Association of British Credit Unions Limited

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Dear Judith,

Call for evidence: regulation of insolvency practitioners; review of current regulatory landscape

Please accept this as a response to your ongoing call for evidence *"Regulation of Insolvency Practitioners: Review of the Current Regulatory Landscape"*. We would like to welcome the fact that this issue is subject to review at this time, and appreciate the work of the Insolvency Service in engaging with us on it to date.

The Association of British Credit Unions Ltd is the primary trade association representing credit unions in England, Scotland and Wales, with around two thirds of credit unions in mainland Great Britain affiliated to us. As a co-operative we work closely with our members to inform our policy work.

Credit unions are co-operative societies that provide financial services – primarily savings and loans facilities – to their member-customers. They are registered as co-operative societies under the Co-operatives and Community Benefit Societies Act 2014 and the Credit Unions Act 1979. As deposit-takers they are dual-regulated by the Prudential Regulation Authority and the Financial Conduct Authority.

Credit unions have, since their inception in Britain in 1964, been closely associated with anti-poverty and financial inclusion. They tend to provide savings and loans facilities to those with limited or no access to financial services from mainstream providers, generally due to their low income and / or lack of a developed credit profile. They have been a central element of numerous government and philanthropic initiatives to extend financial inclusion and address the lack of adequate provision of affordable credit and secure savings facilities for large sections of the population. They are capped in the interest that they can charge at 43.6% APR under the CUA 79 and provide credit in competition with high-cost lenders who charge several hundred (in the case of doorstep lenders) or several thousand (in the case of payday lenders) % APR.

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They are numerous, with around 300 credit unions active in mainland Great Britain today, and have around 1.3 million members and £1.5 billion in assets under management. They range from mid-sized businesses of up to 50 staff or more to small voluntary organisations.

Over recent years the sector has become increasingly concerned with the growth of Individual Voluntary Arrangements (in England and Wales), and Protected Trust Deeds (in Scotland). The most recently published statistics show that there were 12.1% more IVAs between April and June of this year than the equivalent quarter the previous year. The last three quarters have seen the highest number of IVAs recorded since their inception.

In Scotland, we see a similar story in Protected Trust Deeds (PTDs) – statistics from the Accountant in Bankruptcy show that, between April and June there was an increase of 18.6% on the previous year. As is the case with IVAs, the last few years have seen an escalation of the use of this solution that far exceeds the trends seen in other debt solutions.

This is reflected in the anecdotal evidence we were hearing from our members and so, in November 2018, we launched our own call for evidence to better understand the impact of this trend on the credit union sector. The comments below reflect the feedback we received during that process. Our comments are in relation to IVAs and PTDs, and focus on the firms offering these solutions.

We should be clear at this stage that we do appreciate that not all Insolvency Practitioners are guilty of the practices outlined below, and we recognise that there is valuable work being done by some RPBs. However, changes within the sector in recent years now see the majority of debt solutions handled by a small number of firms within the jurisdiction of one RPB. The market has therefore changed profoundly and the system simply has not adapted to reflect that.

Below we have set out the answers to the questions posed in the call for evidence, and afterwards have expanded on some of our wider concerns about the failures of the current system. You should also refer to a separate communication sent on this jointly from all of the credit union trade associations in Great Britain which demonstrates the sector's consistent overall strength of feeling on this issue.

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?
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?
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?

We note that the Call for Evidence document highlights the relatively small amount of complaints made through the Complaints Gateway, and our experiences in gathering evidence of this from our own sector reflect this – it's clear that knowledge of the Gateway is poor, and there is a complete lack of confidence in the current arrangements by those who do know about it. From working with our members we feel that they are likely to seek other ways to handle this problem – either through revising lending policies, or seeking other means to address it. In Scotland, for example, we have taken a number of cases to the Accountant in Bankruptcy which has resulted in them concluding that the rules were not being applied correctly and removing protected status. Effectively this provides confirmation that the IP was not acting correctly, but these cases will never end up with an RPB for consideration.

If we compare that to a situation we faced with a credit union based in Wales, who contacted us in December 2018 to seek advice on how they could take forward a very credible complaint they had against an IP. We advised them to that the correct thing to do was to use the Complaints Gateway, which they did, and the complaint was then directed towards the Insolvency Practitioners Association. At the time of writing, in October 2019, the only response they've had from the IPA is to confirm that they are 'awaiting further information from the firm'. It's clear that such situations, in additional to the clear advocacy RPBs provide on behalf of their members, are fuelling a perception that they are not an independent body likely to find against their own members regardless of the evidence presented of malpractice.

6. In what ways have the RPBs used the introduction of regulatory objectives to improve professional standards within the insolvency profession?
7. When dealing with insolvency practitioner conduct, how transparent are RPBs in their decision making?

We note the requirement within the regulatory objectives encourage 'a coherent and consistent approach'. However, the Insolvency Service's own monitoring report of RPBs, published in September 2018, as well as a report published regarding the Insolvency Practitioners Association in September 2019, raises concerns about a lack of consistency in decisions, which remains unaddressed.

Again, this sadly reflects our own experiences. For example, though RPBs have an obligation to both consider complaints and as well as proactively monitor their membership, the serious concerns we have about the sector appears not to be at all visible to the RPBs.

It is now commonplace in many debt solutions for a software fee to be applied as an outlay chargeable to the debtor – typically costing between £300 and £500 in each case. We understand that at least one RPB has advised members that they would not consider this to be a cost which could legitimately be applied. However, the fact that it appears as standard for many volume firms suggests that at least one other RPB either has not noticed this, or does not consider it problematic.

We have also raised this with smaller insolvency firms, who not only confirmed that they did not see this as a legitimate cost, but were astonished that some IPs were able to apply in it in the manner they have. It's become clear to us that, despite extensive efforts to establish a position on that matter, there is no agreement across the 5 RPBs or the sector at large as to what outlays can or cannot be applied to cases.

We would like to add that a firm managing around 3,000 cases a year, applying a £300 software fee to each, would be paying almost a million pounds a year in software costs. This is quite clearly not the case.

8. Does the current system of regulation provide for the effective scrutiny of insolvency practitioner fees? If not, what improvements would you suggest?
9. What are RPBs doing to promote the maximisation and promptness of returns to creditors? Please share examples of good and bad practice.

As a sector we have no visibility of the relationship between RPBs and their members. As the main trade association for the credit union sector, we can also confirm that RPBs have made no proactive attempts to engage with us directly to understand whether we are satisfied with current arrangements. (Indeed, we responded to the Joint Insolvency Committee's consultation on revisions to the Insolvency Code of Ethics, which closed in the summer on 2017, arguing strongly that the code was not fit for purpose. To date, more than two years later, the JIC have failed to make any revisions to the code in response to this). Therefore, we can only answer this point based on our experiences of the level and promptness of returns to creditors, and we have serious concerns about this point.

One of the strongest messages we received from our members was concern at the levels of fees being charged by Insolvency Practitioners, which are being paid by those in a problem debt solution and so reduce the return to creditors. Indeed, despite the fact that the legislation across the UK requires that IPs maximise returns to creditors (and the Bankruptcy and Debt Advice Scotland Act makes the Common Financial Tool a legislative requirement in all statutory solutions), it is clear that the volume providers see the "going rate" as being a 10% return to creditors, which is presumably based on the level it is known that mainstream banks will accept.

For example, we were recently asked for advice from a credit union in Scotland. Having received a proposal for a Protected Trust Deed, the credit union had advised the IP that they would be making use of its majority creditor status to block the PTD. This was based on what they felt to be an inappropriate level of fees and outlays being charged relative to the contributions by the debtor, and an unacceptable return to creditors. The credit union subsequently received a phone call asking whether it would be minded to change its vote if the IP could find a way to increase the return to creditors.

As outlined above, the legislation in Scotland requires that all statutory insolvency solutions are calculated according to a Common Financial Tool, currently the Standard Financial Statement, and that all surplus income is paid into the PTD. The outlays are also subject to separate regulations. It should therefore not have been the case that the IP could have been in a position to renegotiate based on the minimum amount to that they knew they could get creditors to agree to, and demonstrates that, for volume firms, there is a culture of encouraging a 10-20% return to creditors to be seen as a 'starting point'.

We would highlight that, though outwith the jurisdiction of the Insolvency Service, there is a statutory Debt Arrangement Scheme which currently requires that that debtors repay 90% of the sum owed to creditors. Many of the cases we are seeing put forward for a PTD could clearly be a DAS case based on the amounts owed and the nature of the debts. However, we can only conclude that it is the fact that DAS is not as lucrative to insolvency firms as PTDs which is making the latter the ‘solution of choice’ for volume firms. For the creditors, this typically sees a fall in returns from 90% to between 10-20%.

To demonstrate how this is achieved we have attached an example of a trust deed, which gained protected status. Please note that, to conceal the identity of the debtor we have rounded up some figures relating to income, though the outlays remain accurate. In this instance the debtor had a low income from part time employment, and was the single parent to one child. They entered the PTD with debts of around £10,000, clearly demonstrating that they had not been able to live within their means prior to seeking advice. Despite this, they were advised that their best option was to enter a PTD and repay around £7000 over a 5 year period. As the enclosed statement shows, £6160 of this was being charged by the IP, resulting in a return to creditors of around £900 between them. In additional to a fixed fee of £1440, the IP was charging:

- Separate costs attributed to an Anti Money Laundering Check (£96), ID Verification (£48), and Echosign (£96), despite these processes all arguably being the same process. Credit unions, which generally do not have the scale or resources of a volume insolvency firm, are typically able to enforce money laundering and ID check requirements for only a few pounds per case.
- A PPI Search Fee at a cost of £360, despite the Financial Conduct Authority advising that this could be done for free.
- A packaged “Bank Account Review Fee” of £90.
- A separate one off case management fee of £150, in additional to both a case management monthly fee and the permanent trustee fee.
- Courier charges of £114, despite there being no requirement to use couriers.
- A credit check fee of £114, again despite most organisations being able to carry out credit checks for only a few pounds per case.
- “Storage costs” of £300.

It’s clear that these costs in no way reflect actual costs, but are just a means of firms maximising how much the IP could recover for their firm. This case is by no means rare – indeed, most of the outlays listed here appear as standard charges by some firms. The detriment to creditors is significant, with credit unions now being forced to write off significant sums as a result of these trends.

The credit union that received the case voted against it, but it gained protected status – and remains a live case – because the larger creditors’ have systems in place for voting that does not scrutinise these issues. The credit union usually does not have a deciding vote and, though the we realise that its reasonable that any system reflects the status of each creditor fairly, the reality is that current system is enabling these costs to go through unchecked, to the detriment of both creditors and debtors.

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

Firstly, we should be clear that we are not acting on behalf of the advice sector, nor debtors. However, as a non-for-profit creditor sector whose mission is being on 'the side' of its members we are concerned about the impact on the individuals who enter these debt solutions, the majority of whom do so in good faith.

Firstly, the example outlined above demonstrates that many people are being asked to pay back significant sums, despite firms proactively marketing these solutions as a simple means of debt relief (an advert currently being promoted on Facebook advises that there is a "Government backed scheme for mothers to write off 75% of debts"). It's clearly unethical and unfair to promote a solution on this basis, before effectively asking the debtor to repay most of what they are owed, none of which will be used to repay their creditors. There is now a real danger that some individuals will be repaying all or most of their debts, yet finding themselves excluded from credit in the future, because of the actions of IPs and the firms for whom they act.

This is reflected in the conversations credit unions are having with their own members. One advised us that

"We speak to our members if we can, most of them have told us they were not given any advice or alternative suggestions, some are for such small amounts".

Another highlighted the fact that the full ramifications are not being explained:

"We have cases where members just didn't understand the implications and that the IVA would stay on their credit file for 6 years. We have a member who withdrew from the process once it was explained to them by us what an IVA involved, and went down a DMP route instead".

Another trend we are particularly concerned about it the increasing amount of debt solutions that are failing. According Insolvency Service data, the number of IVAs failing within one year has almost doubled as a percentage since 2013. In Scotland, there is a similar trend. The Accountant in Bankruptcy's recently published annual report shows that the two firms generating the most PTDs doing have failure rates of 25% and 30%.

The reality of this situation for the debtor is that they effectively end up back at square one, having paid off very little (if any) of their existing debt, yet having contributed (often significant) fees towards the IP, and with no protection under the law from future creditor enforcement. Given that feedback from the RPBs suggests very few complaints are received about IVAs and PTDs each year, relative to how many are processed, its fair to assume that, in the majority of cases there is not consequence for IPs who are 'churning' out solutions deemed to fail.

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

Given the evidence set out above, we feel it is clear that the current system is simply not addressing significant concerns within insolvency. We are particularly concerned that:

- The escalating number of IVAs and PTDs is not being the subject to any scrutiny, because RPBs appear to be focusing on only individual complaints, and not the 'bigger picture'.
- There is a clear and obvious conflict of interest in industry self regulation.
- The Complaints Gateway does not have the profile, nor the powers, to adequately address the problems identified in this response.
- There is significant consumer detriment happening, particularly to people in vulnerable situations. Even where a complaint is upheld, there is not compensation being paid to those who been impacting by the wrong doing.

We would therefore ask that the Government:

- Introduces a single, independent regulator for the insolvency profession.
- Brings the whole insolvency and debt advice sector under the jurisdiction of the FCA, to ensure effective supervision and accountability of firms as well as individual IPs.

Below we have made some other comments, based on our evidence from members that, though not specifically mentioned in the Call for Evidence, we feel is relevant to the discussion.

Since the current system was put in place its clear that there have been significant changes within the sector, prompted by the changing business model within many firms. As the Call for Evidence document suggests, the majority of debt solutions are now handled by a small group of firms. Appointments are no longer obtained in the traditional manner; rather firms are actively promoting specific solutions to bring in new customers.

As you are aware, most Insolvency Practitioners are exempt from the FCA's regime on the basis of their RPB membership. There is also not necessarily any FCA oversight of insolvency firms, depending on what services they offer.

One trend within the sector we have considerable concerns about is the use of lead generators. It is now common for some firms to use third party marketing firms to obtain customers, and pay them based on individual leads. We have heard reports that this can be up to £2000. A recent case brought to us by a credit union saw a £1200 lead generation fee being applied as an outlay. In practice, this meant a debtor who had sought advice because they were in problem debt became liable to pay the costs of the advert that brought them into contact with the firm.

From what we can see, there is no regulatory oversight of these activities. It would appear that the firms marketing these products, though clearly promoting debt solutions and gaining financially as a result of doing so, are not subject to scrutiny within the system. The RPBs' only interest is the activities of individual IPs, who are probably not involved in the marketing or the overall business direction of the firm. Indeed, our discussions with one RPB about this suggested that, though they sympathised, they had no jurisdiction over this part of the business.

As set out above, we therefore feel it is extremely important that the Government puts in place a system that ensures comprehensive oversight of the whole sector, including marketing and lead generation activities.

We would also like to note our concerns about the frequency with which credit unions are deliberately being prevented from using their voting rights in voluntary debt solutions. As you will be aware, the Insolvency Act states that solutions apply to all unsecured creditors, irrespective of whether they supported it in their vote, or in instances where they were unknown as a creditor at the point the vote took place. The law is largely the same in Scotland.

In cases where a credit union could be in a position to block a solution, there is a very clear pattern of communications 'getting lost in the post'. One member credit union advised us that:

"In the last few weeks we were called by an IVA company to see what our likely vote would be. That only ever happens when your vote could veto the proposal so I warned the credit controller that in cases where a decisive vote might go against them, proposals had a nasty habit of going "missing in the post" Lo and behold, the proposal and notice of creditors meeting didn't arrive with us until it was too late."

We also have had an ongoing complaint with a prominent volume firm who repeatedly sent IVA proposals to ABCUL's head office, despite us not being a lender, and so never having been a creditor in any case. We do not have access to our member credit unions' lending data, and so would not have been in a position to direct it to the correct creditor. After raising this with the firm involved on numerous occasions, we were only able to resolve it by raising a complaint with the Information Commissioner's Office. As well as being a data breach, it's probable that the credit unions that should have received that information were denied the right to vote in each case.

It's clear that, despite significant fees being applied for professional services, there is very little due care being taken, and almost certainly deliberate attempts to skew the voting process. The example of the complaint we referred to above to the IPA, which remains unsolved after ten months, is in relation to a deliberate attempt to prevent a credit union blocking an IVA. However, the IVA remains ongoing, and the complaint unaddressed.

For this, as well as the reasons set above, we feel that there needs to be an independent regulator of the sector.

In closing, we would like to be clear that the current situation is having a disproportionate impact on credit unions, due to our mission of inclusion and the provision of affordable credit to the vulnerable and underserved. Our sector seeks to support those who are typically excluded from mainstream credit, in order to reduce their dependence on high cost credit. As you will appreciate, the sector is reluctant to address this problem in the manner that a mainstream lender might, which is to restrict who they lend to and further exacerbate the ‘poverty premium’.

Since 2015, aggregate credit union sector data shows that the amount of loans in arrears or written off has grown by 25% in the period to 2018. An increase of this scale is a significant drag on credit unions’ ability to sustainably lend to excluded and underserved communities.

If no action is taken in rectifying the current position, the practices of the insolvency practitioner industry will only serve to exacerbate exclusion and vulnerability as ever more mainstream creditors and affordable alternatives like credit unions decide to withdraw their services in order to manage credit risk and ever more debtors find themselves subject to inappropriate insolvency solutions.

I hope that these points will be taken into account in your considerations, and we appreciate you taking the time to investigate this matter. We are happy to discuss this further in needed.

Best wishes,

Karen Hurst.

Karen Hurst
Policy Officer, Association of British Credit Union Ltd.