



## Report on direct debit energy payments

December 2008

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### Background and summary findings

1. The Financial Inclusion Taskforce was established by HM Treasury in April 2005 and our terms of reference extend to 2011. The Taskforce's remit covers the Government's strategic priorities to improve access to banking, affordable credit, free face-to-face money advice, savings and insurance. The

Taskforce also advises on stimulating demand for financial services amongst hard-to-reach groups.

2. Under the Taskforce's terms of reference for 2008-2011, the Taskforce will monitor and influence progress towards the Government's goal that people should be able to manage their money on a day-to-day basis, effectively, securely and confidently.

3. As a part of the Home Energy Saving Programme<sup>1</sup>, announced on 11 September 2008, the Government asked the Taskforce to work individually with the energy suppliers, with Ofgem and with other stakeholders to develop new ways to encourage greater use of direct debits. The Taskforce was asked to report back in December with recommendations to help more people to benefit from direct debit payments and to make bill payments easier and more affordable for vulnerable customers. The terms of reference for this work are included in Annex A of this report.

4. We believe there is a strong link between initiatives to promote financial inclusion and reduce fuel poverty. Since its inception, the Taskforce has wanted to see an increase in the take-up of banking services so as to improve the opportunities people have to reduce their cost of living through reducing transaction costs. We therefore welcome the opportunity to examine how greater use of direct debit as a payment method could be stimulated amongst energy consumers.

5. The Taskforce takes an 'informed choice' approach to the issue of consumer payment behaviour. With this in mind, we would like to stress that the Government, energy companies and others need to be sensitive to people's circumstances in recommending direct debit payments and should not encourage people to move where it could put extra pressure on their ability to manage their money or increase the risk of over-indebtedness. We would also strongly oppose any move to make direct debit payments more attractive by purposely raising the cost of other payment options. Nor should addressing the question of direct debits distract attention from aiming to reduce the costs of other payment methods and tackling unfair pricing differentials.

6. Since the announcement, the Taskforce has worked with representatives from all six of the big energy suppliers, and with Ofgem, Bacs, the British Bankers Association (BBA) and the Payments Council, to discuss issues concerning direct debit payments. We are grateful to all these organisations for their openness and support.

7. Our findings can be summarised as follows;

- A large number of energy customers could save money by moving to pay by direct debit, but choose not to. There are several different reasons why a person might choose another form of payment.

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<sup>1</sup> The full text of the announcement can be found at; <http://www.number10.gov.uk/wp-content/uploads/energy-saving-programme110908.pdf>

- Some people take a passive approach to managing their energy costs and are unaware of the opportunity to save money. Others are unaware of the protection offered to users of direct debits and are suspicious of promotions and assurances from their suppliers. Others are confused by the apparent complexity and differences between the deals available from each supplier.
- Many people fear that using direct debits will deprive them of the ability to control their payments. Moreover, in practice moving to direct debit payments usually means moving to paying monthly on the basis of estimated usage. Recent press coverage suggests that there is a mistrust of the way in which energy companies estimate customers' consumption, which in turn has exacerbated the fear of loss of control.
- A significant proportion of households currently paying by standard credit could comfortably move to paying by direct debit and benefit from the cost savings by doing so.
- There is also a significant group of people, including many pre-payment meter customers, who are not in a position to move to direct debit payments without compromising their ability to control their finances. For consumers on lower incomes, the ability to control the timing and amount of payments is much more important than for customers on higher incomes.

8. The Taskforce has put forward a package of recommendations to encourage a greater rate of migration towards direct debit payments where appropriate. Our recommendations include;

- **Information** - we believe that many customers would move to direct debit, or at least to a cheaper payment option, if they were better informed about their choices and also about the protection and control that direct debit payments offer. Experience suggests that information from a trusted source (not necessarily energy suppliers) is more likely to be effective.
- **Changes to payment methods** - we believe that the range of payment methods offered for energy could be improved to enable more people to benefit from a reduced tariff by providing them with greater clarity and control over their payments.
- **New payment systems** - in the longer term, it may be possible for energy suppliers to use new and emerging payment technologies to offer less expensive payment forms that provide a greater measure of flexibility for customers.

## The Ofgem energy supply probe

9. The Government has asked the Taskforce to take on our review as a part of a broader agenda to help people save money on their energy bills. For

example, recent work by Ofgem<sup>2</sup> to investigate the costs of energy supply and the way that customers are charged for their energy has already shown how many people can make an immediate saving on their bills simply by changing supplier. The energy supply probe found that almost all energy customers paid a premium where they remained with the previous monopoly energy supplier in their area. These customers could save an average of 6% (within a range of 2-12%) simply by moving to another provider<sup>3</sup>.

## How consumers currently pay for their energy

10. Ofgem figures show that, over the last five years, the analysis of how customers use different payment forms has changed as follows<sup>4</sup>;

Payment form	Electricity '03	Electricity '08*	Gas '03	Gas '08*
Monthly direct debit	39%	48%	44%	52%
Standard credit**	46%	38%	46%	37%
Pre-payment meter	15%	14%	10%	11%

\*n.b. figures for 2008 are drawn from Q1 and Q2 data only.

\*\*n.b. includes customers paying by Fuel Direct, weekly and fortnightly budgeting schemes and other forms of payment.

11. There has been a clear shift towards monthly direct debit payment, achieved mainly through a reduction in customers on quarterly cash/cheque payment (known as “standard credit”). Nevertheless, around 50% of households do not use direct debit – with the largest group of around 38% of households preferring to pay quarterly by cash or cheque. The proportion of customers on pre-payment meters has remained constant.

12. Customers are less likely to suffer an immediate withdrawal of their energy supply in the event of non-payment compared with services such as a mobile phone contract or satellite television. Energy is a basic need and suppliers are understandably slow to disconnect non-paying customers, being subject to a number of licence conditions and other protections, including a ban on disconnecting vulnerable customers. This reduced likelihood of service removal also makes the energy market distinct from other services for which payment could be made by direct debit. It provides customers with greater scope for choosing when to make a payment, particularly if they choose a non-automatic payment method such as standard credit.

<sup>2</sup> Ofgem Energy Supply Probe 2008, found here; <http://www.ofgem.gov.uk/Markets/RetMkts/ensupro/Pages/Energysupplyprobe.aspx>

<sup>3</sup> Ofgem Energy Supply Probe 2008, at para 7.35

<sup>4</sup> Ofgem’s figures differ from figures given in Bacs’ annual consumer payments survey. Bacs figures suggest that 66% of gas customers (8.7m households) pay by direct debit and the same proportion of electricity customers (66%, 10.3m households) pay for electricity by direct debit. We have decided to rely on Ofgem’s figures for the purposes of this report.

## **Demographic analysis and behaviour of customers on different payment methods**

### ***Direct debit customers***

13. Figures provided by Ofgem suggest that there are 12.7m people who pay for their electricity by direct debit. Over the year, based on today's average annual bill of £445, in total this group pays the big six suppliers £5.6bn. There are 11.2m people who pay for their gas by direct debit. In total, they have paid approximately £8.8bn in the year to December 2008 and their average annual bill size is £788.

14. Ofgem data on electricity customers suggest that a relatively high proportion of direct debit customers (81% compared with 70% of the population) are owner-occupiers. A lower proportion (8% compared with 20% across the population) rent from social landlords. Direct debit customers are more likely to be in the ABC1 socio-economic group. Ofgem report that they are also more likely to be aware of other suppliers and the deals they offer. They are the most likely group to switch supplier as a result of their own enquiries (although half of those who switched in the last 12 months did so in response to a sales call).

### ***Standard credit***

15. Ofgem figures suggest that 10m people pay for their electricity by standard credit. Over the year, based on today's average annual bill of £466, this group pays the big six suppliers approximately £4.7bn in total. There are 8m people who pay for the gas by standard credit. In total, they have paid approximately £6.6bn in the year to December 2008 and their average annual bill size is £821.

16. Ofgem data suggest that 69% of standard credit customers are owner-occupiers and 18% rent from social landlords, in line with the proportions in the general population. Although a significant proportion of standard credit customers are in the ABC1 category, the profile of this group tends towards the C2, D and E socio-economic groups. The proportion of standard credit customers switching to other suppliers lags behind direct debit and pre-payment meter customers, which may suggest a lack of pro-active management of their energy costs.

### ***Pre-payment meters***

17. Pre-payment meters were introduced primarily as a tool for managing debt. However, only 17% of pre-payment customers for electricity and for gas are currently in debt to their suppliers. The majority of pre-payment customers have either cleared outstanding debts on their meters, or (more likely) have never been in debt and have inherited meters from the previous occupants of their homes.

18. Figures provided by Ofgem suggest that 3.6m people pay for their electricity by pre-payment meter. Over the year, based on today's average

annual bill of £472, this group pays the big six suppliers £1.7bn in total. There are 2.4m people who pay for the gas by pre-payment meter. In total, they have paid approximately £2bn in the year to December 2008 and their average annual bill size is £834.

19. A much greater proportion (61%) of pre-payment customers rent their properties from social landlords (accounting for 35% of all social tenants). Pre-payment meter usage is focussed in the D and E socio-economic groups. These groups are more likely to be at home to receive sales calls from energy companies and may be more receptive to suggestions to switch supplier<sup>5</sup>. Recently pre-payment meter customers have shown the greatest rate of switching. 70% of customers switched in response to direct sales and about 47% of these customers actually switch to more expensive deals<sup>6</sup>.

### **Direct debit energy payments**

20. A direct debit payment is an instruction from a customer to their bank or building society to allow an organisation to make pre-advised collections from their bank account. The organisation sends these payment details to the customer's bank through the Bacs system and pays their bank a fee for each payment.

21. Payments made by direct debit are protected by means of the Direct Debit Guarantee. This means that customers will be given 10 working days notice (unless altered by prior agreement) of any change in the amount to be debited from their account or in the date or frequency of collection. They will be entitled to an immediate refund from their bank or building society if an error is made. They can cancel at any time by contacting their bank or building society<sup>7</sup>.

22. Businesses who offer their customers the option to pay for services by direct debit either collect fixed payment amounts or variable amounts, linked to usage. Payment frequencies also vary and may be, for example, annual, quarterly or monthly. Telephone companies, digital TV providers, credit card companies and other service providers use direct debit payments to enable them to take variable payments in arrears for services provided in the previous month or quarter. Insurance providers, water companies, council tax and other subscription-based services often use direct debit payments to enable them to break down a fixed and known annual payment into more affordable quarterly or monthly instalments.

23. For domestic energy payments, moving to direct debit usually means paying monthly, in advance, on the basis of estimated usage. An energy

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<sup>5</sup> See Ofgem's research on vulnerable consumers' engagement with the energy market, prepared by FDS International, March 2008, found here; <http://www.ofgem.gov.uk/Sustainability/socaction/Publications/Documents1/vulnerable%20customer%20engagement%20with%20the%20energy%20market%20research%20report.pdf> at page 11

<sup>6</sup> See the Ofgem energy supply probe at paras 8.53 and 8.54

<sup>7</sup> The direct debit guarantee can be found here: <http://www.bacs.co.uk/Bacs/Businesses/Direct+Debit/Paying+by/Your+rights/>

company will estimate a customer's expected usage in the year to come. The company will then divide the total payment for expected usage into twelve monthly instalments. Customers can expect to be in debit for some part of the year (usually the winter months when more energy is used for heating) and in credit at others (typically summer). For example, British Gas estimate that their customers typically start the winter £6.50 in credit and end the winter with £70 of debt. This system allows customers to divide their energy payments into regular instalments, making it easier to budget across the year from a regular income.

24. Customers are entitled to set the level of their payments themselves rather than accept their suppliers' proposed payment instalments, but they bear the risk of making overpayments or underpayments that will have to be corrected later.

25. Energy companies then monitor customers' usage over the year on the basis of actual or estimated meter readings, and may propose revised usage estimates and payment values, usually every six months. The value of monthly payments can also change when prices change. At the end of the year, when a customer's expected usage for the following year is set, any outstanding debt or credit is taken into account in setting the monthly payments for that year.

26. Some suppliers offer the opportunity to pay quarterly in arrears by direct debit, but in most cases no discount is offered for doing so and this form of payment is not actively promoted.

### **The benefits of paying for energy by direct debit**

27. For customers, the primary benefits of paying for energy by direct debit are that they pay a reduced tariff and that payment is smoothed throughout the year. If prices do not rise, or fall, and estimates of usage are accurate then consumers should not be presented with unexpectedly high bills to pay at short notice. Direct debit payments also potentially offer savings in time compared with taking a quarterly bill to a bank or post office counter (possibly also incurring counter fees) or paying by cheque or cash, or sending a cheque through the post.

28. All suppliers agreed that it was in their interests for more customers to opt to pay by direct debit. Most energy companies offered incentives and training to their sales staff to promote direct debits and some had set themselves challenging targets for future growth.

29. Direct debit payments offer significant administrative savings for energy companies in comparison to other payment methods (such as quarterly payments in arrears and pre-payment meters). They also offer a more regular and reliable source of income. By contrast, the timing and amount of quarterly bill payments are less predictable and energy suppliers occasionally need to follow-up with customers to secure payment<sup>8</sup>. For these reasons,

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<sup>8</sup> Ofgem Energy supply probe at para 7.59

energy companies offer substantial discounts to customers who are willing to pay by monthly direct debit.

30. Ofgem's energy supply probe suggested that some energy companies' direct debit tariffs, particularly online tariffs, may be too low to be cost-reflective and may be driven by customer acquisition strategies rather than cost differentials<sup>9</sup>. Whether the existing discounts are cost-reflective or not, we are satisfied that direct debit is a more efficient payment method than the alternatives and that this cost differential justifies a reduction in price. As things stand, energy discounts for direct debit payments can vary significantly across different companies. Their maximum value ranges from £28 to £109 per year (on dual fuel deals).

***Standard credit and direct debit average annual bills and differentials (December 2008)***

31. Ofgem has provided the following table, which gives calculations of the average cost differential (in £s) across the big six energy suppliers, based on average annual consumption of 3,300kWh for electricity and 20,500kWh for gas.

Supplier	Electricity			Gas			Dual Fuel		
	SC	DD	Diff.	SC	DD	Diff.	SC	DD	Diff.
British Gas	461	421	<b>40</b>	882	834	<b>48</b>	1328	1240	<b>88</b>
EDF Energy	451	442	<b>8</b>	793	776	<b>17</b>	1211	1169	<b>42</b>
RWE npower	494	473	<b>21</b>	797	779	<b>18</b>	1291	1189	<b>102</b>
E.ON	474	459	<b>15</b>	785	760	<b>24</b>	1259	1195	<b>63</b>
SSE	473	463	<b>10</b>	781	764	<b>17</b>	1225	1198	<b>28</b>
ScottishPower	442	410	<b>32</b>	887	811	<b>76</b>	1319	1210	<b>109</b>

32. In the Home Energy Saving Programme announcement, the Government provided figures, derived from BERR's quarterly Energy Prices report for September 2008 (produced by National Statistics)<sup>10</sup>, which suggested that households paying their gas bills by standard credit could save around £55 on their yearly energy bills if they switched to direct debit payment. The announcement also stated that households paying for their electricity by standard credit could save around £46 by moving to direct debit payments.

33. The same figures showed that households using prepayment meters for gas could make even greater savings of about £92 a year by paying by direct debit. Households using prepayment meters for their electricity could save in the region of £64 if they paid by direct debit.

**The drawbacks of paying for energy by direct debit**

34. With savings of up to £109 per annum, it might be asked why the overwhelming majority of customers do not pay by direct debit. Direct debit

<sup>9</sup> Ofgem's energy supply probe at para 7.62

<sup>10</sup> Reports can be found here;

<http://www.berr.gov.uk/whatwedo/energy/statistics/publications/prices/index.html>

tariffs do in fact have several disadvantages, especially for people on low and/or variable incomes.

35. These customers often do not use monthly direct debits because their pattern of income makes it necessary or preferable to budget on a weekly or quarterly basis. Many of these customers are content with their current frequency of payment as matching the flow of their finances. Some people accustomed to paying their bills weekly may not be in the habit of managing their money within a bank account and may be uncomfortable doing so. Where they have an account they may withdraw their full income, shortly after it is paid in, and then budget in cash.

36. Without sufficiently frequent or accurate readings of customer usage, several difficulties can arise. Underestimates of consumption, particularly common where households have switched suppliers, can lead to large 'catch up bills' at the end of a year or a period of time; overestimates of consumption can result in a large credit building up with the supplier – which may deprive people on low incomes of funds for day-to-day expenditure. And when prices are changing frequently, suppliers have to apply a formula to allocate consumption within a single period accurately to different prices – sometimes resulting in a customer perception of unfairness.

### **Further barriers to take-up of direct debit payment**

37. Our discussions with suppliers and other stakeholders have shown there are several more reasons why many people still choose not to pay by direct debit and why, for some of them, it is unsuitable for their circumstances.

#### ***Lack of understanding***

38. It is possible that some customers simply do not realise that they could benefit from switching payment forms. Often customers can take a passive approach and do not take pro-active steps to find the best way for them to pay for their energy. Many also have low levels of trust in messages from their energy companies seeking to convince them of these benefits. Suppliers reported response rates to direct mail promotions of only between 1% and 2%.

#### ***Transparency of direct debit tariffs***

39. The Taskforce has noted a wide diversity of practice between energy suppliers in setting and communicating the benefits of their direct debit tariffs. Some companies reduce annual bills by a fixed percentage and others apply a flat rate discount. This diversity makes it harder for customers to compare the offers effectively and to appreciate the difference that paying by direct debit might make.

#### ***Loss of control***

40. In 2006 we asked Bacs to investigate the reluctance of some people to take advantage of the available cost savings available by using direct debit payments. Bacs found that 6.7m people had a bank account but did not use

direct debit. They conducted comprehensive qualitative research among this group and reported back to the Taskforce in November 2007.

41. The most prominent fear for respondents in Bacs' survey work was of losing control of their bank account. Standard credit offers customers control over the timing for their payments, with many appreciating the opportunity to manage their finances by waiting for the 'red bill'<sup>11</sup>. This outweighs the perceived benefits from direct debit discounts.

42. We believe that the perception of a loss of control may also partly stem from confusion or mistrust surrounding their energy suppliers' use of an estimate of consumption to recalculate direct debit payments, especially where people paying quarterly in arrears experience consistent over-estimates of their usage. It may also reflect a lack of awareness of a customer's right to set their own direct debit payments.

43. We note that this perception has probably been exacerbated by recent press coverage of energy suppliers substantially increasing monthly direct debit payments. These increases may be due to changes in tariffs to reflect increased wholesale energy prices and to prevent customers from getting into debt. However reports of energy companies readily reducing monthly payments by £20 or more when challenged by customers will do little to re-assure potential direct debit customers that monthly payments are calculated in a rational and transparent way<sup>12</sup>.

### ***Fear of higher costs***

44. Customers are often reluctant to move to direct debits because they do not want to incur charges made by their banks for missed payments, where they have insufficient funds to meet a direct debit. Some respondents in the Bacs survey felt that they would not be able to put aside sufficient money to meet monthly payments or ensure that funds were available in time for collection. Of the older people surveyed by Bacs, typically half had stopped using direct debits because they had incurred bank charges or found mistakes.

45. Banks currently impose charges of between £8 and £38 for missed direct debits, including on basic bank accounts. The danger of incurring charges is particularly acute for people on low and/or variable incomes, particularly where they rely on Income Support or Jobseeker's Allowance. We note that proceedings are being taken forward in the High Court following an OFT investigation into the fairness of bank charges.

46. Six out of the seventeen basic bank accounts available offer a 'buffer zone' of £10-15, which allows underfunded direct debit payments within this

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<sup>11</sup> See also Ofgem's research on vulnerable consumers at page 22.

<sup>12</sup> See recent coverage in the Guardian at: <http://www.guardian.co.uk/money/2008/nov/29/energy-household-bills-gas-consumer-dissatisfaction>

zone to be paid. Other basic bank account providers will automatically cancel direct debits after they are declined two or three times<sup>13</sup>.

## **The potential for migration from other payment methods**

47. We believe that financial inclusion must be based on the principle that people should be able to make an informed choice between different forms of payment and get help and support to do so. Where they can benefit by moving to direct debit payments, we would want them to be fully aware of the opportunity to do so – and have access to appropriate advice and support to enable them confidently and successfully to change the way that they manage their money and payments. However, we would not want them to move into paying for energy by direct debit where it does not suit their circumstances, and especially not where there is a serious risk that doing so would destabilise an already precarious financial position.

48. We therefore believe that the scope to migrate will vary between customer groups.

### ***Standard credit***

49. The Taskforce believes that a significant proportion of the households currently paying by standard credit could benefit by switching to direct debit payments for their energy bills. Hard data has not been available to us but, based on our discussions, we believe that those most likely to benefit from switching will be younger, employed and either owner-occupiers or private renters. These are mainly people with stable incomes who are already financially included and capable of using direct debits with confidence. We would like to do further work with Ofgem to see whether this group can be more accurately identified and quantified.

50. Not all standard credit customers are necessarily in this position, for example some pensioners may manage on low incomes in spite of owning their homes.

### ***Pre-payment customers***

51. Historically pre-payment users have paid the highest tariffs for their energy, reflecting the higher costs of the meters themselves and the infrastructure required to support them. This is a situation which many consider unfair, given that many pre-payment customers are among the poorer socio-economic groups. Ofgem's energy supply probe found that the differential between pre-payment and direct debit tariffs rose from £80 at the beginning of 2005 to £125 at the beginning of 2008<sup>14</sup>. In December 2007, Energywatch found that prepayment users could be paying an average of £195 extra each year for their gas and electricity as compared with the best available deals.

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<sup>13</sup> Details of the terms and conditions for all basic bank accounts are given in the FSA moneymadeclear leaflet found here;

[http://www.moneymadeclear.fsa.gov.uk/pdfs/bank\\_accounts.pdf](http://www.moneymadeclear.fsa.gov.uk/pdfs/bank_accounts.pdf)

<sup>14</sup> Ofgem's energy supply probe at para 7.47

52. Ofgem research suggests that some pre-payment customers are unconcerned about paying more, given the perceived benefits of seeing a clear and direct link between cost and consumption<sup>15</sup>. The research even gives examples of people deliberately defaulting on their payment to force their suppliers to install a pre-payment meter.

53. Energy companies find that this group are often their most satisfied customers and that they are the least willing to move to other payment methods. Limited survey information gathered for Ofgem also suggested that the majority of pre-payment meter customers were satisfied with the service<sup>16</sup>.

54. Pre-payment meters offer several advantages to their customers, which can compensate for the inconvenience of making regular payments. They enable them to link usage directly with payment, allowing them to budget precisely and also to ration their usage within their budget<sup>17</sup>. Some customers, particularly older ones, will use pre-payment meters as a form of saving, building up credit in the summer by adding regular amounts in anticipation of higher levels of usage in the winter<sup>18</sup>. To a degree this mirrors one of the benefits of monthly direct debit payments, albeit in a much more flexible way.

55. Although research has identified that some people do make a successful transition from pre-payment meters to other forms of payment, we believe that many pre-payment customers would struggle to do so. Moving to making a regular monthly payment by direct debit can put excessive pressure on a small and/or variable weekly budget, even though the smoothing of payments can make winter fuel bills more manageable. Encouraging people in this position to move to monthly direct debit could put them at greater risk of bank charges for having insufficient funds and of over-indebtedness.

56. The Taskforce has noted continuing government pressure on industry to reduce prepayment tariffs and recent moves by the big six suppliers to reduce their tariffs. We also note Ofgem's recent decision to consult on proposals to change suppliers' licences to ban unfair prices<sup>19</sup>. Several suppliers have equalised their tariffs for pre-payment meters with standard credit tariffs and at least one, Scottish Power, has reduced its tariffs below the cost for standard credit customers. In principle equalising tariffs in this way may be one way to ensure that poorer customers who use pre payment meters are not paying more for their energy than other people. We note that if prices are reduced below the cost of providing the service then pre-payment customers would need to be subsidised by other customers. Many more "fuel

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<sup>15</sup> See Ofgem's research on vulnerable consumers' engagement with the energy market, at page 18.

<sup>16</sup> See Ipsos MORI's Prepayment meter customer workshop for Ofgem, February 2007 (available here; [http://www.ofgem.gov.uk/Sustainability/socaction/Publications/Documents1/Prepayment\\_meter\\_Customer\\_Workshop.pdf](http://www.ofgem.gov.uk/Sustainability/socaction/Publications/Documents1/Prepayment_meter_Customer_Workshop.pdf)) at page 14 onwards.

<sup>17</sup> *Ibid.*

<sup>18</sup> Ipsos MORI's Prepayment workshop at page 11.

<sup>19</sup> See their press release on 16 December at; <http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=213&refer=Media/PressRel>

poor” people pay for their energy by standard credit than by pre-payment meter and it seems objectionable that they should bear the cost of any such subsidy. We would urge Ofgem to ensure that pre-payment meter and standard credit customers are not paying any more than they need. We hope that Ofgem’s proposals to ban unfair payments can achieve this.

### ***Social Tariff Customers***

57. Social Tariffs have generated continued debate since their introduction. Each supplier has so far taken a different approach to setting the level of the tariff, the conditions for eligibility and the tariff’s promotion. In August 2007 Ofgem found that around 365,000 customers were on social tariffs and that this was a significant contribution by energy suppliers to supporting vulnerable customers<sup>20</sup>.

58. This is a complex area and, as it does not relate directly to the choice between payment methods, we have decided to leave it out of the scope of our work for the time being. We would urge suppliers and Ofgem to continue their efforts to ensure that the best available deals are available to vulnerable households. We would be happy to support them in further work to engage vulnerable groups.

### **The impact of migration to direct debit payments**

59. The Taskforce therefore recognises that there is a substantial group of people including some standard credit customers and most pre-payment customers who will not be able to move immediately to direct debit payments without compromising their ability to manage their finances. We believe that this group also deserves support in choosing the most appropriate and economical form of payment for their energy costs.

60. The Taskforce also notes that stimulating movement onto a direct debit tariff could increase the average cost to serve standard credit customers who continue paying by cash/cheque by increasing the proportion of bad debtors within this group. We would urge energy companies to ensure that measures to enable more people to benefit from direct debits are not delivered at the expense of vulnerable households who could otherwise see their prices rise as a result.

### **Recommended measures to encourage migration to direct debit payments**

#### ***Information about direct debits and discounts***

61. One immediate way to encourage people to use the most appropriate and affordable payment method is to ensure they have accurate information available to them, from a trusted source and at the right time, to enable them to make an informed choice.

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<sup>20</sup> Ofgem’s review of Suppliers’ voluntary initiatives to help vulnerable customers, August 2007

62. Where standard credit customers can move to direct debit payments, clear messages showing the benefits could help them to take that step with confidence. The Taskforce appreciates that energy customers are currently presented with significant volumes of messages on cutting usage, reducing emissions and saving money. Any new messages must therefore run coherently alongside the other priorities in the Home Energy Saving Programme. We note that the benefits of direct debit have already been included in the ‘Act on CO<sub>2</sub>’ press campaign<sup>21</sup>. We encourage the Government to continue to include messages about direct debit and to review these messages in light of our report.

63. We have also noted the low response rates reported by many energy companies to direct mailings or telephone sales to existing customers. However, we believe that messages that are perceived to have a degree of independence and messages that come at the right time (i.e. following a substantial bill) are more likely to achieve a shift in attitude and behaviour.

64. Where energy customers are unlikely to be in a position to move to direct debit payments, because their pattern of income and budgeting would make it inappropriate, we believe that it is important also to offer these customers support and advice on paying for energy in the most appropriate way.

65. The Taskforce has noted recent joint work by Ofgem and Citizens Advice, now funded by DECC, to deliver an ‘Energy Best Deal’ campaign, targeted at households at risk of Fuel Poverty. Training and awareness sessions have been delivered by local organisations such as advice providers, housing associations and local authorities to raise awareness of the advantages and disadvantages of different payment methods. This approach follows the same model as the OFT’s Save Xmas campaign. A recent independent evaluation found that this latter was an effective way to reach more vulnerable households, to help consumers to make a more informed choice and to change their behaviour<sup>22</sup>. We would encourage further public campaigns such as this, where possible, perhaps within the remit of Consumer Focus<sup>23</sup>.

### ***Changes to existing payment options***

66. We believe that existing payment options could be modified in a number of ways to make it possible for more people to benefit from the savings that are possible through paying by direct debit.

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<sup>21</sup> See [www.direct.gov.uk/actonCO2](http://www.direct.gov.uk/actonCO2)

<sup>22</sup> The full evaluation report can be found at <http://www.oft.gov.uk/news/campaigns/savexmas/>

<sup>23</sup> The Consumer Focus website can be found here; <http://www.consumerfocus.org.uk/>. Part of their work plan is to “Support advice agencies through the provision of information and policy resources to help them advise energy and post customers”.

#### Discounts for quarterly direct debit payments:

67. Although most energy suppliers will offer customers the opportunity to pay quarterly in arrears by direct debit, only two offer customers a discounted rate, compared to paying quarterly by cash/cheque.

68. The recent Ofgem energy supply probe suggested that the increased cost to serve standard credit customers resulted mainly from greater levels of bad debt and the need to follow up customers to secure payment<sup>24</sup>. Based on Ofgem's findings we anticipate that, by offering quarterly direct debit payments, energy suppliers could reduce much of the extra cost for standard credit. Ofgem's findings suggest that the remaining cost difference for standard credit customers would be a higher cost of working capital (around £12 per customer). We would therefore anticipate that quarterly direct debit payments, made in arrears could be offered at a discount worth a large proportion of the average premium of £80 per year paid by standard credit customers<sup>25</sup>.

69. This would give existing standard credit customers access to a discounted tariff in return for regular, non-fixed payments at a frequency they are currently choosing. It would be a suitable tariff for people who do not wish to commit to regular monthly payments, or who are uncomfortable with setting their payments on the basis of an estimate of their future usage.

#### Greater transparency and flexibility in monthly direct debit calculations:

70. As noted above, at paragraph 43, recent press coverage and political interest in energy companies' direct debit tariffs has focused on the mechanism that companies use to estimate usage in the year ahead. We believe that more people would have the confidence to pay by monthly direct debit if it were easier to understand the rationale underlying the calculation of projected use.

71. We believe that energy suppliers should agree good practice as a part of the Energy Retailers Association Billing Code<sup>26</sup>, for explaining the way in which they calculate usage in the year to come, for the timescales for reviewing payments and for dealing with customer queries. This would enable customers to see, in a clear and consistent way, how their charges will be set for the year ahead. It would provide a consistent process for customers to challenge estimates and, where appropriate, obtain redress where they believe that charges have been calculated incorrectly. It could also help to make tariffs easier to compare and so enable customers to understand better the savings they could make.

72. We also think that suppliers could help customers to understand and value the savings opportunities offered by direct debit payments by simplifying the tariffs and the discounts available, to ensure greater comparability.

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<sup>24</sup> Ofgem energy supply probe at para 7.59

<sup>25</sup> Ofgem energy supply probe at para 7.61

<sup>26</sup> More information about the code can be found at: <http://www.energy-retail.org.uk>

### Weekly direct debits

73. Customers whose income arrives weekly and who budget on this basis find monthly and quarterly billing harder to plan for. Moving to monthly payments could therefore put them at greater risk of getting into debt. However, some may be able to make regular weekly payments through direct debit and to save money by doing so. This could be an attractive payment option for a number of customers currently using pre-payment meters.

74. Many suppliers already offer a weekly or fortnightly budgeting scheme, whereby customers use a card to pay a regular amount, set by forecasting usage on the same principles as a monthly direct debit. For some customers this is a way to clear outstanding energy debts. Others find it a useful budgeting tool. This latter group (provided they have a bank account) may also welcome the opportunity to move to automatic payments, which would be cheaper to collect than payments made through Post Office or Paypoint.

75. This service could put extra pressure on energy suppliers' payment systems by increasing the number and frequency of incoming direct debit payments (though it could also reduce the number of weekly payments made through budgeting schemes). It would also cost more in direct debit fees to draw payments weekly than it would to take them monthly. However, we would not expect this difference to be so great that there was no cost saving at all. We appreciate that some suppliers' systems may currently constrain them from offering weekly payments; however we believe that several suppliers' systems could have the capacity to handle them. We would encourage suppliers to consider offering this service and to investigate the costs and benefits of doing so.

### Direct debit text alerts

76. It would improve some customers' ability to control direct debit payments if energy suppliers offered to send text reminders to a mobile phone several days before a direct debit payment is due. (Several banks already offer text alert services, sent at regular intervals to confirm a customer's account balance or triggered by the balance reaching a specific level.)

77. Energy suppliers are in the best position to issue a reminder to their customers several days ahead of payment dates, before they submit a payment request to Bacs. The cost of sending the messages would be fairly low. The key challenge would be triggering the message through the supplier's billing system.

78. The Taskforce believes that this service could go some way towards re-assuring people that they can retain control over each direct debit payment drawn from their account. We would like energy suppliers to explore a service of this kind.

### Quarterly bills to show possible savings

79. One way of showing customers the savings they could achieve through direct debit payments, at the time when they are most likely to act on it, would be for energy companies to include a notice, on bills for customers paying quarterly, showing what they would have been charged over the previous year if they had been paying by direct debit. At least one of the major energy suppliers is already planning to introduce such notices for customers on standard credit. We would like all the major suppliers to provide their customers (of one year or more) with this information.

### Bank Charges

80. The Taskforce is following with interest the OFT's test case in the High Court concerning overdraft charges and "returned item" charges. Existing buffer zones and provisions for cancelling direct debits after a certain number of rejected payments help to provide customers on low incomes with greater confidence in using direct debits to pay energy bills. We believe it would be in the interests of customers if all basic bank account providers offered similar safeguards.

81. The Taskforce also believes that support for customers by 'ring-fencing' funds within a bank account for specific bills could help them to have confidence that they will be able to meet regular direct debit payments. We understand that some retail banking providers are planning to introduce such a service and we have also noted proposals to offer a service dedicated to utility payments for poorer people.

### ***New payment systems***

82. For the longer term, developments in payment systems, such as the mobile phone account-to-account service currently under consideration, may provide new and attractive payment methods, which might themselves attract discounts.

83. The Taskforce also believes that smart meters have significant potential to improve the efficiency of energy charging. In October 2008, the Government announced its plans to ensure that smart meters are rolled out to all domestic customers over a ten-year period. By providing better information about the timing and quantity of energy consumption, smart meters should enable customers to control their usage more actively and should increase competition between providers by enabling different tariffs at different times of day.

### **Conclusion**

84. We have made the recommendations above on the basis of a series of short discussions with energy suppliers and their regulator. We believe that the key priority should be for suppliers and the Government to support people in making the best choice about how to pay for their energy. We would urge the energy companies and the Government to consider what steps they can take to implement the recommendations and evaluate their impact. We would

welcome Ofgem taking an active role in this process. We will continue to work with suppliers and with Ofgem over the next year to pursue these recommendations and to explore further their role in increasing financial inclusion. We will make our next formal report to the Government on Financial Inclusion in time for the Budget 2009 and we will include an update on these recommendations in that report.

## **Annex A: Terms of Reference for a Financial Inclusion Taskforce review of direct debit energy bill payments**

Under the Taskforce's terms of reference for 2008-2011 the Taskforce will monitor and influence progress towards the Government's goal that people should be able to manage their money on a day-to-day basis, effectively, securely and confidently.

To support this objective over the next few months the Taskforce will work with energy companies, Ofgem and other stakeholders to consider and address the barriers that prevent customers paying their energy bills by direct debit. In particular the Task Force will review:

- data and research on direct debit usage and people's attitudes and behaviour towards direct payments, including Ofgem's research into switching behaviour amongst vulnerable consumers;
- initiatives by utility companies, banks and others to encourage greater use of direct debit bill payments; and
- whether forms of bill payment other than direct debit could be streamlined to bring further savings.

The Taskforce will report in December with recommendations on how more people can benefit from the savings direct debit bill payments can bring and to make bill payments easier and more affordable for vulnerable customers.