Regulatory Policy Committee

Breathing Space

HM Treasury

RPC rating: fit for purpose

The impact assessment (IA) is now fit for purpose as a result of the department's response to the RPC's initial review. As first submitted, the IA was not fit for purpose.

Description of proposal

The department estimates that there are 9 million overindebted people in the UK, of which only around 1.1 million receive debt advice each year. Emotions and knowledge, particularly stress and anxiety, play a big role in people's attitudes to their debt. This can lead to people taking the quickest rather than most sustainable solution or can prevent them from seeking advice at all. These emotions are added to when creditors start to take enforcement action, at which point it is too late for debtors to seek advice.

To address this issue, the department proposes to provide protections to overindebted people for a 60-day period. The department states that this period should provide overindebted people the opportunity to utilise professional debt advice, which will encourage and incentivise more people to achieve better, more sustainable outcomes by:

- pausing enforcement action;
- freezing interest, fees, and charges; and
- pausing creditor contacts with debtors in relation to debt repayment.

The department argues that the proposal will help two main groups of people:

- overindebted people who often seek help at a late stage and opt for a quicker rather than sustainable solution; and
- overindebted people who would benefit from debt advice but do not seek it.

Impacts of proposal

The department has provided a detailed breakdown of direct and indirect costs and benefits to businesses, as well as costs and benefits to the government.

Costs

Transition costs: The department estimates a total transition cost of £31.7 million. This amount is comprised of:

- **Systems changes**: The department estimates that the indirect transitional systems changes cost will be £29.1 million, under the assumptions that administrative workarounds are likely to be more economical for most bodies than implementing system changes;
- **Dissemination costs**: The department estimates that the direct transitional dissemination cost will be £1.9 million;
- **Familiarisation costs**: The department estimates that the direct transitional familiarisation cost will be £0.4 million; and
- **Government system changes**: The department estimates that the cost of government system changes will be £0.3 million.

Annual costs: The department estimates a total cost of £2.1 billion. This amount is comprised of:

- **Interest foregone**: The department estimates that the cost to creditors of interest foregone would be £1.5 billion. This amount is made up of direct costs of £1.3 billion relating to persons who do not alter their behaviour to enter Breathing Space. The remaining is made up of indirect costs of £164 million. These amounts are both split between those individuals under the protections of Breathing Space for 60 days, those individuals under it for 30 days and those individuals who enter the scheme via the Mental Health Crisis Moratorium. The government would incur a cost of £3.7 million as a result of interest foregone;
- **Administrative costs**: The department estimates that the direct cost to creditors and debt agencies of administration would be £358 million;
- **Charges foregone**: The department estimates that the cost to creditors of charges foregone would be £208 million. This amount is made up of a £186 million direct cost and a £21.5 million of indirect costs; and
- **Delayed revenue**: The department estimates that the indirect cost to creditors of delayed revenue would be £1.4 million. The government would incur a cost of £0.3 million as a result of delayed revenue.

Benefits

Transition benefits: The department estimates no transition benefits.

Annual benefits: The department estimates a total benefit of £13.7 billion. Estimated benefits are comprised of:

- **Benefit to creditors**: The department estimates that the indirect benefit to creditors from higher recoveries would be £6.1 billion;
- **Benefit to employers**: The department estimates that the indirect benefit to employers from higher employee productivity would be £3.7 billion for the duration of the policy proposed by the IA;
- **Benefits to debtors**:
  - **Improved quality of life**: The department estimates that the benefit to debtors through improved quality of life would be £2.2 billion. This amount is the sum of estimates of lower rates of depression, anxiety and panic attacks as well as higher debtor well-being; and
  - **Economic transfers from creditors to debtors**: The department also estimates that debtors will benefit from an economic transfer from creditors of £1.7 billion. This amount is made up of business charges foregone, interest foregone and delayed revenue.

Non-monetised benefits: The department lists a range of additional non-monetised benefits, including:

- Lower dependence on state-subsidised housing;
- More positive education and employment outcomes, largely due to higher levels of parental engagement;
- Lower risk of children being taken into care;
- Lower rates of desperation crime;
- Lower risk of eviction or repossession;
- Lower risk of job loss;
- Increased social security take-up;
- Lower rates of relationship breakdown;
- Higher rates of small business continuity; and
- More positive future credit access.

These are not monetised as there is no strong evidence suggesting that the link between debt advice and the benefits listed above would result in a substantial economic impact.

Quality of submission

The IA provides explanations for the methodology and assumptions used to estimate the direct costs and benefits and other relevant calculations for each of the considered options. The updated IA has an adequate Small and Micro Business Assessment (SaMBA). This contains a justified rationale as to why exempting Small and Micro Businesses (SMBs) from the policy or providing mitigating measures for them would not enable the government to achieve the policy objectives.

The RPC commends the department for sufficiently revising the IA on the red rated issues as well as points of improvement.

Red rated issues addressed following RPC's initial review

1. **SaMBA:** As originally submitted the IA originally did not discuss the possibility of exempting or mitigating SMBs. The department did not provide a breakdown of the market structure and did not fully consider what factors could cause disproportionate costs to SMBs. The department has addressed these points by splitting the updated SaMBA into three sections:
    a. setting out a market structure;
    b. expanding on whether costs may fall disproportionately on SMBs; and
    c. focussing on where exemptions and mitigations are appropriate or not. This is achieved through providing separate sections setting out each option considered, their advantages and disadvantages, and a conclusion drawing from the evidence base the department sets out.
2. **Direct/indirect impacts:** The IA previously included direct benefits to business which the RPC did not consider direct. This affected the calculation of the EANDCB.
   Specifically, the RPC did not consider the benefit to employers of improved productivity direct. Such benefits depend upon the debtor's decision to engage with debt advice and is therefore a second-round impact. The revised IA considers this benefit indirect.
   Further, the RPC did not consider the benefit to creditors of increased recoveries direct. Although this is closer to the direct and indirect boundary, it is not a first-round impact and is dispersed across the whole economy rather than in the regulated market. The revised IA considers this benefit indirect. See more about this distinction in the RPC's guidance[1].
   Additionally, the updated IA splits the costs into a direct section if debt advice is received in the counterfactual scenario, and an indirect section if debt

[1] https://www.gov.uk/government/publications/rpc-case-histories-direct-and-indirect-impacts-march-2019

advice is not received in the counterfactual. The RPC welcomes the revised analysis presented by the department.

3. **Missing calculations:** As first submitted, the IA did not include the calculations informing the estimated Breathing Space caseload of 681,000 in 2020-21, rising to 1.20 million in 2030-31; a figure crucial to the EANDCB. The updated IA provides a step-by-step explanation on how the final figures were calculated.

The department has also improved on the following points identified in the RPC's initial review as areas of improvement.

1. **Unjustified assumptions:**
    a. The department previously assumed that the total cohort of people who enter Breathing Space via the Mental Health Crisis Moratorium would grow at the same rate as under the counterfactual but provided no explanation for this. The updated IA considers and explains the overlap between mental health and debt in adequate detail;
    b. the department previously assumed that firms would only make system changes where it is economical to do so and would not need a deep understanding of the new requirements to implement the changes but provided no explanation for this assumption. The revised IA considers system changes in more detail by splitting the market into larger firms, smaller firms, and firms which are reliant on automation;
    c. the department previously reduced debt advice supply by 7.5% to remove Scotland and Northern Ireland but provided no explanation for this reduction. The updated IA clearly cites a source which provides an explanation for this figure; and
    d. the department previously assumed that the three cohorts for individuals within Breathing Space, i.e. those protected for 60 days, those protected for 30 days and those who enter via the Mental Health Crisis Moratorium, will all have the same debt compositions, but provided no explanation for this assumption. The revised IA sets out hypotheses and an evidence-based conclusion to why there may or may not be differences in debt composition amongst the three cohorts.
2. **Evidence to support calculations:** The IA would have benefitted from a more detailed explanation to further support figures presented in the IA and the accompanying EANDCB calculator. The updated IA includes costs to the government of interest foregone, as well as providing more quantitative evidence to accompany the existing qualitative explanation.

3. **Monitoring and evaluation and implementation plan:** The IA did not provide a sufficiently detailed implementation or monitoring and evaluation plan. The updated IA includes a more detailed monitoring and evaluation plan split into two sections describing the implementation plan of Breathing Space and a Post-Implementation Review plan.
4. **Direct/indirect impacts:** The IA should have clearly classified costs and benefits as direct or indirect in the IA to match the accompanying EANDCB calculator. The revised IA has a table which concisely presents impacts as either direct or indirect, in line with the accompanying EANDCB.
5. **Missing calculations:**
   a. The previous IA did not clearly state the number of debtors, creditors and employers used in the calculation on pages 13 and 14. The updated IA provides tables detailing the assumptions and calculations used to estimate the benefits; and
   b. The previous IA did not provide sufficient detail to support the department's assertion that the NPV of regulatory Breathing Space would remain positive and be five times as large as a similar voluntary Breathing Space if the benefit of debt advice fell from 14% to 7% and marginal take-up fell from 10% per annum to 0%. The revised IA provides a more detailed explanation around present value terms and worst-case scenarios.
6. **Non-monetised costs and benefits:** The IA did not sufficiently quantify several costs and benefits, including the development of a central digital portal to facilitate Breathing Space. The updated IA explains the costs of this portal, as well as providing justification for why certain costs or benefits haven't been quantified i.e. the IA only monetises benefits where a clear link between debt advice and improved outcomes has been identified.

Further areas of improvement

Following review of the revised IA, the RPC believes that the IA would be strengthened by further development of the points below:

1. **Unjustified assumption:** The IA uses an estimate from a StepChange report to state that people who wait six months to seek advice see their debts grow 14% larger than those who seek advice at an earlier stage. This figure is derived from the interest and charges added to debt in six months. Firstly, Breathing Space protections only last two months, and secondly, the purpose of Breathing Space is to find sustainable debt solutions rather than save debtors some

money in terms of less interest and charges. It is assumed, however, that this 14% increase is equivalent to the benefit debtors receive for seeking advice in Breathing Space. The IA would benefit from a clearer explanation of why the department has made this assumption and whether it considered other possible ways to estimate the likely increase in debt when individuals delay seeking advice.

2. **Pass-through**: On page 21 of the revised IA, the department notes that creditors will need to charge interest to "*cover the risk taken by creditors, their profit margins, and the cost of servicing their own debt*". Although the benefits to creditors outlined in the IA may prevent this circumstance from occurring or reduce its impact, the IA would benefit from consideration of the possibility of pass-through.
3. **Further impacts:** The department explains that as a consequence of the policy, civil society organisations and debt advisers are likely to incur some initial costs. It is possible that these will be offset by subsequent reduced demands on their services. The policy may also lead to an increased demand on medical professionals to provide evidence of people who are receiving mental health crisis treatment. The IA would benefit from further consideration of these wider impacts.

Departmental assessment

Classification	Qualifying regulatory provision (IN)
Equivalent annual net direct cost to business (EANDCB)	-£860.5 million (initial estimate) £169.3 million (final estimate)
Business net present value	£6,132.0 million
Overall net present value	£9,151.4 million

RPC assessment

Classification	Under the better regulation framework rules for the 2017-19 parliament: Qualifying regulatory provision (IN)
EANDCB – RPC validated[2]	£169.3 million (2021 prices; 2021 base year) – subject to validation once the framework rules for the current parliament are set
Business Impact Target (BIT) Score[2]	£846.5 million (2021 prices; 2021 base year) – subject to validation once the framework rules for the current parliament are set
Small and micro business assessment	Sufficient
RPC rating of initial submission	Not fit for purpose

Regulatory Policy Committee

[2] For reporting purposes, the RPC validates EANCB and BIT score figures to the nearest £100,000.