EXPLANATORY MEMORANDUM TO

THE SOCIAL SECURITY (CLAIMS AND PAYMENTS) AMENDMENT (NO.2) REGULATIONS 2006

2006 No. 3188

1. This explanatory memorandum has been prepared by the Department for Work and Pensions and is laid before Parliament by Command of Her Majesty.

2. Description

2.1. The purpose of these changes is to introduce a scheme that will provide a facility for certain lenders to apply for deductions from specified benefit payments to repay loans, in certain circumstances, in the event of default. The scheme will be known as the Eligible Loan Deduction Scheme (formerly known as the Affordable Credit Deductions Scheme) and forms part of the Government's Financial Inclusion Strategy.

3. Matters of special interest to the Joint Committee on Statutory Instruments.

3.1. None

4. Legislative Background

4.1 These regulations amend Schedule 9 of the Social Security (Claims and Payments) Regulations 1987 to include the Eligible Loan Deduction Scheme as a third party deduction. Previous announcements relating to the scheme were made in the Budget 2005 and in the document *Promoting Financial Inclusion* published as part of the Pre- Budget Report 2004. In the 2006 Budget, Ministers announced that the scheme would be in operation by the end of 2006. Relevant extracts from these statements are shown at Annex B.

5. Extent

5.1 This instrument applies to all of Great Britain.

6. European Convention of Human Rights

6.1 As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy Background

7.1 The Eligible Loan Deduction Scheme forms part of the Government's Financial Inclusion Strategy to help increase the supply of affordable credit to those on low incomes, encountering exclusion from mainstream financial services. The intention is to achieve this by helping to reduce the risks and costs associated with lending to low-income groups. This is a scheme where, in certain circumstances, eligible lenders could apply for repayment to be made by deductions from specified benefit, where normal repayment arrangements have broken down.

7.2 The lenders eligible to join the scheme will be:

(a) a body registered under section 1 of the Industrial and Provident Societies Act 1965;

(b) a credit union within the meaning of section 1 of the Credit Unions Act 1979

(c) a charitable institution within the meaning of section 58(1) of the Charities Act 1992; or

(d) a body entered on the Scottish Charity Register under section 3 of the Charities and Trustee Investment (Scotland) Act 2005,

which, except for a credit union, is licensed under the Consumer Credit Act 1974.

7.3 Where such a body wishes to join the scheme, the Secretary of State will require it to behave in certain ways in relation to offering loans and dealing with defaulters. These requirements will be set out in a Memorandum of Understanding between the Secretary of State and the body. The existence of the Memorandum of Understanding will assist the Secretary of State in his decision whether a particular lender is one to whom it is appropriate that payments under the scheme are made.

7.4 To be eligible for deductions the loan must be a personal unsecured cash loan, it cannot be a cash advance against a credit card or a business loan.

7.5 The rate of deduction mirrors the rules as for other third party deductions however, these loan deductions will take a lower priority than all other forms of deduction, most of which are intended to safeguard essential requirements for the claimant, such as housing costs and fuel.

7.6 The scheme was referred to the Social Security Advisory Committee who undertook formal consultation on the proposal.

7.7 Following consultation, the Social Security Advisory Committee recommended that the proposal should be withdrawn.

7.8 The Department considered the recommendations and concluded that the scheme should be implemented, subject to two adjustments to the original proposal, as it forms part of the Government's strategy for tackling financial exclusion. A copy of the Department's response is attached at Annex A.

7.9 This Statutory Instrument will be incorporated into the Blue Volumes in 2007 and will be available to the public, through our internet site, at no cost.

8. Impact

8.1 A Regulatory Impact Assessment has not been prepared for this Instrument because it does not impose a cost on business, charities or the voluntary sector. The scheme is entirely voluntary.

8.2 The impact on the public sector is that additional expenditure and administration costs will be incurred, for which funding has been approved.

9. Contact

9.1 Caroline Vincent at the Department for Work and Pensions Tel: 01253 688831 or e-mail: Caroline.D.Vincent@Jobcentreplus.gsi.gov.uk can answer any queries regarding the instrument.

Annex A

DWP response to the Social Security Advisory Committee

Statement by the Secretary of State for Social Security in accordance with section 174 (2) of the Social Security Administration Act 1992.

Introduction

1. The Social Security (Claims and Payments) (Amendment) Regulations 2006 were referred to the Social Security Advisory Committee on 2nd August 2006 for consultation in accordance with section 174 (1) of the Social Security Administration Act 1992.

2. These regulations amend Schedule 9 of the Social Security (Claims and Payments) Regulations 1987.

3. The purpose of these changes is to introduce a scheme where, in certain circumstances, lenders can apply for repayment to be made by deduction from benefit, where normal repayment arrangements have broken down. The changes are being introduced as part of the Government's financial inclusion strategy.

4. The scheme will be known as the Eligible Loan Deduction Scheme (ELDS), formerly known as the Affordable Credit Deductions Scheme (ACDS), and its purpose is to increase the accessibility of affordable loans for people on low incomes, encountering exclusion from mainstream financial services, by reducing the high risk levels and costs associated with lending to low-income groups.

5. Full details of the scheme are shown in the Explanatory Memorandum to the Social Security Advisory Committee.

The Regulations

6. The regulations will set out the conditions under which deductions from benefits may be made, including the lenders who will come within the scope of the scheme, the priority order of benefits from which deductions should be taken, rules on the maximum amount of deductions which should be taken and conditions on the circumstances, time of making, where deductions can be taken, and termination of deductions.

The Committee's Report and Recommendations

7. The Committee's report acknowledged that there was some support for the scheme from lenders and advice agencies. It concluded, however, that, while the Committee supported the Government's aim of increasing access to affordable sources of credit for people on low incomes, they did not feel that the proposed ELDS would achieve this aim.

8. The Committee therefore recommended:

That given its concerns the proposals should not be implemented and that the Government should look for more effective ways of improving access to low cost credit to low - income consumers.

That there should be a review of the system of deductions from benefits, including those for debts to third parties, before there is any further widening of the system. This review should consider issues of consistency in policy and efficient administration as well as the impact on claimants of deduction from benefits.

The Government Response

9. The Committee's conclusions and recommendations were based on four main areas of concern:

- The costs and inefficiency of the scheme
- The risk that it could encourage bad debt recovery practices
- The risk that it could encourage irresponsible lending
- The priority being given to third sector debts in the context of wider third party deduction policy

The Committee's conclusions are summarised and the Government's response given in the following paragraphs.

Costs and efficiency

10. The Committee concluded:

"*If take-up of the scheme among lenders turns out to be as low as suggested, then the cost becomes hard to justify. The money might be better spent on increasing the Social Fund budget*."

11. While accepting that take-up might be low initially, there has been strong interest and support for the scheme among third sector lenders and the Government believes it has potential to make a useful contribution to the availability of affordable credit for people on low incomes , as part of a package of measures including the £36 million Financial Inclusion Growth Fund. Considerable care has been taken in designing both the policy and the operation of the scheme as simply as possible. Of the £10 million originally allocated from the Financial Inclusion Fund it is now estimated that less than £3million will be needed for the one-off cost in setting up the scheme. These resources have already been committed. The running costs are expected to be low – only around £100 - £150k per year depending on take- up.

12. The Social Fund provides an important source of interest-free credit targeted on the most vulnerable people on income-related benefits. An additional £210 million over the three years from 2006/07 to 2008/09 has been invested in the Social Fund Budgeting Loans scheme to fund significant improvements which will simplify and expand the scheme.

Resources from the Financial Inclusion Fund are intended to be used to move people towards mainstream financial services. The relatively modest investment of £3million from the Financial Inclusion Fund should make a positive contribution to other measures to help expand access to more affordable credit.

Encouragement of bad arrears recovery practices

13. The Committee concluded:

"*As currently designed we believe there are inadequate safeguards in the scheme and that it could encourage debt recovery practices that are more harsh than those generally deployed by unsecured creditors. Moreover it is discriminatory as an attachment of earnings order would not be granted for only two months' arrears*."

14. The Government has considered the points made and has amended the draft regulations to provide that deductions will not be taken unless payments have not been made under the terms of the original, or re-negotiated, loan agreement for at least thirteen weeks. This should enable lenders to take positive and sympathetic action to agree suitable alternative arrangements with someone having genuine difficulties in repaying a loan before an application for benefit deductions is made.

15. The Memorandum of Understanding between the Secretary of State and eligible lender has been amended to be more explicit about the way in which lenders are expected to deal with default before a referral is made. It will include an expectation that lenders will take steps to agree alternative arrangements for re – scheduling, taking into account other financial commitments, personal factors affecting ability to repay, such as long-term health problems; and work with recognised debt-counselling agencies if appropriate. A safeguard will be built into our processes whereby, in the event of a dispute between lender and borrower about the liability for the loan and the amount owing, a referral will not be accepted.

Encouragement of irresponsible lending practices

16. The Committee concluded:

"We believe there is a danger that it could also encourage irresponsible lending and undermine steps being taken among third sector lenders to improve risk assessment techniques as they widen access to loans."

17. It is the Committee's opinion that it might have been better to require third sector lenders who use the ELDS to become signatories of the Banking Code as this provides detailed guidance on dealing with customers who are in arrears both sympathetically and responsibly and Code compliance is routinely monitored by the Banking Code Standards Board.

18. It is not possible, and neither is it the role of the benefits deductions scheme, to set rules for consumer credit practice or the credit industry

generally. However, the Government has taken care to try to ensure that the scheme is only available to lenders who can demonstrate that they follow good lending and arrears management practices. The Memorandum of Understanding between the lender and Secretary of State will set out the standards lenders will be expected to follow and this will be subject to review.

19. The Department will monitor the extent to which lenders adhere to the Memorandum of Understanding ie. whether proper warnings about deductions were issued at the time the loan was taken out, whether borrowers in financial difficulty were treated sympathetically and whether adequate information about debt advice had been issued. The Memorandum of Understanding incorporates a requirement that income and expenditure risk assessments will be conducted prior to lending and, that where the borrower is experiencing difficulty, the lender is required to take steps to agree alternative arrangements for re – scheduling repayments and/or providing a source of independent free debt advice prior to referral for deductions. The lender will be required to demonstrate their adherence to these practices both as part of the assessment process before DWP enters into a Memorandum of Understanding and with each referral which will be accompanied by the signed loan agreement form. These will provide proof of the terms agreed at the time the loan was taken out. The regulations also provide that where a lender does not adhere to the terms of the Memorandum of Understanding, deductions will cease. Ongoing lender eligibility and adherence to the terms of the Memorandum of Understanding will be reviewed on an annual basis.

Diversion from main purpose of third party deductions and the priority being given to third sector debts (and the amount of deduction) in the context of wider third party deduction policy.

20. The Committee concluded:

"The proposed level of deduction is too high for a non-priority debt and the ACDS (now known as ELDS) *effectively promotes a small number of third sector lenders to the status of priority creditor.*

We are concerned that although originally set up for priority debts (housing costs and fuel) the third party deduction scheme is gradually being extended in an ad hoc fashion; and

We are concerned that the ACDS (now known as ELDS) *scheme will in effect take priority over rent and fuel for those receiving Carer's Allowance and certain other contributory benefits, and we consider that this is undesirable."*

21. For the scheme to fulfil its purpose of creating the conditions which will help lenders reduce the cost of affordable credit and lend more widely to people on low income it is important that the deduction is set at a level which could make a difference to their costs. At the same time, the Government is mindful that the deduction should not place an unreasonable burden on benefit recipients, where they

are having difficulty in repaying their bills. The deduction rate is set at a standard 5% of the income support personal allowance for a person aged not less than 25. This is in line with the rate for other third party deductions, which has been accepted as being a reasonable and sustainable amount to repay debts. The Government believes that this achieves a reasonable balance between those two aims.

22.The eligible loan deduction is placed as the lowest of the priority order of all third party deductions, after essential costs such as housing, fuel, and water, and all the limits and safeguards that apply to the wider scheme have been applied, thus protecting the customer's benefit income. The rules ensure that no more than three deductions are taken in repayment of debts. This means that for customers with multiple debts, a loan deduction will not be taken where more essential debts take priority.

23. The third party deduction scheme is long standing, starting in the 1970s initially to safeguard benefit claimants fuel supply, and it's purpose has been primarily to safeguard the position of people receiving income-related benefits where they fall into arrears with essential bills. This remains the principal rationale for the scheme although deductions are also made under wider powers to discharge debts which help in enforcing compliance with social and financial obligations (eg. fines, Child Support). There has not been any new type of deduction since 1993, when deductions for Council Tax replaced those for Community Charge although there have been some changes in recent years to the scope and amount of existing deductions.

24.The Government takes the view that introducing a new deduction to repay a private loan in the circumstances prescribed fulfils a public policy role which, given the protections planned, should be beneficial to people on low income including people on benefits. It does not accept that the scheme is being added to in an arbitrary ad-hoc way and will continue to keep arrangements under review to ensure that new deductions are not introduced without careful consideration of the value and consequences of doing so, and to ensure they are consistent with the wider rules for deductions and take account of other debts and commitments.

25. Loans deductions may be applied to the full range of income-replacement benefits to ensure maximum impact for people on low incomes through wider access to affordable credit that the scheme is intended to support. There is no good case for excluding one or other of the benefits from this form of deduction. Other third party deductions will continue to apply only to income –related benefits as they are intended to safeguard the position of the most vulnerable from the consequences of not meeting essential financial commitments.

Conclusion

26. The Government is grateful to the Committee, and the agencies who responded to consultation, for their consideration of the scheme and resulting comments.

27. It is hoped that the amendments to the scheme and the responses provided will have reduced the concerns expressed by the Committee and those agencies who responded to consultation.

28. For the reasons outlined in this statement, the Government has decided to implement the proposals with the amendments outlined.

29. These regulations are now laid before Parliament.

Annex B

Extracts from budget reports relating to the Affordable Credit Deductions Scheme:

Pre - Budget report 2004

The Government is committed to promoting fairness alongside enterprise so that everyone can take advantage of opportunities to achieve their full potential in an outward-looking, flexible economy. The reforms of the welfare state introduced by the Government since 1997 reflect its aims of eradicating child poverty, supporting parents to balance their work and family life, promoting saving and ensuring security for all in old age. The Government is also committed to a modern and fair tax and benefit system which encourages work and saving and ensures that everyone pays their fair share of tax. This Pre-Budget Report sets out the next steps the Government is taking to support these aims, including:

- a package of measures to promote financial inclusion, by increasing access to banking services, affordable credit and face-to-face money advice;

5.31 The Government is also committed to promoting financial inclusion to ensure that everyone can access the financial services and products that they need to manage their finances, avoid high cost credit and start to save. Discussed later in this chapter, Promoting Financial Inclusion, published alongside this Pre-Budget Report, sets out the Government's proposals to tackle financial exclusion.

5.48 Many low-income households rely on the 'alternative credit market', where typical products have Annual Percentage Rates (APRs) of over 100 per cent, many times the APRs of standard mainstream products. The Government has been working to identify creative solutions to reducing the cost of lending and increasing access to affordable credit, building on existing good practice. The Government is considering mechanisms whereby, in certain circumstances, private and 'third' sector lenders could apply for repayment to be made by deduction from benefit where normal repayment arrangements have broken down, in order to boost the ability of private, voluntary and community sector partners to offer affordable loans to those on the lowest incomes.

5.49 Not-for-profit or 'third' sector lenders such as credit unions and Community Development Finance Institutions (CDFIs) have a key role to play in the provision of affordable credit to those on low incomes. Promoting Financial Inclusion sets out a range of measures the Government will put in place to boost the coverage, capacity and sustainability of the sector in providing affordable loans to the financially excluded.

Budget 2005

Promoting financial inclusion

5.52 Access to mainstream financial services is restricted for many people on low incomes. This imposes costs on those who can least afford them and can prevent people from getting started on the savings ladder. Promoting Financial Inclusion, published alongside the 2004 Pre-Budget Report, set out the Government's strategy for tackling financial exclusion, outlining policy measures in three key areas: access to banking; access to affordable credit; and access to money advice. It established a Financial Inclusion Fund of £120 million over three years to support these measures, and a Financial Inclusion Taskforce, launched in February 2005, to oversee progress.

5.54 Many low-income households rely on the 'alternative credit market', where typical products have Annual Percentage Rates of over 100 per cent. Through the Consumer Credit Bill, the Government aims to increase transparency and fairness in the market and improve consumers' access to redress mechanisms. To reduce the costs and risks of lending to vulnerable groups, and following consultation, the Government will work towards a scheme where, under certain circumstances, lenders could apply for repayment through deduction from benefits, where normal repayment arrangements have broken down.

Budget 2006

5.42 Access to mainstream financial services can be restricted for many people on low incomes. Promoting financial inclusion outlined the Government's strategy to tackle financial exclusion, including the establishment of a Financial Inclusion Taskforce to oversee progress and a Financial Inclusion Fund of £120 million to support initiatives to tackle financial exclusion.12 £20 million of the Financial Inclusion Fund will now be made available for broader financial inclusion objectives, including stimulating demand for mainstream financial services.

5.44 Many low-income households rely on credit products with interest rates of over 100 per cent. The Financial Inclusion Fund is being used to establish a 'growth fund' of £36 million to support third sector lenders providing alternative affordable credit and successful bidders to this fund will be announced in June. To give flexibility to better serve low-income groups, the maximum rate of interest that credit unions can charge on loans will be increased from 1 per cent a month to 2 per cent a month. This change will be implemented as soon as possible.

5.45 The Government has also consulted on extending Community Investment Tax Relief to the personal lending activities of community development finance institutions. Responses to the consultation indicated support for an extension and highlighted a range of practical issues that need to be addressed. As announced in the Pre-Budget Report, the Government will continue to consider the case for, and practicalities of, this extension. In order to reduce some of the increased risk and cost associated with lending to vulnerable groups, the Government will implement, by December 2006, a scheme where, under certain circumstances, lenders can apply for repayment of arrears through deduction from benefits, where normal repayment arrangements have broken down.

Full details of these reports, including the document *Promoting Financial Inclusion* published as part of the Pre- Budget Report 2004, can be found on the Treasury website at the links shown below:

http://www.hm-treasury.gov.uk/media/92B/F6/pbr04_chap05_282.pdf

http://www.hm-treasury.gov.uk/media/AA7/40/bud05_chap05_209.pdf

http://www.hm-treasury.gov.uk/media/20F/02/bud06_ch5_180.pdf

http://www.hm-treasury.gov.uk/media/8F9/37/pbr04_profininc_complete_394.pdf