, therefore, almost certainly require an interview survey.

Sampling for an interview survey

There are two possibilities for identifying a sample of people for interview: creditor records and court records.

On the whole, creditors proved reluctant to participate with third party research. Of the eight creditors approached only two agreed to assist. Even with these two creditors the process of negotiating the sample of clients was protracted.

In the past, creditors have been far more willing to assist with research, but the new Data Protection legislation has eroded this willingness. While recent customers are generally asked to sign to accept terms and conditions that permit their personal details to be used for third party research purposes, more longstanding customers may not. As a consequence many creditors fear that they will be in breach of the legislation.

Consequently, it would be preferable to use court records for sampling purposes. This would also have the added advantage that the sample would be more clustered and could, therefore be interviewed face-to-face. About a third of the people in the sample for the feasibility study had telephones that had been disconnected.

Response rate and sample bias

Achieving an acceptable response rate will be the major stumbling block for an interview survey. This will lead to a bias in the sample; will lengthen the time needed for interviewing; and increase the costs appreciably.

Fieldwork undertaken for the feasibility study has shown that, among people in the late stages of debt recovery, there is a very high incidence of people who have moved from the last address known to the creditor (40 per cent) and also a very high level of non-contact after six or more calls (20 per cent). This last group will include people who are deliberately avoiding contact with anyone other than their immediate circle of friends, people who may have moved, as well as the more usual group of very busy people.

Previous research has found similar difficulties. Response rates decline across the stages in the debt recovery process and are generally in the region of 25-40 per cent among people who are facing court proceedings or who have had their debt passed to a debt collector. Typically half or more of the people selected for interview have either moved or they cannot be contacted (Herbert and Kempson, 1995; Rowlingson and Kempson 1993; Baldwin, 2003 forthcoming).

Moreover, there is a real possibility that debtors who won't pay will be under-represented among the people who are interviewed, as the proportion of people who have moved or cannot be contacted is higher for creditors that with arrears management procedures designed to avoid taking people who can't pay to court. The data resulting from the survey would, therefore, be of dubious quality. Indeed, recent research carried out with county court and High Court defendants found that those who were interviewed greatly under-represented those who had proved uncooperative with courts and creditors and had been reluctant to pay (Baldwin, 2003 forthcoming).

Finally, it should be noted that even the successful interviews were only achieved after many attempts to make contact. There was also a high level of broken appointments.

Taken together with the high level of unsuccessful interviews, this would mean that the time to complete the interviews will be much longer than the average for surveys of this kind and the fieldwork company would charge a premium for the interviewing, making it very expensive.

Questionnaire

While not impossible, designing a structured questionnaire will not be easy. It takes time to gain the trust and confidence of people who are often being harried by a range of creditors. Some people are clearly reluctant to discuss details of their arrears. It can be difficult to identify when arrears begin and to link these to life events. Finally, attitudes to bill-payment and approaches to money management can change over time. While all these difficulties can be tackled in a depth interview, they will be far more difficult to handle in a structured one.

Most respondents needed time to feel comfortable answering sensitive questions. This will have implications for the structure of the questionnaire. Importantly, it will lengthen the interview, which will need to start with a series of innocuous questions designed to build trust. Although we were working from a semi-structured questionnaire, interviews typically took between one and a half and two hours to complete.

Some people were clearly reluctant to divulge all the information we were seeking – or changed their story during the course of the interview. These included some people who were reluctant to admit the seriousness of their situation even to themselves. But they also included people who were being evasive. It will be difficult to capture robust data for both these groups in a structured survey, although it may be possible, using Computer Assisted Personal Interviewing, to identify and probe inconsistencies in replies.

Many of the people we have interviewed found it difficult to give us accurate timings for their arrears. There were a number of reasons for this:

- some people had got into a cycle of missed payments on a number of bills;
- some were so disorganised that they had no idea whether or when they had paid a bill;
- some people were experiencing high levels of stress and anxiety which made it difficult for them to think clearly;
- while others worked the system and had no reason to remember when they had fallen into arrears.

Previous surveys have tended to rely on respondents' own accounts of the reason why they had fallen into arrears, backed up by specific questions on changes in circumstance. Some of the people interviewed attributed their arrears to a change in circumstance, which had, in fact, occurred either after they had fallen into arrears or a very long time before the difficulties. Earlier quantitative research into mortgage arrears has used life histories to locate arrears in relation to major life events (Ford, Kempson and Wilson, 1995). Analysis of the data can then determine whether arrears followed or preceded a life event. Even so it is difficult to collect reliable information in this way.

In some cases it seemed as if people were presenting themselves in the best possible light. Few of the people delaying or withholding payment said this was the reason for their arrears. And while some did say that they were over-committed, this was frequently only one of several explanations.

Finally, it was clear that some people had changed both their attitudes to money management and bill-payment and also the ways in which they managed their money. This was especially marked among those who had fallen into arrears through being disorganised. The experience of falling into arrears had made them confront their lack of organisation. So, at the time of the interview they appeared to be highly organised people who believed in paying promptly and were repaying their arrears. As a consequence, it will be difficult to identify this factor in a structured questionnaire.

In conclusion

Although designed to test the feasibility of a quantitative study, the depth interviews with people at the late stages of debt recovery provided valuable information in their own right. In particular, they have provided very detailed insights into the motivations and actions of debtors with little or no intention of paying the money they owe.

They, and earlier research, have shown, however, that it will be very difficult to undertake reliable quantitative research on the numbers of can't pay and won't pay debtors within the processes for debt recovery.

INDUSTRY CODES OF PRACTICE AND GUIDANCE

The Banking Code

History

Banking Code introduced in 1991. Most recent edition published in 2001 and new edition due in February 2003. The most recent review of the Code was carried out by an independent reviewer – in line with the recommendation made by the Julius Committee to HM Treasury.

It covers the great majority of banks and building societies.

The current Code

Like the Mortgage Code and FLA Consumer Code of Practice, the British Bankers Association Banking Code includes a commitment to consider cases of financial difficulty sympathetically and positively.

It also gives details of CABx, money advice centres, National Debtline and CCCS. *Guidance to subscribers* is published to advise Code subscribers on how they should comply with the spirit of the Code.

Following extensive discussions with money advisers, more detailed guidance on assisting customers in financial difficulty was issued in April 2002. This sets out that it is good practice for subscribers to:

- Have procedures in place to help customers who may be in financial difficulty
- Provide straightforward information in plain English on their procedures and systems for dealing with customers in difficulty
- Develop a repayment plan with the customer which gives them sufficient money for reasonable day-to-day expenses
- Consider a full range of options for dealing with the customer's situation
- Work with the customer's nominated money adviser

A leaflet has been produced for consumers in financial difficulty explaining the help they should be able to expect from banks and building societies.

Monitoring and compliance

Each bank and building society has a 'Code Compliance Officer'. The Code is monitored by the independent Banking Code Standards Board.

There is also a Banking Ombudsman.

Availability of Code and Guidance

www.bba.org.uk

The Mortgage Code

History

In December 1991, after detailed discussions with the Government, the Council of Mortgage Lenders re-affirmed that it is the policy of lenders to take possession only as a last resort.

Second edition of Mortgage Code produced in April 1998, which has a section on financial difficulties. There is also a more detailed Statement of Practice on Arrears and Possession, prepared in January 1997. Over 98% of mortgage lenders have signed the Code.

Mortgage regulation is, however, being taken over by the Financial Services Authority and the Code will be replaced by a set of FSA rules. The draft rules draw on the existing Code.

The current Code

Like the BBA Banking Code and FLA Consumer Code of Practice, the Mortgage Code includes commitments to:

- Consider cases of financial difficulty sympathetically and positively;
- Set up repayment plans that are consistent with the needs of both borrower and lender, and
- Seek possession only as a last resort when attempts to reach alternative arrangements have failed.

It also gives details of CABx, money advice centres, National Debtline and CCCS.

The Statement of Practice on Arrears and Possession gives further guidance on handling arrears, alleviating arrears problems through forbearance, levying charges on accounts in arrears, obtaining possession, the sale of properties taken into possession and recovery procedures in the event of their being a shortfall following possession.

Monitoring and compliance

Each mortgage lender has a 'Code Compliance Officer'. The Code is monitored by the independent Mortgage Code Compliance Board.

There is also a Mortgage Ombudsman.

Availability of Code and of Practice on Arrears and Possession

www.cml.org.uk

Finance and Leasing Association Consumer Code of Practice

History

New Code introduced in 2002.

2002 Consumer Code of Practice

Modelled on the Banking Code, the Consumer Code of Practice gives a commitment to consider cases of financial difficulty 'sympathetically and positively'.

It also:

- Tells consumers to make contact as soon as possible;
- Gives details of CABx money advice centres, CCCS and National Debtline; and
- Says will pass information to credit reference agencies and the likely impact of this.

Monitoring and enforcement

No independent monitoring. But have introduced a CEO compliance letter in 2002 members are required to confirm in writing that comply with individual sections of the Code. Have a Code Monitoring Group (a group of independent people as well as FLA members) who meet quarterly to review the submission, review the number and nature of complaints and recommend changes to the Code or where further guidance is required.

There is a Code complaints line.

Availability of Code

www.fla.org.uk

Consumer Credit Association Code of Practice

The code of practice was originally launched in 1984. After being updated and approved by the Director General of Fair Trading, the code was relaunched at the House of Lords in 1989. It was also launched in the Republic of Ireland in 1990 with the support of the Trade and Commerce Minister.

The Consumer Credit Association represents the majority of businesses in the home credit industry and has over 550 member businesses.

The current Code

The Code includes commitments to:

- Encourage consumers to inform members of financial difficulties at the earliest possible moment and to be sympathetic in approach;
- Provide a named contact of a trained member of staff on all correspondence;
- Take into account all information supplied by the consumer before determining whether to enforce an agreement;
- Inform the consumer of debt advice agencies if they have disclosed a debt problem; and
- Not putting unreasonable pressure on the consumer.

Monitoring and Compliance

When a company seeks to become a member of the CCA there is a process of induction and training. This has several stages and requires that the applicant company satisfy the Association as to its conduct and competence before membership is confirmed. The Association also provides compliance training for members and their employees.

Through the medium of the credit documentation supplied by the Association to member companies, consumers are advised of the Code of Practice and to whom they can address any enquiries.

Availability of the CCA Code of Practice

Consumer Credit Association, Queens House, Queens Road, Chester, Cheshire, CH1 3BQ. Telephone:01244 312044

Gas and Electricity Codes of Practice

History

Under standard licence conditions, all electricity and gas companies are required to prepare a code of practice for domestic customers on paying bills, including guidance for customers who may have difficulty in paying their bills. These codes must be submitted to Ofgem for approval.

In 2001, Ofgem published Guidance on the coverage of these codes. This guidance was modelled on previous code of practice guidance issued to public electricity suppliers and enhanced guidance published under the Ofgem Social Action Plan published in May 2000.

In September 2002 a set of draft guidelines on preventing debt and disconnection was published by energywatch and Ofgem. These were developed by an advisory group of representatives of Ofgem, energywatch, fuel suppliers, consumer groups and the DTI. The consultation period on these draft guidelines closed in November 2002.

Current Codes of Practice and Ofgem Guidance

The 2001 Guidance from Ofgem sets out that company Codes of Practice must cover:

- The arrangements for ensuring that a variety of payment methods are available;
- The arrangements for identifying customers in difficulty and distinguishing them from others in default; and
- The procedures for dealing with customers having difficulty paying and the options available for them to avoid disconnection of supply.

Monitoring and compliance

Company Codes of practice must be submitted to Ofgem for approval. Standard licence condition 26 deals with monitoring and reporting arrangements. Companies are required to monitor performance against their Code, to keep statistical records of their performance, to report to Ofgem and energywatch, and to publish a report on performance annually. Ultimately a company's failure to comply with their Code is a matter for legal enforcement by the regulator.

Availability of the Guidance

www.ofgem.gov.uk

Guidance for Providers of Publicly Available Telecoms Services on the Content and Scope of a Company Code of practice to Help Customers to manage their Bills and avoid Disconnection

History

New guidance on debt and disconnection for telephone companies was published by Oftel in October 2002. This was produced by a Disconnections Steering Group, which included representatives of Oftel, telecoms companies and consumer groups. This was set up following a request in the Communications White Paper for the industry to take a degree of collective responsibility for payment of bills and disconnection levels.

The Guidance is primarily directed at companies offering direct access to fixed-line telephony services.

The current Guidance

The new Guidance recommends that all telephone companies should produce codes of practice to help consumers manage their bills and avoid disconnection. These Codes will tell customers:

- The procedures that the company has to help disabled people;
- What action will be taken if bills are not paid;
- That if they are willing to discuss their payment difficulties they can often be helped;
- That they are not obliged to pay a bill while proper dispute procedures are being followed; and
- Which agencies can offer advice to customers in financial difficulty.

The Guidance also covers good practice with regard to:

- Minimising debt and credit risk eg through credit checking and security deposits;
- Bill-payment methods;
- Procedures for handling non-payment of bills;
- Supporting customers who are in debt; and
- Disconnection procedures.

Monitoring and compliance

The regulator will assess whether company Codes conform with the Guidance and will monitor companies' observance of their Codes.

When it is established, the Telecommunications Ombudsman Scheme will be made aware of the Guidance and of the Codes of individual companies.

Availability of the Guidance

www.oftel.gov.uk

Ofwat Debt Recovery Guidelines

History

Guidance for dealing with domestic customers in debt was first issued to the Water Companies in England and Wales in April 1992. The aim of these was to minimise both the need to use the courts for debt recovery and to disconnect customers for non-payment. The Water Industry Act 1999 made it illegal for water companies to disconnect domestic water supply for non-payment and, as a consequence companies needed to revise their debt collection procedures. Following a period of consultation and review, Ofwat issued new Guidance in October 2002. These guidelines take into account the fact that companies are now much more likely to use debt collection agencies and court procedures such as garnishee orders and charges on property for the collection of debt. They also reflect the wider range of methods that companies now use in attempting to make contact with customers.

The 2002 Guidelines

The new Guidelines set out 5 broad principles:

- Companies should be pro-active in attempting to contact customers who fall into debt before proceeding to court action;
- Companies should provide a reasonable range of payment frequencies and methods for all customers that are well publicised;
- Letters or notices sent to customers should be written in a non-threatening style and set out the action the company will take if they do not pay or make contact;
- Companies will take into account the customer's ability to repay when agreeing payment arrangements; and
- Customers whose accounts are managed by debt recovery agents should receive a similar level of service and care to those whose accounts remain with the company.

The Guidelines also provide fairly detailed guidance on what is expected of companies in complying with these principles.

Monitoring and enforcement

Companies' policies and practices with regard to customers in debt are audited by WaterVoice (customer service) committees, who report to Ofwat. They visit companies and examine the records of customers in arrears.

Availability of Guidance

www.ofwat.gov.uk

DCA Research Series No. 4/03

**CAN'T PAY OR WON'T PAY?
A REVIEW OF CREDITOR AND DEBTOR APPROACHES
TO NON- PAYMENT OF BILLS**

With assistance from HM Treasury's Evidence-Based Policy Fund, LCD commissioned this research to identify and characterise, where possible, the distinction between debtors who do not pay their creditors and those who cannot pay. In particular, it explored the following questions that arose from the Report of the First Phase of the Enforcement Review.

- why don't debtors pay?
- what features, if any, indicate a 'can't pay' debtor?
- how effective are different bodies responsible for enforcement at identifying and responding to 'can't pay/won't pay' distinctions amongst debtors?

The research included depth interviews with both creditors and debtors and has evolved a detailed map of the can't pay/won't pay divide, which takes into account both the debtor's ability to pay and their intention of doing so. This shows that the great majority of people who fall into arrears have every intention of paying but are unable to do so either through a drop in income or living long-term on a low income. There is, however, a minority of debtors who have little or no intention of paying the money they owe and have a range of reasons for not paying. Creditors vary widely in their ability to distinguish between these different groups of debtors.

For further copies of this publication or information about the Research Series please contact the following address:

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