

Debt (mis)management

Evidence on debt management companies
from Scottish Citizens Advice Bureaux



*based on the evidence of
Citizens Advice Bureau
clients across Scotland*

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The Citizens Advice Service in Scotland

Citizens Advice Scotland and its member bureaux form Scotland's largest independent advice network. CAB advice services are delivered using service points throughout Scotland, from the islands to city centres.

The CAB Service aims:

to ensure that individuals do not suffer through lack of knowledge of their rights and responsibilities, or of the services available to them, or through an inability to express their need effectively

and equally

to exercise a responsible influence on the development of social policies and services, both locally and nationally.

The CAB Service is independent and provides free, confidential and impartial advice to everybody regardless of age, disability, gender, race, religion and belief and sexual orientation.

Executive summary

The market for debt management services has grown hand in hand with the exceptional rise in personal debt in the UK. An estimated 375,000 people in the UK are on a commercially provided debt management plan,¹ costing them £250 million in debt management fees each year.²

One of the effects of the recent economic downturn has been an increase in debtors seeking help with their debts and a concurrent increase in the number of commercial debt management companies willing to offer their services. Whilst many companies offer support to those in financial difficulty, others can take advantage of people who are at their most vulnerable.

Scottish citizens advice bureaux have seen significant numbers of clients who have sought advice after experiencing problems with a debt management company. These problems include:

Providing misleading information about their services

- Companies who use names and logos that imply that they are a government agency or charity
- Misleading information about the fees that are charged for their services, including claims of free advice when fees are involved
- Exaggerated claims about the services that the company can provide for a client, including misleading claims about debts and charges that can be written off.

Companies that provide inappropriate financial advice to clients

- Failure to give information on the full range of debt remedy solutions available to the client
- Failure to offer the debt solution that is in the best interests of the client and instead promote that which is most profitable to the company. This can leave a client in a worse financial position than they were in prior to receiving advice
- Failure to advise clients to pay their priority debts first, such as their mortgage, which can lead to significant difficulties for clients.

High management fees

- Clients who have been charged an upfront fee of up to £50 for consideration of their case, only for the company to decline without refunding the client
- Clients who have been charged up to £1,000 before receiving any advice
- Clients who pay significant monthly fees to debt management companies only to find that little money is being paid to creditors.

Recommendations

- Consumer bodies should work together to increase consumer knowledge and awareness of debt advice and debt solutions
- The UK and Scottish Government should provide adequate resources for free debt advice to help as many people as possible.

Introduction

Debt management companies offer services to consumers who are often at a very vulnerable stage in their life; they are likely to be over-indebted, stressed and desperate for help to manage their financial problems. It is therefore fundamentally important that these consumers receive the appropriate advice and support that will allow them to improve their position.

However, there is a growing body of evidence to suggest that many debt management companies are failing to provide the right kind of support for vulnerable consumers, many of whom end up in a worse financial situation than when they first sought help.

Following a review of debt management companies, the Office of Fair Trading cracked down on 129 debt management companies in 2010 who were failing to meet the terms of their licence. At the start of 2011, 43 companies surrendered their licence and 11 were informed that their licence would be revoked.³

The findings from the review “shine a spotlight on a market where poor practices appear to be widespread... it is clear that standards across this market are not as high as should be the case.”⁴

Debt management in the UK

There has been a significant increase in the number of debt management companies operating in the UK. A 2009 study estimated that there were over 150 companies offering debt management plans for a fee compared

to fewer than 40 companies ten years previously. The majority of these companies offer a national telephone or internet based service.⁵

Commercially provided plans are generally marketed at people with debts of less than £15,000, with at least two creditors, and sufficient disposable income to make repayments. Research has shown that customers are more likely to be in work and have higher incomes than those who use free debt advice.⁶

Citizens advice bureau clients

A number of CAB debt clients have used a debt management company in the past. Our research found that around 7% of CAB debt clients had used a debt management company to repay creditors - more than twice the proportion that used such companies in 2003.⁷ CAB debt clients tend to have high levels of debt and low levels of income, and are likely to be vulnerable to poor debt advice. This briefing examines the poor service that bureau clients have experienced from debt management companies under the following headings:

- Cold calling
- Misleading advertising
- Inappropriate financial advice
- Management charges
- Poor creditor distribution.

Cold calling

Debt management companies can misrepresent their services and charges in cold calls to clients, which can result in clients handing over their bank details and being debited an initial charge.

- ▶ **An East of Scotland CAB reports of a client who was charged £300 after being cold called by a debt management company. The client was telephoned on her mobile by the company and, despite not being in arrears on her debts, gave her debit card details. The company immediately debited £300 from the client's account.**
- ▶ **A West of Scotland CAB reports of receiving a cold call from a debt management company claiming that they could get 50% of the adviser's debts written off. When questioned where they got the number from, the caller advised that they would have had a credit agreement in the last two years. When the adviser mentioned that this was a citizens advice bureau, the line went dead.**

Citizens advice bureaux have seen an increase in companies who masquerade as a debt management company in order to profit from people at their most vulnerable. This practice includes cold calling potential customers with promises that they can write off their debt or help them reclaim "illegal" charges. After paying for the service, the customer will then find that the contact details that they were given are false, and they have little chance of recovering their money.



- ▶ **A West of Scotland CAB reports of a client who was cold called by a debt management company who pressurised her into giving them details of her four credit cards to consolidate her debt. The client paid the company over £1,000 and now they have seemingly disappeared. The client has cancelled all her cards but she is really worried because she is in even more debt now and is a single parent and not working.**
- ▶ **An East of Scotland CAB reports of a client who paid £100 to a debt management company, but has been unable to contact them since. The client's creditors have been in touch to say that they have received no payments. The client tried to phone the company on the number given, but found that the number had been disconnected.**

Misleading Advertising

The OFT review of the debt management sector found that misleading advertising was the most significant area of non-compliance, in particular misrepresenting debt management services as being free when they are not. Their review of 100 debt advice and debt management websites found that no websites complied fully with the guidance for debt management.⁸

Citizens advice bureaux in Scotland have seen a number of practices that mislead clients into paying for a service that is different from that which is advertised, including:

- Exaggerated claims about the services that the company can provide for a client, including misleading claims about debts and charges that can be written off
- Companies who use names and logos that imply that they are a government agency or charity
- Misrepresenting the services provided by the free advice sector in order to secure more business.

Internet advertising is widely used among debt management companies alongside more traditional forms of advertising such as the Yellow Pages or local newspapers. It has also been reported that loan companies act as an 'introducer' to debt management companies.

Exaggerated claims

Debt management companies can make exaggerated claims about the services

that they can provide for a client in their advertising and cold calls, including misleading claims about debts and charges that can be written off.

▶ **A North of Scotland CAB reports of a client who was cold called by a debt management company who indicated that they could get his loan wiped out. The bureau was able to advise that whereas some debts can be unenforceable, this was extremely unlikely and the fact that the company had contacted him directly was suspicious.**

▶ **A West of Scotland CAB reports of a client who contacted the bureau after seeing an advert in a newspaper. The company was unnamed in the advert, but were offering customers the chance to have the balance on their credit card wiped out. The contact details involved a phone number only.**

Misleading names and logos

Debt management companies can use websites or adverts that use names and logos that imply that the company is a government agency or non-fee charging charity, leading a potential customer into believing that the service is free or part of a government run scheme. Clients may only realise their mistake after they have signed up to the service and are presented with charges.

▶ **A West of Scotland CAB reports of a client who responded to an advert in the paper for what he thought was free money advice.**

However, the advert was for a debt management company that used a name and logo that implied that it was linked to the Scottish Government. The client checked whether the company had a licence and was told that their licence was terminated in 2006.

- ▶ A West of Scotland CAB reports of a client who was sent a card by a debt management company which used a saltire as a logo and contained numerous references to the Scottish Government. The client wanted to know if this represented free money advice from the Government. The advert was from a debt management company and promised a number of outcomes that would not be possible for the company to achieve. The bureau has seen a number of clients (including members of staff) who have received the same card, all of whom are homeowners.
- ▶ A North of Scotland CAB reports of a client who had made contact with a company whose title and logo suggested that they were part of a Government debt scheme. The client had taken this to mean that he was dealing with a government adviser, but approached the bureau for advice when he felt he was being pushed into entering a protected trust deed.

Misleading information about the free advice sector

Debt management companies can provide misleading information about

other debt advice providers in order to secure business. This can include informing clients that citizens advice bureaux charge for advice or that they are not specialist money advisers. The OFT market study identified evidence of some companies actively seeking to discredit or misrepresent the services provided by the free advice sector in advertising and marketing materials.⁹

- ▶ A West of Scotland CAB reports of a client who was told by a debt management company that a citizens advice bureau would charge £400 to put the client through the low income low asset (LILA) route to bankruptcy. The bureau advised the client that she would need to pay a £100 fee to the Accountant in Bankruptcy for LILA, but that there would be no charge from the bureau.
- ▶ An East of Scotland CAB reports of a client who was told that CAB were not approved specialist money advisers and would not deal with her case on a one-to-one basis. The client had signed up to a debt management plan, but had approached the bureau for help after the company refused to cancel the agreement for the client despite being within the 14 day cooling off period. After speaking to an adviser, the company agreed to cancel the agreement, but told the client that the bureau would not contact the client's creditors and the client was risking court action. The bureau set up an appointment with a specialist debt adviser for the client.

Inappropriate financial advice

The OFT market study on debt management companies found that frontline advisers working for debt management companies are lacking in competence and are providing poor advice based on inadequate information.¹⁰ Citizens advice bureaux have seen cases where companies have offered such poor financial advice that the person ends up worse off financially for having been advised by the debt management company. Examples of poor practice include:

- Failure to give information on the full range of debt remedy solutions available to the client
- Failure to offer the debt solution that is in the best interests of the client but instead offering one that was most profitable to the company. This can leave a client in a worse financial position than they were in prior to receiving advice
- Failure to advise clients to pay their priority debts first, such as their mortgage, which can lead to significant difficulties for clients.

Citizens advice bureaux in Scotland have reported a number of clients who have been pushed by a debt management company towards entering a Protected Trust Deed. However, this debt remedy was often inappropriate for the client's situation and could have led to them losing their home. In these cases, the clients felt pressured into taking this option and felt that they had not been advised of any alternatives.

▶ A West of Scotland CAB reports of a client who received inappropriate advice from a debt management company. On approaching the company, the client was told that they could not help her as her debt was too small, but that her husband should enter into a Protected Trust Deed for his debts. The client asked about fees but was told that there was no fee. On being sent the papers, the client noted that the agreement stated that they had been advised of all the possibilities of clearing their debt, which she felt had not been the case. In addition, the proposed schedule of repayments included a professional fee of over £8,000. The bureau advised the client that a Protected Trust Deed would be totally inappropriate for their circumstances, as the clients would risk losing their home.

▶ A West of Scotland CAB reports of a client who responded to an advert in the paper for what he thought was free money advice. The client was pressured from the start into entering a Protected Trust Deed costing £700 per month. The client was also to pay £1,000 to protect his house from diligence. The bureau has now taken over this case and is assisting the client regarding the Debt Arrangement Scheme (DAS) or a voluntary repayment plan.

- ▶ **A North of Scotland CAB reports of a client who had made contact with a company whose title and logo suggested that they were part of a Government debt scheme. The client approached the bureau for advice when he felt he was pushed into entering a protected trust deed. The bureau looked at the client's finances and determined that given their level of debt and housing status that this would not be the recommended option for them.**

Bureaux have reported cases in which the debt management company has failed to advise clients to pay their priority debts first, such as their mortgage, which can lead to significant difficulties for clients.

- ▶ **A West of Scotland CAB reports of a client whose debt management company did not explain that she should have dealt with priority creditors first, and who instead encouraged her to make offers via themselves to non priority creditors and took a fee for doing so. As a result, the client is struggling with mortgage arrears.**

Management charges

By the end of 2010, the total cost to consumers in fees paid for debt management had hit the £250 million mark.¹¹ Many debt management companies routinely frontload fees and charges to the client, meaning that most of the initial payments go to the debt management company and not towards paying off the client's debt. Examples of high management charges include:

- Clients who have been charged an upfront fee of up to £50 for consideration of their case, only for the company to decline without refunding the client
- Clients who have been charged up to £1,000 before receiving any advice
- Clients who pay significant monthly fees to debt management companies only to find that little money is being paid to creditors.

Citizens advice bureaux have seen many clients who have paid significant upfront fees for debt advice, including clients who have paid companies to consider their cases, only for the company to decline without refunding the client.

- ▶ **A South of Scotland CAB reports of a client who paid an upfront fee to three debt management companies who he had approached for help. All three had asked for an upfront fee to "consider" his case in the region of £49 to £56. All three had then declined to take his case.**

Clients can be charged significant fees – in excess of £1,000 – before receiving any advice or service. These fees can be unclear and confusing to clients who can have the funds debited from their accounts without their knowledge.

- ▶ **A West of Scotland CAB reports of a client who was passed on to a debt management company after being turned down for a consolidation loan. The company claimed they could repair her credit rating and help her reduce her outgoings. The client said that she had become confused and upset on the phone and gave the company her bank details. Her account was then debited with £245 and £250 charges. When she received the terms and conditions of the agreement, she realised that the work would involve fees of over £1,000.**
- ▶ **A North of Scotland CAB reports of a client with credit card debts of over £60,000 who is paying significant amounts of money to a debt management company. The client was cold called by the company and took up the offer after being told she would be debt free in three years. He paid an upfront payment of £1,000 and is making monthly payments of £260. However, some of his creditors have not accepted the agreement and are pursuing court action.**

Clients report that debt management companies can charge significant fees for alleged costs, including additional insurance cover and court costs.

▶ **A North of Scotland CAB reports of a client who was charged £450 by a debt management company to go through the low income low assets (LILA) route to bankruptcy. The client was told that the £450 was charged for 'court costs', although the only cost involved in LILA is the £100 application fee. The client was not advised about the implications of bankruptcy or any other options she might have to deal with her debt.**

▶ **An East of Scotland CAB reports of a client whose debt management company are adding interest charges from her creditors to her outstanding balance. The client has evidence that in some or all cases the interest payments were suspended when the payment plan was arranged. The debt company have refuted her claim and threatened to cease payments to any creditors if she disputes the amount owed to them.**

Poor creditor distribution

A BBC investigation in May 2011 found that some debt management companies have been holding on to clients' cash rather than paying it to creditors. The investigation quoted a senior figure in the debt management industry who states that 10,000 people could be in danger from the practice.¹² Citizens advice bureaux in Scotland have advised a number of clients who have complained about debt management practices that mean that little of their payments are reaching creditors, including:

- Very little of the client's initial payments going to creditors due to companies front loading their fees and charges
- Clients reporting that their debt had actually increased after using a debt management company
- Debt management companies who are making late payments to creditors causing interest and charges to be added to the client's debt.

One of the causes of this problem is the practice of front loading fees for setting up debt remedy solutions. The OFT found that this practice is widespread and is part of the business model operated by three-quarters of debt management companies.¹³ This generally means that the initial payments made by debtors almost solely go to the debt management company and little is paid to creditors. This makes the debtor's situation worse before it gets better.

▶ **An East of Scotland CAB reports of a client whose debt management company has been passing on very little of the payments to creditors. The client has been making payments of £184 per month for the last five months, but upon checking her current balance discovered that only £2 had been deducted from the original balance.**

▶ **A West of Scotland CAB reports of a single mother whose debt management company passed on very little payment to her creditors. The client is a single parent in receipt of Income Support, but was assessed by the debt management company as having £100 per month available to repay her debts. It was agreed that the debt management company would take £25 a month as their administration fee, with £75 going to the creditors. The client made seven monthly payments before discovering that only the first payment of £75 had been forwarded on to her creditors.**

Clients can report that their level of debt has actually increased despite having an agreement in place to repay their debt with a debt management company. This can be a source of significant stress and worry for a client who may have assumed that their debt was being managed on their behalf.

- ▶ **Citizens Advice Direct reports of a client whose debt has risen since using a debt management company. From owing £15,000 which was to be paid off over six years, the client has now been told that she owes £31,000 and it will take 12 years to clear her debts.**

Clients have reported experiencing problems with their creditors after the debt management company has been late with or has failed to make payments on their behalf. Clients can have charges added to their debts or have formal recovery actions taken against them as a result.

- ▶ **A West of Scotland CAB reports of a client whose debt management company have been paying creditors late or sometimes not at all. As a result, the client is being contacted by creditors and threatened with penalty charges. The client pays £650 a month to the debt management company.**
- ▶ **A West of Scotland CAB reports of a client whose debt management company are failing to make payments to creditors on time. The client has paid nearly £2,000 in fees to the company in the last 18 months. The client is receiving numerous letters from creditors saying that they are behind in payments, some of them more than two months behind. The client is accruing additional debt as a result of late payment charges.**

Clients can report that the debt management company is failing to pay all of their creditors and had not made this clear to the client.

- ▶ **A North of Scotland CAB reports of a client who faces possible repossession of her home after her debt management company failed to pass on payments to a secured lender. The client paid over £320 a month to the company which was to be split between two loans. The client later discovered that no payments had been made towards the secured loan as the company 'do not service secured loans', but had failed to inform her of this. The client is now in serious arrears on the secured loan.**

Recommendations

Citizens advice bureaux have seen significant numbers of clients who have come for advice after experiencing problems with a debt management company. These problems can include high administration charges of up to £1,000, inappropriate financial advice that would put the debtor in a worse financial position, and misleading information about their ability and that of others to help the person.

The OFT's review of the debt management companies showed an industry where poor practice is widespread. This is of particular concern at a time when many people are experiencing financial difficulties and may find themselves exposed to the poor practices that exist in the industry. It is imperative that all consumers in financial difficulty have access to quality advice and support that is appropriate to the individual. To this end, policies and practices must be improved right across the industry.

We recommend:

- The OFT prepares a revised Guidance for Debt Management to make clear the areas that debt management companies need to improve upon
- The OFT continues its proactive monitoring to ensure compliance with the guidance and that it takes swift action where the guidance is not being followed and consumer detriment clearly exists
- Consumer bodies should work together to increase consumer knowledge and awareness of debt advice and debt solutions
- The UK and Scottish Governments provide adequate resources for free debt advice to help as many people as possible. Research has shown that many people turn to debt management companies because they were unable to get an appointment with a free debt advice provider.¹⁴

References

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- ³ BBC News – <http://www.bbc.co.uk/news/business-13762996>
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- ⁵ Sharon Collard, *An independent review of the fee-charging debt management industry*, University of Bristol/Money Advice Trust (June 2009), pg.20
- ⁶ Ibid, pg.36
- ⁷ *Drowning in Debt*, Citizens Advice Scotland (2009)
- ⁸ Debt management guidance compliance review, Office of Fair Trading (September 2010), pg.62
- ⁹ Ibid, pg.8
- ¹⁰ Ibid, pg.7
- ¹¹ Ibid, pg.4
- ¹² BBC News – “Debt management firms holding on to cash” 27th May 2011, <http://www.bbc.co.uk/news/business-13568152>
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