StepChange consultation response: Joint Insolvency Commission consultation on changes to Statement of Insolvency Practice

SIP 9 (England, Wales and Northern Ireland)

Do you believe that SIP 9 should apply to members' voluntary liquidations? Please explain your answer below.

StepChange deals largely with individual rather than corporate insolvencies so this is not directly relevant to our practice. However, we believe SIP 9 should apply to voluntary liquidations. As a principle, where people are paying for an IVA we think it's wise that these regulations be applied to safeguard against abuses on cost.

Do you agree with the change of approach to payments to associates? Please explain your answer below.

We agree with the need for a change of approach to payments to associates. The new wording adds some useful clarity about what is reasonable. Our main concern here is with the IVA market generally. Although fixed fees have gone some way to addressing the concerns of the Insolvency Service about payments to associates, we still think that more could be done in the wording to ensure IVA providers do not charge excessive costs. The rapid growth of IVAs in recent years has not always been to the benefit of consumers. When IVAs fail, which they increasingly do, the fees that have been charged can mean that despite having maintained IVA repayments for a period, people's debts have not been significantly reduced. We feel that more could be done to ensure that costs for payments to associates do not automatically land with the consumer when an IVA fails. More fundamentally, we believe that the potential complexity of abuses related to payments to associates means that changing the wording of the SIP will not be enough by itself to change practices.

Although recent changes to repayment structures which mean a maximum of 70% of repayments after the first two months of an IVA can go on fees have helped, more could be done to protect consumers. Improving the definition of associates could help protect creditor estates by limiting the ability of IVA providers to find new avenues to increase returns from cases but it does not address areas of consumer detriment. Even if costs are limited to what is 'reasonable', they fall on consumers in cases where an IVA fails.

We would like to see something in the SIP about ancillary services and other charges to consumers. Protecting consumers from these costs should be as much of a priority as protecting creditors on dubious associate payments. For example, in its 2018 review the Insolvency Service highlighted the issue of early exit loans being sold to consumers. In these cases, IPs allow people to settle their IVA early by providing a loan equivalent to the value of the IVA. These end up costing consumers considerably more due to the uncompetitive annual interest rate while the IVA provider makes significant savings for no longer having to supervise the IVA. We would like to see more attention paid to these costs to consumers in the wording of SIP9.

There are further issues with attempting to address payments to associates abuses through SIP regulations. As the Insolvency Service's 2018 review detailed, large IVA firms are structured in a way that means individual IPs are often supervising thousands of cases with little control or say over the policies of the firm. In this context, employees of an IVA provider may not know the firm's relationship with the many companies providing services for them and therefore are unable to judge whether fees paid should be designated category 1 disbursements. Tracing the flow of money is difficult and presents a serious challenge for regulatory bodies looking to crack down on abuses. While we welcome the new wording of SIP 9, it needs to be backed by effective regulatory oversight of both IPs and firms providing IVAs. Without this, changes to SIP wording may not deliver the required change.

Wider consideration should also be given to the fee structure generally. Recent reforms have seen the introduction of fee caps, a welcome change. However, these are set privately between creditors and providers, meaning there is still limited transparency for consumers looking for an IVA provider on what they will be paying. Alongside tighter regulation of how firms apply costs, the question of whether there is a better funding model for IVAs should also be posed.

Do you believe that the revised version of SIP 9 identifies all appropriate principles?

Yes, the principles cover the most important areas and seem like a good basis from which to set practice standards in the sector. We support the emphasis on reasonable costs. However, as previously stated, we are concerned that the current regulatory structure is not well placed to ensure compliance with these principles.

Do you believe that the revised version of SIP 9 identifies the key compliance standards?

The standards comprehensively list the key information office holders should be sharing with creditors to ensure costs can be properly understood and challenged. The list of charges which are not permissible is also a welcome clarification. However, while we welcome the inclusion of 'debtors' (although we would prefer another term like 'client') in the definition of other interested parties to whom information should be disclosed, we think compliance should place greater emphasis on reducing the potential costs for consumers rather than just notifying them of costs.

As previously stated, the increase in break rates means the risks to consumers of bad outcomes from an IVA are increasingly high. Although the standards are clear in the expectations they place on IPs to disclose details of costs, we would like to see more recognition of the costs that can fall on consumers and a requirement for IPs to actively try and reduce costs and the risk of costs for consumers at every stage of an IVA.

These standards reflect the Insolvency Service's recommendation that IPs should be required to justify costs. However, the standards are unlikely to have the desired effect without effective sanctions of both IPs and firms, where IPs are employees. As previously mentioned, IPs on their own often have only limited control over the actions of the firm and therefore additional scrutiny and standards for their activities will not be enough to shift the practice of firms.

Do you agree with the changes made to the section on expenses and disbursements?

Please explain your answer below.

Yes. We think these changes should help with historic abuses by adding much needed clarity on what expenses and disbursements are and how they should be accounted for. However, this consultation comes after the introduction of a fixed fee regime for many, but not all, new IVAs. A maximum fee provides a transparent limit to expenses and disbursements and there is perhaps an arguable case to consider extending this to all IVAs.

That said, it is not clear why the IVA fixed fee should be set at the level it has been and we would ask what the criteria should be for fair and reasonable IVA fees. We strongly question whether IVA fees should reasonably include an amount to cover large fees to lead generators. We continue to see problems with brand infringement and misleading claims in online promotions by IVA lead generators, practices that are funded by IVAs fees.

We have highlighted how consumers, not creditors, meet IVA providers' costs where an IVA fails, and IVA failure rates have been increasing. The focus of this consultation has been on protecting creditors against unreasonable fees; but there is also a need to protect financially vulnerable consumers against unreasonable fees. There is little price transparency, no price differentiation in the fixed fee regime, and little competition (other than competition between providers for leads) in the IVA market. Elsewhere, this would call for scrutiny of outcomes for consumers and a stronger regulatory approach to the way fees are set in the absence of competition. We would ask how this problem will be addressed.

Do you believe it is helpful for the SIP to distinguish between disbursements and other expenses?

Please explain your answer below.

Yes. This is a helpful clarification for the sector.

The SIP as drafted explains what is a disbursement. Should the SIP explain what is meant by disbursements (in the context of SIP 9)?

Please explain your answer below.

Yes. We think it is important for terms to be defined as clearly as possible to ensure that this practice standard is not undermined by exploiting loose definitions. However, we would ask whether the problems with disbursements raised by the Insolvency Service are the result of poor regulatory oversight.

The SIP as drafted does not define what is an overhead. Should the SIP explain what is meant by overheads (in the context of SIP 9)?

Please explain your answer below.

Yes, we believe it is important for there to be a clear definition of what is meant by overheads in SIP 9. However, there must also be careful consideration of the impact of such a definition on the industry before it is published, and adequate time given for firms to adjust their business models and become compliant.

We are particularly interested in the allocation of IT costs. Historically, IT costs have been a category 1 disbursement. This has allowed firms to charge fees to cover the cost of the software used to process and manage IVAs. These software costs are significant and will damage business models if they were to be reclassified as an overhead and not specifically chargeable to creditors. For StepChange, software costs are our biggest expenditure and a change to the historic treatment of these transparent functional costs could threaten the viability of our current operating model and we would need time to adjust our business model to ensure that compliance does not lead to the collapse of the service. The JIC must therefore give careful thought before establishing a definition of overhead in SIP9.

SIP 9 (Scotland)

Please only answer these questions if you have comments which relate specifically to SIP 9 (Scotland) and not to any other jurisdiction.

1 Do you agree that the changes made to SIP 9 (Scotland) are appropriate?

Please explain the reason for your answer below.

We agree with the changes to SIP9 for Scotland. Trust Deeds are governed by much more prescriptive legislation in Scotland, but the regulatory structure is the same. As a result, although we welcome the effort to bring greater clarity to the regulations on expenses and payments to associates, we are skeptical of how successful these tweaks will be in preventing abuses. As in England and Wales we think the focus should be on more vigorous regulation and sanctioning of firms rather than changing the wording of regulations.

SIP 3.1 (England and Wales and Northern Ireland)

Do you agree that the changes made to SIP 3.1 are appropriate?

Please explain the reason for your answer below.

There are some positive elements to the new wording of SIP 3.1 but we do not think the new text goes far enough to protect consumers from being mis-sold IVAs. There needs to be greater levels of prescription in certain areas. In particular, the wording could set out more precisely what is required of IPs when meeting the needs of vulnerable people. It could also give more direction on the checks that need to be conducted to ensure that an IVA is the right solution and then on the way information on costs are communicated to consumers.

Advice to the debtor

8. The insolvency practitioner should have procedures in place to ensure that the information and explanations provided to the debtor at each stage of the process (that is, assessing the options available, and then preparing and implementing an IVA), are designed to set out clearly:

c) whether the debtor will require additional specialist assistance which will not be provided by any supervisor appointed;

This clause seems to be intended to improve support for those with additional needs. It suggests there will be instances where this will not be provided by the supervisor. We think there could be more information on exactly what is meant by special assistance and what kind of support could be provided. If this is a reference to disability or other vulnerabilities, there is a huge range of types of support that someone could need, and the current wording is too vague to result in consistent improvements to support provided. It also suggests there will be instances where the supervisor will not be providing such support, yet it is not clear whose responsibility it will then be to provide it. It should be clear that the IP has responsibility not just to identify need but also to make provisions.

The proposal

14. Where the insolvency practitioner has been asked to assist the debtor to prepare a proposal, the insolvency practitioner should have procedures in place to ensure that the proposal is considered objectively, has substance and contains the following:

(a) iii. any other attempts that have been made to solve the debtor's financial difficulties, if there are any such difficulties and the alternative options considered, both prior to and within formal insolvency by the debtor;

We share the concerns noted in the Insolvency Service's 2018 Review that 'poor quality advice is being given to people in debt, potentially leading them to enter an IVA when other debt solutions could have been more appropriate.' We do not think this new wording will be enough to prevent this poor advice.

While the intention is right, it will be easy for an IP to claim they considered options 'objectively'. Given that we have been seeing an increase in IVA break rates (including one year terminations), we believe the SIP needs to be clearer and more directive about the steps an IP must take to assess the suitability on an IVA. This should include a strong requirement for IPs to assess the risks of an IVA not completing, using data on past cases and other means to assess the risk of failure. The SIP should ensure that this information is explained to consumers as part of the informed decision requirement. The SIP should include a stronger requirement on IPs to consider any other 'red flags' which indicate a person may be unsuitable for an IVA. There should also be clarity about the steps an IP should take when it appears an individual should consider an alternative solution. There could also be provisions that require IPs or firms to evidence the steps taken to rule out other options. These more explicitly outlined steps would go some way to establishing consistent approaches to risk across the IVA market. Variations in break rates between firms suggests approaches differ markedly under current regulations. It is unlikely vague requirements for IPs to be 'objective' in their assessment of a customer's efforts to resolve their financial situation will be enough to change this.

Ultimately, however, there need to be structural changes which mean firms are held responsible for cases in which poor advice has been given. Placing the onus on IPs who may have little control over the policies of the firms they are employed by where they process large volumes of IVAs will not result in wholesale improvements to practices.

14. (j) an explanation of how debts which it is proposed are compromised will be treated should the IVA fail; and

k) the circumstances in which the IVA [may] will conclude or fail, including what may happen to the debtor in such circumstances.

We believe there needs to be much more specific guidance on how information on costs and the structure of IVAs is communicated to consumers. For example, IPs could be required to provide diagrams which clearly illustrate how monthly payments will be divided and the time frames for when an individual's debts will be paid down. The JIC could provide an industry standard plain English explanation to ensure that all consumers have a clear explanation. These measures would go further to ensure that in cases where an IVA fails people are not shocked to find a substantial amount of their repayments has gone on paying fees.

There should be a requirement on IPs to provide an illustration as to how much of each debt will be paid off if the IVA fails at various stages. This should be illustrated on an annual basis. It should also show the impact of the IP fees and charges on how much debt will have been paid at each stage. It should also be clear that, should the IVA fail, the consumer will owe the remaining balance of each debt again. Most importantly, this should demonstrate the impact to the balance when all outstanding interest is added back in.

Should any other changes be made to SIP 3.1?

Please explain the reasons for your answer below and set out the changes you wish to be made to the SIP.

We continue to see problems in the way IVAs are marketed and agreed which we believe contributes to the rise in break rates. There is not enough in the new wording to put the onus on providers to carry out due diligence into how a customer has chosen to proceed with an IVA solution. There is also nothing of substance in relation to advertising and incitivised referrals. This SIP should build on provisions in the insolvency ethics code to strengthen requirements on due diligence for IVA providers using lead generators.

The IVA market is growing. 2019 saw the highest number of new IVAs of any year– with nearly 78,000 new IVAs being registered, a 10% increase on the year previous. This is a 32% rise on 2017 and is over 50% up in comparison to 2009. We are not seeing the same growth in bankruptcies and debt relief orders (DROs). In 2019, the number of DROs decreased slightly while individual bankruptcies increased by less than 1%. This suggests the increase in IVAs cannot be explained simply by an increase in the number of people needing an insolvency option to deal with their debt. Break rates also point to significant problems. By the middle of 2018 over 1 in 5 IVAs started in 2016 had been terminated. These high termination rates seem to be concentrated in the larger IVA firms. By contrast, less than 1 in 10 StepChange VA IVAs had been terminated by the same point. This suggests providers are taking vastly different approaches in their consideration of risks for consumers.

In this context we think more could be done in the wording of SIP to ensure a common risk appetite, with clear guidelines for how providers should consider risks for consumers. The wording of the SIP attempts to set an advice standard for IPs but the wording is too weak to control the level of mis-selling. It fails to make explicit the steps an IP should take or establish the necessary processes that would prevent people being put onto inappropriate IVAs.

Throughout SIP 3.1 there are references to ensuring an IVA is the correct solution for a consumer. For example, 12e) calls for an explanation of why an IVA is 'best suited for the (debtor's) circumstance.' In 14b) the regulations call for a comparison of 'estimated outcomes' if and IVA is approved or not while Principle 3 requires IPs to present sufficient information on potential outcomes for customers to be able to make an 'informed decision.' However, this guidance does not put enough responsibility on firms to assess risk for consumers nor establish processes that could construct a universally acceptable level of risk for a consumer entering a solution. In fact, the wording suggests the priority for IPs should be securing the agreement of creditors while leaving consumers to decide on risk on the basis of information that does not allow for an informed decision based on IVA providers' current performance in key arrears like break rate. Principle 5 calls for IPs to be satisfied that the IVA proposed is 'achievable' and a 'fair balance' is struck between the interests of the creditor and consumers. The word 'achievable' here seems to put the emphasis on IVAs that can get the agreement of creditors rather than ones that the customer will be able to maintain for the duration.

To strengthen the regulations on this point, there could be more explicit reference to the steps that an IP needs to take to ensure affordability for a consumer. For example, the FCA's responsible lending rules require that firms must consider the customer's ability to make repayments under the agreement as they fall due over the life of the agreement. Breach of the responsible lending rules can and does result in serious regulatory sanctions; consumers can also claim redress form the Financial Ombudsman Service. We do not see the same regulatory intent, or redress for consumers in the IVA market. The wording of SIP should attempt to replicate this. Rather than presenting options to a customer, the wording should require IPs to conduct a thorough assessment of the risks of non-completion through the duration of the IVA.

FCA lending rules do not end with the consideration of an individual's circumstances. They also require firms to consider typical drawdown and repayment patterns of their whole customer base using available data. Balancing considerations of typical customer behaviour with the circumstances of the individual. Something similar could be replicated in SIP. It should be made explicit that providers must use legacy data on break rates to inform decisions about putting individuals onto an IVA. If providers were required to use data from prior cases when considering an IVA it's likely we would begin to see the precipitous rise in break rates slow as the type of customers who regularly fail to complete their IVAs would begin to be sign-posted to other solutions. Over time, this would build a model of suitability, improving understanding in the sector about the types of customers least able to maintain an IVA for the duration.

Another way to improve protections for consumers on this point would be greater transparency in consumer outcomes. Data on IVAs is limited and termination rates are not publicly available for each firm. The SIP should require firms to share this data. This is already standard practice in Scotland where the Accountant in Bankruptcy (AIB) requires firms to publish their break rates. This is not to say problems have been resolved in Scotland. We see the same issues in this jurisdiction as the Insolvency Service remains the regulator of last resort and it is their lack of action against firms when problems are exposed that means standards are not raised. However, the requirements of the AIB are a step in the right direction. Requiring firms to use data in their assessment of suitability and then publishing portions of this data would allow RPBs to better assess why IVAs have failed. This could allow RPBs to challenge providers in cases where IVAs are shown to have been unsuitable. Further onus could be placed on providers in the wording of SIP to address issues related to these cases. The FCA's DISP rules on root cause analysis require firms to consider systemic factors that have led to a complaint. Placing responsibility on firms to look deeper at their processes of assessing suitability when IVAs fail would strengthen requirements to properly assess risks for customers by linking inadequate processes with penalties later in the process.

Another driver of the growth in IVAs and their increased instability is the way in which lead generators are incentivised to refer people to IVA providers. The Insolvency Service's 2018 review raised questions about how the commercial relationship between lead generators and IPs was incentivizing inappropriate advice. It found cases where income, expenditure and employment status were manipulated to get an IVA approved, or to increase the referral fee paid to a lead generator. We have seen examples of lead generator firms imitating advice agencies, in one case using StepChange branding and our own charity history on their website. In another instance we saw IVA's being promoted as a prize in a 'raffle to have your debts written off'. This activity is a result of the referral fees which mean lead generators can see substantial renumeration for channeling as many people as possible to IVA providers. Much of the regulation aimed at preventing this is in the Insolvency Service's Code of Ethics, and we welcome their recent updates made to this document, however we'd like to see greater focus on these abuses in the SIP regulations.

The current wording of SIP 3.1 requires IPs to have 'procedures in place' to ensure that the customer has received appropriate advice on their way to being put in contact with the IVA provider. This has not been strong enough to prevent firms neglecting the poor advice given to customers from lead generators. Given lead generators are outside of FCA regulation, the wording of SIP needs to be much stronger in requiring firms to do thorough due diligence on all the firms that have interacted with a customer before they arrive at an IVA provider and the content of the advice given. This should make clear that providers must trace the full chain of referral organizations which consumers may have been in contact with, not just the one immediately preceding a client being introduced to the IP. The Insolvency Service's updated Code of Ethics provides a useful example which should be embedded and amplified in the SIP. It explicitly sets out the kind of things an IP should look for when assessing the who a customer has received advice from. It makes it clear that it should have been fair and not misleading, that it did not involve unsubstantiated statements, that it was honest, legal, decent, and truthful, adhering to advertising ethics. The wording of SIP would benefit from this additional clarity about exactly what an IP should look for when conducting due diligence and would make it easier to identify firms which haven't followed the regulations for sanctions to be applied accordingly.

This should help in tackling the absence of direct regulation on lead generators and limiting the impact of the poor advice people receive from them. However, if lead generators continue to receive upwards of £1,000 from IVA providers for referring someone for an IVA this problem is unlikely to be resolved. Regulators need to investigate thoroughly the economics of the current arrangement and build a structure of incentives and sanctions to change practices. There need to be fines sufficiently large that IVAs become unprofitable for providers in cases where they fail to properly assess the advice given to consumers by lead generators.

Finally, on a more general note, we would like to see the term 'debtor' replaced with 'customer', 'consumer' or 'client' in the wording of SIP. As a debt advice charity, we know that there are complex causes that lead to someone falling into debt and that people often find themselves in vulnerable circumstances. Using the term 'debtor' has the potential to stigmatise people and frames the regulations outside the narrative of consumer protection in which they should sit. How we define people is closely linked to how we treat them and we feel that changing this term is an important step in shifting the perception of professionals involved in the IVA process towards the people in need of a debt solution.