

Insolvency Service call for evidence: Regulation of insolvency practitioners Review of current regulatory landscape Response from Citizens Advice Scotland October 2019

Citizens Advice Scotland (CAS), our 59 member Citizen Advice Bureaux (CAB) and the Extra Help Unit, form Scotland's largest independent advice network. Advice provided by our service is free, independent, confidential, impartial and available to everyone.

In 2018-19, the Citizens Advice Service network helped over 270,000 clients in Scotland and dealt with almost 750,000 advice issues. With support from the network, clients had financial gains of over £131 million and our self-help website Advice in Scotland received approximately 3.7 million page views.

Introduction

CAS is pleased to respond to the call for evidence on the regulation of insolvency practitioners. We welcome the fact that the UK Government and the Insolvency Service are seeking views on the current regulatory landscape.

Our response mainly focuses on Protected Trust Deeds (PTDs) because we see most consumer protection issues arising from lack of consistent Recognised Professional Body (RPB) regulation in this market. The evidence in this response is largely based on information we gathered for our submission to the Scottish Government Proposals for Protected Trust Deeds consultation in April 2019¹. The Insolvency Service call for evidence acknowledges several of the same issues, however we have concerns that the specific proposals on which views are sought may only have a limited impact and more fundamental change may be needed to ensure consumer protection.

The regulation of the PTD market is diverse, with insolvency firms coming under 5 different RPBs for areas of professional conduct as well as the Accountant in Bankruptcy (AiB) who can audit fees. Some firms may also be regulated by the FCA for other aspects of their work. As well as directly to the RPB, complaints can be made about trustees through the Insolvency Service's complaints portal and we think the picture is confusing for consumers (especially in

¹ https://www.cas.org.uk/system/files/publications/citizens_advice_scotland_response_-_protected_trust_deeds_consultation_final.pdf



Scotland where the consumer may not understand why the complaints portal is hosted on the Insolvency Service's website, rather than the Accountant in Bankruptcy's).

Where detrimental business practices are not adequately dealt with by the RPBs there can be significant adverse effects on consumers and many of these consumers approach our bureaux essentially to help them pick up the pieces and get advice on their next steps. From the feedback we receive we have particular concerns about a small number of "high volume" firms who appear to be commercially maximising their own returns over the interests of other parties in the PTD process, which may be attributable to gaps in the current regulatory framework. We are also concerned that some of the people we see have essentially been mis-sold a niche debt solution at a time when they are most vulnerable and susceptible to influence. To support our response we include case studies based on feedback and also include responses from a survey of debt advisers across the network on their experience with PTDs, previously submitted to the AiB consultation.

In summary, the key issues for CAS around the current landscape are that:

- in too many cases a PTD is not the best option for people.
- commercial interests are driving many people's choice to take part in a PTD.
- lead generators who sell potential appointments to IPs are not regulated by the Financial Conduct Authority (FCA) or the RPBs.
- the levels of fees chargeable for PTDs compared to other debt options militates against people getting best advice.
- the level of PTD failure in previous years confirms that some debtors have not been offered the best option for their circumstances.
- the least safe route to the discharge of debt, i.e. a PTD is the most popular debt solution in Scotland.
- the RPBs' powers of governance are focused on professional conduct, not consumer detriment.
- vulnerable consumers have their complaints and issues determined not on the basis of fairness, but on the technocratic grounds of professional conduct.

Please note, we have only addressed the questions in the response form relevant to our client base and our duty of consumer advocacy. Unanswered questions have been deleted.

Questions:

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?

CAS has concerns that in too many cases a PTD is not the best option for people and Full Administration Bankruptcy (FAB) or a Debt Payment Plan under the Debt Arrangement Scheme (DAS) would have been a better option.

PTDs overtook the number of bankruptcies in 2002, and were higher each year until 2009. Since 2012, PTDs have again been more common than bankruptcies for all except one year (2015) when they were almost equal in number.

These figures represent an incongruity and a concern to CAS because they do not seem to reflect the number of clients that our advisers see, to whom a PTD would be suitable as part of a suite of options. For the last 3 years less than 5% of CAB clients who sought advice about a debt solution or remedy obtained advice about PTDs.² It is possible that CAB clients are not wholly representative of the demographic of people who would be most likely to grant a PTD. Nonetheless, the limited numbers of clients who would benefit from a PTD, when given an impartial set of options in CAB, gives us cause for concern that commercial interests are driving many people's choice to take part in a PTD, and not necessarily their best interests.

To add to the incongruity, there is not a lot of practical difference in the effects on a debtor of a PTD or a Full Administration Bankruptcy (FAB). But in operation a FAB is more advantageous as, irrespective of changes in financial circumstances, a discharge is virtually guaranteed, apart from in the most extreme cases of non-cooperation with a trustee. A PTD on the other hand has

² We surveyed CAB advisers to ask how often they would recommend a PTD as a realistic option: 79% of respondents said they would recommend it to fewer than 5% of their clients. This proportion did not increase even when limiting the frame of reference only to those clients who were due to enter a formal debt solution (either a debt payment plan within a DAS, a PTD or a bankruptcy). Two-thirds of advisers either agreed, or strongly agreed, that PTDs do not provide an effective debt solution for their clients.

We also asked advisers why they wouldn't recommend a PTD as an option for their clients. The most common answers given were as follows:

Reason	%age of advisers saying this was true "very frequently" or "all the time"
A bankruptcy would achieve the same ends, with no greater impact on the client	74%
Client has too low an income to qualify	69%
Concern that if the PTD fails, contributions will have had little or no effect on the debt originally owed	58%
A repayment solution (e.g. a Debt Payment Plan) would be more appropriate	58%
Client's income is unlikely to be sustained over four years	58%
Client is ineligible (e.g. on benefits)	53%

no guarantees of discharge from debt and failure to be discharged is more likely for the most vulnerable consumers who experience income shocks and changes of circumstances more often.

We also have concerns about the levels of fees charged for PTDs and whether the sums involved distort the market and prevent people getting best advice. In bankruptcy the fees are fixed by regulation whereas for PTDs they are largely determined by the trustee. The average amount of PTD fees is £6,300 including outlays³. The fees include sums for regulatory supervision by the Accountant in Bankruptcy and may also cover fees for lead generators who are indirectly paid for promoting PTDs and packaging clients. The trustee's fees will always be paid first and if the person in debt fails to complete the PTD, they do not get debt relief, their debts are not written off and they are back where they started or worse off. The risk is all borne by the person in debt.

With this risk in mind we also have concerns that the levels of PTD failure seem disproportionate and would indicate that some debtors have not been offered the best option for their circumstances. In 2017–18, according to Accountant in Bankruptcy figures, more than 1,700 PTDs failed, which was a quarter of the number of PTDS concluded that year. The consequences of failure for debtors are severe, especially if the debtor has maintained their contributions for one, two or three years. Fees and outlays arising from the administration of the PTD could swallow up all of the debtor's contributions – amounting to several thousands of pounds, leaving the debtor in just as bad a financial position as at the outset of the PTD. In such circumstances, the debtor would have been better off entering a FAB to begin with, as s/he would be discharged after 1 year and contributions would be based on their ability to pay, as assessed under the common financial tool - this includes making a zero payment where the circumstances warrant it.

A West of Scotland CAB reports a client signed a PTD in November 2015 for debts totalling £6,813. Contributions of £125 a month for 48 months were agreed upon. This meant she would repay £6,000, leaving very little after covering the trustee's outlays of £5,101. Given that the client could have repaid the debts in full with that level of contribution and a little more time, the PTD was effectively mis-sold to the client. The PTD then failed as she could no longer afford it; by this time she had paid £2,743 towards it. She has been told that this only covered the trustee's fees. Effectively she has lost all of the money she paid in with nothing to show for it.

Given the front loaded fee structure, the conflicts between the trustee's interests and that of the debtor and the risk of failure, how often would a PTD be regarded as appropriate, or in the best interests of the consumer, when compared with a FAB or a DAS, if insolvency was to fall under the Financial Conduct Authority regime? We have to question how well the regulatory system for insolvency is working against a background where the least safe route to the discharge of debt is the most popular.

³ <https://www.gov.scot/publications/foi-19-01126/>

11. Are RPBs doing enough to promote the public interest and protect the public from harm? Please share examples of good and bad practice.

CAS would like to see the RPBs powers of governance focusing on consumer detriment and not just professional conduct. Currently the approach taken to complaints is based on a much narrower band of rules based regulatory considerations, which does not compare well to other systems which have the consumer as their main focus.

The evidence we present of the lack of suitability of PTDs to bureaux clients, the contrasting relentless statistical growth in new PTDs and significant failure rates suggests a fair degree of mis-selling of PTDs in Scotland. Given that the RPBs are charged with the professional conduct of IPs, it seems this alone is not adequately addressing these consumer issues. The problems in the PTD market have been ongoing for several years and an effective and more comprehensive regulatory system would have dealt with these issues in a quicker time frame.

We also think that it is unacceptable that some lead generators who sell potential appointments to IPs are not regulated by the Financial Conduct Authority (FCA) or the RPBs so there are no public guarantees beyond the industry's own claims and self-policing that they are adhering to basic standards of acceptable practice, such as highlighting the constraints upon PTDs, assessing debtor circumstances properly or treating customers fairly. We have a number of examples below where clearly this advice has been inadequate.

A North of Scotland CAB reports a client answered an advert, was advised that a PTD would be a good debt remedy for her, and signed up for one which was then protected. She told the company arranging it about her circumstances, and was told there would be no further problems if she kept up the agreed payments of £100 a month for 4 years. She did not have a face-to-face interview at any time. She signed the papers alone, with no witness, and returned them to the IP by post. She now realises that her husband is jointly and severally liable for almost all of their debts so the PTD is not going to solve anything other than her liability.

An East of Scotland CAB reports a client is currently in a PTD which she entered into in January 2017 and agreed to pay £100.00 per month. At the outset she thought the student loan would be included, but found out it could not be after she had already signed the papers. As it is not, she now suffers from a wages arrestment of £56 per month, which is to pay off other debts of £886. The wages arrestment means she can no longer afford the PTD contributions. The trustee is now pursuing her for these and threatening a further wages arrestment.

An East of Scotland CAB reports a client initially turned to a PTD because of action being threatened for her student loan. She was not told that it could not be included. The Student Loans Company then instigated an earnings arrestment which meant that she could not then afford the PTD payment. The client felt pressurised into signing. The paperwork does not specifically say that the student loan was excluded or that the client was advised to this effect. It says, "all" debts must be included, with no further clarification.

The Insolvency Service's own findings on some RPB's also echo some of the issues regarding volume PTD/IVA providers, in particular poor quality advice, lack of justification of charges and potential for mis-selling financial products to those who take up the IVA option.⁴

In terms of good practice we would point to the Financial Ombudsman Service (FOS), which deals largely with the same parties (debtors and creditors) and allows for a wider range of circumstances and solutions to be considered on the basis of what is fair and reasonable. Although the FOS model as it stands does not deal with professional conduct issues we think that an independent regulator could operate a system that manages both. Given the similarities of issues at stake in an insolvency and financial services complaint, it seems incongruous that consumers at their most vulnerable (in debt) find the issues raised are determined not on the basis of fairness, but on the technocratic grounds of professional conduct.

12. "The regulatory objectives are fit for purpose"

1 2 3 4 5

For the reasons given at Q11, We would regard the regulatory objectives too narrow in scope.

13. "The RPBs function in a way that delivers the regulatory objectives and this has increased confidence in the system"

1 2 3 4 5

Both from our comments and evidence given above, the Insolvency Service's own Regulatory Reviews and Accountant in Bankruptcy statistics it is apparent that the continued issues with high volume PTD/IVA practices undermine confidence in the overall system.

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

1 2 3 4 5

See our comments at Q's10 and 11 and overall evidence. The regulatory regime provides too narrow a scope for adequately dealing with the issues of a modern market. Again the continued PTD/IVA issue highlights this.

15. "There is confidence that government oversight sufficiently holds the RPBs to account to deliver the regulatory objectives"

1 2 3 4 5

⁴ P10-16 Review of the monitoring and regulation of insolvency practitioners September 2018

While the annual reviews are welcome and thorough the influence on some RPB's seems to be minimal when issues are raised.

16. Does the reserve power provide sufficient flexibility in the options for a single regulator? If so, which option would most effectively deliver the regulatory objectives?

The objectives are framed flexibly enough within the legislation to accommodate a comprehensive system of regulation. For example see s144, 145 and schedule 11 of the Small Business, Enterprise and Employment Act. An existing body would probably have the greatest scope to frame a more comprehensive regulatory regimen given the wide power contained within S145 (3) in terms of setting regulations.

17. Should government look to create a different type of regulatory framework that better suits the current insolvency system (for example firm regulation in certain sectors)? If so, what type of framework would best deliver improvements to public confidence?

We think there is still a role for RPBs to ensure professional standards and membership recognition; but these functions are not necessarily compatible with policing business practice or addressing issues of consumer detriment.

To address bad business practice and consumer detriment a more comprehensive regulatory system is required which addresses the needs of a modern market and provides a just system of regulation and redress. It should be applicable to all bodies including lead generators.⁵ In terms of complaint mechanisms a single identifiable and entirely independent body is our preference, based on a fair and reasonable approach similar to that employed by the FOS.

If there is not the appetite for this then we would recommend that at the very least the IVA and PTD market regulation should be strengthened considerably to give consumers the right to be released from mis-sold or badly advised insolvency options and to be restored to the position they were previously in, including refunding any fees paid.

18. Should government have a role within any new or improved regulatory framework?

As the UK and Scottish governments are providers of insolvency services directly or through an agency, their participation in exercising the regulatory function is incompatible with natural justice. As service provider and subcontract purchaser they should be subject to the same rules as other bodies providing insolvency services and be covered by any new independent regulator for their insolvency functions.

⁵The Financial Conduct Authority's current remit includes all the relevant financial bodies including brokers / Introducers.



Response Form

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I want my response to be treated as confidential

Please select which best describes you or your organisation:

Respondent type (please tick)

<input type="checkbox"/>	Insolvency practitioner
<input type="checkbox"/>	Recognised Professional Body
<input type="checkbox"/>	Trade body
<input type="checkbox"/>	Creditor organisation
<input type="checkbox"/>	Creditor affected by financial failure
<input type="checkbox"/>	Individual subject to insolvency proceedings
<input type="checkbox"/>	Company subject to insolvency proceedings
<input type="checkbox"/>	Government department (please specify)
<input checked="" type="checkbox"/>	Other organisation: Third Sector Advice
<input type="checkbox"/>	Other individual (please specify)