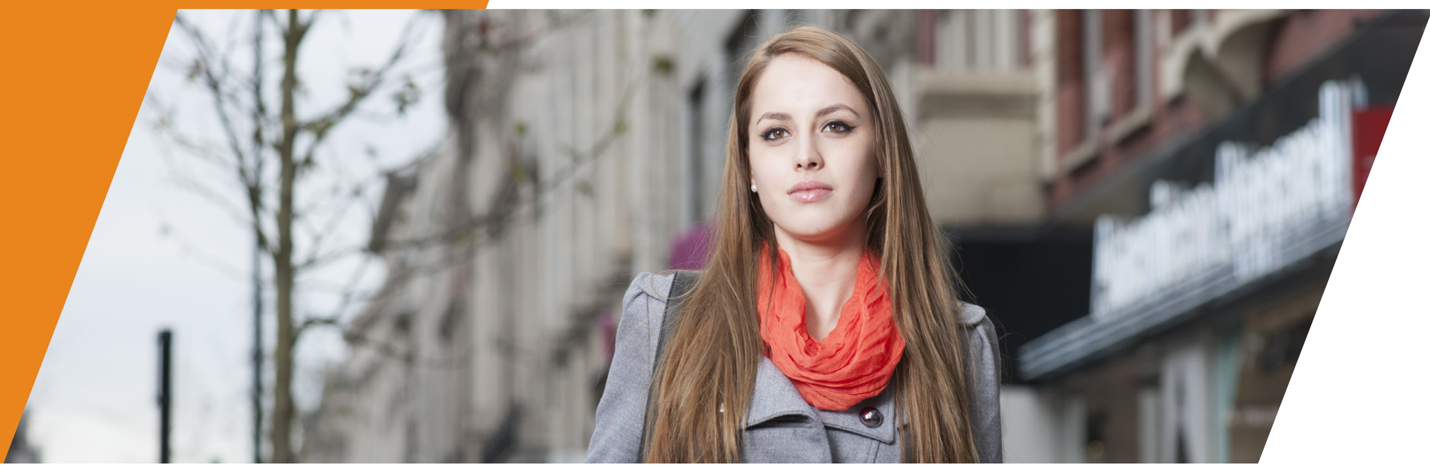
Financial Conduct Authority

Quality of debt management advice

June 2015



Thematic Review

TR15/8

Contents

Abbreviations used in this paper

CASS	Client Assets Sourcebook (FCA Handbook)
CONC	Consumer Credit Sourcebook (FCA Handbook)
COND	Threshold Conditions (FCA Handbook)
DAS	Debt Arrangement Scheme
DMP	Debt Management Plan
DISP	Dispute Resolution: Complaints (FCA Handbook)
DPP	Debt Payment Programme (as part of DAS)
FCA	Financial Conduct Authority
FSMA	Financial Services and Markets Act 2000
GEN	General Provisions (FCA Handbook)
HCSTC	High-cost short-term credit
MI	Management information
OFT	Office of Fair Trading
LILA	Low Income Low Asset process (sequestration)
MAP	Minimal Asset Process (sequestration)
MAS	Money Advice Service
PPI	Payment Protection Insurance
PRIN	Principles for Businesses (FCA Handbook)
QA	Quality Assurance
SYSC	Senior Management Arrangements, Systems and Controls (FCA Handbook)
UTCCR	Unfair Terms in Consumer Contracts Regulations 1999

1. Executive summary

Background

1.1 We took over regulatory responsibility for consumer credit in April 2014, with a mandate to improve outcomes for consumers. As part of our supervisory role, we undertake thematic reviews to assess current or emerging risks relating to an issue or product across a number of firms within a sector or market.

1.2 This is our second thematic review into the consumer credit market – the first looked at how payday lenders and other high-cost short-term credit (HCSTC) providers collect debts and treat borrowers who experience financial difficulty.[1]

1.3 Debt management firms that meet our standards can help consumers who are struggling to repay their debts and, so, can provide an important service. Individuals trying to deal with problem debt, however, can be amongst the most vulnerable in society and can be prey to firms that do not have customers' best interests at heart and do not treat them fairly.

1.4 There are many types of organisation that provide debt management services. Some charge customers a fee for their services, whereas others are free to customers – but are funded by other means. Firms operating in this sector include for-profit firms (which typically charge customers a fee for their services, but can also be funded by creditors) and not-for-profit organisations (such as charities).

1.5 There are also a wide range of different debt solutions available to customers – and these vary across the UK. We do not regulate advice on all of these. The Insolvency Service (for England and Wales), the Accountant in Bankruptcy (for Scotland) and the Department of Enterprise, Trade and Investment Northern Ireland - as well as the Money Advice Service – play key roles in this sector.

1.6 For the activities that we regulate firms should have been complying with our rules since 1 April 2014. In September 2014, we reiterated that debt management firms must 'raise their game' as the results of our supervisory work demonstrated significant non-compliance with our consumer credit rules.[2]

1.7 We consider that debt management is one of the highest risk activities in consumer credit, our concerns include that:

- Customers are not sufficiently made aware of the nature of the service being offered to them – including any fees they are required to pay. This includes customers not being made aware that help in managing debt is available free of charge from various sources.

1 www.fca.org.uk/news/tr15-03-arrears-and-forbearance-in-high-cost-short-term-credit
2 www.fca.org.uk/news/debt-management-firms-must-raise-their-game

- Debt advice provided may not be in the customer's best interests and that recommended debt solutions are not suitable, affordable and sustainable.
- Customers are recommended or sold additional products and services (such as fee-charging bank accounts, insurance products etc.) that may not be suitable or in their best interests.
- The nature and level of fees charged by some fee-charging debt management firms is such that they affect customers' ability to make significant repayments towards their debts.
- Firms do not market themselves in a manner that is clear, fair and not misleading. This includes using misleading trading names which imply that services are free (when they are not) or have some form of government or charity backing or status.
- Client money is not adequately protected, accounted for or passed to creditors in a timely manner.

1.8 Our thematic review focused on certain specific concerns in the debt management sector, as outlined below. We have previously outlined other areas where firms need to improve, and we continue to address these using the variety of regulatory tools available to us. Section 3 provides further information on the other work we are doing to secure protection for consumers using services in this sector.

1.9 The purpose of our review is to assess the level of compliance with our existing rules – most of which are based on the Office of Fair Trading's (OFT) former Debt Management Guidance. It does not establish any new standards or expectations.

1.10 All firms that held an OFT Consumer Credit Licence must apply for FCA authorisation. Existing for-profit debt management firms must now have applied for authorisation if they wish to continue to provide FCA-regulated services. Individual firms must demonstrate to us that they meet our threshold conditions (COND) and other rules, and have customers' interests at the heart of their business, in order to be granted authorisation.

1.11 Consumers often use the services of debt management firms when they are at their most desperate. They need to be confident that they are getting the help they need and are being treated fairly.

1.12 The FCA is not alone in seeking better outcomes for consumers in debt – various initiatives are underway across the wider sector. We are committed to delivering a debt management sector that works in the interests of consumers and will work in partnership with other stakeholders to help deliver this.

1.13 This report summarises the findings from our thematic review, gives an overview of other work we are conducting and highlights the actions we are taking to secure greater protection and support for consumers.

Scope and approach

1.14 Our review focused on the core service offered by debt management firms – the advice they provide. The scope of this project covered:

- Quality of advice: assessing whether debt advice was suitable, in the customer's best interests and that recommended debt solutions were appropriate and sustainable.[3]

- Transparency and disclosure: assessing whether customers received clear, fair and not misleading information (including the 'small print') to enable them to make informed decisions relating to dealing with their debts. This included whether customers were informed about the availability of free advice.

- Cross selling and incentives: assessing whether additional products that were recommended or sold by debt management firms were of value and in the best interests of the customer. We also considered whether staff incentive schemes influenced the sale of those products or the quality of debt advice provided.

- Systems and controls relating to debt advice: firms need effective systems and controls in place to ensure that customers receive appropriate advice. We assessed key controls such as quality assurance, management information and compliance arrangements.

1.15 This review used a sample of eight firms of varying sizes and business models to assess the quality of advice provided across the debt management sector. Our sample included firms that charge fees to customers and also those that provide their services free of charge.

1.16 The review process included the assessment of individual advice cases, the review of documentation (including internal processes, customer-facing documentation and management information) and visits to firms (which included interviews and live observations).

Key findings

1.17 We found that the firms in our sample had fallen short of the standards we expect.

1.18 We found that:

- The quality of advice provided by the fee-charging debt management firms in our sample was of an unacceptably low standard. Firms were not assessing customers' financial circumstances reasonably and this could result in a solution being recommended that was not suitable.

- The various debt solutions available to customers were not adequately explored in the advice process. This was particularly the case where a potential solution would result in little, or no, remuneration for the firm and for customers in Scotland who were recommended debt management plans.

- Advice provided by the 'free to customer' debt management firms in our sample was generally of a higher standard. These firms exhibited fewer of the more significant failings seen in the fee-charging firms, but, there was still scope for material improvements.

3 Where a debt solution involves a debt repayment offer to lenders, the offer should be realistic and sustainable.

- Information about the availability of free advice was either not provided, was not sufficiently prominent or was biased against, or derogatory about, the free sector.
- Debt management firms were not adequately considering the suitability, or appropriateness, of additional products that they were offering the customer.
- Some firms lacked the fundamental regulatory infrastructure needed to manage the risk of providing unsuitable advice. This included deficiencies in compliance resources, management information and quality assurance arrangements. All of the firms in our sample were, to varying degrees, still developing their control frameworks even though our SYSC rules applied from April 2014.[4]

Outcomes from our review

1.19 Our findings were very disappointing and have reaffirmed our view that poor debt management firms pose a high risk to consumers (particularly those in vulnerable circumstances) and, accordingly, to our objective to protect them.

1.20 Considering this, we are taking, or have taken, the following action:

- We provided prompt feedback to our sample firms on areas that they needed to address. We agreed with one firm that it would cease taking on new business while it substantially changed its processes for assessing customers' financial circumstances.
- We have required that wider past business reviews are undertaken in five debt management firms. These are being overseen by skilled persons appointed under s166 of FSMA – where the cost is borne by the firm. Two further firms are also undertaking more focused reviews of specific types of advice cases. All of these reviews will involve providing redress to customers if they have lost out.
- Considering the significant failings, we have already undertaken further supervisory work on some additional debt management firms that were not part of our original sample.

Next steps

1.21 Our review was in-depth and focused on assessing the quality of advice provided by a sample of firms (of varying types) in the debt management sector. We are now undertaking a broader assessment – on a firm by firm basis – as to whether each individual firm meets the standard to be FCA authorised.

1.22 For those firms that are successful in obtaining authorisation, we will continue to focus on the quality of debt management advice as part of ongoing supervisory work. We will seek to ensure that the improvements we have required are maintained and that all firms are providing advice to an appropriate standard.

4 Senior Management Arrangements, Systems & Controls

1.23 We welcome the recommendations relating to debt advice made by the 'Review of the Money Advice Service' undertaken by Christine Farnish[5] and also the previous Government's response[6] which commits to a review of the legal framework for debt administration. As we have previously announced, we look forward to working in partnership with other organisations, including the Money Advice Service and Government, to improve outcomes for those consumers who are struggling with debt.

Who should read this report?

1.24 This report will interest firms operating, or considering operating, in the debt management sector and trade bodies representing these firms. It will also interest the organisations that represent consumer interests.

5 www.fca.org.uk/your-fca/documents/john-griffith-jones-mas

6 www.gov.uk/government/publications/governments-response-to-the-independent-review-of-the-money-advice-service

2.
The debt management sector

Consumers

2.1 Debt management customers often have multiple debts ranging from credit cards, loans and catalogue debt to priority debts such as utility bills, rent and council tax that are no longer manageable.[7]

2.2 The consumers of debt management services are often at their most desperate when they seek help with their debts. It is generally accepted that consumers usually seek help with debt too late. The trigger for seeking help is often when a critical event occurs, such as a visit from a bailiff, the arrival of a Court summons or simply when the increasing contact from creditors (including phone calls and text messages) becomes personally overwhelming.

2.3 Sometimes customers are not actually seeking debt management services when they first come into contact with a debt management firm. They may be looking for other products or services (e.g. loans) but are contacted by a debt management firm following, for example, being declined a loan (the customer's details having been sold to the debt management firm by a third party, such as the loan provider).

2.4 Our work on consumer vulnerability[8] identifies over-indebtedness as a risk factor for vulnerability. Consumers in debt often also exhibit other risk factors we identify (such as job loss, divorce or ill-health) because these can be a cause of debt problems.

2.5 This vulnerability can lead to a number of poor outcomes. Customers are very unlikely to 'shop around' for help with debt. They are more likely to engage with the first organisation they contact (or that contacts them) and that offers the prospect of 'making the problem go away'. As such, debt management is a 'distress purchase' with customers often more focused on dealing with the symptoms of over-indebtedness (e.g. persistent contact from creditors) rather than dealing with the actual debt itself.

2.6 Once engaged with a debt management firm that offers the prospect of help, customers can be susceptible to influence or may make choices that are not in their best interests. For example, they may feel the need to prove their 'eligibility' for the firm's service (like they would with a loan) and may commit to a budget plan that is not actually sustainable.

2.7 Customers may also be sold additional products such as fee-charging bank accounts or insurance products. Our work indicates that some customers may buy these products because they are predominately focused on the core proposition and feel the purchase of any secondary products is 'part of the package' when obtaining help with their debts.

7 www.fca.org.uk/firms/firm-types/consumer-credit/consumer-credit-research/debt-management

8 www.fca.org.uk/your-fca/documents/occasional-papers/occasional-paper-8

Debt management firms

2.8 There are a wide range of organisations that provide consumers with help and advice on debt issues. These services can include help with budgeting, legal advice etc. through to full debt management services.

2.9 Our review focused on those firms that provide debt management services (i.e. they negotiate with creditors on behalf of debtors and act as a conduit for payments between them).[9]

2.10 Debt management services can be provided by varying types of organisations – including commercial firms (seeking a profit) and not-for-profit bodies such as charities. For this report we have used the term 'debt management firms' to cover the range of operators in this market.

2.11 Debt management firms can be funded in varying ways:

- Firms that charge customers a fee for their services. This can be in various forms, but is often a percentage of the customer's disposable income (the surplus they have available to put towards their non-priority debts).

In this report we have used the term 'fee-charging debt management firms' to cover these firms.

- Firms (which can be for-profit or not-for-profit) that are funded by creditors. Participating creditors typically pay a percentage of the debt repayments that they receive through the debt management firm. This funding model is known by the term 'fair share'.
- Firms that offer their services free to consumers may have other sources of funding (e.g. local government, through the Money Advice Service, charitable donations etc.).

We have used the term 'free-to-customer debt management firms' to cover these firms.

2.12 Both types of firm may also receive revenue from selling additional products, or by referring customers to providers of other products. We assessed this 'cross-selling' to customers in debt as part of our review.

Debt solutions

2.13 The options for dealing with problem debt are wide-ranging – from simple help with budgeting to formal insolvency/statutory solutions such as bankruptcy.

2.14 Not all of these solutions fall within the remit of the FCA. The Insolvency Service (England and Wales), the Accountant in Bankruptcy (Scotland) and the Department of Enterprise, Trade and Investment (Northern Ireland) have responsibilities in relation to the statutory schemes available in their jurisdictions.

9 The activities of *debt counselling* or *debt adjusting*, alone or together, carried on with a view to an *individual* entering into a particular *debt solution* or in relation to any such *debt solution*, and activities connected with those activities.

2.15 The solutions available to customers fall broadly into two types.

Debt management

2.16 The main debt management solutions available are:

- Debt management plan (DMP). An informal arrangement between the debtor and creditor(s) typically arranged through a debt management firm. Creditors are requested to freeze interest and charges but they are under no obligation to do so.

- Debt Payment Programme (DPP) under the Debt Arrangement Scheme (DAS) (Scotland only). A formal solution governed by legislation where creditors are required to freeze interests and charges.

Debt relief

2.17 When customers lack the ability to repay their debts (i.e. they are insolvent), they are likely to require some form of debt relief - with some or all of their debts written off.

2.18 The main debt relief options available (for individuals) are:

England, Wales and Northern Ireland:

- Individual Voluntary Arrangements.

- Debt Relief Orders.

- Bankruptcy.

Scotland:

- Trust Deeds/Protected Trust Deeds.

- Sequestration – either full administration or Minimal Asset Process (MAP) (MAP from April 2015 onwards, Low Income Low Asset (LILA) prior to April 2015).

Other products

2.19 There are other, less common, solutions available from debt management firms. These include:

- Debt settlement plans – where a nominal (‘token’) payment is made to creditors and the bulk of the customer’s disposable income is accumulated by the debt management firm with a view to offering a ‘full and final settlement’ to a creditor for a percentage of the amount owed.

The regulatory landscape

2.20 The FCA does not regulate the whole of the debt sector. Our remit concerns the activities of debt counselling and debt adjusting when they relate to debts due under credit (or consumer hire) agreements.

2.21 As stated above, the Insolvency Service and the Accountant in Bankruptcy have roles in relation to the statutory debt solutions referred to above. Consequently, we have engaged with both of these organisations as part of this review.

2.22 Another important stakeholder in this area is the Money Advice Service (MAS). MAS has a key role in the co-ordination of debt advice services and works with partners to make debt advice easier to access, and also to improve standards and quality across the sector. MAS is also a major funder of free debt advice across the UK. The Money Advice Service's objectives complement our own and, again, we have engaged with them in respect of this review and also on wider initiatives to help customers in debt (see also 'next steps' in Section 5).

The FCA regime

2.23 Our current regulatory regime for debt management is largely based on that carried over from the previous regulatory regime – the Consumer Credit Act 1974 (as amended) and Office of Fair Trading (OFT) guidance. The OFT's 'debt management guidance' formed the backbone of many of the conduct requirements introduced in our Handbook. We did, however, because of our concerns about the sector, decide to enhance consumer protections in two key areas by introducing rules to ensure that:

- Customers are informed of the availability of free debt advice upon first contact with a debt management firm.[10]
- Fees and charges do not have the effect that the customer pays all, or substantially all, of those fees in priority to making debt repayments; and, do not undermine the customer's ability to make significant debt repayments throughout the duration of the plan.[11]

2.24 Our conduct of business rules relating to consumer credit firms are contained in the CONC Sourcebook – part of the FCA Handbook.

2.25 Consumer credit firms must also comply, where relevant, with our other Handbook rules including our Principles for Businesses (PRIN), Threshold Conditions (COND), Client Assets (CASS) and Senior Management Arrangements, Systems and Controls (SYSC). Furthermore, firms should also ensure that their contractual terms are fair in accordance with the Unfair Terms in Consumer Contracts Regulations 1999 (UTCCRs).

10 CONC 8.2.4R

11 CONC 8.7.2R

3. Scope, approach and related work

3.1 As highlighted in Section 1, we have a wide range of concerns relating to the debt management sector. When determining an appropriate scope for a thematic project we considered a number of factors including other work underway within the FCA.

3.2 We elected to focus on the core service provided by debt management firms – their advice proposition. We also looked at those areas that can directly impact on the advice received by customers.

3.3 We focused on four key areas:

- Quality of advice. We assessed whether debt advice was suitable and in the customer's best interests; that it adequately took into account the customer's circumstances and that recommended debt solutions were appropriate, affordable and sustainable.
- Transparency and disclosure. We assessed whether customers received clear, fair and not misleading information about the availability of free advice, the nature of the service (including fees and charges) and the benefits and risks of the solutions available to them.
- Cross-selling and incentives. We looked at the additional products (e.g. fee-charging bank accounts, insurance products etc) that were recommended or sold by debt management firms to assess whether these were of value and in the best interests of the customer. We also considered whether staff incentive schemes influenced the sale of those products or the quality of debt advice in a negative way.
- Systems and controls relating to the provision of debt advice. Firms need effective systems and controls in place to ensure that customers receive appropriate advice. We assessed key controls such as quality assurance, management information and compliance arrangements.

To maintain the focus of our review, it was necessary to exclude other specific concerns from the scope of our thematic project. It is important to note, however, that we have a wide-ranging programme of work underway in the debt management sector.

Other FCA work

3.4 Our work to protect consumers in the debt management sector includes:

Authorisations

3.5 Consumer credit firms that held an OFT licence moved to the FCA regime with an 'interim permission'. On a staggered basis up until March 2016, these firms must apply for full authorisation. Most for-profit debt management firms have now applied and their applications are being considered.

Financial promotions

3.6 Debt management firms tend to use the internet as the main way in which to promote their debt advice and debt management services to consumers - either through banner adverts or via their own websites. They also promote their services on social media.

3.7 As part of our ongoing supervisory work in this area, we have continued to review financial promotions issued by debt management firms to see whether they market themselves, and their services, clearly and fairly.

3.8 We review promotions in response to referrals we receive from consumers and other parties about potentially non-compliant promotions, and we also carry out proactive monitoring of a number of promotions in this area.

3.9 Some of the concerns that we have raised with debt management firms include:

- a lack of balance in highlighting the potential benefits of particular debt solutions without equal prominence being given to potential downsides; and
- misleading statements about the firm's ability to freeze the interest and charges levied by lenders.

3.10 We have been pleased to note that, where we have raised our concerns with debt management firms about their financial promotions, firms have generally taken positive steps to satisfactorily address them.

Client money

3.11 Debt management firms receive, hold and pass on their clients' money. Accordingly, they must comply with our rules on holding client money. These rules are in our Client Assets Sourcebook (CASS) – chapter 11.

3.12 Since we became responsible for regulating consumer credit in April 2014, our specialist CASS Consumer Credit team has visited more than 50 debt management firms and reviewed their compliance with the relevant OFT Guidance[12] and CASS rules and have taken action to ensure that client money is adequately protected.

3.13 In instances where we have identified an unacceptable risk to client money we have taken urgent action to freeze the client money accounts. We have requested five firms to provide us with a Skilled Person report (under s166 FSMA) in relation to the adequacy of their client money arrangements and compliance with our rules.

Other supervisory work

3.14 Our supervisory approach comprises various elements. Undertaking thematic reviews is just one of these. Another aspect involves responding to individual issues or risks arising in firms.[13]

3.15 Through this reactive work we have taken action to protect customers. This is particularly the case where we have found debt management business models that resulted in customers paying a significant amount of their disposable income in fees rather than reducing the amount owed to creditors. In some examples, customers were not aware of their true debt position for long periods of time.

12 This still applies in certain circumstances during interim permission

13 Pillar 2 of our Supervision model

3.16 We have also taken action for firms to recompense customers where a firm's systems and controls failings have resulted in customers not receiving the service they are paying for.

3.17 We have found firms falling well short of our high-level standards and Principles for Businesses. As a result, 16 firms have agreed to suspend new business activities and work with us to address our concerns while others have decided to leave the industry.

Fees

3.18 We have not explicitly considered firms' fee models as part of this focused review. The general appropriateness of an individual firm's fee structure is fundamental to their overall business model and culture and we consider that this is best assessed as part of our authorisation assessment.

Sample firms

3.19 The sample for our thematic review comprised eight debt management firms (or groups of firms) chosen to cover a cross-section of size, business model and geographical jurisdiction. This included both fee-charging and free-to-customer firms.

3.20 This enabled us to review a range of practices from across the market. Some firms offered a wide range of solutions and some offered a more limited range but with referral agreements in place with other firms to deal with customers for which one of their solutions was not suitable.

3.21 Most sample firms offered their services over the telephone (sometimes supported by internet-based functionality) but some also offered face-to-face advice.

Process

3.22 Our review comprised three key elements:

- The assessment of individual advice cases – typically through the review of telephone call records and the associated paperwork. We assessed cases based on their compliance with the requirements of our Handbook and the likelihood of resulting harm to customers (as high, medium or low risk).
- The review of processes, procedures, training material, management information, contracts, customer-facing information and other documentation.
- Visits to our sample firms – which included interviews with staff at all levels (from senior management to debt advisers) and live observations of processes occurring in practice.

4.
Detailed findings

A: Quality of advice

4.1 Our key findings in this area relate to:

- Assessing customers' personal circumstances
- Assessing customers' financial positions
  - Customers' disposable income
  - Income-related issues
  - Expenditure-related issues
  - Asset-related issues
  - Evidence of income, expenditure and assets
- Recommending a debt solution
  - Information on available solutions
  - Consideration of formal insolvency solutions
  - Advice for Scottish residents
- Dealing with vulnerable customers

Assessing customers' personal circumstances

4.2 Before giving debt advice, firms are required to carry out a reasonable and reliable assessment of the customer's personal circumstances. This includes determining the reasons for the financial difficulty and any known, or reasonably foreseeable, changes in the customer's circumstances.[14]

4.3 It is important to understand the cause of a customer's financial difficulty in order, where possible, to try and prevent a reoccurrence. Foreseeable changes in the customer's circumstances must be taken into account to ensure that any recommended debt solutions are appropriate and affordable.

14 CONC 8.3.7R(2)

Our findings

4.4 In the majority of firms sampled we found examples where staff had not adequately reviewed aspects of customers' circumstances. In some cases, this had a significant impact on the suitability of the debt solutions offered.

Example – failing to assess foreseeable changes in a customer's circumstances

A customer approached a firm with debt of approximately £27,000. After assessing the income and expenditure, the firm calculated the customer had a disposable income of £110pm. The firm recommended a debt settlement plan. Taking into account fees, the firm estimated it would take the customer approximately 17 years to clear the debt. The customer was single, 60 years old and had an interest-only mortgage. The adviser did not explore when the customer would retire, or ask when the interest-only mortgage was due to finish, or whether there was a repayment vehicle in place. These are all factors that would significantly impact the customer's financial circumstances and therefore the suitability of the plan.

4.5 In many cases, customers were not asked whether there were any known or foreseeable changes expected in their circumstances. This happened even where information suggested this was likely to be the case, for example, customers approaching retirement age or with children approaching school leaving age. These likely changes were therefore not considered when recommending the most appropriate debt solution.

4.6 In other cases, advisers made unsubstantiated assumptions about future changes in circumstances which influenced their recommendation. For example, recommending a long-term debt management plan (DMP) as suitable on the assumption that a future improvement in circumstances would enable the customer to reduce the length of the DMP (by increasing the level of payments).

Example – making inappropriate assumptions about a future change in circumstances

A customer who was about to retire contacted a firm to seek help with their problem debts. As the customer's expenditure was greater than their income, the adviser suggested a number of significant reductions to the non-essential outgoings. Even with the reductions, the projected length of a debt management plan was over 20 years.

The adviser's recommendation assumed that the customer would be able to increase payments in future (and, therefore, reduce the term of the DMP) – despite no evidence to support this (the customer being about to retire on a fixed income).

4.7 Some advisers failed to establish the reasons for customers' financial difficulties. It is important to understand whether the customer might face similar issues in the future that would make committing to a regular monthly payment over a number of years unsustainable. Advisers also failed to properly assess whether the customer's financial difficulties were temporary or longer term in nature to determine whether a long-term debt solution was necessary and appropriate.

4.8 In the debt advice sector, certain types of debts and obligations are considered to be higher priority than others. This is because the consequences of failing to pay such taxes, fines, child support payments and debts could result in loss of access to essential goods or services or repossession of, or eviction from, the customer's home. Our rules require firms, when providing advice, to warn the customer of these consequences.[15]

4.9 In assessing customers' financial positions, firms should establish the nature of the customer's debts – including those that are higher priority. Although firms typically enquired about such debts, only a few adequately explored their status (e.g. any enforcement action) unless specifically raised by the customer.

4.10 In addition, most firms did not establish when specific debts were due to be repaid and, accordingly, whether additional monies would become available to apply to other lower priority debts. This could have a bearing on the suitability of the debt solution recommended.

Assessing customers' financial positions (including income, capital and expenditure)

4.11 Again, before giving debt advice, firms must carry out a reasonable and reliable assessment of the customer's financial position – including their income, capital and expenditure.[16]

4.12 This is not always easy as many consumers do not have a good understanding of their expenditure (particularly in areas such as food). It is important, however, that a robust assessment is undertaken because accurately establishing what the customer can (or cannot) contribute towards their debts may be fundamental in determining what debt solution is best for the customer and, where applicable, whether they can afford it.

Our findings

4.13 Across all the fee-charging firms we reviewed, the assessment of customers' financial positions fell well below the standard we would expect.

4.14 The standard of assessment was better in the free-to-customer firms, though there were still significant areas for improvement.

4.15 We found a variety of failings across the firms we reviewed. Some of these are detailed below.

Customers' disposable income

4.16 The key purpose of undertaking an income and expenditure assessment is to establish whether a customer can make payments towards their debts and, if so, how much.

4.17 What customers in debt can contribute towards their debts is based on their disposable income.

4.18 Most debt management firms (particularly fee-charging ones) set a minimum level of disposable income (typically £70-£100pm) which customers must have to access their products and services.

15 CONC 8.3.4R (3)(a)
16 CONC 8.3.7R (2)

4.19 Our rules require that a firm must refer a customer to an appropriate not-for-profit debt advice organisation where the customer does not have enough disposable income to pay the firm's fees.[17]

4.20 Unfortunately, we saw a significant number of cases where the customer did not have sufficient disposable income to meet the firm's minimum level, but where the recorded figure for the customer's disposable income had been misrepresented to meet the firm's minimum requirement.

4.21 This was typically achieved by reviewing and amending a customer's income and expenditure assessment after the original assessment had identified a disposable income level below the firm's minimum. Expenditure items would often then be removed, or reduced, without evidence to support the change – or a clear commitment from the customer that any proposed changes (i.e. 'cutting back' on expenditure areas) were appropriate and sustainable.

4.22 We also saw examples where customers' expenditure items were misrepresented to show an increase in expenditure (and, therefore indicate a reduced disposable income) so that the repayment term fell into the firm's minimum parameters.

Example – misrepresentation of income and expenditure

A customer contacted the firm to seek help with their debts of £1,195. The firm assessed the customer's income and expenditure and calculated a disposable income of £628 per month, which could clear the debt within two months.

The firm told the customer they could only help him if it would take longer than six months to clear the debt (their minimum period). The firm actively encouraged the customer to show increased levels of expenditure; housekeeping, rent and travel were increased in total by £300 per month.

The firm also repeatedly questioned the customer (in a leading manner) asking if they were sure they did not owe any family members any money which they were repaying. The customer finally, after persuasion, stated he paid a family member £50pm, resulting in a disposable income of £278pm which after taking into account the firm's fees would result in a six month debt management plan.

4.23 We further describe our findings relating to the assessment of customers' expenditure below.

4.24 As highlighted in Section 2, the vulnerable nature of debt management customers is such that they accept these practices because they believe, or are told, that the alternative is that they cannot be offered help.

Income-related issues

4.25 We found areas where customers' income levels were not adequately established.

17 CONC 8.3.7R (3)

4.26 For example, where customers indicated that their income varied (e.g. due to overtime), many advisers suggested an average figure to record as income. Although using an average may be appropriate, advisers often failed to discuss or establish how material variances in income levels would impact on the ongoing affordability of a solution.

4.27 This particularly applied to customers with employment that varied by season. Customers could have extended periods receiving income below (or above) the annual average figure. Advisers failed to establish how this would be managed – particularly where the upcoming period was one where the income would be lower than the average (and the customer had not had an opportunity to build up any 'reserves').

Example – failure to undertake a reasonable and reliable assessment of income

A customer contacted the firm as they were struggling with their problem debts of over £90,000. The customer had only started work two months before contacting the firm. The customer explained their income was, and would continue to be erratic, as it was a demand-led role and the income was solely commission based.

The customer had received two commission payments (as paid monthly); the second payment was twice the size of the first payment. The firm stated they would use an average figure, but used a figure which was almost the same as the higher figure and did not take into account how the customer would maintain their payments in months when their income was lower.

Expenditure-related issues

4.28 We found various failings relating to establishing customers' expenditure. These failings ranged from advisers not having sufficiently detailed, or probing, conversations about expenditure through to the deliberate alteration or misrepresentation of items and the use of standardised figures for all customers (irrespective of their actual personal expenditure).

4.29 The failure to have appropriate discussions included not challenging particularly high, or low, expenditure areas or not exploring obvious expenditure items that the customer did not volunteer. Examples included:

- Not exploring pet food costs when the customer had a pet.
- Not exploring utility bills, council tax or telephone costs.
- Car owners with no expenditure for fuel, insurance or maintenance.
- A parent with five children but no discussion of costs for clothing or school activities.

4.30 We also saw examples where customers' actual expenditure in particular areas was higher than typical. Advisers often reduced this down to an industry-standard figure without seeking an explanation of why the spending was high (which could have been for a valid reason) or understanding whether this could be sustainably reduced.

4.31 We generally found that expenditure assessments were not sufficiently detailed or granular – particularly considering the long-term nature of some debt solutions. For example, only in a relatively limited number of cases did we see any allowances for property maintenance, car maintenance, dental treatment or other areas of infrequent expenditure where even for customers in debt (and accordingly, creditors), it would be reasonable to incur some expenditure.

4.32 In some cases it was only after a customer indicated that the calculated level of disposable income appeared too high that the adviser asked about other categories of expenditure that were not considered in the initial assessment.

4.33 In general, the fee-charging firms reviewed were not effective at identifying instances where a customer did not have enough disposable income to pay the firm's fees, and referring that customer to an appropriate not-for-profit debt advice body.

Example – failing to properly assess customers' expenditure and affordability

A customer contacted a firm about switching debt management provider.

The customer advised that they were currently on a debt management plan (with another provider) paying £80pm but were struggling to sustain this.

The customer disclosed that they smoked but the adviser did not ask how much was spent on cigarettes. The adviser also disregarded the cost of a child's after-school clubs in arriving at a disposable income figure.

By failing to adequately assess expenditure correctly, the adviser determined a disposable income of £100pm for the customer (the minimum for the firm). This was despite the customer previously advising that were already struggling to maintain payments of £80pm.

4.34 In one instance, the firm automatically used standard expenditure figures (in areas such as food, insurance, transport, mobile phone etc.) for all customers. The resulting budget did not accurately reflect the customer's individual circumstances and posed a high risk of not being affordable in the longer term.

Example – failure to appropriately assess a customer's financial position

A customer approached a firm to seek help with their debts of approximately £9,000. The firm calculated the customer's disposable income using standardised figures for items such as food, clothing, mobile phone and insurance. This resulted in a disposable income of £253.

The customer subsequently amended the income and expenditure statement (sent to the customer after the initial telephone call) to reflect their actual expenditure. The changes resulted in the customer's disposable income reducing to a negative figure. The firm then called the customer to inform them that the disposable income had to meet their minimum amount. The firm said they would change the figures to fit this, and did so, without any discussion with the customer about their ability to commit to such a significantly reduced budget.

4.35 While it can be useful for advisers to have some guideline figures (particularly in subjective areas like food expenditure), these should be used as a starting point for a comprehensive discussion about the customer's actual expenditure. In the example above, the firm's advisers were explicitly instructed not to disclose the standardised figures to the customer in the initial advice call.

4.36 Firms must ensure that financial statements sent to lenders on behalf of customers are accurate and realistic, and present a sufficiently clear account of the customer's income and expenditure, debts and the availability of surplus income.[18]

Asset-related issues

4.37 In assessing the customer's financial position, some advisers did not ask whether the customer held any assets or otherwise effectively assess the customer's capital position, even though this could have a significant impact on the suitability of available debt solutions.

4.38 For example, solutions were discounted on the basis of a customer simply being a homeowner – without exploration of the level of equity that the customer had. Values of assets (particularly vehicles) were not explored even though these can be directly relevant for certain solutions (e.g. debt relief orders).

4.39 We also found that advisers failed to challenge customers' misunderstandings about how assets would be dealt with in the event of insolvency. For example, where a customer believed that, in the event of bankruptcy, they would no longer be able to retain a vehicle – even though it was necessary for their employment.[19]

Evidence of income, expenditure and assets

4.40 Many firms did not consistently request documentation or other evidence to verify their customers' income and outgoings. Where documentation was received it was not always routinely reviewed. We saw examples where the documentation provided showed a discrepancy from the information provided orally in the initial income and expenditure assessment. These discrepancies were often not followed up to obtain an explanation from the customer and no adjustment made to the assessment of the customer's financial position.

18 CONC 8.5.1R (1)

19 A motor vehicle may be treated as exempt from the bankrupt's estate if necessary for personal use in his/her employment, business or vocation.

Recommending a debt solution

4.41 The ability to give appropriate debt advice is dependent on undertaking a reasonable and reliable assessment of the customer's financial position, personal circumstances and other relevant factors.

4.42 The failings noted in paragraphs 4.16-4.40 meant that in a high proportion of cases insufficient, or inaccurate, information had been gathered to inform the advice decision-making process. This called into question the appropriateness of the advice then provided.

4.43 This is particularly the case where the eligibility of the customer for a certain solution (e.g. debt relief order) is directly linked to the amount of disposable income that the customer has.

Advice case reviews

4.44 We assessed individual advice cases based on their compliance with the requirements of our Handbook and the likelihood of resulting harm to customers:

- **High risk** – examples of where we considered advice to be high risk included:
  - where the advice was not appropriate and in the customer's best interests, and
  - where the recommended solution was potentially unaffordable and any offer to lenders unsustainable (e.g. if the assessment of the customer's financial position was materially inaccurate)
- **Medium risk** – examples of where we considered advice to be medium risk included:
  - where inaccurate, insufficient or imbalanced information was provided (but not to a degree that may have impacted on the suitability of the solution), and
  - other failings (e.g. less material failings in income and expenditure assessments) which fell below our standards
- **Low risk** – where there were no, or very minor, failings.

4.45 While the quality of advice varied between firms, the overall results of our case reviews were disappointing.

- Only approximately 20% of cases reviewed overall were assessed as posing a low risk of harm to customers.
- Half of the cases reviewed were assessed as posing a high risk of harm to customers.

4.46 We found that, in general, the standard of advice provided by the fee-charging firms in our sample was lower than that provided by the free-to-customer firms.

- Approximately 60% of the fee-charging cases we reviewed were assessed as posing a high risk of harm to customers – compared to 20% from the free-to-customer firms.

Although the advice provided was generally of a higher standard overall, the free-to-customer firms still demonstrated failings, for example:

- Just under half of the free-to-customer cases were assessed as medium risk.

In addition to the overarching failings above, we identified some particular themes.

Information on available solutions

4.47 Firms are required to provide their customers with a source of impartial information on the range of debt solutions available to the customer.

4.48 All firms reviewed did present their customers with information on a range of solutions, but this information was not always clear, fair and not misleading - being incomplete or not impartial.

4.49 In presenting information on the range of solutions available, many advisers presented some solutions negatively, giving undue emphasis to the disadvantages and risks of some solutions, while over-emphasising the advantages of others. In some cases solutions that were available to the customer and could potentially be suitable were not mentioned at all. This failing particularly manifested itself in regard to formal insolvency solutions.

Consideration of available insolvency solutions

4.50 We found that firms, particularly fee-charging firms, often failed to give fair and balanced information and advice about some insolvency solutions such as bankruptcy and debt relief orders.[20]

4.51 Understandably, many customers have strong personal views about these options. They may also consider that they have some understanding of the implications, or features, of these solutions (which may or may not be accurate).

4.52 In acting in the customer's best interests, firms and their advisers should ensure that any customer views are supplemented by accurate and impartial information about the advantages and disadvantages of solutions that may be appropriate for them and how these apply to their individual circumstances.

4.53 We found that, in some instances, where customers indicated their reluctance to consider formal solutions such as bankruptcy, this was accepted as an outright customer preference and no further discussion was entered into. Advisers did not seek to understand whether the customer properly understood the features of those solutions or provide further information that would allow customers to make an informed decision.

4.54 Some advisers played on and reinforced customers' misconceptions, or wider negative attitudes in society, in order to deter customers from pursuing solutions such as bankruptcy even though it may have been in the customer's best interests.

4.55 We found many instances where customers were recommended very long-term debt management plans (often many decades long, some 100+ years) when debt relief solutions are likely to have been more appropriate but adequate information and advice was not provided.

20 Or their Scottish equivalents (see paragraphs **2.18)**

Example – failure to properly consider insolvency solutions

A customer had a high level of debt and a low level of disposable income. The customer told the adviser that she had considered bankruptcy but did not want to go down this route because she would lose her car – which was a requirement for her job as a care assistant.

Among other failings, the adviser failed to correct the customer's likely incorrect assumption that she would be unable to retain a car (of some type). The adviser went on to recommend a debt management plan that would run for 125 years when a formal insolvency solution is likely to have been suitable.

Example – failing to properly explain and explore a potentially suitable insolvency solution; bankruptcy

A customer contacted the firm to seek help with around £21,000 of debt. The customer was single, renting, and had few assets of any value.

The firm provided very little information about bankruptcy and the information that was provided was not balanced and impartial. The firm said they would only recommend bankruptcy as a very last resort due to its impact on assets (the customer had minimal assets), on employment (without checking if this was a relevant factor for the customer), and because of the stigma of bankruptcy.

The failure to establish whether the disadvantages of a particular solution were relevant to the customer's circumstances meant that a solution that may have been suitable was not properly considered.

Advice for Scottish residents

4.56 Firms must conduct their business with due skill, care and diligence. A firm should ensure that it gives appropriate advice to customers residing in the different countries of the UK.[21]

4.57 As highlighted in Section 2, there is a different range of debt solutions available to Scottish residents.

4.58 These include the Debt Arrangement Scheme (DAS) which is, in essence, a formal, statutory debt management plan. One benefit of the scheme is that creditors are required to freeze interest and charges.

4.59 For many Scottish customers – who have a reasonable level of disposable income after meeting basic needs (and who otherwise qualify) - this solution may be in their best interests. This is particularly in contrast to an informal debt management plan (DMP) – which is more flexible but where, for example, there is no guarantee of interest and charges being frozen.

21 Principle 2 and CONC 8.2.2G

4.60 We found that DAS was not always explained properly and that customers were frequently recommended informal DMPs when a DAS would appear to have been in the customer's best interests.

Dealing with vulnerable customers

4.61 Firms must have clear and effective policies and procedures to identify particularly vulnerable customers and deal with them appropriately.[22]

4.62 All firms had introduced some form of vulnerable customer policy but the actual implementation of these varied in practice.

4.63 For example, we saw instances of customers who met the firm's own definition of vulnerability but were not identified as such and dealt with appropriately. These included:

- Customers who disclosed recent, significant medical problems (e.g. cancer).
- Customers who disclosed (or clearly exhibited) difficulties in understanding financial or legal issues – and who needed family support in such matters.
- Customers who disclosed recent bereavements or relationship issues that had contributed to their debt problem.

4.64 Some firms, however, had more robust processes in place.

Example – dealing with particularly vulnerable customers

One firm had specific advisers to deal with their particularly vulnerable customers.

When a customer was identified as particularly vulnerable they would be transferred to one of these advisers. These advisers had received specific training, were allowed more time to deal with cases and had more autonomy to deviate from standard procedures. This enabled them to provide greater support.

In establishing this team, the firm had engaged with a range of experts (e.g. physical and mental health charities) to help them understand the particular needs of vulnerable customers.

22 CONC 8.2.7R

B: Transparency and disclosure

4.65 Our key findings in this area relate to:

- Disclosing the availability of free advice.
- Complaint-related disclosures.
- Other customer communications.

4.66 Many customers who seek debt advice are doing so for the first time and with little knowledge about what to expect. As highlighted in Section 2, the nature of customers in this market means that they are not well placed to compare providers or 'shop around'.

4.67 To help customers, where possible, make informed choices, our rules require that firms make a number of disclosures to customers at various stages in the debt advice process.

4.68 A key one of these disclosures is about the availability of free debt advice.

Disclosing the availability of free debt advice

4.69 Customers may choose to pay for debt management services if they so wish (for example, if they consider that a particular fee-charging firm offers additional benefits or a service more appropriate to their needs) but they should do this in the full knowledge that a debt management service is available to them free of charge from certain providers.

4.70 So, our rules[23] require for-profit debt management firms, to make customers aware in their first communication, that free debt advice is available and that the customer can find out more by contacting the Money Advice Service. We expect all fee-charging firms to make their customers fully aware, in a clear, fair and not misleading manner, that they have the opportunity to receive debt advice and support without paying a fee.

4.71 Firms must treat customers fairly – firms should not actively discourage customers from considering alternative sources of debt counselling.[24]

Our findings

4.72 We found that customers were not consistently informed about the availability of free debt advice. Where our disclosure requirement applied to firms, none of them met the standard in all the individual debt advice cases reviewed.

4.73 This disclosure was often absent in its entirety. Or, where it was provided, it was either not provided at the point required by our rules, was rushed, was not impartial or was not sufficiently prominent.

4.74 For example, a number of firms did not make the disclosure in the first communication with the customer – making it in subsequent calls, or in subsequent written communications.

4.75 We also found that some firms did not disclose this key piece of information in a prominent manner (such that customers would notice and could make use of the information), and instead would inform the customer after the customer had agreed to a fee-charging debt solution (and was less likely to change their mind). We also found examples where the statement informing

23 CONC 8.2.4R

24 Principle 6 and CONC 8.2.2G

the customer of the availability of the free sector was delivered in a very rushed and incoherent manner, typically in a lengthy statement combined with other legal and regulatory disclosures.

4.76 We also observed staff from fee-charging firms providing unbalanced, inaccurate and disparaging information about the free sector. Some staff informed customers that the free sector was "owned by the banks"[25] and that the customer should only use the free sector if "they were prepared to do all the work themselves".

Complaint-related disclosures

4.77 An assessment of firms' complaint-handling processes was outside the scope of this review. We did, however, assess how firms described their complaints processes as part of our review of customer-facing documentation.

4.78 We found a number of failings relating to compliance with our Dispute Resolution: Complaints (DISP) sourcebook. These included:

- Firms with two stage complaints-handling processes in place, despite this being abolished in 2012.[26] This process is inherently prone to misuse, as the Financial Service Authority's review of complaints handling in banking groups[27] identified. This is because it can incentivise firms to deal with complaints unfairly at the first stage on the assumption that only a small number of complainants will take their complaint further.

- Firms establishing barriers to complaining, for example by insisting that customers make a complaint in writing. This approach may deter customers from raising a complaint.

- Firms referring customers who were dissatisfied with the outcome of their complaint to their trade association, rather than referring the customer to the Financial Ombudsman Service.

Other customer communications

4.79 Firms are obliged under our rules to ensure that they communicate information to consumers in a way which is clear, fair and not misleading.[28]

4.80 Firms must also ensure that, in accordance with Regulation 7 of the Unfair Terms in Consumer Contracts Regulations, their contracts are expressed in plain, intelligible language and do not contain unfair terms. This helps customers to fully understand what they are signing up for, the implications of any potential changes to that contract, and the service that will be provided by the firm.

4.81 During our review, we found examples of firms' communications with customers that were potentially misleading and difficult to understand – particularly considering the vulnerable nature of their customer base. We also found examples of contract terms likely to be unfair which we have required firms to address.

4.82 Firms must ensure that they have regard to the information needs of their customers and provide information that is clear, fair and not misleading.

25 Referring to the 'fair share' funding model described in paragraph 2.11
26 The 'two-stage' complaint-handling process was abolished in 1 July 2012; this meant a firm's first response will be its final response.
27 Review of complaint handling in banking groups, FSA report (April 2010)
28 Principle 7 and CONC 3.3.1R

Example – failing to provide clear, fair and not misleading information about the nature of the service provided

A customer had recently applied online for a loan to consolidate their debts - and was unsuccessful. A firm that provided debt management services purchased the customer's details (from the lender the customer applied to) and contacted the customer explaining they were making contact in relation to their recent loan application.

Throughout the conversation with the customer, the firm used loan-related terminology, such as 'consolidation plan' and consolidating into 'one monthly payment' rather than making it clear that they were discussing a debt management plan.

C: Cross-selling and incentives

Cross-selling of other products to debt management customers

4.83 Most of the firms we reviewed offered additional products and services to their customers alongside their core debt advice and debt solutions proposition. These were either offered by the debt management firm itself or through referrals to other providers (often within the same group). These included:

- Bank accounts (often with an account fee).
- Payment Protection Insurance (PPI) reclaims.
- Insurance products to protect DMP payments.
- Utility switching (e.g. gas, electric).
- Insurance switching (e.g. life, car, house insurance).

4.84 We have seen in other financial services sectors that customers are less focused on the value and suitability[29] of 'secondary' or 'add-on' products and this is likely to be even more the case in the debt management sector where the primary product (i.e. help with debt) is very much a distress purchase.

4.85 Customers of debt management firms can be susceptible to influence and, as we have demonstrated in other parts of this report, may make irrational or inappropriate choices to obtain help with their debts. This may include purchasing other products if they feel it is 'part of the package' of getting help.

29 Market Study MS14/1 - General Insurance add-ons: Provisional findings of market study and proposed remedies – March 2014

4.86 The sale of an additional product often reduces the customer's disposable income and, therefore, the amount available to repay to creditors. As a minimum, this extends the length of time the customer is in debt.[30]

4.87 To help satisfy themselves that customers were being treated fairly, some of the firms in our sample had implemented a policy of only selling (or recommending) additional products or services to customers where this had the effect of reducing their expenditure and, so, increasing their disposable income.

4.88 Firms undertaking FCA-regulated activities, including debt management firms, must comply with our rules. This includes treating their customers fairly and taking reasonable steps to ensure the suitability of any advice they provide.[31]

4.89 We found, however, that in some cases, the suitability assessments and controls relating to sales were not sufficient to mitigate the risks to consumers.

4.90 We also identified cases where an additional product was sold, following the recommendation of a debt solution, but the cost of the additional product was not factored into the customer's income and expenditure assessment. This resulted in a failure to carry out a reasonable and reliable assessment of the customer's financial position and affected the affordability of the recommended solution.

Example – failure to include the cost of additional products in the customer's income and expenditure assessment

A customer approached a firm to seek help with their debts of around £27,000. The firm assessed the customer's financial situation and calculated a disposable income of £90pm, taking into account the firm's fees; it would take the customer approximately 37 years to clear their debt.

The firm also sold the customer a fee-charging bank account at £14.50pm. This was not taken into account when calculating the £90pm disposable income, therefore reducing the amount the customer had available to pay towards their debts (to £75.50pm), and increasing the length of the debt management plan by an additional 10 years. This was not discussed with, or explained to, the customer to enable them to make an informed decision about the additional product.

4.91 We expect firms to treat customers in debt fairly. This includes not exploiting their vulnerable circumstances to make a profit. Debt management firms must take reasonable steps to ensure the advice they provide, and the products and services they sell (whether debt management or otherwise), operate in the best interests of their customers.

Staff incentives

4.92 Incentive schemes, if not properly managed, can result in mis-selling or unsuitable advice.

30 It may also add to the sum of the indebtedness if interest and charges continue to be levied.

31 Principle 9 and Principle 6

4.93 We, and our predecessor regulator, the Financial Services Authority, have conducted various pieces of work assessing how firms manage the risks arising from their financial incentives and performance management schemes.[32]

4.94 Debt management firms should not unfairly incentivise debt advisers to the extent that an incentive might lead to the firm not acting in the customer's best interests.[33]

4.95 We found that most of the firms in our sample operated some form of financial incentive scheme. These either related to the debt solutions offered, additional products – or both.

4.96 To help them manage the risks arising from their financial incentives, some firms were changing their incentive schemes to reduce the variable element or include quality measures in the calculation of incentive payments. One firm was in the process of removing all incentives and moving to a salary-only model for its advisers.

4.97 We found, however, that some firms' incentive schemes included features that could increase the risk of mis-selling. Firms need effective controls to identify and manage this risk.

4.98 As our findings on systems and controls demonstrate (see Section D), firms' control arrangements (particularly quality assurance checks) were not sufficiently robust to mitigate the risks arising from their incentive schemes.

4.99 In many fee-charging firms there was evidence of a historic 'sales culture' – with a focus on sales rather than the quality of advice. Financial incentives can play a large part in defining this culture and influencing staff behaviours.

4.100 We recognise the efforts that some of the firms were taking to move towards an advice culture that is focused on achieving better outcomes for customers. Senior management must ensure that cultural change is driven from the very top of the organisation.

4.101 In view of our findings from this work, and other supervisory work in the consumer credit sector, we announced in our 2015/2016 Business Plan that we would undertake a thematic review assessing staff incentives and remuneration in consumer credit firms.[34]

D: Systems and controls

4.102 Our key findings in this area relate to:

- Governance and risk management
- Quality assurance
- Compliance arrangements
- Management information
- Record keeping

32 www.fca.org.uk/news/tr14-4-risks-to-customers-from-financial-incentives
www.fca.org.uk/news/guidance-consultations/gc15-1-risks-to-customers-from-performance-management-at-firms

33 CONC 8.3.2R & CONC 8.3.6G

34 www.fca.org.uk/news/our-business-plan-2015-16

Governance and risk management

4.103 Debt management firms are required to have robust governance arrangements and effective processes to identify, manage, monitor and report the risks they are or might be exposed to.[35]

4.104 Firms must also establish, implement and maintain adequate policies and procedures sufficient to ensure compliance of the firm including its managers, employees and appointed representatives with its obligations under the regulatory system.[36]

4.105 In general, we found that firms lacked adequate governance and risk management arrangements. In this area in particular, we identified that firms had not adequately prepared for FCA regulation in April 2014. All of the firms in our sample had extensive change programmes underway to deliver governance and control frameworks to meet FCA requirements. These programmes were typically targeted on the date that the firm had to apply for authorisation.

4.106 In all the firms we reviewed, the quality of advice provided to customers fell short (to varying degrees) of the standards we expect, and this was in part attributable to governance and risk management processes that either did not identify, or did not effectively address, the risk that the firm may provide unsuitable advice.

4.107 Some firms had, however, made recent significant changes. These included, for example, establishing appropriate governance committees, holding regular, documented Board meetings, and establishing compliance and quality assurance functions.

4.108 In some cases, these initiatives were too embryonic to determine whether they would be effective in identifying and managing risks. In others, we found that the arrangements were not effective.

4.109 Particular areas where we identified failings were quality assurance, compliance arrangements, management information and record keeping.

Quality Assurance

4.110 Most firms had some form of quality assurance (QA) arrangements in place to monitor the performance of staff providing advice. These arrangements were designed to ensure compliance with their obligations under our rules, including CONC.

4.111 However, these arrangements were not always achieving what firms intended, for example:

- QA schemes were often focused on assessing compliance with processes (e.g. adherence to scripts) and not assessing good customer outcomes. Where measures were included on the actual quality of advice or fair treatment of customers, these were sometimes given relatively little weight.

- The number and proportion of cases assessed being very low. In managing their risks, it is up to firms to determine what is appropriate in terms of the scale and nature of QA arrangements. We found, however, many firms used simple ratios (e.g. X number of calls per adviser, per month). When considered in the context of the number of calls advisers typically dealt with over a period, the number of cases assessed was too low to be an effective control over the quality of advice provided.

35 SYSC 4.1.1R

36 SYSC 6.1.1R

- Some firms were not effectively reviewing the outcomes of QA checks and conducting root cause analysis to deliver improvements. We saw an example where QA identified common failings across the adviser population but the firm failed to effectively address recurring issues.

Example – quality assurance: failure to address root causes

A firm's QA process identified issues with the quality of their income and expenditure assessments. This issue continued to recur over many months.

Although the firm made some attempts to address the issue (by reminding staff of procedures) – this continued to be a problem area. The firm failed to undertake robust root cause analysis to investigate the source of the issue which was, in our view, likely to be the firm's staff incentive scheme which provided increased rewards for cases with higher disposable income. As previously demonstrated, customers' disposable income levels can be misrepresented through deficient income and expenditure assessments.

Compliance arrangements

4.112 A firm must establish, implement and maintain adequate policies and procedures sufficient to ensure compliance with its obligations under the regulatory system.[37]

4.113 As highlighted above, many firms were still in the process of establishing, or re-organising their compliance arrangements ahead of applying for FCA authorisation. Accordingly, at the time of our review, these firms did not have adequate compliance policies and procedures.

4.114 Firms must have appropriate resources for the regulated activities that they carry on.[38] Debt management firms should take account of the need to maintain a permanent and effective compliance function. Further, depending on the nature, scale and complexity of its business, it may be appropriate for a debt management firm to have a separate compliance function.[39] We found that some firms did not have basic compliance functions appropriate to their size and the nature of their business.

Management information

4.115 We expect firms to make use of suitable management information (MI) to monitor the outcomes that they are achieving for customers. This may comprise a range of information of different types, both numeric and descriptive, but it is important that it is forward-looking (enabling management to identify risks to customer outcomes rather than dealing only with known issues) and that it is acted upon when necessary.

4.116 In some of our firms, MI was solely focused on commercial measures such as the volume of debt solutions sold and did not include any customer-focused measures.

4.117 Other firms had included some information on customer-related matters. Information included complaints data, customer feedback scores, savings achieved for customers, and the results of call monitoring or quality assessments.

37 SYSC 6.1.1R
38 COND 2.4
39 SYSC 6.1.3AG

4.118 Firms failed to demonstrate, however, that the information they did have was used effectively to identify potential issues. In all the firms we reviewed we identified issues with the quality of advice provided that had not been identified or highlighted by the firm's MI.

Record-keeping

4.119 Firms must keep orderly records. These must be sufficient to enable us to monitor compliance with regulatory requirements and ascertain that the firm has complied with its obligations to customers.[40]

4.120 The standard of record-keeping across the firms we reviewed varied considerably. In most cases, firms were able to provide records of advice given to customers including recordings of telephone calls. However, some firms had incomplete or missing records of advice given to some customers, making it impossible for us to monitor the quality of advice provided.

4.121 Adequate records need to be kept irrespective of how the advice is transacted. In one case, where advice was provided on a face-to-face basis, the standard of record-keeping fell below the standards we expect.

Example – failure to keep appropriate records

One firm provided advice on a face-to-face basis. The firm had a relatively detailed 'fact-find' document for advisers – but the level of completion was such that the firm could not demonstrate compliance with our rules. For example, there was insufficient, or no, information retained about the customer's circumstances including the reason for their debt.

There was insufficient oversight provided by management or other control functions to ensure that appropriate information was captured and recorded.

40 SYSC 9.1.1R

5. Outcomes and next steps

5.1 The results of our review were very disappointing – particularly those that relate to the fee-charging firms in our sample.

5.2 We still consider, however, that debt management firms that meet our standards (whether fee-charging or free-to-customer) can provide a valuable service to customers struggling with debt.

5.3 Our thematic review was focused and provided an in-depth assessment of the quality of advice provided by the firms in our sample – which were varying in nature.

5.4 We are now assessing the broader suitability of individual debt management firms more fully as part of our authorisation process (this assessment is currently underway for most for-profit firms).

5.5 While we are in the process of making those assessments, we have taken, or are taking the following action regarding the firms in our sample:

- We provided prompt feedback to our sample firms on areas that they needed to address. Considering the materiality of our findings, we felt that it was not appropriate to wait until we had concluded our review (as is our normal practice) before providing feedback to individual firms.
- We agreed with one firm that it would cease taking on new business whilst it substantially changed its processes for assessing customers' financial circumstances.
- We have required that wider past business reviews are undertaken in five debt management firms. These are being overseen by skilled persons appointed under s166 of FSMA with the cost being borne by the firms involved. These reviews will involve providing redress to customers if they have lost out.
- Two further firms are also undertaking more focused reviews of specific types of advice cases. These may also involve remediation for customers if they have suffered harm.
- Considering the significant failings, we have also undertaken further supervisory work on two additional debt management firms that were not part of our original sample.

Next steps

5.6 As stated above, as part of the ongoing assessment of consumer credit authorisation applications, we will determine, amongst other matters, whether individual debt management firms meet our threshold conditions and therefore, whether they should be granted FCA authorisation.

5.7 Where firms are successful in obtaining authorisation, we will continue to focus on the quality of debt management advice as part of ongoing supervisory work. The findings of our review demonstrate non-compliance with our rules and the previously applicable OFT's Debt Management Guidance. We expect firms to take note of our findings and ensure that they are providing advice to an appropriate standard.

5.8 We welcome the recommendations relating to debt advice made by the 'Review of the Money Advice Service' undertaken by Christine Farnish.[41]

5.9 It is relevant for this report that in March 2015 the previous Government accepted a recommendation that it reviews '*the legal framework for debt administration, in order to provide consumers who agree to specified debt repayment schemes with a 'breathing space' by freezing interest and charges, and to ensure a fair and appropriate basis for debt repayments to different classes of creditor.*'

5.10 The previous Government confirmed that HM Treasury and the Insolvency Service, in close consultation with the FCA, MAS and other stakeholders will undertake an in-depth review of this area.[42]

5.11 We would welcome this initiative and look forward to continuing to work in partnership with other organisations, including the Money Advice Service and the Government, to improve outcomes for those consumers who are struggling with debt.

41 www.fca.org.uk/your-fca/documents/john-griffith-jones-mas. https://www.gov.uk/government/publications/review-of-the-money-advice-service

42 www.gov.uk/government/publications/governments-response-to-the-independent-review-of-the-money-advice-service

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