

Response by the APPG on Debt and Personal Finance to BIS call for evidence in support of the Consumer Credit and Personal Insolvency Review

Dealing with debt – the need for more effective regulation of debt management plans

May 2011

About the All Party Parliamentary Group on Debt and Personal Finance

The All Party Parliamentary Group on Debt and Personal Finance was established in 2003 to provide a forum for MPs and peers to discuss debt and personal finance issues, to monitor legislative developments in this area, and to provide an opportunity for liaison between Members and organisations with an interest in these issues.

The Group is chaired by Mark Lazarowicz MP and the other officers include: Yvonne Fovargue MP, Nicholas Dakin MP, Mike Weir MP, Andrew George MP, and Damian Hinds MP. Current priorities for the group include fuel debt, future funding for free money advice, improving access to affordable credit and ensuring vulnerable consumers have access to appropriate debt remedies.

The Secretariat for the Group is provided by the Citizens Advice Public Affairs team, and funding for the Group's activities is provided by the subscriptions levied on affiliate members.

A full list of members and affiliate members of the group is available at www.citizensadvice.org.uk/debtgroup.

Debt management plans and debt management companies

A debt management plan is an arrangement with creditors to pay back a debt by regular instalments. Some organisations (such as Citizens Advice Bureaux) will negotiate a repayment plan with all a client's creditors on their behalf, while the client retains responsibility for administering the monthly repayments to each of their creditors.

Debt management companies (DMCs) collect a single monthly payment from the client and administer the repayments to each of their non-priority creditors (ie consumer credit debts) on their behalf. Usually the client will have to pay for this service although there are some DMCs who will do this for free, such as the [Consumer Credit Counselling Service \(CCCS\)](#) and [Payplan](#). These DMCs are funded through a fair share approach to debt management. This ensures that the creditor, rather than the debtor, pays for debt advice and support by returning a percentage of the payment made by the debtor to the debt management plan operator. The creditor, however, credits the debtor with the amount of the full payment.

The advantages of using a DMC are that:

- The debt client makes only one payment direct to the DMC who will distribute the money to their creditors fairly.
- The debt client does not have to contact their creditors themselves, because the DMC does this on their behalf

However there are also disadvantages to using a DMC:

- most DMCs only deal with non-priority debts (i.e debts for which one cannot lose one's home, liberty, or supply of essential goods and services) so the client has to deal with any priority debts, such as mortgage, rent, council tax or fuel debts themselves
- most DMCs do not give benefits advice or legal advice about debts so clients can lose out on important information about their finances.
- DMCs cannot guarantee that creditors will freeze interest and charges on the clients debt so some people can pay into their monthly debt management plan for years without reducing their total debt
- DMPs can be a poor option for people suffering temporary total income loss, such as losing their job. People in this situation need to be protected from spiraling interest and charges in the short term until they can assess what their income is likely to be in the medium – long term and they can set up a sustainable repayment plan.
- DMPs do not offer debt relief.

There are further disadvantages for consumers who enter into DMPs with DMCs that charge for their services:

- most DMCs charge an initial upfront fee which can be quite high leaving the debt client with less money to pay off their debts
- most DMCs also charge an administration fee to the customer each month. This leaves the client with less money to pay off their debts
- some DMCs take one or more month's payment as a fee, putting the client's account into arrears by a month or more. These arrears are recorded on the client's credit file
- They may not advise consumers to apply for debt remedies such as bankruptcy even where it would be the most appropriate option for the client
- most DMC providers require clients to repay a minimum amount per month and so will not accept clients with very low disposable incomes. Clients may feel pressure to repay more than they can afford in order to meet the minimum monthly repayment to be accepted by the DMC.

The APPG on Debt and Personal Finance is concerned that the experiences of members' constituents and Citizens Advice Bureaux clients across England and Wales highlight consumer detriment arising from the practices of some DMP providers. This includes providing poor advice, poor service and excessive charging as well as cold calling and charging upfront fees for services which do not materialise. Bad practice by debt management companies can make debt problems much worse and harder to get out of. It is our view that all too often fee-charging debt management companies do not provide anything like an adequate service to people in unmanageable debt.

Bad practice by debt management companies

Citizens Advice Bureaux frequently report concerns about the practices and service provided by fee-charging debt management companies. During 2009/10, Citizens Advice Bureaux in England and Wales dealt with 3,000 enquiries about debt management services, a 16 per cent increase on the previous year.

Issues reported include:

Cold calling and aggressive marketing practices – where often the client has not given permission for their details to be released to the company. For example

A CAB in Damian Hinds MP's constituency saw a couple who had entered in to a debt management plan following a cold-call from a fee charging debt management company. At the time the couple had been close to panic about their debts, which totaled almost £70,000. In addition, the wife, who took the call, was disabled and was recovering from a brain haemorrhage. As a result, the couple were repaying £109 per month to their creditors but paying the debt management company £209 per month in fees. The couple had mentioned to the company that they would like to seek advice from a Citizens Advice Bureau, but the company advised them not to.

Another CAB in Damian Hinds MP's constituency saw a man who had county court judgments. After judgment had been entered, he received a letter from a fee-charging debt management company offering debt management services. The client initially believed that the letter was from the court because all of his county court judgment details were listed at the top of the letter. The letter did not state that the company would make a charge if the client took out a debt management plan with them. He showed the letter to the bureau who advised him not to follow up contact with the company.

Excessive charges for debt management services. For example

A CAB in Yvonne Fovargue MP's constituency saw a client who had a debt management plan with a fee-charging company. They were repaying £100 per month through the debt management plan but the company was taking £35 of this each month in administration charges.

Charging up front fees for services which fail to materialize or without making it clear to the client what they can expect in return for the payment. For example

A CAB in the East of England saw a self employed builder who had been unemployed for 18 months due to mental health problems but was now looking for work. His wife worked part time. Two and a half years earlier, the couple had bought a car on a hire purchase agreement. They were managing the repayments until last October when they were no longer able to maintain them due to the work situation. Out of the blue, the client's wife received a phone call from a debt management company asking if they had any debts. She told them about the hire purchase agreement and subsequently agreed to pay the company £135 per month: £30 as a management fee and £105 towards repaying the hire purchase agreement. The client subsequently received a default notice from the hire

purchase company. The client did not know why he had received it as he was up to date with his payments to the debt management company.

Poor advice, particularly where other debt remedies would be more suitable for the client's circumstances. For example:

A CAB in Wales saw a client who had received inappropriate advice from a DMC. The client was on a low income and had multiple non-priority debts together with a small amount of rent arrears. He had entered into a DMP, which he initially wrongly believed was an individual voluntary arrangement (IVA). The bureau identified that in fact, a debt relief order would have been most suitable for the client's circumstances and advised him so. After that, the client was contacted by his DMC which suggested he might qualify for an IVA. However, this was not appropriate as the client had less than £200 per month surplus income and no assets. The DMC's assessment of the client's income and expenditure would leave him with only £60 per month for all housekeeping.

Failure to pass on payments to creditors. For example:

A CAB in London reported that a 75-year-old pensioner had taken out three unsecured loans to do work on her house. The contractual payments for these loans came to approximately half of her total income. The client was unable to maintain the minimum payments and engaged a DMC to negotiate and make reduced payments on her behalf. However, unknown to her, the company was experiencing financial difficulties and did not pass on most of the payments that the client made. The company had subsequently ceased trading and the management of the client's debts had been taken over by another company. However, the debts had been sold to a debt collector and the client was facing court action and potentially a charging order.

Ignoring priority debts, such as mortgage/rent, fuel and council tax, where the ultimate sanction for non-payment is loss of home, fuel supply or liberty. For example:

A man went to see a CAB in the South West because he was being threatened with eviction. He had set up a DMP with a fee charging company and was using his disposable income to pay off his non-priority debts. As a result he was not paying his rent and was therefore at risk of becoming homeless.

Excessive charges for debt management services. For example

A CAB in the East of England saw a man with two credit card debts totalling £15,000. He had previously contacted a debt management agency who had arranged a repayment plan of £61.43 per month. However, £29 of this amount was their fee, meaning that only £32.34 went towards the debt. The CAB calculated that it would take the client almost nine years to clear this debt at this rate, during which time the debt management company would receive £13,450 for doing very little.

Action by the Office of Fair Trading (OFT)

All providers of debt management and debt advice services have to have a consumer credit licence from the OFT. The OFT sets out the behaviour it expects from licence holders in general and subject specific guidance. There has been detailed guidance on debt management practices since 2001.

In September 2010, the OFT published the findings of its review into industry compliance with their debt management guidance. The findings of this review support the APPG's and Citizens Advice's concerns about the prevalence of bad practice among fee-charging debt management companies.

The OFT found that:

- there is widespread non-compliance with the guidance by debt advice and debt management licensees, with most debt management firms audited failing to some extent in at least three areas
- misleading advertising is the most significant area of non-compliance, in particular misrepresenting debt management services as being free when they are not
- frontline advisers working for debt management companies generally lack sufficient competence and are providing consumers with poor advice based on inadequate information
- industry awareness of the Financial Ombudsman Service scheme for resolving consumer complaints is low and there is widespread non-compliance with the Financial Ombudsman Service's complaint handling rules
- the two main trade associations, the Debt Managers Standards Association (DEMSA) and the Debt Resolution Forum (DRF), could do more to lead the way by introducing more robust compliance monitoring and auditing systems for their members

Limitations of debt management plans as an effective remedy for multiple debt

Even where debt management companies operate in accordance with best practice, as a form of voluntary agreement DMP's cannot offer a firm guarantee of protection from creditors' collection and enforcement activity. Neither can they guarantee that a client's offer will be accepted and that creditors will not continue to add interest and charges. Many debt management plans fail because some creditors are unwilling to accept reduced offers of repayment. For example

A CAB in the South West of England saw a lone parent on benefits who owed about £15,000. She had been paying £100 per month to a debt management company for two years; however, her debts were still increasing as interest was being added to her loan at a greater rate than the repayment. The client told the CAB that she could no longer continue with payments to the debt management company.

The APPG on Debt and Personal Finance believes that people in financial difficulties who contact their creditors, seek advice and pay what they can objectively afford should be

protected against further collection or enforcement action and spiralling debts. However at present people who try to take responsibility for their debts can find themselves at the mercy of unhelpful, aggressive and unscrupulous practices that can make dealing with debt an unbearable experience. Many people become vulnerable to sharp practices by unscrupulous debt management companies because of they are under intense pressure from their creditors.

At present insolvency options are the only available options for people seeking guaranteed protection from their creditors, but these are not always appropriate. Homeowners who suffer a temporary or severe income shock, such as losing their job, may not want to pursue insolvency as it means they would lose the equity in their home. People on very low incomes may be unable to afford a bankruptcy application or the monthly repayments required under an IVA.

A statutory debt management plan could remedy this, giving a guarantee of fair protection to people trying to deal with their debts in a responsible way by repaying what they can afford. We are disappointed that the Ministry of Justice have decided not to implement the statutory debt management scheme contained in the Tribunals Courts and Enforcement Act 2007.

Most debt management plan providers require clients to make a minimum repayment each month so they are unsuitable for clients with very low disposable incomes. There will always be a need for a free independent debt advice service for those on the lowest incomes who are unattractive to commercial debt remedy providers. In 2008 58 per cent of CAB debt clients were unable to make any offer of repayment to their non-priority creditors after meeting their essential expenditure¹.

Recommendations for more effective regulation

The APPG on Debt and Personal Finance recognises the Government's commitment to supporting businesses and introducing new regulation only as a last resort. However, members of the group from both sides of the house agree that robust action is needed to protect vulnerable consumers from bad practice on the part of fee-charging debt management companies.

As well as sustainable investment in the not-for profit advice sector, there is an urgent need for more effective regulation of the fee-charging debt management sector including

- an immediate ban on cold calling
- an immediate ban on the charging of upfront fees for debt management
- effective auditing of for-profit debt management companies

Cold calling and upfront fees

We understand that the OFT is currently investigating a super complaint, lodged by Citizens Advice, calling for a ban on cold calls offering credit or debt management services, and a ban on up-front fees.

¹ *A life in debt The profile of CAB debt clients in 2008*, Citizens Advice, February 2009

We believe that the Consumer Credit Act 1974 should be amended to prohibit cold calling for consumer credit business (specifically credit broking, lending and debt management services) and to prohibit lenders, brokers and debt management firms from taking any upfront payment in respect of arranging or setting up a loan or other agreement until that agreement has been concluded in accordance with consumer credit and other consumer protection law. This would prevent debt management companies from charging upfront fees from clients before they have confirmed that an agreement has been reached with the clients creditors and what that agreement entails, including whether or not the creditors have agreed to freeze interest and charges. If debt management companies cannot charge large upfront fees, but are forced instead to recoup their costs over the course of the debt management plan, this removes the incentive for companies to mis-sell inappropriate debt management plans or charge unsustainably high monthly repayments.

We also believe that there is a need for the OFT and the Information Commissioner's Office to work together to investigate the way that consumer contact information is being used by credit firms. We are particularly concerned at evidence suggesting that information passed among firms is being used for predatory targeting of consumers in financial difficulty.

Better powers for the regulator

We understand that the OFT is in the process of revising their Debt Management Guidance to explicitly reference unfair practices connected to cold calling and make it clear to firms that these will not be tolerated in future. Although the OFT has issued guidance on debt management, the OFT does not have the powers and resources needed to supervise the smaller to medium sized practitioners effectively.

Although the OFT now has more extensive regulatory powers as a result of the Consumer Credit Act 2006, we are concerned that enforcement action has, historically, been slow and there is a need for quicker and more nimble enforcement mechanisms. Proving that a firm has engaged in "unfair practice" can be a lengthy and resource intensive process. In our view the OFT needs powers to suspend trading pending investigation and set more prescriptive, positive standards for firms to meet. Should responsibility for consumer credit regulation pass to the proposed new financial services regulator, the Financial Conduct Authority, we believe that it will need to have sufficient powers and resources to take effective action against debt management firms.

The need for a statutory scheme

There is a desperate need for the government to reconsider introducing the statutory debt management plan provisions in the Tribunal, Courts and Enforcement Act 2007, or consider introducing measures with a similar purpose. People in debt who engage constructively with their creditors, seek advice and pay what they can objectively afford should be protected against further collection or enforcement action and spiralling debts. The absence of such protection makes people in debt vulnerable to sharp practices by unscrupulous debt management companies.

Funding for free debt advice

There is a need for a sustainable cross government strategy for the provision of free independent debt advice, to guarantee that people have access to advice about the most appropriate debt remedies for them, free from commercial pressure and regardless of their disposable income. Over half of CAB debt clients have no disposable income with which to repay non-priority debts (i.e debts for which one cannot lose one's home, liberty, or supply of essential goods and services) and so will never be attractive to commercial debt management providers. In Spring 2011 several members of the APPG on Debt and Personal Finance raised the issue of future funding for free debt advice with the Government asking Parliamentary Questions, signing EDMs and participating in Westminster Hall debates on the issue. We warmly welcomed the Government's response that the Financial Inclusion Fund would continue for another year, providing £27 million for face to face debt advice. However, free debt advice agencies need certainty beyond the end of this financial year. We believe that there should be a levy on the financial services industry to supplement central and local government funding for free debt advice.