ECONOMY, ENERGY AND FAIR WORK COMMITTEE

Debt Arrangement Scheme (Scotland) Amendment Regulations 2019

SUBMISSION FROM MONEY ADVICE SCOTLAND

Introduction

Money Advice Scotland is Scotland's money charity. Our mission is to be the driving force towards financial wellbeing for the people of Scotland.

We welcome the opportunity to respond to the request from the Economy, Energy and Fair Work Committee for written evidence on the Debt Arrangement Scheme (Scotland) Amendment Regulations 2019 in September. The regulations are the latest in a series of changes intended to make the Debt Arrangement Scheme more attractive for clients and advice organisations.

The introduction of short-term financial crisis payment breaks is hugely positive. People typically pay for longer in DAS (usually six or seven years, compared to four years for bankruptcy or protected trust deed) so it is inevitable that some slack will be required throughout the arrangement. Similarly, the changes to the automatic approval process will go some way to alleviate the administrative burden previously associated with DAS.

It is natural that the most eye-catching element of the new regulations is the change to payment distribution (PD), and the repercussions of this for returning funds to the free advice sector. The changes are proposed at a time when the free sector faces a crisis in funding. These regulations alone won't solve this funding crisis, but would act as a welcome precedent to redirect funds and apportion value on the free sector in Scotland. It is our hope that the Committee's consideration of the regulations prompts a broader and essential debate on how free debt advice is funded in Scotland.

Summary of key points

- The introduction of short-term financial crisis payment breaks, and changes to automatic approval bring increased flexibility to DAS
- The free advice sector faces a funding crisis in Scotland. These regulations cannot address this alone, but the changes to payment distribution represent an innovative new approach to return funds to the free sector and this is to be welcomed
- We would have preferred a set money adviser fee within the regulations. We note that the primary beneficiaries of the changes at this stage will be larger organisations, rather than the free sector which is currently overstretched and underfunded

- The case for applying the new fee structure retrospectively to existing cases is persuasive
- The changes to PD may yet incentivise DAS when other debt solutions are more suitable – this will require close scrutiny to protect clients from detriment
- In line with the recommendations of the Scottish Government's Tackling Problem Debt Group, we hope that these changes pave the way to introduce a new levy across all statutory debt solutions to support the funding of the free advice sector

Free sector advice definition and context

For the purposes of this submission, we follow the same definition of free sector that is set out in the AiB consultation on returning funds – namely meaning advice agencies within local authorities, citizens advice bureaux and other independents. Advice organisations such as StepChange, PayPlan, and many insolvency practitioners are of course free-to-client at the point of access, but they have various other means of generating income and recovering costs (including fees, fair share funding arrangements, and payment distribution under the proposals set out within these regulations).

The changes are proposed at a time when the free sector faces a crisis in funding. Between 2014/15 and 2016/17, local authority funding of money advice services declined by 45%. That did not correlate to falling demand for advice services. Rather, research from the Money Advice Service found that in 2017/18 Scotland had the ignominious accolade of being the region within the UK where demand for advice most outstripped supply. By their reckoning, demand for advice stood at 143,553, with supply around just half of that however at just 76,175.

In a recent survey to inform a new workforce strategy, we found that fewer than half of money advisers in Scotland feel optimistic about the future of free-to-client money advice. Only 36% of money advisers feel secure in their job. Our submission to the committee views the proposed changes firmly in the context of the challenges currently facing the free advice sector.

Changes to payment distribution

Currently, payment distributors are appointed through a tender process and can charge up to 8% to perform the PD function. The AiB's own analysis circulated to the DAS Regulatory Review Working Group suggests that the current average fee to a PD is between 5–6%.

The changes will mean that the PD must charge a new statutory fee of 20% of the sum to be paid each month to creditors. AiB will levy a 2% administration fee across all cases. This compares to proposals from HM Treasury for their own new statutory debt management scheme in England and Wales for an 8% money adviser fee; 1% PD fee; 1% Insolvency Service administration fee.

It would certainly have been preferable to have a set fee for the money adviser in line with the HMT approach. The fee structure at present attributes considerable value to the role of PD, underplaying the value of the money adviser.

What are the implications for free sector organisations?

It has been suggested that free sector organisations could refer all DAS cases to a larger commercial organisation that is set up for payment distribution, freeing up free sector organisations to deal with other clients. In our view, this is overly simplistic. Best practice in advising clients dictates that all options must be considered after building a full picture of a client's situation. This is a painstaking and complex process, with many clients presenting in vulnerable and distressing circumstances. Moreover, this can take weeks and even months in some cases. At the point of transfer to a larger organisation with PD function, money advisers will have already undertaken a considerable amount of work yet receive no contribution from the 20% fee.

In a similar way, it has been put forward that free sector organisations could come to individual agreements with PDs, rather than selecting AiB. In our view, this would undermine the independence of free sector organisations. This would also seem counter-intuitive – under the proposed fee structure, if free sector organisations are encouraged to select other PDs in the commercial sector, this means less funding coming back to the free sector.

We welcome the changes that will allow the AiB to perform PD. Indeed, in our response to the initial consultation we mooted the possibility of AiB performing PD in all cases. While there are clearly matters of competition to consider, this would go some way to alleviating concerns that clients might end up in DAS even when it is not suitable, as well as generating vital income for free sector advice organisations. The regulations make no reference to returning funds to the free sector and, again, we would have preferred to see a set money adviser fee detailed within the regulations.

Who stands to gain from the PD changes?

The AiB's analysis estimates that if free sector organisations select AiB as PD in all cases, c.£100k will be available to be returned to the free sector in the first year based on current case numbers. Initially, the AiB has said that it will retain 5% for its own costs and return 15% to the free sector.

Fundamentally, in terms of financial gain the changes will benefit larger organisations who are performing the PD function. This may not necessarily be a bad thing if this frees up other funding streams – specifically debt advice levy funding – for free sector organisations who are not benefitting from fees via the PD function. In our consultation response (and in the interests of transparency) we called for modelling to be published on probable returns

across the entire sector based on current case numbers, in the same way as the AiB has since published analysis on probable returns to the free sector.

The changes will apply to new DAS cases only. In our view, the case for applying the new fee structure retrospectively to existing cases is persuasive. In 2017/18, £37.6m was repaid through the Debt Arrangement Scheme. Applying the fee structure to existing cases would provide a much-needed lifeline to an underfunded and overstretched free advice sector.

Potential risk of creating incentives

During the consultation phase, we highlighted that the changes to the PD fee structure make DAS a lucrative prospect, and may incentivise certain organisations to recommend DAS even when it is not the most suitable option for clients. An example of this might be a client who is more suitable for a debt relief option such bankruptcy, but for whom it might be profitable to put in DAS.

The FCA's thematic review of debt advice found evidence of clients with unrealistically low levels of spending on essentials such as £10 per week per adult for food, toiletries and clothing. As highlighted during the consideration of the CFT regulations, so-called excessive expenditure is scrutinised and must be evidenced. However, expenditure that is considered too low is seldom subject to the same level of scrutiny. It is not difficult to envisage a scenario where a financial statement could be shaped to maximise a client's disposable income to make DAS seem workable when another solution is more suitable.

The AiB acknowledges the potential risk of incentivisation when another solution might be better in its 2019 consultation on returning funds to the free sector. If this is a risk when considering the arrangements for allocating funds back to the free sector, then this is a risk that applies to the changes as a whole.

The precedent here is what is happening with protected trust deed (PTD). At present, the trust deed market is dominated by bulk providers with high failure rates among some firms. It is worth noting that in these failed cases, any payments made by the client are typically swallowed up in fees to the trustee, rather than paying down debts. Effectively, the client can make payments for a number of years, but still owe the same level of debt that they had at the outset.

If someone enters a DAS when it is not suitable, the level of potential detriment is not on the same scale as when a trust deed goes wrong. However, we could still have a scenario where when cases cease to be profitable, they return to a free sector that is already overstretched and not benefitting from the new fee structure to the same extent as those performing the PD function. Typically, when things go wrong, the free sector is the adviser of last resort; one adviser commented to us recently, "we don't do debt advice any more, we fix other organisations' advice."

Changing profile of debt clients

In recent years, the number of people accessing DAS through free sector advice organisations has declined. This reflects the changing profile of clients accessing free sector advice – increasingly, the impact of welfare reform, stagnating incomes and rising living costs means that people in debt have little or no disposable income, and limited options to deal with debts.

For cases where a client has a disposable income, there will always be an incentive for larger providers who can recover costs via fees, fair share funding arrangements, and payment distribution. We are already in a scenario where some debt advice clients have more value than others. These regulations increase that value on clients who are entering DAS, however, they also offer the opportunity to direct more funding back to the free sector.

If the majority of DAS cases are dealt with by larger organisations, free sector organisations will continue to be left primarily with the most difficult and complex cases, typically requiring more time and face-to-face support. The impact on adviser morale on dealing with only the most problematic cases cannot be understated. Our research has found that the increasing complexity and difficulty of client cases is the main cause of declining adviser wellbeing.

As the profile of people in debt continues to change, we need to get as much funding as possible to free sector organisations. These regulations start to do that, but we need to go much further. We hope that these changes set a precedent to explore a new debt advice levy across all statutory solutions that can be redistributed to parts of the sector that are primarily dealing with the growing number of clients for whom there is no incentive for other organisations to help.