Citizens Advice response to the Insolvency Service call for evidence on Insolvency Practitioner regulation

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citizens advice

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Overview

Citizens Advice welcomes the opportunity to respond to this call for evidence on on Insolvency Practitioner regulation.

Debt is the second largest issue that we deal with at Citizens Advice. We helped more than 2 million people last year. Of these, around 340,000 were seeking help with their debts. We spoke to around 8,100 people about Individual Voluntary Arrangements. The issues that we see have been reflected in our responses to the questions below.

Over the past 12 months we've seen a 6% rise in the amount of clients approaching us for help with Individual Voluntary Arrangements. Within that figure we've seen significant rises in the amount of issues we're seeing around the IVA process (up 25%), the role of Insolvency Practitioners (up 35%) and complaints and redress (up 28%). When coupled with anecdotal evidence from our advisers it gives rise to some serious concerns about aspects of the IVA market and the existing regulatory model.

The lack of regulation around lead generating firms and money advice provided by Insolvency Practitioners, the mis-selling of IVAs as a solution, the increasing early failure rate and linked profit making activities that firms are making are all causing detriment to our clients. This is in addition to the inconsistencies around fees and the existing complaints mechanism.

We have particular concerns about unsuitable advice being given to people. In 2017-18 51% of the people we spoke to about IVAs stated that they were receiving benefits. We've addressed these issues in the questions we've opted to answer below.

Based on the cases we see the regulatory model for IPs is insufficient. Where practice is demonstrably poor, there doesn't appear to be proportionate repercussions. Adding to the problem is that many of the IPs at larger firms have poor oversight of what is happening at the ground level, with administrators managing the majority of cases. Having a number of membership bodies results in an inconsistent and patchy approach to regulation and complaints management. Having a single regulatory body, which has powers of redress, would provide a more consistent and customer focused oversight.

Recommendations

As a result of this review Citizens Advice would like to see the following:

1. The establishment of a single regulatory body for insolvency practitioners (IPs), which has powers of redress. This would provide a much more consistent approach to regulation and complaints management.

2. IPs should only be able to accept leads from Financial Conduct Authority (FCA) regulated money advice providers.

3. The exemption on IPs for debt counselling should be removed. This additional regulation could be funded by a new levy on IP firms.

4. IP firms should be restricted from selling clients that are in an Individual Voluntary Arrangement (IVA) further products, such as loans or claims management services, that could directly impact the outcome or suitability of that IVA.

5. A clear, easily recognisable and independent complaints body should be established.

6. Unless there are exceptional circumstances, people on benefits only income should not be able to enter into an IVA.

7. After receiving advice on an IVA, customers should be signposted to free and independent money advice. This should be mandatory and would provide the client the chance of getting additional impartial information.

8. Once an IVA application has been made customers should be allowed a 14-day 'cooling off' period, to allow the customer to reflect on the decision and, if required, seek advice. This should be after a proposal is agreed between IP and client, but before the creditor's meeting.

9. The introduction of a mandatory standardised declaration that must be signed of part of an IVA application, where a customer is not a homeowner and owes less than £20,000. It would detail what a debt relief order (DRO) is and that the client understands the implications of one. Clients who are not eligible for a DRO would need to sign a statement that explained why they were not eligible.

10. Is there confidence that people who are in financial difficulty and wish to enter a statutory solution are routinely offered the best option for their circumstances?

No. Although money advice firms are regulated by the Financial Conduct Authority (FCA), there are a significant number of lead generating firms and non-FCA regulated IP firms that habitually push unsuitable IVAs onto people. At Citizens Advice we have seen a number of examples of both bad practice and unsuitable advice by such firms. This includes cases where:

- clients have been inappropriately placed into an IVA while on benefits
- clients have been escalated into an IVA because they have no funds to pay the £90.00 fee for a debt relief order (DRO).
- clients have been talked into making IVA applications by IP firms without being given full advice and information about all of their other options.
- Clients have been inappropriately placed into an IVA when they would have been eligible for a DRO.
- Clients are entering into repayment agreements at rates they can't afford.

We have provided a number of anonymised client stories to illustrate these examples below:

Case Study 1

Our client lives alone in a rented property. She has a history of mental health problems, is currently on antidepressants and has undergone a number of types of therapy. The client is currently in an IVA with Money Plus paying £70.00 per month towards debts of around £10,000. She was on Employment and Support Allowance when this was first set up and she has since moved onto JobSeeker's Allowance. The client could never have afforded the monthly payments and should not have been given an IVA. Under bankruptcy or a DRO the client would not have to make any monthly payments and would be free of her debts after one year.

Case Study 2

An IVA firm recommended an IVA when this was clearly not the best option for our client. The client has non-priority debts of around £13,000 and disposable income of £500 per month. They are not a homeowner and could repay the debts in full using a free debt management plan in just 26 months. However the IP firm recommended the client applied for an IVA lasting 5 years. The client stated that the firm had persuaded him against a Debt Management Plan (DMP), claiming an IVA would be a better option. They also assessed his disposable income as being above £500, as they didn't

take into consideration money for food. If the client had not sought further advice from Citizens Advice he could have entered a 5-year IVA. He would have suffered a serious adverse impact on his credit rating and not benefited from any debt write-off. An IVA could also have a serious effect on his profession and tenancy agreement.

Case Study 3

Client has no assets or savings, lives in social housing, and is employed earning £1,400 per month. She has £29,000 in unsecured credit debt. She was sold an IVA in March 2017, paying £70.00 a month which she couldn't afford. The client was much better suited to bankruptcy. When asked, the IVA firm stated that the client simply opted for an IVA, but the client states that she was told by the firm that this was the better option for her. The IVA firm has also not accounted for the extent to which the client's situation is due to change in the near future - she has 2 dependent children living in Nigeria and is seeking to raise funds to pay for their passports so they can come and live with her. Her situation is very difficult, and being tied into a 5 year IVA is unlikely to help matters, especially when it is likely to fail.

Case Study 4

Client owes around £16,000 and lives in rented accommodation. She is separated from her husband and has 2 dependent children, one of whom is disabled and is in receipt of Disability Living Allowance. Client receives carers allowance which is topped up with other means tested benefits. The client stated that her personal life took a spiral - her grandmother was seriously ill and her husband left her, and this led to an alcohol problem. The client stated that because of this, and the need to address the debt, she approached An IVA provider. The firm stated that she was not eligible for bankruptcy (despite there not being strict eligibility criteria) and would need to consider an IVA. They determined that the client could pay £100 per month towards an IVA. The client stated that she could not afford this amount, but agreed to an IVA as thought it was her only option. The client has not made a payment towards the IVA for 4 or 5 months, but the IVA has not been terminated and the firm are suggesting the client considers amending the original IVA.

Case Study 5

The client had been advised by a firm to apply for an IVA and came to Citizens Advice for a second opinion. The client and his wife have credit debts of around £10,000 - 12,000. They are not yet in arrears but are struggling to maintain payments. They're paying around £400-£500 in interest, but can only realistically afford £200-£300. Based on what they can afford the client could repay these debts in 5 years or under on a free debt management plan. The firm the client approached are a fee-charging company offering IVAs and appear not to have acted in the clients' best interests, which is a serious breach of FCA regulations. The client and his wife were being pressed to take out interlocking IVAs, with two sets of related fees. This is likely to have resulted in them repaying more and suffering greater damage to their credit rating.

Case Study 6

The client entered into an IVA with an IP company when he was self employed. He was able to make monthly payments but not at the rate that they were set. The client states he did not budget enough for food each month (£100) and the payments were unaffordable. The client states he was not advised about any alternative options and was persuaded into entering an unrealistic and unaffordable IVA. The client is now single and living with a friend due to being evicted from his previous property. The client is claiming Universal Credit, but is receiving a reduced amount due to repaying a short term advance. He receives no other income. He has tried to end the IVA, and even signed the termination notice, but the IVA has yet to show on the Insolvency Register as terminated.

Case Study 7

Our client was interested in taking out a debt solution last year for around £15,000 of debt. She approached a number of debt management firms seeking a face to face meeting, but found none that would accommodate that - they all only spoke with customers over the phone. Eventually a company agreed to visit the client, but sent an administrator rather than an Insolvency Practitioner. The administrator spent just 20 minutes with the client, and claimed that the only option the client had was an IVA. The client and her husband set up interlocking IVAs, but were unable to maintain the monthly payments of £90. The company have been unable to offer any further advice or suggestions and client has stated that she does not wish to continue the IVA. The client has contacted the company to advise of the termination and was advised to send an email, which she has done. The client stated that she has since heard nothing from the company about the termination notice. After looking at their finances the client and her husband are ideal candidates for a DRO.

We understand that much of the bad practice complained about by our clients and their advisers is driven by lead generation firms. There is a regulatory gap that needs to be closed. The FCA has failed to do this and regulation of Insolvency Practitioners won't either. We recommend that IPs should only be able to take leads from firms regulated by the FCA.

All debt advice should be FCA regulated. One way of regulating the standard of advice would be to ensure that IPs, and the firms they work for, must be FCA regulated. The current exemption on IPs for debt counselling should be removed. The FCA rules and principles are more robust than the Insolvency Act objectives. This additional regulation could be funded by a new levy on Insolvency Practitioner firms.

We strongly believe that there needs to be accountability at firm and IP level. The IVA industry is no longer IP led, but dominated by big volume firms. Something akin to FCA regulation is now essential so that IPs could be individually certificated (in a similar way to the FCA's Senior Managers and Certification

Regime), and firms would be accountable for their business model and suitability.

Linked products and services

IVA loans and other services (Payment Protection Insurance and other claims management activities) are often linked. What happened in the Varden Nuttall case - when the mid-size IVA firm went into administration with evidence of fraud from one of the IPs - should never be allowed to happen. In this case there were too many interested and linked companies. Much better oversight of these arrangements is required, with certain arrangements being banned outright. It's a conflict of interest for IVA providers to give their clients loans or to make claims on their behalf. If an individual is looking to make such a claim through a firm, that firm should be entirely separate from any interested parties in the IVA.

Somewhere along the way the IP industry appears to have forgotten that it's about impartiality - to both creditors and clients. Insolvency is about dealing with debt and returning clients to stability, and returning money to creditors where possible. It should never be about selling products and services.

Inconsistent complaints routes

At present both the market and its complaints mechanism is inconsistent for consumers. If a particular client gets unsuitable debt advice from an FCA regulated firm, and their complaint cannot be resolved by the firm, they're able to complain to the Financial Ombudsman Service where there is potential for compensation. They're able to refer to the FCA rules and principles in complaints or even court action. If the same client received the same advice from an IVA provider who is not FCA regulated, the client can still complain about the same gateway, but would use a different set of rules and standards, and with no possibility of compensation (there is no direct recompense through sanctions on IPs). From a consumer viewpoint, it's potentially very inconsistent and confusing.

14. On a scale of 1 to 5, to what extent do you agree with the following statements? (1 being strongly agree, 5 being strongly disagree.) Please provide an explanation for your score and supporting evidence if possible.

"There are matters of significant concern, which are currently affecting confidence in the regime, which are not addressed adequately by the regulatory objectives"

1

In 2018, IVAs increased by 20%. They were already the most common type of personal insolvency in 2017 and have been rising since 2015. In 2018, IVAs accounted for 62% of the total insolvency numbers in England and Wales, and personal insolvencies have risen across the board for the past 3 years. While the increase in IVAs is not surprising in isolation, the rate that they have accelerated compared to other types of insolvency (especially debt relief orders) is a cause for concern.

Failure rates

Of particular concern is the rate at which IVAs are failing, especially first and second year failures. Without hard data it's difficult to say for sure, but when the failure rate is held next to the increase in IVAs overall, we would suggest that this points to mis-selling.

In 2017, the Insolvency Service analysed how many IVAs were failing in their early years. This analysis found that one and two-year failure rates had risen in 2017. The same analysis done for 2018 showed that the failure rates had increased again.

For IVAs that started between 2011 and 2014, the failure rate for the first 3 years was roughly similar. About 5% failed in the first year, 12% failed within 2 years and 16% failed in the first 3 years.

Since 2014, new IVAs have been failing much more often. 9% of IVAs started in 2017 failed in the first year and 18% of IVAs started in 2016 failed in the first 2 years. These figures strongly suggest that IVA providers are failing to properly assess the suitability of an IVA in ever increasing numbers. A failure in the third, fourth or fifth year may be put down to an unexpected change in circumstances

or 'plan fatigue'. However, a failure in year 1 or 2 will often not only be foreseeable, but quite possibly inevitable. In some instances we might even describe these arrangements as 'designed to fail' because the consumer was not in a position to afford the repayment from day one. These statistics give weight to the numerous and increasing reports from money advisers who are seeing clients being given IVAs when they would be better suited to an alternative option (such as bankruptcy or a debt relief order).

This is a worrying trend, especially when coupled with the escalating rates of IVAs across the board, and some of the examples of unsuitable IVAs that advice agencies have been seeing.

We agree with the revised IVA protocol (which is yet to be introduced) that people with benefit-only income shouldn't be allowed to enter into an IVA, unless there are exceptional circumstances. However, given that the protocol doesn't guarantee sanctions we'd also like to see additional measures introduced to help clients to make more informed choices. The introduction of mandatory sign-posting to free and independent money advice after a client receives advice on an IVA would at least give the client the option of obtaining additional impartial information. We'd also suggest a 14-day 'cooling off' period after an IVA application is made, to allow the customer to reflect on the decision and, if required, seek advice.

Our advisers see many clients in IVAs who would be much better suited to an IVA. Therefore, where an IVA proposal comes from a client that owes less than £20,000 and isn't a homeowner, the Insolvency Practitioner should be required to have the client sign an extra declaration stating that they have chosen an IVA over a DRO. This declaration should be standardised and drawn up by statutory organisation. It would detail what a DRO is and that the client understands the implications of one. Clients that are not eligible for a DRO would need to sign a statement that detailed why they were not eligible (e.g. "I am not eligible for a DRO because the amount that I have left over each month after I have met all my reasonable living costs is more than £50").

Low complaints numbers

It's important to note that the number of complaints received about IVAs should not be used as a measure of success for the industry. A low level of complaints doesn't necessarily indicate a healthy market. IVA clients are often unaware that they have grounds for a complaint. Many are too scared to complain while their IVA is still going in case it's cancelled as a result. The complaint levels could also

be influenced by a poorly communicated or overly complex complaints process. Without a clear, easily recognisable and independent complaints body, people may not be aware of who they should be complaining to, or if they will act in the client's best interests. Until these issues are addressed the level of complaints shouldn't be considered as an indication of the IVA market's success. In fact the complaints mechanism itself is in need of review. However, the market could - and we suggest should be - measured by the ever increasing numbers of early IVA failures.

This is an issue that practice market regulation might be able to fix.