ECONOMY, ENERGY AND FAIR WORK COMMITTEE

Debt Arrangement Scheme (Scotland) Amendment Regulations 2019

SUBMISSION FROM Alan McIntosh

The Debt Arrangement Scheme (Scotland) Amendment Regulations 2019 broadly propose to do four things:

1. First, they will increase the fee's that are charged to creditors from a maximum of 10% to 22%;
2. Second, they will amend who can act as a Payment Distributor (PD) with a view to encouraging greater private sector involvement in delivering the Scheme and allow the Accountant in Bankruptcy to become a PD;
3. Third they will make several changes to how Debt Payment Programmes (DPPs) under the Debt Arrangement Scheme (DAS) are administered, with a view to streamlining the process;
4. Finally, they will ban any private sector fee being charged to the consumer for the provision of a DPP under DAS.

I propose to address only point 1, as I have no issues with the other three points.

Funding of Free Sector Advice

The primary driver behind these regulations has been the declining take up of the DAS since 2014, with a 45% decreased in cases, that has mirrored a similar decrease in local authority funding of money advice services over the same period.

The funding of free money advice in Scotland can be categorised as coming from three main sources. These are:

- Local Authority Funding;
- FCA Debt Advice Levy Funding;
- Fair Share Scheme Funding;

Local Authority Funding

Local authorities are significant creditors because of council tax arrears, but also the largest funder of free money advice services in Scotland, primarily through local authority services and Citizen Advice Bureaux (CABx).

However, as has been reported by the Improvement Service, this funding fell by 45%, between 2014 and 2017 (2014-15 £21m; 2015-16 £13.3 m; 2016-17 £11.72 m) This decline in take up of the DAS corresponded with decline in funding.

FCA Debt Advice Levy Funding

This funding is raised across the UK by the FCA from consumer credit lenders. However, no funds are raised from utility firm providers, HMRC or telecommunication firms, who are all significant creditors, but contribute little to the cost of providing free money advice. The Scottish share of this Levy has now been devolved to the Scottish Government since January 2019. Sir Hector Sants, Chair of the Money and Pension Service has recently said this funding needs to be increased by 100%. Many lenders accept this but wish for other creditors to contribute such as HMRC, utility providers and telecommunications firms.

Fair Share Funding
This is operated by the central clearing banks, for Debt Management Plans, which involves two providers being allowed to retain a percentage of any funds ingathered from repayment plans (believe to be around 10-11%).
The only providers who benefit from this are the debt charity Stepchange (who raised £42.8 million in 2017 from DMP fees); and Totemic (Payplan), a private company (which raised £12.3 million in 2017 through DMP fees). No other free sector provider benefit from this source. This Scheme is often criticised, as some argues it incentivises the delivery of one solution over others for reasons of self-interest for the solution provider.
One of the criticisms of the new DAS Regulations is they are modelled on this funding model and are primarily driven by the need to provide Stepchange with a funding model, as the clearing banks don't apply the Fair Share Scheme to DAS. They, however, do not attempt to provide any solutions for the free face to face advice sector, with their existing 7,000 current cases, despite the fact they have been the backbone behind DAS since 2004 (whereas Stepchange only began providing it in 2013).

Flawed Proposed new Fee Structure
My concerns with the increased fee and model for applying it are:

a) The proposed fee structure is not transparent and marginalises the role of the money adviser in the process;
b) The fee structure focuses on increasing take up of DPPs, ignoring the funding crisis in the free sector and how the administration of 7,000 current cases, returning £15 million each year to creditors, will be resourced;
c) The fee structure will result in a consolidation of the market into the hands of a few high-volume providers, reducing competition and choice for consumers, not only in who they can access the service through, but how they access it;
d) The proposed fee structure provides no benefits for anyone, other than the AIB, raising the question why it was chosen;
e) The funding model proposed is one that incentivises providers to supply a specific solution and creates a risk provider's will be rewarded for providing inappropriate solutions, increasing the risk of consumer harm.

Fee Structure
The proposed fee structure is not transparent and hides within the PD Fee the cost of providing money advice services. This is despite the fact it is the cost of providing money advice being transferred to creditors that is justifying the fee increase.
Such a fee structure will be detrimental for CABx, local authorities and small insolvency practitioner firms who do not act as PD for their clients. These providers, if not PDs, will have no legislative right to charge a fee and, therefore, no legal way to recoup their costs, unlike large volume providers, such as Stepchange, who through the PD fee, will be able to recoup their advice costs.
It acknowledged the AIB have said they will redistribute funds back to public sector and in a proposal circulated only after the Regulations were laid, have proposed that amount should be 15%, but only where the AIB are the PD.
It is not specified in the regulations how or to who that fee should be returned.
It should be noted that the decision as to what PD is appointed is legally the consumers, as the PD works for the client and not the money adviser. Where the

consumer chooses to appoint a PD other than the AIB, then the money advice agency has no statutory right to be paid by the PD.

A similar problem exists for small insolvency practitioner firms, who do not have the means or the capacity to provide a PD service, in that they will be required to negotiate with other firms a share of the PD fee, when they are appointed to their cases. By virtue of the fact PD will be larger and likely the competitors of small firms, there is a strong risk the fee structure will distort the market and act as a barrier to small independent providers entering or remaining in the market.

If the purpose of these regulations is to increase take up of the DAS, it is likely these changes will result in a decline in face to face services, with no benefit for the consumer or the creditors, as the volume providers will continue to charge 20% (it will not be cheaper to creditors if advice is provide by phone or face to face).

The only beneficiary of this fee structure is the AIB, as it encourages public sector providers to ensure their clients use the AIB services and allows the AIB to acquire a significant market share of PD, currently being provided by the private sector.

It also means the AIB is legally entitled to the 20% and it is for them to determine how much is returned to the free sector and by what means it is returned.

A more obvious, and transparent, fee structure would have been to have three components to the fee structure:

- A Payment Distributor Fee;
- A Money Adviser Fee; and
- An AIB Administration Fee

This is the model the UK Government is proposing for the UK scheme. It is a more obvious fee structure, as it recognises the different roles in the DAS (it is interesting to note the UK Government is proposing the PD fee should be 1%).

Such a structure would have no detrimental effect on the creditors, as they would still pay a maximum of 22%; it would ensure consumers are truly free to choose the PD of their choice; and it would cause no detriment for volume providers like Stepchange. They would still receive the full 20% as providers of both money advice and PD services. In fact, arguably they would benefit from such a model, as consumers using other providers could appoint them as their PD and the other providers would have a statutory right to recover their costs from the case.

It would, however, impact on the AIB, as they would only be able to charge the administration fee and the PD fee, where they act as a PD. It would, also benefit local face to face services as it would ensure they have a statutory right to recover some of their costs.

Current Cases

The new fee structure will only apply to new cases and ignores the fact 7,000 cases are currently under administration by local authorities and CABx and return £15 million to creditors each year.

It ignores the risk that further funding cuts will have on free money advice services and the future sustainability of these cases. Applying the new fees structure could raise £2-3 million for the free advice sector each year and safeguard the future of these cases and the funds which they return to creditors.

The Risks of a Product-Related Incentivisation Scheme

There is an inherent risk for consumers and creditors in adopting a funding model that incentivises organisations to provide one solution over others. It creates a risk of

mis-selling and that vulnerable people become commodities to be traded for commission.
These regulations include no measures to mitigate against that risk and there was little or no discussion of the risk in the DAS Regulatory Working Group.
The AIB, as a regulator, has not shown itself to be an effective regulator in relation to other markets, such as the Trust Deed market, and has displayed what I would argue is a high level of tolerance when it comes to consumer harm.

Scottish Debt Advice Levy
My preference would be for a Scottish Debt Advice Levy and previously submitted a paper on this for the Tackling Problem Debt Working Group, established by the Scottish Government, which in their recommendations, proposed the Scottish Government consider the proposal.
In 2017-18, £74.1 million was the net amount distributed to creditors through Scottish formal debt solutions, after the AIB, private Insolvency Practitioners and PDs took tens of millions in fees.
Despite the fee advice sector being major providers of advice and formal debt solutions, and regularly having to advise consumers already in solutions, such as Protected Trust Deeds (arguably due to poor regulation by the AIB), the amount returned to the free sector from these funds in 2017-18 was £0.00.
A Scottish Debt Advice Levy would apply a service charge to these funds, before they are distributed, to help fund free advice services, ensuring free advice in Scotland remains sustainable regardless of the solution chosen.
Even a 10% levy, applied to just the net amount distributed to creditors would generate an extra £7.4 million.
Such a levy would have the advantage (unlike the FCA Debt Advice Levy) that it would also be applied to all creditors, including local authorities, utility firms, telecommunication firms, HMRC, and consumer credit firms.
It would also acknowledge the vital role that local authority money advice services, law centres and CABx play in providing the vital infrastructure that supports Scotland's formal debt solutions which provides creditors with these levels of return.
It is also likely to increase returns for creditors, as it is widely acknowledged that at time of under capacity (the current situation), investing in money advice has a multiplier effect of returning between £4-9 to creditors for every £1 invested.
Evidence of this exists in the fact local authority funding for money advice is believed to be approximately £11.72 million, but DAS cases administered by these services return £15 million per year to creditors. For most agency DAS as a solution probably accounts for less than 10% of all the solutions they use for clients.
The truth is there is no commercial reason why free money advice services should be underfunded and no political reason why the public purse should bear a disproportionate share of the cost of providing free money advice services.
I would ask that these Regulations are rejected.
My preference would be for a Scottish Debt Advice Levy to be brought forward as a matter of urgency, as many advice agencies are facing an existential threat from their lack of funding.
However, if the Scottish Government choose to continue with this model of funding, I would ask the regulations are amended to:

- Allow a "Money Adviser Fee";
- To specify what the "Money Adviser" and "Payment Distribution" Fee should be;

- To allow the fees to be applied to existing live cases.