



Pre-consultation discussion paper

**Review of Ofwat guidelines for
dealing with customers in debt**

April 2006

Introduction

In April 1992 we first issued guidance to water companies covering procedures for dealing with customers in debt. The aim of the guidelines was to help companies develop a common strategy to minimise the build up of debt and subsequent disconnections.

From 30 July 1999 the Water Industry Act made it illegal for any water company in England or Wales to disconnect any dwelling occupied by a person as his only or principal home for non-payment of charges.

Water companies argued that the loss of ability to disconnect would lead to higher numbers of customers choosing not to pay their bills, or paying them late. They therefore needed to review and adapt or expand their range of debt recovery procedures so that they could maximise their ability to collect debt from household customers.

A seminar held by Ofwat and WaterVoice in May 2001 acknowledged that the guidelines needed to be revised to reflect the change in operating climate and legislation. The preference was for a less prescriptive approach to allow flexibility for companies to tailor their approaches to fit the circumstances of individual customers. The move away from a “one size fits all” process was widely supported.

Following consultation, revised ‘Guidelines on dealing with customers in debt’ were issued in October 2002. These set out our expectations of how water companies should manage their indebted household customers.

It should be emphasised that the guidelines are not intended to describe best practice in recovering debt. Rather, they are intended to set out good practice in handling indebted customers, particularly those who may have real difficulty in paying their bills.

The costs of recovering or writing off bad debt are paid for by all customers through their bills, as they are with all businesses. Thus, those on low incomes who try hard to pay their bills will be paying towards those who do not meet their obligations. It is therefore essential that companies are able to recover revenue as efficiently and effectively as possible. These guidelines seek to ensure that those customers in real difficulty are treated fairly while allowing companies to collect revenue effectively.

Monitoring application of the guidelines

The Consumer Council for Water (CCWater) also use the guidelines to help them assess how well companies actually deal with customers in debt. CCWater’s assessment is reflected in Ofwat’s overall assessment of companies’ performance, which is published each year in our Levels of Service report.

Later this year CCWater intend to look at how the Ofwat debt guidelines should be interpreted when assessing companies’ debt collection practices in order to ensure consistency in approach across England and Wales.

Current review

We committed in our 'Forward programme 2005-06 to 2007-08' to work with CCWater and other stakeholders to continue to promote good practice on social issues across the industry, including a review of the 'Guidelines on dealing with customers in debt' in 2006.

Additionally, the 'Cross-Government Review of Water Affordability Report' noted as one of the recommendations that "Ofwat should undertake a review of the debt guidelines in 2006 (last updated in 2002)".

We are now, therefore, beginning our work to review the guidelines. The objectives of this project are to:

- review our current guidelines for dealing with customers in debt to make sure that they are still relevant, comprehensive, up-to-date and easy to follow;
- give stakeholders the chance to comment so that the guidelines are improved where necessary;
- make sure that the guidelines continue to offer a reasonable balance between customer protection and the industry's ability to collect debts in a fair manner; and
- make sure that the guidelines are flexible enough to allow differentiated approaches in companies' debt recovery activities to reflect different customers' circumstances.

This paper outlines four broad areas for discussion, setting out various questions and ideas which might usefully be considered when reviewing the guidelines.

We do not expect to change significantly any of the five principles currently set out in the guidelines as these appear to have worked well. Instead, the review will focus on considering whether the current practice identified under each principle is still relevant and whether the expectations are still appropriate.

We also intend to update the guidelines to reflect various changes in technology and terminology that have occurred since the last review took place. Examples include updating WaterVoice to CCWater and reflecting new payment methods, such as telephone and Internet banking. These smaller changes are not discussed in this paper, but will be included in the formal consultation paper.

It must be noted that whilst the guidelines set out expectations for companies, they are not legal requirements, and should not be considered as such. Companies are accountable for their own decisions in the way they choose to manage their business. Whilst we would encourage companies to follow the guidelines, we accept that there will be some cases, due for example to practicality, cost or knowledge of customers' circumstances where they may not wish or be able to do so.

Issues for discussion

Discussion item 1

Do the current guidelines strike an appropriate balance between customer protection and the industry's need to collect its debts?

Points to consider

- Do the current guidelines give the customer too much protection, making debt management difficult and/or costly for the company? Or do they not provide sufficient protection for customers? In the long term, all customers benefit from robust policies aimed at those who manipulate the payment system. However, many customers who fall into debt will be vulnerable and have genuine difficulty in paying their bills. How should the appropriate balance be struck between the company and the customer?
- Should the guidelines place greater emphasis on the requirement to pay water charges? The current guidelines encourage companies to be flexible when considering payment arrangements offered by customers. Companies have the legal right to collect water charges from customers. However, if they are too flexible the full recovery of charges may become difficult, especially from those for whom water charges are not a personal priority even when they can afford to pay. Ideally, companies should aim to do all they can to target persistent and willing non-payers, while dealing with those genuinely struggling to pay in a more sympathetic way. How should this be reflected in the guidelines?
- Should the guidelines make it clear that it is for companies to decide in individual cases whether specific activities should be undertaken? The current guidelines state that "it is for companies to decide how revenue can most cost-effectively be collected". Whilst the expectations set out the type of services we encourage companies to offer, they are not absolute requirements which must be adhered to at all times. As an example, home visits, by building relationships with customers, can be a productive way of collecting outstanding debts. However, if the cost of making the home visit is more than the debt itself, should the company still be expected to offer it? Similarly, new technology can be used to improve segmentation and thus tailor debt recovery approaches but this also adds costs which may affect the bills of all customers. A balance between the additional costs incurred and the likely benefits needs to be carefully considered by companies when formulating cost-effective debt strategies.
- Should the guidelines address the issue of the recovery of additional debt collection costs? Some companies charge additional amounts to cover costs incurred in the debt recovery process. As water companies are required under statute to supply services to household customers (there is no legal contract), is it fair for them to charge additional debt collection costs and/or interest costs, particularly as domestic customers cannot switch to alternative suppliers?

One argument is that debtors should be liable to pay reasonable costs associated with debt recovery provided that they are given sufficient notice that costs will be added to the debt. Otherwise, shareholders and/or other customers will ultimately pay. However, consumer organisations have pointed to cases where costs are added unfairly, for example, where the actual costs incurred by the company when undertaking debt recovery are not significant, or where costs are added without prior warning. They note that it is unreasonable to expect debtors to pay these additional costs, especially where the debtor is already struggling to pay their charges. We welcome views on this.

Discussion item 2

Are the current guidelines sufficiently flexible?

Points to consider

- The 2001-02 review of the guidelines attempted to draw a reasonable balance between giving companies the flexibility to manage revenue collection effectively whilst clearly setting out expectations of how customers in debt should be managed. Companies need the flexibility to tailor their debt recovery activities appropriately so that individual customers benefit from receiving the most suitable approach to debt recovery. The expectations set out in the guidelines need to be as non-prescriptive as possible to allow this flexibility whilst at the same time setting out our minimum expectations of how customers in debt should be handled to make sure they are dealt with fairly. Should the guidelines be made less prescriptive? If so, which areas would benefit from being made more flexible?
- A key question concerning flexibility is whether companies should accept what a customer is able to pay. Although companies are legally entitled to collect what is due, some feel that the guidelines are written in a way which means that to satisfy the expectations they should only collect what a customer can afford to pay. The concern is that this is not sustainable in the longer term as customers' circumstances will not necessarily improve. This could have implications for other customers, including low-income customers who do manage to pay their bills.

However, from the customer perspective, it has been suggested that customers genuinely struggling to pay would benefit if companies operated more flexibly and considered any level of payment offered by the customer. This would help to create a regular routine and encourage future payment if and when circumstances improve. Whilst this may be viewed as good practice when dealing with customers in debt from a social perspective, how can these two views be reconciled in the guidelines?

- Should companies offer all services set out in the guidelines at all times to all customers? Or should they have the flexibility to be selective and use them only for those customers genuinely in need, where the use of them will prove effective, both economically and productively? Some companies feel that the way the expectations are set out under the current guidelines mean that they should aim to offer all the services discussed and adhere to all of the expectations for all customers. They note that this could prove expensive, especially where the customers concerned are able to pay their bills. If certain debt recovery methods or payment options are relatively expensive to operate, should companies be entitled to apply them selectively, in the interests of keeping operating costs down which will ultimately benefit all customers? If so, how can this be made clear in the guidelines?
- Should companies be encouraged to involve either CCWater or us in proposed changes to their debt recovery procedures? The current guidelines state that “we

encourage companies to discuss with their WaterVoice committee any proposals to alter substantively their approach to debt management”.

Whilst companies need the freedom to apply innovative solutions to debt prevention and recovery and the flexibility to make changes to the process at relatively short notice, it does not seem unreasonable that CCWater should be given an opportunity to comment on any substantive changes, to help ensure that the customer perspective has been considered.

Discussion item 3

Should the current guidelines be more focused at targeting “vulnerable” customers?

Points to consider

- Whilst the guidelines were originally written with vulnerable indebted customers in mind, companies tend to use them when dealing with all customers in debt. Should the guidelines be targeted at only those customers in debt who can be described as “vulnerable to debt” or should they apply to all customers? Should companies attempt to differentiate between deliberate non-payers and those in genuine financial difficulty in order to target debt recovery strategies. Companies have told us that whilst the guidelines are useful for dealing with customers in debt who want to pay, they do not translate easily to the important and potentially more serious issue of how to deal with deliberate non-payers.
- If a definition of “vulnerable” were agreed, then companies could use the guidelines when dealing with those that met the criteria, but could take a firmer approach with other customers. The definition of “vulnerable” used under the Water Industry (Charges) (Vulnerable Groups) Regulations requires metered households to be on a specified means-tested benefit and have three or more children in full-time education or include a member of the household with a medical condition which necessitates the significant additional use of water. This narrow definition would not be particularly helpful in defining vulnerable customers for the purpose of the debt guidelines.

The Energy Retail Association notes in its guidance to energy companies on which groups of customer should not be disconnected that “defining vulnerable customers is not an exact science”. The definition included is “a customer is vulnerable if for reasons of age, health, disability, or severe financial insecurity they are unable to safeguard their personal welfare or the personal welfare of other members of the household”. However, this relatively wide definition would still involve some subjectivity, and may prove difficult for companies to determine whether the indebted customer meets the criteria.

An alternative to requiring the company to demonstrate that the customer could be defined as “vulnerable” using agreed criteria would be for companies to take a tougher line where customers are known not to be on a low income or “vulnerable” and are therefore potentially more capable of paying their bills. However, this would also require an element of subjectivity from the company.

- Additionally, it is often difficult to identify genuine cases of hardship because of the lack of information available to companies on customers’ circumstances. It is now more common when recovering debt to attempt to segment customers. This can be based on various profiling techniques or past payment history, and means companies can then vary timescales and techniques depending on circumstances. What further information could be used to match customers’ circumstances to the companies’ approach to debt management?

Discussion Item 4

How should the guidelines be updated to reflect key changes in operating practices over time?

Points to consider

- **Customers billed via local authorities.** Some companies have a large number of billing agreements with local authorities or housing associations where the local authority is responsible for billing and recovering revenue from the customers. It is generally the local authority that is responsible for recovering the debt if these customers fall behind in their payments. In such cases, it is important for companies to make sure that, wherever possible, the agreements between themselves and the local authority are drafted so that the customer retains the status of a water company customer and does not by implication become a resale customer.

Should a section covering local authority agreements be added to the existing Guidelines?

As an example, we an expectation could be added that, subject to the legal rights of local authorities, companies should discuss how tenanted households can receive the same benefits that directly billed water customers do, such as a sufficient range of payment options. Additionally, companies could request that local authorities make a commitment not to evict tenant customers simply for the non-payment of water charges.

If a section were to be included, CCWater may wish to consider how to fully monitor the role of such agents in the same way as they can monitor the role of debt collection agents. The current guidelines state that “WaterVoice committees can audit individual cases handled by the debt collection agents” and that companies are expected to “show the WaterVoice committee that customers whose accounts have been placed with agents are not receiving a poorer service that customers whose accounts remain with the water company. If the Guidelines were extended to cover third parties such as local authorities, should similar words be included to cover the monitoring of treatment of customers who are billed for water by the local authority?

- **Third Party Deduction Scheme (TPDS).** Whilst the guidelines currently include an expectation that “customers on benefits could be encouraged to agree to direct deductions from benefits” this could be amended to recommend that companies are more pro-active in offering this option.

Additionally, whilst this method of payment for customers in debt can now be set up without the customers’ permission (which will need to be reflected in the guidelines), good practice would be for companies to do this only after making reasonable attempts to discuss the scheme with customers.

Should the guidelines be updated to reflect changes in the operation of the Third Party Deduction Scheme?

- **Void property notices.** Some argue that these notices (which typically state that as the property is believed to be empty that the supply will be disconnected) should be viewed as threats of disconnection and should therefore be addressed in the guidelines. In our view a number of procedures should already have been followed to make sure that the property is indeed vacant. The notices should not be misused in order to prompt payment or contact from customers believed to be in residence. We invite views on including such a passage in the Guidelines.
- **Charitable Trusts.** The current guidelines state that “Where a charitable trust or a restart scheme is in place, companies should, where appropriate, tell customers about them or refer customers to a relevant contact. Companies which do not have such schemes should consider the value of establishing them independently or jointly with other companies or utilities.”

Evidence from companies has shown that charitable trusts and restart schemes can play an effective part in debt management, with many customers assisted through such schemes to maintain a payment habit. If companies would simply have written off the debt then the use of charitable trusts could be seen as a positive debt management tool. Should the guidelines be amended to place more emphasis on the use of such schemes?

- **Debt management companies (DMCs).** DMCs offer a service to individuals in debt in return for a payment. They provide advice to the customer and negotiate with creditors on their behalf to set up payment plans that typically might involve a reduction in monthly payments and a freeze on interest charges. The individual customer makes one payment to the DMC which is then distributed to each creditor. Whilst these services can be helpful, many customers may not be aware that such companies charge a fee for providing the service so caution should be used. Referral to non-charging advice services such as Citizens Advice or Money Advice Centres would be preferable. Should DMCs be mentioned in the guidelines?
- **Debt sale.** We are aware that some companies have sold debt to an independent debt agent as a means of managing their delinquent debt portfolios. This typically occurs once all recovery activities have been exhausted and will be sold for an agreed fee. The agent will then seek to recover as much money as possible in order to make the agreement profitable.

Advice we have given to companies on this practice has generally been that we do not see any objection in principle, provided that the company takes care to protect its relationships with customers.

If companies do use this approach, care is needed when selecting agents to use, in the same way as care is needed by companies when selecting debt collection agents who recover debt on behalf of the company. Monies recouped by selling the debt will be worthless if the company receives bad publicity as a result of the agent not practising within the OFT guidelines. We would expect companies to follow a due diligence process when selecting third party debt collection firms to work for them, making sure that the third party complies with the OFT guidance

on debt collection and debt management and the Code of the Credit Services Association.

We intend to make this clear in the guidelines, subject to comments received.

- **Commercial and mixed-use premises.** The current guidelines apply to all household customers. We propose to make it clear that the guidelines also apply where the household element of a mixed-use premises is the bill-payer. However, we invite views on whether the guidelines should be extended to cover commercial customers.