October 2019

StepChange Debt Charity response to the Insolvency Service call for evidence on *Regulation of insolvency practitioners* and *Review of current regulatory landscape*

Insolvency Service consultation response:

StepChange Debt Charity welcomes this opportunity to reply to this Insolvency Service call for evidence on the *Regulation of insolvency practitioners* and *Review of current regulatory landscape*. StepChange is the largest specialist debt advice charity operating across the UK. We exist to help create a UK society free from problem debt.

In the first six months of 2019 StepChange Debt Charity has been contacted by 331,337 people seeking help with problem debts. Of those that opted to take full debt advice, around 5.5% were recommended an Individual Voluntary Arrangement as the best solution for their circumstances.

StepChange Voluntary Arrangements is a wholly owned subsidiary that provides IVAs. StepChange VA was supervising 5,395 active IVAs as at the end of June 2019 and currently sits just below the 2% volume provider threshold. We are therefore responding to this call for evidence both as a debt advice charity with a public policy objective and as a provider of IVAs.

Key points:

IP regulatory framework

As a debt advice charity supporting individuals in financial difficulty (rather than firms) our focus for this consultation is on the regulation of Insolvency Practitioners (IPs) providing services to individuals and the Individual Voluntary Arrangement (IVA) market.

The IP sector is currently regulated as a profession, with relatively little differentiation in regulatory approach between the different activities, clients and business models of services delivered by IP's. The needs and vulnerabilities of a low income financially distressed individual will be different to a large corporate client. The business model of a sole practitioner IP advising a small number of individuals may raise different regulatory risks and challenges to a large volume IVA provider, particularly where the IP or IPs may be employees of the provider with little control over key aspects of the provider's policies and practices.

Therefore we believe that the current legislative and organisational structure of IP regulation is not entirely fit for purpose, and we agree with the argument raised in this call for evidence that the Government should look to create a different type of regulatory framework. However this does not necessarily mean that the same regulatory approach is needed in respect of

every activity undertaken by IPs and every business model. Our primary concern is the need to reform the regulatory framework for the IVA market, with a particular emphasis on volume providers.

Regulating the volume IVA market

StepChange Debt Charity believes that regulatory reform is needed in the IVA market.

The number of IVAs has grown almost 10-fold since 2000 and has moved away from the original policy focus of an alternative to bankruptcy for sole traders and professionals. IVAs have become a mass market focused on financially vulnerable consumers that is dominated by a small group of volume providers. Furthermore, this change in focus has arguably been largely 'market led' by providers rather than the result of considered policy innovation to better meet the needs of people entering IVAs.

The potential for this to cause harm has long been understood, from the introduction of the IVA protocol in 2008 (following concerns from both creditors and consumer advocates), to guidance from the Insolvency Service to Recognised Professional Bodies (RPBs) on monitoring volume providers.

Yet recent evidence suggests that the current framework of IP regulation is failing to contain problems in the IVA market.

The Insolvency Service 2018 review on monitoring and regulation of IPs concluded with significant concerns over how IP's at volume IVA providers operate and are regulated.

Equally concerning are the most recent annual IVA outcomes statistics that show an upward trend in the number of IVAs terminating at one, two and three years after registration; with two-year failure rates approaching levels seen before the introduction of the IVA protocol.

This is a centrally important policy concern as a failed IVA can leave people very much worse off than when they started; with no debt relief, possible interest and charges reapplied to their debt and considerable fees paid to a provider. The point here is that IVAs are a high-risk financial product with a target market of financially distressed people. The currently regulatory framework for IVA providers does not seem well equipped to address this.

Given that over 80% of IVAs registered in 2018 were set up by eight providers, significantly improving oversight of volume providers to deliver better consumer outcomes should be a priority following this call for evidence.

Here we recognise changes in the approach to regulating volume IVA providers following the 2018 review. A more pro-active and data-based approach by RPBs is a necessary step forward but we are not convinced that it will by itself be enough to deliver the right outcomes for people entering IVAs. An overview of reasons for this view are set out as follows:

- ***One size does not fit all*:** The regulatory framework for IPs providing IVAs still appears to be designed to deal with risks posed by largely small professional service providers providing a low volume of products. The regulatory risk profile of large providers transacting with thousands of financial vulnerable consumers looks entirely different. We urge the Insolvency Service to consider the need for a specific regulatory structure for volume IVA providers.
- ***Fractured landscape:*** The current IP regulatory landscape is fractured and appears inefficient. The call for evidence paper highlights five RPBs overseeing under 1,600 IPs. Providers are working to SIPs, an ethics code, and the IVA protocol that are developed and monitored in different places and which do not form a single set of standards. While this might serve to oversee professional standards, it does not look like a framework capable of regulating a high-risk mass consumer IVA market.
- ***Practice standards are not set independently:*** The key standards by which IPs providing IVAs operate are still developed largely by the industry itself, through the Joint Insolvency Committee and the IVA protocol standing committee. We do not believe that this provides the necessary critical distance from providers' own concerns to guarantee effective safeguards for IVAs consumers. Independence is generally an important criterion for regulatory success.
- ***The regulatory framework for the IVA market should deliver equivalent standards to the Financial Conduct Authority (FCA) provisions for debt advice and debt management*:** The FCA framework for debt advice and debt management is designed to deal with the sort of conduct risks and oversight challenges that are apparent in the IVA market. So it seems sensible to benchmark regulation for the IVA market against the FCA approach and standards. Indeed, given the closeness of the volume IVA and debt management sectors, with some providers covered by both regimes, we would urge the Insolvency Service to review the possible detriment arising from any regulatory arbitrage between the two regimes.
- ***The regulatory framework needs to cover volume IVA provider firms, not just individual IPs:*** The consultation paper highlights the structure of firms where the IP may be supervising several thousand cases with little control over the actions of policies of the firm. It seems unlikely that IP regulation can guarantee a satisfactory level of standards or outcomes in this situation. We note that the FCA regime allows for regulation of firms, individuals and individuals within firms. So regulation of firms could and should be introduced for the IVA market.
- ***Regulatory objectives:*** The Insolvency Service should consider whether the regulatory objectives could be better employed to deliver better outcomes in the IVA market. We would urge the Insolvency Service to consider whether the 'secure fair treatment' and 'protecting and promoting the public interest' provisions could be used to focus standards on consumer outcomes. For instance, the 'viable solution' provision in SIP 3 do not seem to be effective in controlling potentially harmful early IVA terminations at present. A clearer and more explicit regulatory duty on providers to deliver fair and consistently good consumer outcomes might help improve the effective oversight of IVA providers.

Response to consultation questions:

1. Do you think Recognised Professional Bodies (RPBs) investigate complaints about insolvency practitioners in a way that is fair, and delivers consistent outcomes for all parties? Please share examples of good and bad practice.

We have no response to this question at this time.

2. What level of confidence do you have that RPBs will deal with insolvency practitioner misconduct swiftly and impartially, using the full range of available sanctions set out in the Common Sanctions Guidance?

The concerns raised in the recent Insolvency Service review and statistics showing an increasing number of IVAs failing strongly suggests that RPBs are not always addressing problems in the market swiftly. This is not to say that the RPBs are failing to act impartially, though we question whether a professional association can have the same critical distance from industry interest as a fully independent regulator. However, our low confidence in the regulatory oversight of the IVA market is not based on the character of RPBs, but rather on the nature of a regulatory system that is insufficiently focused on the needs of financially vulnerable consumers.

3. Do you believe the sanctions that the RPBs can currently apply are adequate and sufficient to provide fair and reasonable redress when a complaint is upheld? If not, what sanctions do you believe an RPB should be able to apply?

The sanctions regime must be capable of holding the confidence of market participants, in this case creditors, IVA providers and consumers. Achieving this aim requires three components:

- **Firstly, a full range of sanctions including public censure, financial penalties, requirements and restrictions and removing a provider from the market.** Here we note that the regulatory regime does not apply to IVA firms, only to IPs. This severely limits our confidence in the ability of the regulatory regime to ensure the market works well for all participants
- **Secondly, a regulatory body or bodies with the capacity and appetite to use the sanctions effectively.** It is not clear that the current RPB regime meets either criteria. This is highlighted by the concerns about volume providers raised by the

Insolvency Service itself. Given a very small number of providers are delivering a large majority of IVA, an effective sanctions regime should have been able to prevent these concerns from arising.

- **Thirdly, an effective sanctions regime (and regulatory regime more generally) must be capable of preventing problems arising in the first place – it should have deterrent effect.** We question whether the current regulatory regime is achieving this. It is not clear that the sanctions regime is sufficiently transparent on enforcement decisions or the reasons for those decisions. More fundamentally, it is not fully clear that the RBPs have sufficiently well-articulated regulatory objectives to allow early or pre-emptive intervention to stop market problems.

4. What evidence is there to demonstrate that RPBs collaborate to ensure there is consistency in monitoring and enforcement outcomes?

We have no comment in response to this question at this time.

5. Are RPBs doing enough to promote an independent and competitive insolvency practitioner profession that considers the interests of all creditors? Please share examples of good and bad practice.

We would highlight the rather one-sided nature of this question in relation to the IVA market. We would argue that in the IVA market the interests of creditors are quite well represented, and creditors' agents exercise some considerable power over the market. In contrast the interests of IVA consumers are underserved in terms of both consumer protection and competition. In the IVA market prices are fixed from a consumer perspective (important when an IVA fails), consumers have no information on provider's performance, and there is widespread concern at practices of lead generators who acquire clients for IVA providers.

6. In what ways have the RPBs used the introduction of regulatory objectives to improve professional standards within the insolvency profession?

See responses above. It is not clear that the regulatory objectives have properly embedded into regulatory standards, or the practices of RBPs in a way that produces a clear sense of good IVA market outcomes that would drive and guide effective oversight.

7. When dealing with insolvency practitioner conduct, how transparent are RPBs in their decision making?

We would ask the Insolvency Service to consider how the IP sanctions notices published on the Insolvency Service website compare with enforcement and penalty notices of other

regulators, and FCA notices specifically. Sanctions notices against IPs appear far less detailed, do not give much detail of the problem, or much detail of why a sanction was imposed or deemed to appropriate.

8. Does the current system of regulation provide for the effective scrutiny of insolvency practitioner fees? If not, what improvements would you suggest?

We welcomed the recent review by the Insolvency Service into monitoring and regulation of IPs that picked up issues with IVA fees, including disbursements. That review was clear that RPBs were not always providing a level of scrutiny compatible with the regulatory objective on fair and reasonable pricing. While the review suggests some remedial action, we would ask the Insolvency Service to consider how charging practices deemed unfair or unreasonable may affect consumers, particularly where an IVA fails in a way that questions its suitability.

As mentioned in a previous answer, it is not clear what, if anything, the regulatory system is doing to further the regulatory objective on competition with respect to IVA fees (which may become a real effective cost to consumers where an IVA fails or is extended).

9. What are RPBs doing to promote the maximisation and promptness of returns to creditors? Please share examples of good and bad practice.

We have no response to this question at this time.

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?

The Insolvency Service statistics showing an increase in IVA termination rates suggest that people are not always being offered the best option for their circumstances. Here we do not believe that SIP 3.1 and the IVA protocol compare favourably to the FCA CONC 8 provisions on debt advice providers.

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

As stated previously, it is not clear that RPBs are currently doing enough to protect consumers from harm in the IVA market.

12. "The regulatory objectives are fit for purpose"

Score: 3. The regulatory objectives provide a high-level framework, but it is not clear how these crystallise into a set of outcomes that would guide RPBs or allow them to be held to account. The Insolvency Service guidance on the regulatory objectives seems to leave much to RPBs discretion and tends to focus on process rather than outcomes.

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

Score: 4. For reasons stated above, it is not clear that confidence in the system has increased as the policy motivating the legislation might have expected. Again, we believe there is a problem with the 'one size fits all' approach to regulating IPs that does not clearly apply the regulatory objectives in a risk based differentiated way to different IP activities. Such differentiation will be needed to address problems in the high-risk consumer IVA market.

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

Score: 1. Specifically in the case of the IVA sector, for reasons given previously

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

Score: 3.5. There is some confidence, particularly since the 2018 review. However it is not clear that better oversight of RPBs will make up for broader deficiencies in the design of the regulatory structure.

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?

We believe that there is good reason to further explore the creation of a single regulator for the IVA market. This could be a new body, or an existing RPB if that existing body can demonstrate the capacity and appetite to regulate the IVA market effectively.

We strongly support introducing authorisation and regulation of firms in the IVA sector and cannot see that a system of regulation can be effective without this.

In taking this forward, the Insolvency Service would need to have regard to proportionality. So it may be appropriate for a new single IVA regulator authorising both IPs and firms to have jurisdiction over volume providers only (which may be defined in a different way than currently), or with different organisational requirements for sole practitioners providing a low number of IVAs.

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?

Yes, see the response above. The IP sector is diverse in respect of clients, remedies, business models and activities. We would argue that a single system of professional regulation is not suitable or capable of delivering on the regulatory objectives across such a diverse sector. Therefore we agree there is a strong case to take different regulatory approaches for different activities. In particular we would support firm-based regulation in the IVA sector.

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

We believe that regulation works best when regulators are able to take an independent approach to the functions set out in Section 144 (3) of the Small Business, Enterprise and Employment Act 2015. However there is an important role for Government to set clear and effective objectives for the regulator and ensure that the regulator is properly supported to carry out these objectives.

That said, we would point out that some of the harm consumers can experience form the IVA market is the result of IVA products not being designed to meet the needs of lower income financially distressed consumers. The IVA ‘product’ has been largely re-purposed by providers to meet needs that are arguably beyond the original policy purpose. It is over 30 years since the legislation introducing IVAs was passed and the IVA market has grown and changed considerably. It is time for the Insolvency Service to review the IVA product itself and consider what changes are needed to make this work better for its current target market.

19. How might any future single regulator, or alternative framework, be funded?

We have no response to this question at this time.

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