Financial Services Consumer Panel
AN INDEPENDENT VOICE FOR CONSUMERS OF FINANCIAL SERVICES

Judith Marsden
The Insolvency Service
Policy Team
4 Abbey Orchard Street
Westminster
London SW1P 2HT

2 October 2019

By email: IPregulation.Review@insolvency.gov.uk

Dear Ms Marsden,

Financial Services Consumer Panel response to the Insolvency Service's Call for Evidence: Regulation of insolvency practitioners Review of current regulatory landscape

This is the response of the Financial Services Consumer Panel to the Insolvency Service's Call for Evidence: Regulation of insolvency practitioners Review of current regulatory landscape.

The Panel is established by Statute to advise the Financial Conduct Authority (FCA) on the consumer interest, which includes smaller businesses. Our views on the future regulation of insolvency practitioners (IPs) relate to the impact that the conduct of insolvency practitioners and their firms can have on consumers, especially those who are vulnerable by virtue of being in debt. We are also interested in ensuring that the boundary between the regulation of IPs and the FCA's regime for debt counselling and debt management provides consistent protections for consumers.

With this in mind, we have not responded to all the questions in the Call for Evidence.

Summary

- We do not have a high level of confidence in the effectiveness of the current regulatory regime. This is based on evidence that lead generation, poor advice and fee structures result in consumer detriment, plus a lack of evidence of robust oversight by Recognised Professional Bodies and the Insolvency Practitioner Regulation Section (IPRS).
- We do not believe a single regulator with the same objectives, powers and resources as provided by the current framework will improve confidence or consumer outcomes.
- We believe a wider review is required, focusing on the independence of regulation from the profession, the regulation of firms, standards of conduct that protect consumers, and more rigorous supervision and enforcement. This should include consideration of the role that the FCA should play.

Answers to Consultation Questions

Q2. 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 reputation of the IP profession is damaged by reports of poor conduct by individuals and firms, including aggressive lead generation, rising fees and poor advice.

Within the current regulatory framework, confidence would be improved by:

- A robust system for regulating the conduct of firms alongside supervision of individual IPs
- More intensive supervision of IPs by the Recognised Professional Bodies (RPBs), with a focus on remedying the clients' situation in cases of poor practice as well as sanctioning the IP
- Greater scrutiny of RPBs by the Insolvency Service (IS)
- A better-publicised and simpler system for complaining about an IP
- Greater transparency around sanctions and the outcome of complaints.

Q10. 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?

No. FCA regulated firms are obliged (under FCA CONC Handbook 8.3.2(1)) to:

- advise in the best interests of the customer
- explain why available options are suitable for the customer *and other options are unsuitable*
- signpost to alternative sources of free debt advice.

These rules are designed to ensure that advice for people in debt is driven by the needs of the client not by the firm's preference for one debt solution over another.

Outside the FCA perimeter, we see

- intense lead generation activity (online and by phone) on behalf of Individual Voluntary Arrangement (IVA) providers. Debt advice and debt solutions are a distressed purchase made by vulnerable people – they will tend to accept the first offer of help they receive and are unlikely to change provider after first engagement. There is a risk of detriment if such lead generation does not lead to, or even signpost to, impartial information and advice covering all the clients' options. Some lead generators are FCA regulated, and FCA recently reminded these firms of their responsibilities and the detriment that can arise for consumers if their referral to a debt solution provider is driven by the firm's commercial interests.[1] We will work with FCA to monitor the impact of this intervention, but consumers' interests can only be secured if IVA providers and non-FCA-regulated lead generators similarly put the consumer interest first.
- A rapid increase over recent years in the number of IVAs, which has not been accompanied by increases in Debt Relief Orders or bankruptcies[2]. The incomes and assets of people in problem debt have been falling since the financial crisis, so it is hard to explain why these solutions have not at least maintained market share
- Increased IVA failure rates. By 2018, 1 in 10 IVAs started in 2017 had broken and nearly 1 in 5 of those started in 2016. When an IVA fails, costs that would otherwise

[1] https://www.fca.org.uk/publication/correspondence/dear-ceo-fca-expectations-debt-packager-firms.pdf
[2] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/774327/Commentary.pdf

be borne by creditors fall on clients, who additionally have to find another route to address their debt problems.

IVAs are doubtless a good option for a proportion of debtors and creditors, but regulation needs to address the increasing risk of client detriment by adopting provisions similar to those in the FCA handbook.

Our preference would be a thorough review of the IP Exemption from FCA authorisation and regulation, with a view to providing a simpler, more consistent set of rules to protect people in problem debt. We note with concern that the evidence of potential detriment post-dates various attempts to mirror FCA provisions in the IVA/IP market (eg Statements of Insolvency Practice (SIPs), guidance notes and the 2016 edition of the IVA Protocol).

Q11. Are RPBs doing enough to promote the public interest and protect the public from harm? Please share examples of good and bad practice.

RPBs operate within a framework. The Panel doesn't believe that framework is doing enough to promote the public interest and protect the public from harm. The key requirements are:

- A set of principles that cover all the duties owed by IPs and the firms they work for to clients and the public interest
- Adequate resources for policy, risk-based supervisory and investigative work and the proper exercise of enforcement powers
- Greater transparency and accountability for RPBs and the IS for the outcomes of their market oversight. RPBs do not publish information on their risk frameworks, their view of current and emerging risks, or their range of supervisory and other tools. The annual reviews of RPB oversight do not evidence challenge by the IS of the risk frameworks used by RPBs, their market intelligence or ability to pre-empt emerging risks.

For questions 12-15, on a scale of 1 to 5, to what extent do you agree with the following statements? (1 being strongly agree, 5 being strongly disagree.) Please provide an explanation for your score and supporting evidence if possible.

Q12. "The regulatory objectives are fit for purpose"

1 2 3 **4** 5

The regulatory objectives, read alongside the Codes of Ethics overseen by the Joint Insolvency Committee and the RPBs, cover many of the duties that professionals owe to their clients and to the public interest and broadly mirror provisions in the FCA handbook[3]. However, we have 3 concerns:

- The objectives and subordinate materials like RPBs' Codes of Ethics do not create a clear duty to debtors, or help IPs reconcile their duties to debtors with their obligations to creditors
- The absence of regulation over the firms that IPs work for. The FCA regime focuses primarily on firms, since it is the actions of firms rather than individuals that pose risks to consumers. Their principles accordingly include requirements covering the management and control of firms, financial prudence, and communication with customers. Other principles covering areas such as conflicts of interest, fair treatment of consumers and skill, care and diligence apply to firms. If a similar approach was applied to the firms that employ IPs, it would recognise that consumers can be harmed by actions over which IPs personally might have no

[3] Eg PRIN 2.1.1 – Principles for Business.

responsibility or control (eg financial resources, marketing and client acquisition). The FCA's firm-based approach is, however, increasingly complemented by rules and requirements that bear on individuals who carry out key roles within firms, so a firm-based regime for insolvency firms could build on the oversight of individual IPs.

- The regime ultimately relies on regulation of IPs by IPs. Acknowledging the presence of lay members within several RPB governance and decision-making structures, experience in financial services, the legal profession and elsewhere is that this model of regulation is unlikely to command confidence and often results in significant regulatory failure followed by replacement by independent statutory regulation based on stronger objectives, powers and duties.

Q13. "The RPBs function in a way that delivers the regulatory objectives and this has increased confidence in the system"

1 2 3 **4** 5

As indicated by our answers to other questions, we do not have confidence that regulatory standards are high enough in this market. We cannot comment on levels of confidence prior to the introduction of the regulatory objectives, but merely observe that confidence is not high now.

Q14. "There are matters of significant concern, which are currently affecting confidence in the regime, which are not addressed adequately by the regulatory objectives"

1 **2** 3 4 5

Our answers to other questions set out our chief concerns.

Q15. "There is confidence that government oversight sufficiently holds the RPBs to account to deliver the regulatory objectives"

1 2 3 **4** 5

We believe the intensity of oversight by the IS isn't sufficient in such an important market. The number of RPB firm visits that are observed is very low (approx. 0.5% of the IP population in 2017-18) and there is little evidence of the other tools IS use in their oversight work. Numbers of complaints to the IS portal are low (0.6% of insolvency cases in 2018) and there is no evidence of how IS uses these or other market information to identify risks in the market and RPB supervision. Oversight reports point to areas where RPBs and IPs need to improve, but it is not clear how improvements are ensured or monitored.

Q16. 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?

No. The reserve power does not enable:

- The regulation of firms
- Expansion or strengthening of the regulatory objectives
- Fuller accountability to Government, Parliament and the public for the outcomes of regulation.

Q17. 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?

The essential components of a reformed regulatory system are:

- Regulation of firms as well as individual IPs
- Standards which ensure that debtors get the best advice and solution for their circumstances and are protected from conduct that exploits their vulnerability
- Independence from the profession and the firms it applies to.

The Panel therefore believes a wider review is required that will include options to improve the robustness and consistency of regulation relating to the management of problem debts. This echoes the findings from a report commissioned by the Money Advice Service which involved engagement with around 40 organisations (including debt advisers, insolvency practitioners, their trade bodies and regulators) which found that *"there was a good deal of support from consultation respondents for changes to the regulation of insolvency professionals and lead generators"*[4].

Options for reform might include:

- Removing IPs' exemption from FCA authorisation
- Retaining the exemption but ensuring similar standards are required from IPs and firms which operate under the exemption
- Equipping a new single regulator with wider powers and duties than the current regulatory objectives and non-statutory guidance and codes provide.

Q18. Should government have a role within any new or improved regulatory framework?

The Panel supports the common principle that regulation should be expert, independent of political influence and conducted within a clear scope and a set of powers, duties and accountabilities set by Parliament. The financial services regime could provide a model. It includes the regulation of firms as well as specific individuals and functions. It allows for the scope of regulation to be changed to reflect experience and market evolution. It allows Government to direct regulators when there is a compelling case to do so. It spells out the sanctions and powers at the regulators' disposal. It puts the public interest foremost among regulatory objectives.

Q19. How might any future single regulator, or alternative framework, be funded?

The Panel supports the common public policy principle that firms and individuals should fund the regulation they are judged to require. This principle has operated successfully in financial services, where firms ranging from sole traders to large multinationals pay a fee according to the risks in their business. This allows appropriate recognition of a firm's size and the type(s) of business they conduct. We acknowledge that a more robust regulatory system for the insolvency sector is likely to increase costs, but believe such costs would be outweighed by the benefits in confidence, better consumer outcomes and better business conditions for high quality firms. A regime that regulates firms as well as IPs creates an opportunity to spread regulatory costs more widely and more proportionately and protect small firms and individuals from unsustainable cost increases.

[4] https://masassets.blob.core.windows.net/cms/files/000/000/885/original/MAS_Debt_Solutions_Report_FINAL.pdf

Yours sincerely

Wanda Goldwag
Chair, Financial Services Consumer Panel