CP13/7 High level proposals for an FCA regime for consumer credit.

Response from The Debt Resolution Forum (DRF)

For the attention of:

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Debt Resolution Forum

The DRF is a representational, training, monitoring and complaints handling body for fee-charging debt resolution businesses.

The DRF provides an independently accredited qualification for members' staff (the Certificate in Debt Resolution), monitors members compliance with DRF's standards (and other regulation and guidance, including that provided by the OFT), through an inspection service provided by an insolvency recognised professional body, the Insolvency Practitioner's Association (IPA) and has an independent complaints and disciplinary committee for dealing with any consumer complaints.

The DRF also funds independent research into the work of fee-charging debt resolution firms and the outcomes for their clients.

Further details can be found at www.debtresolutionforum.org.uk

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Q1: Do you agree that our proposals strike the right balance between proportionality and strengthening consumer protection?	The DRF believes that, in relation to debt resolution and with the following caveats, that the high level proposals for an FCA regime for consumer credit are appropriately balanced between proportionality and strengthening consumer protection: 1. All debt resolution organisations that hold debtors' monies and make distributions to creditor's, should be included in the higher risk category and not exempted from interim permissions or the requirements relating to approved persons. 2. All debt resolution organisations that are rewarded by creditors or others in proportion to the recoveries they obtain from creditor's, should be included in the higher risk category and not exempted from interim permissions or the requirements relating to approved persons. 3. The prudential capital requirement suggested for debt management companies by the FCA is unlikely to prove sufficient to be of any use to debtors and a sufficient capital requirement is unlikely to be affordable without putting businesses' financial stability at risk. Consumer detriment due to inappropriate advice is as likely to be caused by an advisor working for a free-to-client debt advice organisation as it is a fee charger. Free-to-client organisations should be subject to the compulsory jurisdiction of the Financial Ombudsman Service.
Q2: Do you agree that we have included the right activities in the higher and lower risk regimes?	Where it relates to debt resolution activities (debt adjusting and debt counselling, The DRF believes the proposals should place not-for-profit debt advice providers in the higher risk category when: 1. They hold and distribute debtors' monies 2. They are funded by performance-based payments from creditors or others (e.g: "fairshare" contributions where providers obtain a proportion of the money they recover for creditors)

	We also believe those bodies authorised in the lower risk group, such as not-for-profit debt advice providers, should be required to come under the jurisdiction of the Financial Ombudsman Service for consumer complaints – consumer's should not have lesser rights simply because they have chosen not to pay for debt advice. The DRF has funded independent research that clearly shows that people in free-to-client plans have issues over the advice and service that they are given and that they should be able to seek redress. The DRF notes that it is proposed that licenced insolvency practitioners should be authorised under the higher risk regime if they provide, for example, pre-appointment debt advice. The DRF believes that this is unnecessary because licenced insolvency practitioners are already subject to a specialised monitoring regime by their licensing body where this is the case. The DRF believes that licenced insolvency practitioners should be subject to higher risk authorisation only where they provide non-statutory debt resolution procedures, such as debt management plans, and where they receive a fee for this advice. ***DRF Research referrals:*** *DRF Free to Fee, May 2013* *4.a Referrals, page 5 (esp 5-6)*
Q3: Do you agree that our proposals minimise the impact on competition within the regulated consumer credit market?	The DRF is concerned that the FSA was unused to dealing with large numbers of small organisations, some of which have a clear determination to avoid, or reduce to a minimum, the impact of authorisation, regulation and compliance. So whilst the proposals probably do minimise the impact of competition on authorised businesses, they do little to minimise the impact of competition from businesses that chose to remain unauthorised and to come and go as they are discovered. This is relevant, sadly, to the cowboys in the fee-charging debt management sector and to the lead introducers who provide client details to cowboy businesses. There is severe consumer detriment here. The DRF has concerns that the FCA may not, initially at

	least, find it easy to concentrate on removing detriment caused by companies and individuals that operate outside the authorisation regime. ***DRF Research referrals:*** *DRF Free to Fee, May 2013* *4.b Creditor Pressure, page 8, 11*
Q4: Do you have any comments regarding our proposals for the interim permission regime?	The DRF is broadly supportive of the proposed interim permissions regime. However: 1. The DRF would welcome early detail concerning the proposed transfer process. 2. The DRF believes holders of group licences who both take in and distribute clients' monies or who are paid a contribution from creditors based on monies recovered should be required to apply for an interim permission. 3. The DRF believes that some debt charities act as lead introducers to associated debt management businesses and should also be required to apply for an interim permission and, in due course, full authorisation.
Q5: Do you agree that we should apply the Threshold Conditions as proposed?	The Threshold Conditions as proposed seem appropriate to the DRF with the exception of the last, entitled "Business model" where the only detail in the consultation is the statement relating to higher risk business that: *"Firms to submit detailed business plan, which is assessed against market norms."* The DRF believes there is insufficient detail in the consultation regarding this for any respondent to make an informed response: 1. What is a detailed business plan? How would it be ensured that the requirement for this was proportionate and not onerous? 2. How are market norms to be decided? 3. How will it be ensured that an assessment against market norms does not drive a move toward product similarity, frustrating enterprise and limiting competition?
Q6: Do you agree that it would be appropriate for the FCA to apply the	The DRF, with one caveat, believes the approved persons regime, as proposed by the consultation, is appropriate.

approved persons regime activities as proposed?	However there is an important issue that probably applies more to debt resolution businesses and, specifically, those with key employees that are licenced insolvency practitioners, than to any other sector. The consultation states that when considering a candidate's fitness and propriety, *"honesty, integrity and reputation"* will be considered. Whilst this is entirely appropriate, it should be noted that insolvency practitioners frequently engage in litigation to meet their statutory responsibilities and don't always win. They may also have a long record of complaints (not upheld) with their licensing body. Whilst DRF can see a test of honesty is easily defined, tests of integrity and reputation may need to take into account that a reputation for being complained of, or being involved in litigation, may be an indicator of good integrity, rather than the reverse. Being robust in certain areas also brings about complaints, which in the main are not upheld. The DRF does not agree that not for profit bodies providing debt advice should be exempt from the requirements to have approved persons if: 1. They hold and distribute debtors' monies 2. They are funded by performance-based payments from creditors or others.
Q7: Do you agree with our proposal not to apply a customer function to any consumer credit activity, particularly debt advice?	We believe this proposal is undermined, as far as debt resolution is concerned, by this statement: *"As advice is important for debt counselling, we consider that individuals who are approved to undertake the 'compliance oversight' function in debt-management firms and credit-repair firms should be responsible for ensuring the compliance and competence of the firm's advisers."* This will only work if not-for-profit debt advisors are required to have approved individuals to undertake compliance oversight within specific organisations. We understand that this proposal is being made against

	the background of Money Advice Service's proposed quality framework for debt advice – which will cover not just not-for-profit debt advisors but also fee-chargers. Fee charging debt resolution companies that are members of trade associations like the DRF also have training standards and compliance with same which is independently monitored (by a recognised professional body – the Insolvency Practitioners Association). The assumption that consumer detriment is only present when fees are charged is incorrect. Poor advice can be given by anyone and the DRF-funded independent research on client outcomes clearly shows and has established that the free-to-client sector can provide poor advice as well. Not to take this opportunity to ensure advice quality is effectively monitored by all organisations offering debt advice would be to see the continuation of avoidable consumer detriment. ***DRF Research referral:*** *DRF Free to Client outcomes, May 2013* *4 GOOD ADVICE? Page 6 (bottom p8)* *6 OTHER PLACES TO FIND HELP, (page14 and same respondent at third quote on p15)*
Q8: Do you agree with our proposed approach to appointed representatives and multi-principal arrangements?	The DRF agrees that this is appropriate.
Q9: Do you agree with our proposed approach to self-employed agents?	The DRF agrees that this is appropriate.
Q10: Do you agree with our approach to professional firms?	The DRF agrees that this is appropriate.
Q11: Do you agree with our proposal to apply prudential standards to debt management firms only?	No. The consultation document states (6.7): *"In terms of harm, we consider that debt management businesses pose a high risk to consumers because they may hold and/or control clients' money (i.e. debt repayments), before passing them on to the customers' creditors. Firms holding client money typically need*

	more time to wind down. Having prudential resources gives them time during which they can continue providing their services while updating and transferring records, thereby improving the opportunity for a more orderly wind-down". This does not appear to take into account: 1. In relation to debt management plans, firms must pass client monies to creditors within five working days of receipt of cleared funds. 2. Debt management plan monies must be held in a separate client account. 3. IVA monies are usually held in either a separate client account or in the name of the Supervisor of the respective IVA (or for Protected Trust Deeds as well). The consultation document states (6.8): "Furthermore**, the potential for debt-management firms to pay redress, in comparison to other consumer credit firms, is increased because they provide advice to some of the most vulnerable consumers in the financial services market.** There is, therefore, a high risk of harm if consumers receive poor advice, such as inappropriate debt solutions, and/or the firm fails." (**our bold).** There is no evidence for this. In fact, in the year to March 2012, debt counselling was not one of the Financial Service's Ombudsman's top twenty areas of complaint. In the year to 31 March 2012, debt counselling accounted for less than 0.05 per cent of complaints to the Financial Services Ombudsman (FOS). In the previous year, debt counselling accounted for 0.08 per cent of all complaints. Complaints about debt counselling are very low and getting lower. (Debt adjustment has a higher level of complaint, but still falls

	outside the top twenty and is less than a fifth of one per cent per cent of complaints received by FOS). Furthermore, the majority, by case number, of debt resolution firms are now members of the two trade associations, DRF and DEMSA, both of which operate independent complaints and conciliation schemes, including client redress. The DRF does not consider that there is the need for a prudential capital requirement on debt management firms and that consumer protection would be better served by making membership of the DRF or DEMSA mandatory. All firms would then be subject to a focused examination of the use of client accounts as part of the company's ongoing monitoring requirements. Adherence to client account procedures is more important than a prudential capital requirement: If firms fail to follow good practice then, on insolvency, it will be very difficult to determine where monies are owed to make any financial redress, even if there is a pot of capital on which to make such claims. The DRF thinks it is more important to require all organisations that hold debtors funds and make distributions to creditors, whether fee-chargers or non fee-chargers, to be subject to annual checks on how firms deal with client monies and comply with FCA regulation in general. Members of the DRF and DEMSA can provide this through their annual independent monitoring process. At present there is no requirement for this and less well-run businesses, often operating outside trade association membership, are subject to lower regulation and checks. The public will, therefore, rely upon the FCA to police them. ***DRF research referrals*** *DRF Client Survey Demographics and Financial Circumstances, May 2013* *8 FINANCIAL CIRCUMSTANCES, page 42 (and, especially. e and f on pp 47-48)* If prudential capital requirements are to be enforced, then any non-fee charging organisations that distribute client funds should also be required to set aside prudential capital. The requirements on these organisations may need to be higher as some, for

	example Step Change Debt Charity, do not distribute funds in debt management plans within five days of receipt but may hold funds for a month or more in violation of the OFT's Debt Management Guigance. If prudential capital is to be required then realistic reserves may be unattainable, making the exercise pointless. Paragraph 6.13 suggests that debt management firms should be required to hold 2.5% of turnover, with a minimum of £5,000. EXAMPLE • Debt management turnover (fees) are typically 15% of monies disbursed for fee charging firms. For non-fee chargers the relevant test will be their income from donations which are generally directly related to the amount they distribute to creditors (the fairshare contribution). • Under the consultation, a fee charging firm with £1m turnover will require £25,000 in prudential capital (2.5% of turnover), which would be less than 1 days worth of distribution to creditors. • £1m turnover represents around £6.7m of client monies distributed in a year. • An average weekly disbursement of client monies to creditors will be in the region of £130,000.Given all fee-chargers are required to distribute every 5 working days (approx. weekly) then that should be the level of capital requirement (i.e. 1/52 of total distributions in a year). If a firm distributes. Say, every 3 working days then we would suggest that should be their capital requirement (3/5 x 1/52 of total annual distributions) - they are thus rewarded for efficiency and for holding less client monies which, ultimately, is what a regulator would want. Non fee chargers/charities, hold client monies and distribute to creditors in exactly the same way as fee chargers – they just get their payment on a different

	basis. If prudential capital were to go ahead free-to-client agencies should, therefore, be subject to the same requirements as fee chargers to protect consumers and it should be related to how long they hold client funds for before distribution. Where some non fee chargers hold funds for 30 days their prudential capital should be on the same basis (i.e. total 1/12 x total annual distributions). A lesser ratio than our suggestion would be of no value to creditors or debtors and, as we have suggested, we think annual audit checks of the client account would protect the public far better. Prudential capital requirements of this nature will, also, do nothing to enable payment of any sums in redress in the event of the failure of a debt resolution business. DRF members are well run and make distributions to creditors on time. Prudential capital requirements will do little to mitigate risk. Close examination of the operation of client accounts is relevant and likely to prevent consumer detriment in a way that prudential capital will never make possible. Prevention is a better remedy than financial redress after the event.
Q12: Are there any difficulties in collecting data on the size of debt contracts being negotiated and/or the amount of client money held (as the basis for our prudential standards)?	None at all. The DRF anticipates its members will be asked to provide this as part of the DMP Protocol market information requirements. However, again, please note monies received by clients are disbursed to creditors within 5 working days of receipt of cleared funds and that, other than in very specific circumstances that are made known to creditors, the only monies retained longer are those returned by creditors (for example when they fail to provide or find client account references) and placed in suspense.
Q13: Are there other measures that would ensure our prudential regime for debt management firms targets the firms that pose the greatest risk to consumers?	Yes, effective monitoring of the activity of client accounts to ensure they contain sufficient funds and are being operated appropriately. In the DRF's opinion, this would diminish consumer risk more effectively than a prudential capital requirement.

Q14: Do you agree with our proposals that the new high-level conduct requirements should apply from 1 April 2014?	No. The DRF does not see any objection to the conduct requirements per se. But, as expressed in the consultation there seems to be a number of unanswered questions on the details of the guidance. By the time these questions are answered it will probably be unreasonable to expect that businesses, especially smaller ones – of which there are many - can make all the necessary changes to be compliant. It is suggested that high-level conduct requirements should apply from 1 April 2015.
Q15: Do you agree with our proposed approach to financial promotions?	The DRF agrees
Q16: Are there provisions within industry codes that you think should be formally incorporated into FCA rules and guidance?	In the case of the DRF member code this would not be relevant or possible. The DRF's standards state that a member must be compliant with all relevant legislation and guidance. FSMA/FCA authorisation, etc. would be part of that.
Q17: Do you agree with the different standards that we propose to apply to different types of debt advice?	The DRF agrees these are appropriate.
Q18: Do you agree with our proposed approach to applying client asset rules to debt management firms?	The DRF broadly agrees. However, we once again point out that debt management firms operating conventional models only hold client monies for five working days and that the risk, for compliant firms, is small. The DRF believes that the greatest risk of misuse of client money exists in small, recently established businesses, and that, whilst a two-tier approach is appropriate care must be taken to ensure non-compliance by smaller organisations can be easily spotted. We welcome the additional consultation on this matter.
Q19: Do you have any comments regarding our proposed approach to peer-to-peer platforms?	No comments
Q20: Do you agree with our proposed approach to	No comments

authorised firms which outsource the tracing of debtors to third party tracing agents?	
Q21: Do you have any comments regarding our proposed approach to supervision and regulatory reporting?	Subject to the DRFs comments above, regarding the non-necessity for a prudential capital requirement, we see this as appropriate.
Q22: Do you have any comments regarding our proposed approach to enforcement?	The DRF agrees this seems appropriate.
Q23: Do you have any comments regarding our proposed approach to complaints and redress?	The DRF strongly believes that consumer detriment is caused by inappropriate debt advice whether that advice is paid for or free. Given the variable standards of quality of debt advice in the free to client sector we believe the likelihood of detriment being caused to consumers receiving free advice is significant. FCA's intention to not to apply the compulsory jurisdiction to free-to-client advisors removes a means of seeking redress and a mechanism for driving up quality in this sector. It also ignores the fact that some debt charities act as lead providers to commercial firms. The DRF believes not-for-profit advisers should be subject to compulsory jurisdiction. Otherwise all the above will lead to a two tier system creating added consumer detriment. ***DRF research referrals:*** *DRF Free to fee, May 2013* *c Free Advice Failures, page 11 (+ two examples p 15-16)*
Q24: Do you have any comments on our proposed approach to tackling financial crime?	The DRF believes the suggested approach is appropriate.
Q25: Do you have any	The proposed interim permission fees seem reasonable.

comments on our proposed interim permission fees?	The DRF is concerned about fees that will be imposed when the interim permission scheme ceases in 2016 and looks forward to the consultation on this. This matter, given the low and reducing margins on which debt resolution firms operate, should be given the usual consultation period of 12 weeks. The DRF is concerned that some "free" debt advice agencies that make distributions to creditors could escape the full cost of authorisation. These organisations are not free, but, through "fairshare" contribution, creditors pay for their services. As with fully commercial debt management companies, both creditors and debtors can lose out if there is poor advice or maladministration. We see no reason why these organisations should be exempt from the full cost of authorisation. ***DRF research referrals:*** *DRF Free to fee, May 2013* *4.c Free Advice Failures, page 11 (+ two examples p 15-16)*
Q26: Do you agree with our proposed approach for the FOS general levy for firms with an interim permission?	The DRF broadly agrees with the proposed arrangements, with the proviso that free-to-client organisations should not be exempt from the charging regime given that they are likely to be subject to consumer complaint too. ***DRF research referrals:*** *DRF Free to fee, May 2013* *4.d Token Troubles, page 18-19*
Q27: Do you agree with our market failure analysis?	No comment.
Q28: Do you agree with the costs and benefits identified?	The DRF is concerned that, within the fee-charging debt management arena, the costs of authorisation and enforcement may be a burden that threatens the stability of some firms and also acts as a barrier to entry to new businesses. Whilst the perception still exists among some that it is wrong to pay for debt advice the fact is that many can afford to do so and achieve more for themselves and their creditors through the discipline of debt resolution. Independent research, funded by the DRF, together with empirical evidence from creditor bodies indicates that fee-charging debt advisors are responsible for

	around three-quarters of the UK's debt resolution plans. If the costs of the FCA regime are too high, they could jeopardise the financial stability of an industry sector that is fundamental to the success of an economy that requires consumer credit as a vector for growth. Without effective debt resolution amongst the millions that require it, long-term consumer confidence in lending will be diminished.
Q29: Do you have any comments regarding our proposed approach to second charge lending?	No comments
Q30: Do you agree with our initial assessment of the impacts of our proposals on the protected groups? Are there any others we should consider?	The DRF has some limited evidence, through the independent research that we have funded, that there may be bias in creditor actions toward protected groups (race) and also by gender. We would be pleased to share this data with the FCA. ***DRF research referrals:*** *DRF Client Survey Demographics and Financial Circumstances, May 2013* *2 GENDER, page 16* *3 ETHNICITY, esp pp22-23*