Debt packagers: proposals for new rules

Consultation Paper
CP21/30**

November 2021

How to respond

We are asking for comments on this Consultation Paper (CP) by **22 December 2021**.

You can send them to us using the form on our website at: www.fca.org.uk/cp21-30-response-form

Or in writing to:

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1 Summary

Why we are consulting

1.1 These proposals aim to reduce the risk that consumers get non-compliant debt advice that is biased towards debt solutions which may not meet the needs of consumers but that generate referral fees for the debt advice firm.

1.2 Our debt advice rules require firms to ensure that the advice they give is appropriate to the individual needs of customers, has regard to their best interests and is based on a sufficiently full assessment of their financial circumstances. The rules provide protection for consumers from the harms which can occur where they enter unsuitable debt solutions which could lead to them making payments which they cannot afford or missing out on solutions which may have been more suited to their circumstances.

1.3 We set out in this consultation paper our evidence that the debt packager business model, which is based almost entirely on income generated by referral fees, leads to advice which does not comply with our rules. By ending this model, the proposed rules are intended to ensure that consumers receive the level of protection which our current rules are intended to deliver, so that they can benefit from the value which debt advice should provide.

Who this applies to

1.4 This consultation applies to:

- Debt packager firms and appointed representatives who act as debt packagers.

1.5 The following will also be interested in this consultation:

- Individual Voluntary Arrangement (IVA) and Protected Trust Deed (PTD) providers and insolvency practitioners
- firms administering Debt Management Plans (DMP) and/or the Debt Arrangement Scheme (DAS)
- not-for-profit debt advice providers (NFP)
- consumer groups

What we want to change

1.6 Debt packagers are authorised, commercial firms that provide debt advice services but do not provide any debt solutions themselves. The debt packager business model relies entirely, or largely, on remuneration from referral fees from solution providers, primarily providers of IVAs and PTDs.

1.7 Where appropriate, IVAs and PTDs can help consumers to deal with their debts, but they can be harmful for people who are not able to afford the repayments, or where another solution would be more suitable. We have included in Box 1 a description of the main debt solutions available to customers.

1.8 This is not the only business model available to commercial, advice only firms – but it is the typical one we see in the market. Where we talk in this paper about debt packagers, we are referring to firms with this model. On average, these firms generate 90% of their income through receiving referral fees. This creates a conflict of interest between giving advice which has regard to the customer's best interests (as our rules require) and making recommendations which generate revenue but which may not suit the customer's individual circumstances. Many debt advice providers receive revenue from referral fees, and it is possible to manage this conflict of interest. However, the conflict is stronger for debt packagers since they rely heavily on this income.

1.9 Despite setting out concerns in 2018 and 2020 around the quality of advice provided by debt packagers, our recent supervision work identified concerns that some debt packager firms appear to have manipulated consumers' income and expenditure to meet the criteria for an IVA or PTD; used persuasive language to promote these products to consumers without fully explaining the risks involved; and provided advice that did not accurately reflect their conversations with consumers or information that consumers had given. We found that their businesses are often set up in a manner which resembles a sales process, rather than an advice service.

1.10 Consumers who seek debt advice are more vulnerable to harm due to being in financial difficulties. They need protection from non-compliant, biased advice which could cause them to enter debt solutions which are not in their best interests. Our existing rules, when complied with, should help provide this protection.

1.11 Our proposals are intended to address the concern that the strong conflict of interest present in the debt packager business model leads to firms not complying with our rules, which creates an unacceptable risk of harm to consumers. This can lead to harm where consumers end up on debt solutions which require them to make payments which they cannot afford or missing out on alternative, cheaper solutions which may be more appropriate to their needs.

1.12 We have already taken supervisory action in this sector, but do not consider that this will address the ongoing risks driven by the inherent, and acute, conflict of interest in the debt packager business model. To ensure that consumers are adequately protected, we are proposing new rules to ban debt packagers from receiving referral fees from debt solution providers. This will end the debt packager business model.

Outcome we are seeking

1.13 We want debt advice firms to provide a high-quality debt advice service to consumers, which supports their recovery and, where appropriate, helps them to access a suitable debt solution. This proposal is an important step to achieving this outcome.

1.14 This links to the work explained in our 2021/22 Business Plan 'ensuring consumer credit markets work well' and supports the outcome we want to see in these markets that 'consumers can take control of their debt at an early stage when they fall into difficulty'.

Measuring success

1.15 We want to remove the risk that consumers access a debt advice service biased towards recommending a debt solution that may be inappropriate because of remuneration incentives, rather than based on impartial debt advice which meets our requirements.

1.16 We expect to see a significant change in the debt packager sector, with none of these firms receiving remuneration based on referrals. We will monitor the impact on debt packagers to see how many leave the market and where others modify their business model.

1.17 We also expect a reduction in applications for authorisation by firms which do not meet our threshold conditions.

1.18 We want to see more consumers receiving compliant advice. As a result, while some customers will continue to be recommended an IVA or PTD where this is appropriate, we would expect fewer customers to be recommended an IVA or PTD than if they had gone to a firm which was incentivised through referral fees to make recommend these solutions.

Next steps

1.19 Please respond to this consultation by 22 December 2021.

1.20 We remind firms that they are expected to comply with our existing rules and guidance, including (and not limited to) the Threshold Conditions, the Principles for Businesses and the Consumer Credit Sourcebook. Firms should have regard to our Dear CEO Letter which highlights our expectations and signposts to key rules and guidance.

1.21 We remind firms that advice provided should have regard to the customer's best interests and not be biased towards debt solutions merely because they generate revenue. We will continue to engage firms on an individual basis where we have concerns and will hold Senior Managers responsible for compliance to account.

BOX 1 Some of the debt solutions available to consumers across the UK (note, this is not an exhaustive list)

Debt Solution	Description	Eligibility	Cost	Statutory
Debt Management Plan	Informal repayment solution designed to repay debts in full. Plans arranged by firms that seek interest & charges to be frozen and distribute repayments across creditors.	Multiple unsecured debts and an ability to make repayments over a reasonable timeframe.	Fees may be incorporated into monthly payments.	No
Charitable Grant Payment	Support in the form of money, services, & products provided by charitable organisations.	Varies depending on the charity and area.	None	No
Token Payment Plan	When a small amount is offered to creditors to demonstrate willingness to repay (but temporary inability to do so).	Sufficient disposable income and a reasonable expectation circumstances will improve.	At least £1 per month per creditor.	No
Consolidation Loan	Clearing debts by taking out new credit in the form of a debt consolidation loan.	Meeting affordability criteria from a lender.	Interest on money borrowed.	No
Full & final settlement offers	Offering creditors less than they are owed to clear debts. Creditors are not obliged to accept this offer.	Funds are needed to make an offer.	None	No
Equity release	Some consumers may be able to use equity release products to access money tied up in a property to repay debts.	Homeowner and age criteria.	Variable	No
Debt Relief Order	Aims to write off most debts within one year.	Consumers must have low assets and low disposable income to qualify.	£90	Yes
Individual Voluntary Arrangement	A formal agreement with unsecured creditors to make reduced repayments, usually over 5-6 years, arranged through an Insolvency Practitioner. Consumers are protected from legal action if a certain proportion of creditors agree to the solution.	Multiple debts and disposable income.	Fees (via monthly payments) vary between different firms, but typically are around £4,000 straightforward IVA.	Yes
Administration Order	A legally binding agreement between consumers and creditors to repay debts in full. Payments are managed by the County Court and interest & charges stopped.	Consumers must have received at least one court judgement and owe less than £5,000.	Court takes a handling fee of 10% of payments.	Yes
Bankruptcy	A legal process that can write off most debts (usually after one year) where assets are used to repay creditors where appropriate.	Consumers can apply for bankruptcy if they cannot pay their debts	Consumers pay a fee of £680 (£683 in Northern Ireland).	Yes
Debt Arrangement Scheme	A legal scheme run by the Scottish Government that allows consumers to repay debts over a reasonable length of time. All interest, fees and charges are frozen.	Scottish resident with multiple debts.	Fees are incorporated into monthly repayments.	Yes
Trust Deed	A formal agreement with unsecured creditors to make reduced repayments with debts written off (usually after 4 years), arranged through an Insolvency Practitioner. Consumers are protected from legal action if a certain proportion of creditors agree to the solution.	Scottish resident with debts of over £5,000 and disposable income.	Fees (incorporated into monthly payments) vary between different firms, but typically are around £4,000.	Yes (if protected)
Sequestration	A form of insolvency that may be suitable for those who cannot repay debts in a reasonable time. Assets can be sold to repay debts and balances can be written off after one year.	Scottish resident with debts of at least £3,000.	£150, subject to eligibility criteria.	Yes
Minimal Asset Process	A form of sequestration aimed at low income consumers with few assets. Most debts are written off after six months.	Scottish resident with debts of at least £1,500 and low assets.	£50, subject to eligibility criteria	Yes
COLOUR KEY	**UK**	**ENGLAND, WALES, NORTHEN IRELAND**	**SCOTLAND**	

2 The wider context

The harm we are trying to reduce/prevent

2.1 The harm we are looking to reduce is consumers not receiving the value which debt advice should provide and, instead, being referred to providers of debt solutions which may be unsuitable for them. We want to tackle the role that referral fees paid by debt solution providers to debt advice providers can play in driving non-compliance with our rules and customers being recommended unsuitable solutions.

2.2 Debt solutions, including IVAs and PTDs, are complex, with differing eligibility criteria and each having different advantages and drawbacks. These will vary depending on the individual circumstances of the customer. Where suitable, they can help people in financial difficulties to better manage their debts.

2.3 Consumers seek debt advice to help them understand the options they have for dealing with their debts and to help them weigh up which of those options is right for their circumstances. Consumers seeking debt advice are often in vulnerable circumstances and may be experiencing high levels of anxiety. This can make navigating the available options more difficult.

2.4 There is currently capacity for around 1.7m people a year to receive debt advice. Most debt advice is provided by not for profit (NFP) providers. These firms might only provide advice or offer both advice and debt solutions. Advice is also offered by commercial firms. In all cases advice is usually provided for free and is generally funded through one or more of: revenue from providing debt solutions, remuneration from referrals onto debt solutions, donations/grants, and funding from commissioners such as the Money and Pension Service (MaPS) or local authorities.

2.5 By helping consumers navigate the complex range of options available, including debt solutions, in an impartial manner and taking account of the customer's individual circumstances, advisers can provide a valuable and important service.

2.6 Debt advice plays a critical role for these consumers, and it is vital that they have confidence in the advice they receive. Our rules therefore require that debt advice firms ensure, among other matters, that all advice given and action taken:

- has regard to the best interests of the customer;
- is appropriate to the individual circumstances of the customer; and
- is based on a sufficiently full assessment of the financial circumstances of the customer.

2.7 These rules are there to provide protection to consumers to ensure that customers can seek debt advice with the expectation that it will be impartial and will support them to find a strategy to alleviate their debt problems. This helps to ensure customers get suitable solutions and outcomes.

2.8 If advice leads to a recommendation of an unsuitable debt solution, this can expose the customer to harm. In particular, there can be serious consequences for consumers if they enter an IVA or PTD when it is not in their best interests.

- **Lower wellbeing:** if the solution runs its course, consumers whose disposable income has been exaggerated to fit the criteria for an IVA or PTD may struggle to keep up with repayments and may experience hardship to maintain them.
- **Increased and prolonged indebtedness:** while debt advice is often free, debt solutions can carry costs. There are significant fees attached to IVA/PTDs, often several thousands of pounds. These are typically front-loaded. As a result, if a consumer enters an IVA or PTD and it fails in the first 2 years, the consumer may have paid little towards their debt. Solutions such as IVAs and PTDs have high early termination rates – over a quarter of all IVA/PTDs terminate in the first 3 years. The typical IVA/PTD lasts 5-6 years if payments are not missed.
- **Consumers pay more than is necessary for a solution:** the most financially vulnerable consumers may also be missing out on cheaper, shorter-term debt solutions designed for consumers with low income and low assets such as Debt Relief Orders (DRO). The risk of this has increased since the criteria for a DRO changed in June this year, resulting is more customers being eligible for a DRO. The fact that for some people both an IVA and a DRO may be available options does not mean that they are interchangeable or that both are suitable. The presence of multiple debt solutions which a customer could enter means that it is essential that debt advice providers carefully consider the individual circumstances of the customers ahead of any recommendation.

2.9 In the rest of this chapter we set out evidence that the debt packager business model appears to lead to non-compliance with our rules. We have serious concerns, in particular, with the quality of advice leading to recommendations for IVA/PTDs at these firms. As around 85% of customers recommended an IVA/PTD by a debt packager go on to enter the solution, there is an unacceptable level of risk of customers suffering the harms described above.

2.10 In Chapter 3 we set out our proposals for new rules which look to remove the conflict of interest which debt packagers do not appear able to manage, leading to non-compliance with our current debt advice rules.

Conflicts of interest from referral fees and debt packagers

2.11 Some debt solutions generate revenue for debt solution providers; others do not. As a result, some debt solution providers pay referral fees to advice providers in exchange for referrals where these lead to a customer taking up a debt solution which generates revenue. Debt solutions that do not generate revenue (such as bankruptcy or DRO) do not lead to referral fees as there is no commercial incentive for the solution provider to pay them. Our survey of debt packagers also found that different solutions earn different levels of referral fees:

- The highest referral fees are paid for IVAs and PTDs – on average (median) these were £930 and £1340, respectively.
- Referrals to DMPs, or in Scotland, Debt Arrangement Schemes (DAS) are on average £240 and £260, respectively.
- No referral fees are paid for other solutions such as DROs or in Scotland, Minimal Asset Process (MAP).

2.12 As not all debt solutions generate a referral fee, and some solutions generate significantly higher fees than others, this can create a conflict of interest. The debt advice firm may benefit from providing recommendations for those debt solutions which generate higher revenue, rather than offering recommendations which have regard to the customer's best interests.

2.13 Referral fees can be a useful source of income to fund the provision of debt advice, but they require firms to manage this conflict of interest. The debt packager business model is one which relies solely, or predominantly, on revenue earned through referrals to debt solution providers. We found that debt packagers receive around 90% of their revenue from referral fees. The conflict of interest is therefore more acute for debt packagers than among firms which have a variety of funding sources and do not rely on this income to be sustainable.

2.14 Our recent supervisory work found that debt packagers are not managing this conflict of interest. Our evidence suggests that the reliance on income from referral fees leads to some debt packagers giving non-compliant advice to customers, which includes recommendations that maximise profits and revenue for the firm rather than benefiting customers.

2.15 Our work found that debt packagers typically set up their businesses to identify customers who might fit the criteria for IVAs and PTDs (which generate the highest referral fees). We have seen that they seek to channel them towards those solutions through the advice process and to quickly filter out customers who are unlikely to be profitable for the firm. The customer journey appears to have been constructed by starting first with the solutions which generate revenue and creating a process to quickly match customers onto these solutions, rather than starting first with the customer, understanding their circumstances and then considering (based on that information) what options would best suit their needs.

2.16 In the firms where we have reviewed customer files in detail, our analysis indicates the following customer journey is typical:

i. **Lead-generator:** Customers are acquired through marketing by unregulated firms who ask high level screener questions (e.g. number and overall value of debts) and pass this information and customer contact details to debt packagers in return for a fee (typically around £30-£40 a lead). Not all debt packagers include this step.

ii. **Initial questions:** Customers are asked a few questions which identify if they clearly do not meet the criteria for an IVA/PTD or are very unlikely to be accepted for a DMP/DAS by a commercial provider. This tends to be a quick process which doesn't usually end in a recommendation. Instead, customers are signposted to not-for-profit (NFP) debt advice, rather than being advised by the debt packager. We found that just under half of all customers who approach debt packagers are signposted to NFP providers.

iii. **Receiving a recommendation:** Customers who remain are considered by firms as candidates for either an IVA/PTD or DMP/DAS. Prospective IVA/PTD customers are taken through a more detailed income and expenditure assessment and if considered eligible are recommended this solution and encouraged to speak with an Insolvency Practitioner (the individual who administers an IVA/PTD) very quickly, often the next day. Firms appeared to use persuasive language to promote these products to consumers without fully explaining the risks involved.
Customers not identified as eligible for an IVA/PTD but who are potentially eligible for a DMP/DAS (which can generate a referral fee) were referred to a debt management firm. In the cases we looked at, these customers were often only

asked a limited number of questions ahead of being referred – rather than a full examination of their individual circumstances (including income and expenditure). Also, it was not always clear why this referral was being made. Indeed, only 53% of those referred to a debt management firm ended up on a DMP or DAS.

2.17 In the next section, we set out our concerns about the outcomes consumers receive from this advice process.

Evidence of poor conduct by debt packager firms

2.18 Our most recent proactive supervision work in 2020/21 clearly indicated to us that firms in the debt packager market are not able to manage the acute conflict of interest present in their business model. This results in consumers being exposed to an unacceptable risk of harm. We reviewed the quality of advice provided by firms representing 61% of the debt packager market by consumer volumes. We identified, in our view, significant concerns that firms appeared to have:

- manipulated consumers' income and expenditure to meet the criteria for an IVA or PTD
- used persuasive language to promote specific products without making clear the risks involved
- provided advice that did not accurately reflect their conversations with consumers or information that consumers had given
- failed to take into account consumer circumstances and vulnerabilities, including mental health issues and economic abuse.

2.19 We conducted a survey of all debt packagers and from this work we estimate that between April 2019 and March 2020, 54,000 sought advice from a debt packager. We found that 29% of people who contact a debt packager are recommended an IVA/PTD (around 17,000 a year) of whom around 85% enter the solution (around 14,000 a year).

2.20 Given the concerns above, we think that these consumers have been placed in a position where they have entered a solution which may be harmful for them. For some of these customers, the IVA or PTD may have ultimately been successful. But it remains an unacceptable outcome of a debt advice service which should *reduce* a customer's exposure to harm that customers are given recommendations to enter into a solution that may not be appropriate and can lead to harms described in paragraph 2.8 above.

2.21 While our primary concern is around the treatment of customers who are recommended an IVA/PTD, we also think that debt packagers do not appear to add any value as an advice service for most of the customers who seek help from them:

- Customers who are quickly passed onto NFP advice providers (45% of debt packager customers) do not appear to receive any advice from debt packagers. This part of the process appears to be there filter out unprofitable customers from those who can be referred to solutions which generate fees. It is unclear whether they go on to seek advice from another provider, or if they disengage leading to delays in receiving the advice they need. This is in a context where we know that many consumers who could benefit from debt advice do not seek it until they are already facing serious financial difficulties.

- Around 15% of customers are referred to DMP/DAS providers. Just under half of these customers did not end up on a repayment solution with that provider. This, in itself, may not be a poor outcome for the customer and could suggest that they received better advice from the DMP/DAS provider. But it indicates that the referral does not add value in terms of advice offered by the debt packager. We found several examples of customers being referred or recommended a DMP/DAS without the firm undertaking an assessment of their circumstances to understand if the solution was suitable. We also note that referrals tended to be to commercial DMP/DAS providers, even though free providers are available and may be better suited to the needs of many consumers. Furthermore, although we do not have direct evidence of this, we consider that being passed between providers may be a poor experience for customers in vulnerable circumstances which could lead to their disengagement from getting help.

2.22 Overall, in our evaluation of a sample of customer files where a recommendation of an IVA/PTD or a DMP/DAS was made, we had serious concerns with 90% of the files we reviewed.

2.23 We are aware that a small proportion of customers (10%) are recommended other solutions including DROs (6%) and bankruptcy (1%). These are not typical outcomes from debt packagers and so we have not reviewed a significant number of customer files where these recommendations are made. As a result, we are not able to give a view on how the firms made these recommendations or whether they give rise to any concerns.

2.24 Following the recent supervision work, we wrote to several firms identifying our concerns over their practices and making clear our concern with firms continuing to offer advice to consumers while those issues remained unresolved. Five firms subsequently applied for voluntary requirements to be imposed. This means they can no longer provide regulated advice services unless we are satisfied that they can comply with the rules.

2.25 In addition to our detailed file reviews (from firms covering 61% of the market), we conducted surveys which covered all commercial, advice-only firms. We found that while there were a small number of firms who did not make use of referral fees, the majority had a debt packager business model and generated all, or most, of their income from referral fees. These firms had a similar pattern of referrals to NFP, DMP/DAS and IVA/PTD. This suggests that the customer journey, explained in paragraphs 2.15 and 2.16 above, which appears to be focused on generating referral income rather than providing compliant debt advice, is common across debt packagers.

2.26 We have previously sought to address harm in this market. In 2018, in response to concerns we identified with some debt packagers, we warned firms in a Dear CEO letter of the potential for their business model to cause harm to consumers and that they needed to review their practices to ensure compliance with our rules.

2.27 We again warned debt packager firms in our Portfolio letter for debt advice firms in July 2020 that we were concerned about the risk of remuneration incentives leading to non-compliant advice. We told them we would be taking action where we found evidence of poor conduct. Throughout this period, we have received applications from firms to become debt packagers that do not meet our standards and that have not gone on to be authorised.

2.28 Our most recent work has found that debt packagers currently in the market have not taken action to address the concerns we have raised. Our evidence shows that the acute conflict of interest inherent in the debt packager business model has not been properly managed and we think there is a significant risk that this is the case across debt packagers more widely. This evidence, together with the lack of improvement from firms after our previous warnings, has led us to conclude that we need to take market-wide action to address the harm we have seen and to secure an appropriate degree of protection for consumers.

2.29 We want to reduce the risk of harm consumers which occurs from being recommended potentially inappropriate debt solutions due to biased, non-compliant advice. We explain in Chapter 3 our proposals to do this through a ban on commercial, advice-only providers receiving referral fees from debt solution providers.

Wider market issues

2.30 Insolvency practitioners, who set up and administer IVAs and PTDs, play an important role in ensuring consumers are not entered into an inappropriate debt solution. In Great Britain insolvency practitioners are regulated by Recognised Professional Bodies (RPBs) with the Insolvency Service overseeing these bodies on behalf of the Secretary of State. In Northern Ireland the Department for the Economy carries out the oversight role. In Scotland, the Accountant in Bankruptcy is responsible for making decisions on debt payment programme applications under the DAS and PTDs.

2.31 We work closely with insolvency regulators and RPBs to address issues of mutual concern in these markets and share intelligence. Our published exchange of letters between Sheldon Mills (our Executive Director of Consumers and Competition) and Dean Beale (CEO of the Insolvency Service) outlines our respective actions and where we are collaborating to reduce harms. We will continue to work closely with the Insolvency Service, and other insolvency regulators, to make sure the journey through debt advice to debt solutions works well for consumers.

How it links to our objectives

Consumer protection

2.32 We are proposing the new rules set out in this CP in order to secure the appropriate degree of protection for consumers.

Wider effects of this consultation

Consumer access to compliant debt advice

2.33 Out of the 1.7m people who receive debt advice each year, we estimate around 54,000 customers a year currently start their debt advice journey with a debt packager. Around half of these receive no advice and are signposted to other advice providers. The proposals may lead to debt packagers leaving the market, which in turn could mean many of these consumers may benefit from accessing compliant debt advice more quickly. This shorter route to advice may reduce the risk of disengagement.

2.34 By reducing the level of non-compliant advice, the proposals could improve overall confidence in the debt advice market more broadly. This could help improve engagement with debt advice.

2.35 Our proposals would end the debt packager business model, which is characterised by its reliance on referral fees. Many firms which currently employ the debt packager model may leave the debt advice market. Our current view is that this would not represent a loss of debt advice capacity as we have not seen evidence that debt packagers offer a valuable service to customers. We expect that the debt advice sector will have sufficient capacity to meet the needs of customers who would otherwise have gone to debt packagers. There are a variety of regulated firms that provide advice and potentially debt solutions to consumers, both on a commercial and not-for-profit basis. Debt advice is almost always provided for free with the costs covered though a combination of revenues generated by debt solutions, referral fees, donations/grants and funding from commissioners such as MaPS. Funding for free debt advice from MaPS for 2021/22 has increased by 70% compared to pre-pandemic levels.

2.36 We acknowledge there may be some loss of benefit to consumers who would not otherwise have sought debt advice, but respond to debt packager advertising and subsequently progress with a referral to the not-for-profit debt advice sector or end up with a suitable solution. However, consumers not seeking debt advice is already a recognised risk and part of a wider problem with getting consumers to engage with their finances, especially where they are experiencing financial difficulties. A number of measures are in progress to address this, including MaPS's strategy to increase pro-active engagement by customers and our own work with creditors to make efficient and effective referrals to debt advice.

Equality and diversity considerations

2.37 We have considered the equality and diversity issues that may arise from the proposals in this Consultation Paper.

2.38 Research from our Financial Lives Surveys indicated that usage of debt advice services between February 2019 and October 2020 was significantly higher amongst men than women and among younger age groups (18-34) than older age groups (55+). The research also found that people from Black and Black British, Asian, Mixed Race and other minority ethnic groups were much more likely to have received debt advice than people from White backgrounds. We are aware that people with long term physical and mental health conditions are more likely to suffer financial difficulties than those without.

2.39 We consider that our proposals would improve outcomes for people seeking debt advice. As a result, we do not consider that the proposals materially impact any of the groups with protected characteristics under the Equality Act 2010 negatively. But we will continue to consider the equality and diversity implications of the proposals during the consultation period and will revisit them when making the final rules.

2.40 In the meantime, we welcome your input to this consultation on this.

3 Our proposals

3.1 This chapter explains our proposals for new rules.

Proposals to tackle the conflict of interest in the debt packager model

3.2 We are proposing new rules which ban debt packagers from receiving remuneration from debt solution providers. We consider that addressing the remuneration model which drives non-compliance is the most effective way of delivering the appropriate degree of protection for consumers. This would end the debt packager model.

3.3 The ban will apply to firms providing regulated debt advice ('debt counselling') which do not also provide debt solutions. The ban would also apply to any of their appointed representatives.

3.4 While the issues we have seen to date have been related to revenue from referral fees, we want to avoid the situation where these fees are simply replaced by other forms of remuneration between debt solution providers and debt packagers who make referrals to them. The proposed rules would prohibit debt packagers from receiving any remuneration from debt solution providers in connection with referring customers to them.

3.5 We are proposing that the ban should apply to debt packagers receiving remuneration from any associate of debt solution providers. This will prevent firms from using or creating other firms in their groups to replicate existing payments to debt packagers, with no real change in the underlying business model or incentives.

3.6 The proposals do not prevent firms from providing debt advice on a commercial basis and other business models may develop in this area but without the inherent conflict of interest we have seen in the debt packager model. We have seen examples of commercial firms which provide debt advice and do not provide debt solutions or receive revenue from referral fees. These firms tend to be commissioned to provide advice for particular groups of consumers, rather than receiving money on the basis of the recommendations they make. Commercial debt advice providers who can evidence that they provide high-quality advice are eligible to apply for funding from sources such as MaPS during their commissioning rounds. We have not specifically reviewed the quality of advice provided by these firms through a file review as collectively they only referred 75 consumers to not for profits or solution providers (compared with 54,000 customers across all commercial, advice only firms). Of these, 2 customers were referred to IVA/PTD providers, and 3 were referred to DMP/DAS providers. This pattern is notably different to that of debt packagers.

Scope of proposals

3.7 **Debt management firms.** We considered whether we should broaden the ban to include remuneration received by debt management firms (i.e., firms which provide repayment solutions including DMP and DAS) for IVA and PTD referrals. However, our survey of debt management firms showed that referrals fees are an insignificant revenue stream. On average debt management firms receive only 1% of their total revenue from referral fees (compared with 90% on average for debt packagers).

3.8 There are also different incentives for debt management firms which better align with customer interests: debt management firms have an interest in the long-term sustainability of recommendations for debt management plans and therefore a stronger incentive to make a sufficiently full assessment of the customer's financial circumstances at the outset. We also found evidence of improved standards of debt advice in our debt management sector thematic review in 2018/2019, including examples of good practice in relation to IVA recommendations by these firms. We therefore do not propose extending proposals to referrals made by debt management firms. We will monitor referral levels in debt management plans through future survey work and supervisory engagement to ensure the risks from referral fees incentives amongst these firms remains low.

3.9 While we are not proposing for the ban to apply to debt management firms, we see a risk that debt packager firms could look to become appointed representatives of a debt management firm. This would mean that they would not be covered by the ban and could continue with the same business model. This would not be an acceptable outcome. Therefore, our proposals include an obligation on debt management firms who act as a principal to ensure that none of their appointed representatives receive any remuneration from debt solution providers unless the appointed representative is genuinely acting as a debt management firm itself. We will be monitoring this actively.

3.10 **NFP providers.** Many NFP providers offer debt advice and do not offer solutions. While some NFP providers receive money from referral fees, we are not aware of NFP firms who use the debt packager business model and rely mainly or exclusively on this income for their sustainability. The business model of NFP firms is different and the conflict of interest presented by any referral fees is less acute. These firms tend to use a range of funding sources, including donations, grants/contracts and funding from bodies such as MaPS. In many cases, these providers are subject to additional oversight around the quality of their advice from their funders. In light of this, and the fact that revenue from referral fees can be a useful, additional source of income to fund free debt advice, we do not propose the ban applying to NFP providers.

Alternatives proposals we have considered

3.11 In this section we set out our consideration of other interventions we have considered. To assess whether these measures would be more proportionate than a ban, we considered whether they would be effective at providing consumers with an appropriate level of protection, in light of the concerns we have with the debt packager business model.

3.12 **Introducing higher quality standards for debt advice.** We do not consider that proposing measures to raise standards in debt packager firms would drive better consumer outcomes given the evidence of non-compliance with existing rules in the sector despite multiple warnings. The strong commercial incentive would remain to give advice without regard to customer's best interests. We already require debt advice firms to not unfairly incentivise debt advisors where this could lead to non-compliance, but these do not tackle the acute incentives within the debt packager business model itself which we see as driving the harm we are looking to prevent.

3.13 **Providing consumers with more information about fees and commission.** Our rules already require firms to disclose the existence of any commission, which would include referral fees. Given the fact that customers seeking debt advice are in vulnerable circumstances where they are looking for assistance in an area which is complex and unfamiliar, it is unlikely that giving consumers more information is likely to be effective. Customers need to be able to trust that debt advisors are acting in an impartial manner.

3.14 **Other interventions around remuneration.** We have considered how we could intervene in the way that referral fees are structured to address bias without banning them. Possible options considered included:

- capping referral fees;
- requiring fees to be set at the same level regardless of solution; or
- restructuring in a way which means that fees can be reduced/clawed back where solutions later fail.

3.15 The key limitation of all these measures is that only a few debt solutions attract any referral fees, namely IVA/PTDs and repayment solutions such as DMP/DASs. Restructuring or harmonising fees would only have a limited effect on eliminating misaligned incentives. Crucially, it wouldn't change the current situation where only some solutions lead to referral fees. As a result, an incentive remains for firms to bias their advice towards solutions which generate revenue, and not consider options such as Debt Relief Orders, for which there are no referral fees, even where they would be in a customer's best interests.

3.16 As a result, such measures would reduce the overall profitability of firms but would be unlikely to address consumer harm driven by misaligned incentives. Firms could still operate a business model which relies on referral fees and which we see as driving non-compliant debt advice. There would still be an incentive to recommend solutions which generate revenue over those which do not, without regard to customers' best interests.

3.17 Furthermore, the option of clawing back fees where solutions fail does not address the fact that consumers can be harmed by an inappropriate solution even where the solution does not fail. The payments for IVA/PTD and DMP/DAS solutions are meant to come from a customer's disposable income, the money left after essential bills are paid. As set out in paragraph 2.8, customers placed on inappropriate (and unaffordable) IVA/PTDs, potentially based on poor assessments of their income and expenditure, could cut back on essential spending in order to meet their IVA/PTD payments.

3.18 There are significant benefits from the proposed intervention. It aims to address the harms which have been set out above. Further, in removing a source of poor advice, consumers who seek advice would be more likely to receive a service which meets their needs, enabling them to access support and, where appropriate, debt solutions which help them to recover. By receiving compliant advice earlier, consumers may have access to a wider range of debt solutions which may lead to a faster recovery. By reducing the number of people who enter unsustainable IVAs or PTDs, consumers will face fewer difficulties meeting unaffordable IVA or PTD payments, and some may avoid going onto IVAs or PTDs when it is not appropriate for them to do so and which could leave them potentially worse off than when they started.

3.19 Taking these considerations into account, we consider the proposed measure to ban all referral fees to be proportionate given the evidence of poor practice and misaligned incentives seen in this sector and the vulnerable circumstances of the consumers involved.

Implementation

3.20 Customers seeking debt advice are in highly vulnerable circumstances and it is expected that the number of people in need of debt advice will increase in the coming months. We see the debt packager business model as presenting an unacceptable level of risk to these customers. We therefore propose (subject to the outcome of this consultation) that the new rules should take effect as quickly as possible with a **1 month period for implementation**.

Q1: Do you agree with our assessment that the remuneration model for debt packager firms is driving consumer harm?

Q2: Do you agree that the only effective remedy is to ban receipt of remuneration for referrals by debt packager firms?

Q3: Do you agree that we should not include debt management firms or not-for-profit debt advice firms in our proposals?

Q4: Do you have any comments on our proposed obligation on debt management firms who act as principals?

Q5: Do you have any comments on the draft rules?

Q6: Do you have any comments on the planned implementation period?

Q7: Do you have any comments on, or relevant additional data for, our draft cost benefit analysis?

Annex 1
Questions in this paper

Q1: **Do you agree with our assessment that the remuneration model for debt packager firms is driving consumer harm?**

Q2: **Do you agree that the only effective remedy is to ban receipt of remuneration for referrals by debt packager firms?**

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Q4: **Do you have any comments on our proposed obligation on debt management firms who act as principals?**

Q5: **Do you have any comments on the draft rules?**

Q6: **Do you have any comments on the planned implementation period?**

Q7: **Do you have any comments on, or relevant additional data for, our draft cost benefit analysis?**

Annex 2
Cost benefit analysis

Introduction

1. FSMA, as amended by the Financial Services Act 2012, requires us to publish a cost benefit analysis (CBA) of our proposed rules. Specifically, section 138I requires us to publish a CBA of proposed rules, defined as 'an analysis of the costs, together with an analysis of the benefits that would arise if the proposed rules are made'.

2. This analysis presents estimates of the costs and benefits of our proposal. These estimates are in monetary values. Where we are of the opinion that particular costs or benefits cannot reasonably be estimated, or it is not reasonably practicable to produce an estimate, we say so and give our explanation for our view.

Problem and rationale for intervention

The Harm

3. Debt packagers are authorised, commercial firms that provide debt advice services but do not provide any debt solutions themselves. The debt packager business model relies entirely, or largely, on remuneration from referral fees from solution providers, primarily providers of IVAs and PTDs. See box 1 in the CP for a detail discussion of debt solutions.

4. Chapters 1 and 2 of the CP set out the risk that consumers get non-compliant debt advice that is biased towards debt solutions which may not meet the needs of consumers but that generate referral fees for debt packager firm. These chapters set out that debt packager consumers are not receiving the value which debt advice should provide. In some cases, consumers may end up on unsuitable debt solutions which could lead to them making payments which they cannot afford or missing out on solutions which may have been more suited to their circumstances.

5. In chapter 2 of the CP, we set out our concerns about debt packager customer outcomes.

- For IVA/PTD recommendations, our recent supervisory work has raised serious concerns with the standard of advice being offered, especially given the harms which can occur where these solutions are not appropriate.
- For DMP/DAS recommendations, we found evidence of referrals or recommendations being made without an assessment being made of customers' circumstances. We are concerned that these referrals were always directed towards commercial debt advice providers without consideration of whether customers would be best served by these providers.

- For consumers who are referred to NFP providers, or to DMP/DAS providers, we are of the view that debt packagers are not adding value as providers of debt advice.

6. We estimate around 54,000 used debt packagers between April 2019 and March 2020.[1] See paragraph 28 for a detailed discussion on our sources and assumptions. As part of our recent supervisory work into debt packager firms, we identified concerns that firms appeared to fall short of the standards set out in our rules. Specifically:

- Manipulation of consumer' income and expenditure to meet the criteria for an Individual Voluntary Arrangement (IVA) or Protected Trust Deed (PTD)
- Use of persuasive language to promote specific products without fully explaining the risks involved
- Advice that did not accurately reflect conversations with consumers or information that consumers had given

7. Failure to take into account consumer circumstances and vulnerabilities, including mental health issues and economic abuse. Non-compliant advice creates the risk that consumers are placed on solutions (in particular IVAs or PTDs) that are unsuitable which leads to the following harms:

- Consumers pay more than necessary for a solution
- Consumers face increased and prolonged indebtedness from early termination
- Lower wellbeing for consumers seeking debt advice
- Creditors may find it more expensive and less efficient to recover outstanding debts

8. Our supervision work found that 90% of the recommendations to enter an IVA, PTD, DAS or DMP presented a significant risk of poor outcomes for consumers based on the quality of advice given by debt packagers.

9. To ensure that we understood the risks to customers of being placed on unsuitable solutions, we asked the largest debt advice NFPs to share evidence of harm caused by customers being placed on IVAs/PTD. They told us:

- The most common reason for a complaint about was because the solution was unsuitable for the consumer.
- Debt advisors found that early termination meant that a client's situation was often worse than when the IVA started. One NFP gave examples of clients who missed essential bills or cut back on other essentials to maintain IVA payments. Moreover, the fee structure of an IVA means that most fees within the first six months go towards paying the fees of the solution provider rather than going to creditors. One NFP found that this put customers at considerable risk of not reducing their debt if their IVA fails within the first year.
- One NFP provided case examples which showed that an IVA failure had significant impact on customers mental health.

10. It is not reasonably practicable to estimate the number of people who end up unsuitable solutions because:

- **Debt advice is a type of 'credence good'**, which means that it may be difficult for a consumer to assess the quality of the advice even after it has been received.

1 Refer to table 2 for a summary of our analytical approach and data collection methodology.

For example, if a consumer is referred to an IVA/PTD and is unable to keep up with the payments, it may be difficult to determine if the solution failed because the consumer received non-compliant advice or other factors.

- **Neither firms nor other regulators collect data** which tracks the outcome of individuals referred from debt packagers. Moreover, our recent supervisory work found that firms appear to have manipulated consumers' income and expenditure information to meet the criteria for an IVA or PTD. Therefore, we would be unable to work out if the referral was suitable for the customer just by looking at the information recorded by debt packagers.

11. Although we have not been able to estimate the number of people who end up on an unsuitable solution after getting advice from a debt packager, the analysis detailed in the following section has found that the incentives to offer non-complaint debt advice exists for all debt packagers.

Drivers of harm

12. Consumers accessing debt advice face asymmetric information and may be prone to several behavioural biases. Although our rules and guidance are in place to address these market failures, we have identified a considerable conflict between consumers' interest and firms' financial incentives. This conflict is incentivising firms to not comply with our rules and guidance leading to the harms outlined in paragraph 7. These drivers of harm are discussed below.

Complexity and difficulty assessing information for consumers (also known as asymmetric information)

13. As described in paragraph 2.2 and Box 1, debt solutions are complex, with differing eligibility criteria and each having different advantages and drawbacks. Consumers will therefore find it difficult to make well-informed choices without good quality debt advice. Moreover, consumers who fall into debt display particular characteristics of vulnerability related to low financial resilience and low financial capability.[2]

14. Debt advice is also a type of 'credence good'. As a result, we cannot rely on consumers being able to identify poor sources of advice and to proactively avoid using them and this increases the risk of consumers being put on unsuitable solutions.

Behavioural distortions which affect consumers assessment of debt advice

15. Individuals seeking debt advice are likely to be particularly prone to behavioural biases driven in part by the challenging context in which they access such advice.

Such behavioural distortions could include:[3]

- **Projection bias** – consumers may take out a solution without considering payment difficulties that may arise in the future.
- **Framing bias** – consumers may overestimate the value of a solution because it is presented in terms of debt-written off.
- **Present bias** – consumers may commit their "future self" to making monthly payments that are inconsistent with their future needs or opt for measures that resolve matters quickly e.g. to stop creditors contacting them in the short term, without considering the long-term implications.

2 Financial Lives Survey, 2020

3 See FCA (2013) Occasional Paper No.1 *Applying behavioural economics at the Financial Conduct Authority* for a detailed discussion of these biases.

- **Overconfidence** – consumers may be overconfident in their belief that they understand the solution they are offered.
- **Persuasion and social influence** –consumers may allow themselves to be persuaded to enter a solution just because the advisor is 'likeable' or believe nobody else would help them.
- **Emotional bias** – consumers may accept a solution for their own peace of mind even if self-help with creditors was feasible.
- **Reference dependence and loss aversion** – Consumers may misjudge the relative merits of different solutions because they are focusing on specific reference points (e.g. loss of current assets such as a car) instead of long-term debt write off.

These distortions leave consumers in debt more vulnerable and emphasise the need for compliant debt advice.

Conflicts of interest from referral fees and debt packagers

16. Consumers seek debt advice from debt packagers to reduce and manage their debt in a way that most suits their needs. However, debt packagers' incentives do not always align with consumers' interests, as debt packagers are paid upon a successful referral to a few limited solutions. So, debt packagers have an incentive to provide advice which does not meet our existing rules and make recommendations for consumers to enter into solutions that may not be suitable for them. There are three possible biases that could be affecting outcomes for consumers:

- **Sales bias** – Debt packagers may refer too many consumers to any solutions that pay referral fees. This leads to more consumers being referred to an Individual Voluntary Arrangement (IVA) or a Protected Trust Deed (PTD) and a Debt Management Plan (DMP) or Debt Arrangement Scheme (DAS) rather than alternatives such as Debt Relief Orders (DROs)/bankruptcy which do not attract referral fees.
- **Product bias** – Debt packagers may be drawn towards recommending solutions that pay the highest referral fee. This leads to more consumers being referred to IVA/PTD rather than DMP/DAS even though both pay referral fees.
- **Provider bias** – Debt packagers may have an incentive to encourage a consumer towards a specific solution provider who pays higher referral fees even if they may not offer a better service for the consumer.

Evidence of sales and product bias from referral fees and debt packagers

17. As outlined in Chapter 2 our recent supervisory work (representing 61% of the market in terms of customer numbers) identified concerns of firms manipulating consumers' income and expenditure to meet the criteria for an IVA or PTD. These practices are an example of sales and product bias. As discussed in paragraph 2.15, debt packagers appear to filter out unprofitable customers and drive the remainder towards solutions which maximise revenue and profits for the firm. 45% of customers are signposted to NFP advice once the debt packager determines that they clearly do not meet the criteria for an IVA/PTD or are unlikely to be accepted for a DMP/DAS by a commercial provider.

18. Our analysis of the business models of all debt packager firms found similar incentives were present for all debt packagers. In fact, the firms included in our recent supervisory work referred a lower proportion of customers to IVA/PTD and DMP/DAS than the market average (36% compared to 44%) suggesting that the sales bias may be at least as strong for firms that were not included in the recent supervisory work.

19. Our evidence from all debt packagers in our firm survey shows that average referral fees are substantially higher for personal insolvency solutions (IVAs and PTDs) compared to DMPs or DASs. Debt packagers referred 29% of customers to IVAs and PTDs combined, the solutions generating the highest referral fee.[4] Of the 1.7 million consumers who seek debt advice in 2020, only 5% (or 88,000)[5] registered for an IVA or PTD in the UK. By comparison, we estimate that over 20% of debt packager customers are accepted on to an IVA or PTD– four times higher than the national average. This is indicative of product bias.

20. The table below shows the average (median) referral fees debt packagers receive from each solution that is recommended.

Table 1: Debt packager referral to solutions[6]

Destination	NFP	IVA	PTD	DMP/DAS	DRO	Bankruptcy/ Sequestration	Other[7]
Proportion of DP consumers referred	45%	28%	1%	15%	6%	1%	3%
Median[8] Referral Fee (£)	0	930	1340	240/260	0	–	–
Range of Referral Fees (£)	0	500 – 1370	1040 – 1500	90 – 500	0	–	–

21. Debt packager referral fees for IVAs and DMPs are generally paid on acceptance and in absolute terms e.g. £1000 per customer accepted. However, while not typical, we saw examples of some fees for DMP referrals which are structured monthly as a proportion of on-going customer payments to the solution provider.

22. Data collected from 26 debt packager firms representing 74% of the market in terms of customer numbers shows that 90% of these debt packagers' revenue is generated from referring a consumer onto a solution. See paragraph 28 and Table 2 for a breakdown of the sources used in this CBA.

23. The presence this acute conflict of interest for debt packagers combined with the behavioural biases and asymmetries of information present in the debt advice market is likely to customers not receiving value the debt advice should provide and put customers at risk of the harms outlined in paragraph 8.

24. Our survey of debt management firms showed that referral fees are an insignificant revenue stream (less than 10%) for all but two firms and, on average, make up only 1% of these firms' revenue. As set out in paragraph 3.7 and 3.8 of the CP, we believe that these firms are better able to manage the conflict of interest. We are not including them in this intervention.

4 The number of customers referred to a solution as a proportion of total customers referred.

5 Calculated using figures for England and Wales Individual Voluntary Arrangements Outcomes and Providers, 2020 (The Insolvency Service), Northern Ireland and Scotland.

6 See table 2 for a summary of the analysis that undertaken of the debt packager market.

7 We found examples of some fees for bankruptcy/sequestration and other solutions. However, it is not consistent across debt packagers.

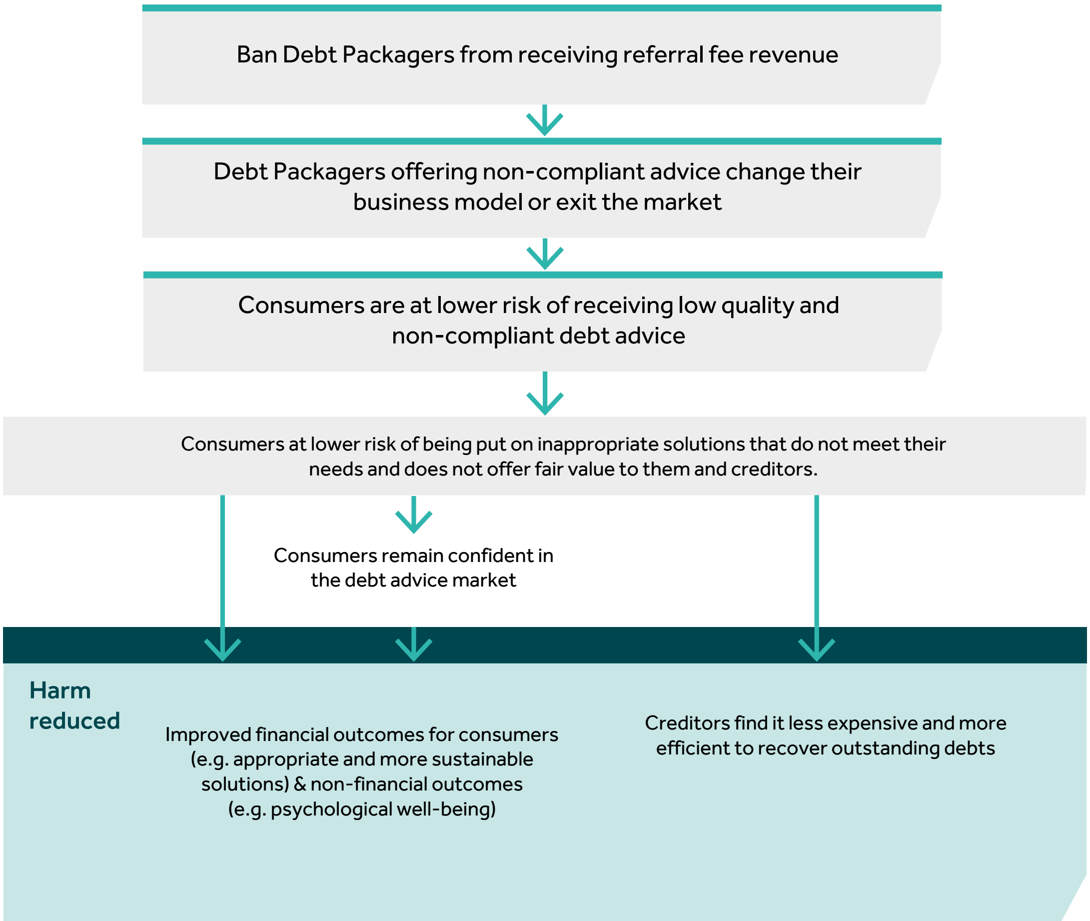
8 Here we have used the median value of referral fees rather than the mean (average) due to the data set being particularly susceptible to outliers. The median shows the middle score for a set of data that is ordered in terms of magnitude.

Overview of our proposed intervention

25. We are consulting on new rules that would ban debt packagers from receiving remuneration for referring an individual to a debt solution provider.

26. The causal chain below outlines how our proposals would result in improved outcomes for individuals seeking debt advice.

Figure 1: Causal chain



Our analytical approach

27. This CBA looks at the following elements to understand the potential impact of our proposed intervention:

- the likely costs to debt packager firms
- the potential costs and benefits to other firms involved in offering debt advice, debt solution providers and lenders
- the likely costs and benefits to consumers

28. We have produced the analysis in this CBA based on evidence from the following sources:

- Phase 1 of the recent supervisory work was a data request to firms representing 82% of debt packagers in terms of consumer numbers, to understand the debt packager business model in more detail. The aim was to gather information on how leads to debt packagers are generated; how referral fees vary according to each solution; and the oversight in place to ensure compliant debt advice.
- Phase 2 was a review of customer files from firms representing 61% of debt packagers in terms of customer numbers to assess their compliance with the rules and guidance in the Handbook.
- A second round of data collection (Phase 3) was sent to all debt packagers, excluding the sample of those in Phase 1 (representing 18% of the market in terms of customer numbers). In this round, we collected revenue data for each financial year between 2017 and 2021.

Table 2: Summary of analysis undertaken of the debt packager market

	Phase 1 (excluding phase 2 firms)	Phase 2	Phase 3
Customer numbers	21%	61%	18%
Assessment of the quality of advice given by firms	No	Yes	No
Analysis of referral rates and levels	Yes	Yes	Yes
Analysis of firm revenue **a) Total referral fees received** **b) Reliance on referral fee**	a) Yes b) No	a) Yes b) Yes	a) Yes b) Yes – where submitted
Analysis of use of lead generators	Yes	yes	No

- A firm survey was also sent to all firms we identify as commercial DMP and DAS providers. We surveyed 47 firms and had roughly an 80% response rate.
- Data from other sources, including:
  - FCA Financial Lives 2020 Survey
  - The Economic Impact of Debt Advice (MaPS)
  - UK Strategy for Financial Wellbeing 2020-2030, MaPs
  - Individual Voluntary Arrangements Outcomes and Providers, 2020 (The Insolvency Service)
  - Our Standardised Cost Model
  - Desk research on Insolvency Practitioners

Baseline and Key Assumptions

29. This CBA considers the impacts of our proposed new rules to prevent debt packagers from receiving remuneration from debt solution providers. Below we outline the firms our intervention affects and describe our assumptions.

30. The debt packager population is made up of two different types of firms: those that operate as a solo entity, which means they provide debt advice as an independent entity; and those that operate using a principal and appointed representative (AR) structure. This is where the principal firm can carry out regulated activities through an AR (who is not authorised by the FCA), but the principal has regulatory responsibility for ensuring the AR is compliant.

31. At the time of our multi-firm work, the debt packager market had:

- 30 firms that operate as a solo entity
- 9 principal firms with 44 active ARs

32. This assessment of the market is based on our multi-firm work. We surveyed all 54 firms that are classified as commercial debt advice firms. Commercial debt advice firms include debt packager firms and refer to all debt advice firms that offer debt advice on a commercial basis, all of which our standardised cost model classes as small firms. Of these 54 firms, the survey revealed 6 firms are no longer operating and have been excluded from the analysis in the CBA. We received no response from two firms and for the purpose of this CBA and have excluded them from our analysis. An assessment of these 2 firms regulatory data finds that these firms are very small and are unlikely to skew our assessment of the market.

33. We examined the revenue data of 33 commercial debt advice firms who provided revenue data (including solo firms, principals and their ARs) which represent 74% of customer referrals (see Table 2). Our analysis found that the majority of the sample rely solely on the referral fees received from solution providers to operate: 7 firms receive some income from referrals and some income from another revenue stream and 19 receive all their income from referrals.

34. We identified 7 commercial debt advice firms that do not receive any income from referrals. Instead they generate revenue from other debt or non-debt activities or receive funding from central government departments or occupational benevolent funds. We expect the 7 firms that do not receive any income from referral fees to not be affected by our intervention. We do not consider these firms to follow the debt packager model and we have therefore excluded them from our CBA analysis.

35. Our analysis of Phase 3 firms revealed that revenue from third party solution providers remained relatively constant between 2017-2020 period. Therefore, we expect this referral fee data to be representative of a typical year.

36. Following the Phase 2 review, we wrote to 5 firms identifying significant concerns over their practices and making clear our concern that the firms were continuing to offer advice to consumers while those issues remained unresolved.[9] The firms all subsequently applied for voluntary requirements to be imposed, meaning they can no longer provide regulated advice services until the FCA is satisfied that they can comply with the rules.[10] While the supervisory evaluation is ongoing, we will be including these firms in our CBA.

37. Most of our analysis considered Principals' responses alongside aggregated responses for their ARs. The only exception to this approach was when we analysed firms' revenue data. Instead, we considered principals and ARs as a single entity because some principals did not provide us with the disaggregated data appropriate for this analysis.

38. As outlined in paragraphs 17-23, our analysis found that the incentives to offer non-compliant or biased advice are present across the remaining firms who receive referral fees from third party solution providers.

9 Please note that the FCA is not attributing any of the specific practices found in its review of the debt packager market, as listed above, to any of these individual firms.

10 See "FCA takes action against debt packager firms" for more detail.

39. Therefore, we assume that the benefits for consumers and costs for firms identified are consistent throughout all debt packagers that received referral fees and their customers.

40. Debt packager firms represent a small proportion of firms offering debt advice. Data from the Money and Pensions Service (MaPS) estimate that 1.7 million people received debt advice in 2020, suggesting debt packagers serve around 3% of the entire debt advice market.[11] Not-for-profits and solution providers provide the majority of debt advice.

41. Our expectation is that demand for debt advice will increase significantly over the coming years.[12] Therefore, we would expect more consumers to be accessing both free and commercial debt advice which, in the absence of our intervention, increases the aggregate harm to consumers posed by debt packagers. Although we acknowledge demand for debt advice is increasing, we use our survey data for April 2020 - March 2021 as our baseline. We note that funding provided to firms through MaPS has increased significantly in recent years to reflect high consumer demand. Funding for free debt advice from MaPS for 2021/22 has increased by 70% compared to pre-pandemic levels. MaPS expect to provide up to a million more debt advice sessions between March 2021 and September 2022.

Summary of costs and benefits

42. The total costs of this intervention are set out in Table 3. We provide detail on the quantification of potential costs and benefits in the paragraphs below.

We expect our intervention to address the inherent and acute conflict of interest in the debt packager business model which is leading to firms providing advice which is not compliant with our rules. As outlined in paragraph 2.28, our view is that consumers receiving advice from debt packagers are at significant risk of the harms outlined in paragraph 7. We expect to see a reduction in these harms as a result of our proposed intervention.

43. Where it is possible to do so we have provided an estimate of the likely number of consumers affected. Where this is not possible, we have provided illustrative examples of the likely outcome. We explore two illustrative examples: First, when a consumer is given a referral to an IVA over a DRO and second, the costs of early termination. The first illustrative examples show that if an individual is referred and completes an IVA when a DRO is more suitable, this could cost them an additional £4,710 and take 5 years longer. The second illustrative example shows that the costs of early termination of an IVA (in year 3) begins at around £720 (if a customer is making £75 monthly payments) and increases depending on the size of the monthly payments. See the benefits section for more detail.

44. Due to the practical challenges associated with monetising and quantifying the benefits of this intervention (particularly those relating to psychological and wellbeing factors), we consider it not reasonably practicable to produce monetary estimates.

11 UK Strategy for Financial Wellbeing 2020-2030, MaPs
12 https://moneyandpensionsservice.org.uk/2021/03/23/debt-advice-budget-update/

45. We expect that the £11.7m of lost revenue from advice that presents a significant risk of poor outcomes for consumers would be transferred to consumers and the rest of the supply chain. We note that the benefits of this intervention are likely to exceed the £11.7m revenue lost by firms through a reduction in harm to consumers and wider benefits to society (or positive externalities) from the provision of good quality debt advice. As such, we expect there to be net benefits as a result of this intervention.

46. Our intervention would lead to some market restructuring which may impact debt packagers, lead generators, solution providers and creditors. As it is uncertain how firms would respond, the costs and benefits to these firms cannot be reasonably estimated. We provide an explanation of the expected effects and explain in more detail why we cannot give monetary estimates for these costs.

Table 3: Summary of costs

	Estimated One-off costs	Estimated Ongoing costs per year
Compliance Costs		
Familiarisation and legal costs	£27,000	£0
Direct Costs to debt packagers		
Transfer of referral fee revenue from advice that presents significant risks of poor outcomes for consumers[13]		*£11.7m*
Loss of revenue from referral fees that does not present significant risk of poor outcomes for consumers	£0	£1.3m
Loss of non-referral fee revenue	£0	*£600,000*
Total costs	**£27,000**	**£1.3m**

Costs to Firms

47. We anticipate that the affected firms would incur direct costs (compliance costs through familiarisation of the incoming policy and lost referral revenue) and indirect costs caused by market reorganisation for debt packagers, solution providers and lead generators.

Direct costs

Familiarisation and legal costs

48. We use standard assumptions from our standardised cost model (SCM) to estimate the one-off familiarisation costs. Assuming 300 words per page and a reading speed of 100 words per minute, it would take around 1 hour to read the document. The average hourly compliance staff salary is based on the Willis Towers Watson 2016 Financial Services Report, adjusted for subsequent annual wage inflation and including 30% overheads. We anticipate there would be approximately 20 pages of policy documentation excluding the legal instrument which all the firms and relevant regulators would have to read, including:

13 Figures in italics indicate a transfer to consumers and the rest of the supply chain which are not counted as a loss to firms (see paragraphs 51 and 53 for more detail).

- 39 Debt Packagers
- 8 Debt Management Firms that receive revenue from third party referrals
- 120 solution providers[14] that pay debt packagers referral fees
- The relevant regulators:[15] The Insolvency Service, The Northern Irish Insolvency Service, Accountant in Bankruptcy and Recognised Professional Bodies

49. The policy will require firms to familiarise themselves with the new rules and check their current practices against these expectations through legal text:

- For debt packagers, debt management firms and small solution providers, we assume it will take 1 member of the legal team 1 day to read the 2 pages of legal text in the document.
- For the largest 10 solution providers, we assume it will take 2 members of the legal team 3 days to read the 2 pages of legal text in the document.
- For the relevant regulators, we assume that it will take 4 members of the legal team 4 days to read the 2 pages of legal text in the document.

50. **We estimate familiarisation and legal costs will be a one-off cost for all firms and relevant regulators, totalling £27,000.[16]**

Loss of debt packagers revenue from referral fees

51. Our analysis found that, from April 2019 to March 2020, debt packagers received £13m in revenue from referrals to debt solutions. Around 86% of this revenue was from referral to an IVA, 10% for referral to a PTD, and the remaining 4% from referrals to a DMP or DAS or other solutions. The policy proposal would ban debt packagers from receiving this income. From the referral fee data submitted by all debt packagers for April 2019 – March 2020, we estimate a £13m loss in revenue per year from referral fee payments to debt packagers.

52. The results of our phase 2 file review indicate that 90% of the recommendations to enter an IVA, PTD, DAS or DMP presented a significant risk of poor outcomes for consumers based on the quality of advice. We do not consider the loss of revenue from providing advice below acceptable standards as a cost to firms. As outlined in paragraphs 17-23, our analysis found that the incentives to offer poor quality advice are present across all debt packagers. We therefore assume that 90% of the £13m referral fee revenue received by all firms is also generated by advice that puts customers at risk of harm and has not been included as a cost in the CBA. Therefore, we calculate the loss to debt packagers as 10% of all referral fee revenue generated.

53. **We estimate a £1,300,000 loss per annum in revenue from referral fee payments to debt packagers.**

Indirect costs from market reorganisation

54. It is difficult to estimate the number of firms who would remain in the market. However, the more reliant a debt packager is on revenue from referral fees, the greater the risk that they would exit in response to the proposed policy.

14 We assume that the largest 10 solution providers are medium sized firms and the remaining 110 firms are small sized firms.

15 We assume that these regulators would face similar familiarisation costs to large sized firms in our SCM.

16 £5,000 of these costs come from debt packagers and the Debt Management Firms that receive referral fees, £6,000 of these costs come from the relevant regulators and £16,000 of these costs come from solution providers that pay debt packagers referral fees.

55. We are uncertain if other firms could adapt their business model to continue operating. For example, some debt packagers may be able to get funding, but this depends on firms' ability to convince funders that they can provide good quality debt advice.

Loss of debt packagers non-referral revenue

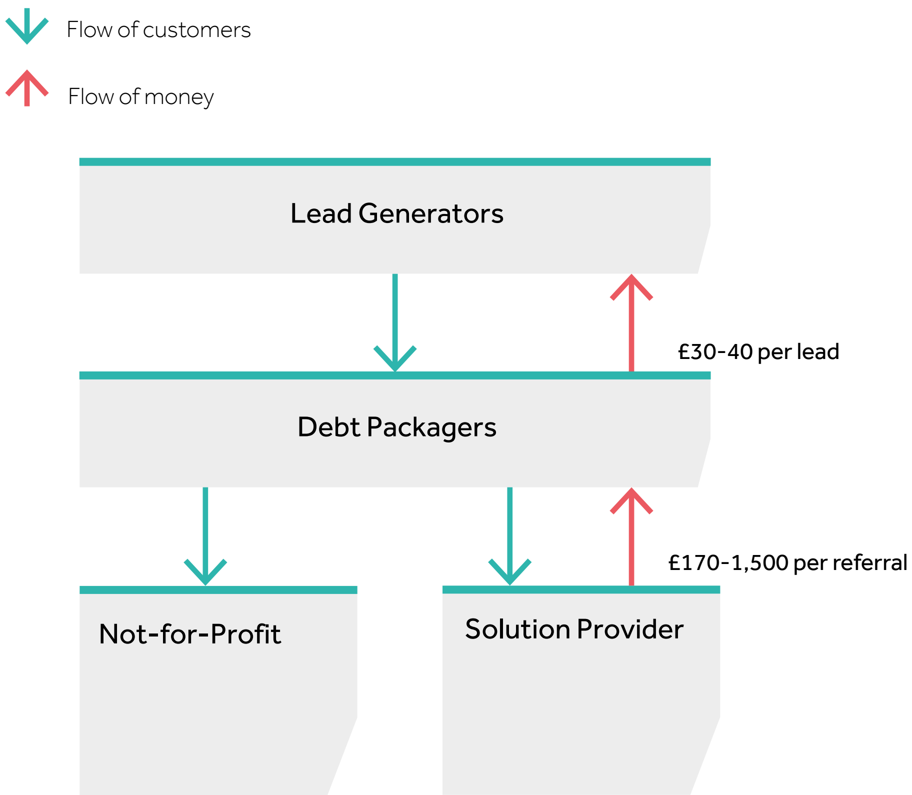
56. We expect the policy to force some debt packagers who are unable to change their business model to exit the market and therefore there may be a loss of revenue not associated with referral fees.

57. We are aware of 7 firms that receive some income from referrals and some income from another revenue stream. Our analysis found £600,000 per annum is generated by these firms through non-referral fee revenue (from both regulated and non-regulated activities). We cannot predict what proportion of debt packagers will be able to adapt their business model or instead exit the market. Nevertheless, we expect that some of this revenue, if lost, will be redistributed to firms that continue to operate (this may not necessarily be a debt packager) and is considered a transfer.

Loss to Lead Generators

58. The consumer journey and the role of lead generators is laid out in paragraph 2.16. Debt packagers play a role in advertising debt advice services and raising consumer awareness. Some debt packagers advertise their own services, and some pay lead generators. The distribution costs are outlined in Figure 2 below.

Figure 2: The role of lead generators and debt packagers in debt solution distribution.



59. Around half of the firms surveyed in Phase 1 used unregulated lead generators to purchase consumer leads. Typically, these firms pay £30-£40 for each lead. There were some outliers present who pay up to £500 – £1000 per lead, contingent on if the consumer takes a referred commercial solution.

60. The exit of most debt packagers would affect lead generators through a loss of revenue from these fees.

61. In response to the regulation, lead generators may offset this loss by providing leads directly to solution providers. However, we do not expect large IVA/PTD providers to accept these leads as the insolvency service has issued guidance stating that in their view it is not appropriate to engage with introducer firms that are not FCA authorised.

62. It is uncertain how lead generators would adapt their business models and if they would be more or less profitable in the long run.

63. **Therefore, it is not reasonably practicable to estimate the overall impact on lead generators from this intervention.**

Customer acquisition costs for solution providers

64. Solution providers of IVAs, PTDs, DAS and DMPs may rely on debt packagers to:

- Provide initial debt advice to consumers and match consumers with solutions
- Market and attract new consumers towards their services.

65. If debt packagers leave the market, we expect solution providers to restructure their customer acquisition.

Debt advice and matching costs

66. While debt packagers could play a useful role in helping match consumers with debt solutions which meet their needs, we highlight in paragraph 2.21 that we do not think that these firms are adding any value as an advice service. As a result, we do not believe that debt packagers offer a valuable service to solution providers in terms of the advice offered to customers ahead of being referred to the solution provider and, in this regard, we will not consider the exit of debt packagers as a loss to debt solution providers.

Marketing costs

67. Our survey of debt management firms (providers of DMPs and DAS) found that around half of consumers are attracted through direct advertising, costing DMP and DAS providers a total of £3.5m per year (2019-2020). In our analysis of the debt management market, we found that around 16% of consumers were acquired using debt packagers (we are only aware of 7 firms that used debt packagers) in 2019 - 2020. As a result, the exit of debt packagers from the market will have a limited impact on the cost of consumer acquisition for debt management firms.

68. If the proposed rules are implemented solution providers may use lead generators instead of debt packagers for client acquisition. As firms are not paying for lead generators to provide advice, this may be more cost effective than paying referral fees to debt packagers. However, we do not expect large IVA/PTD providers to do this as the Insolvency Service has issued guidance which requires them to only accept customers from firms which are FCA-regulated for debt counselling.

69. The factors affecting customer acquisition costs for solution providers will depend on how both debt packagers and lead generators respond to the potential intervention.

70. **Therefore, it is not reasonably practicable to estimate the overall impact of this intervention on solution providers acquisition costs.**

Costs to consumers

71. Banning debt packagers from receiving referral fees will have a direct impact on the journey a consumer takes on the route to debt advice. In the absence of debt packagers, we could see a rise in the demand for free debt advice from other providers proportionate to the number of customers using debt packagers. Debt management providers, insolvency practitioners and NFPs will still be providing advice. MaPS expects there to be an increased demand for debt advice and have planned to increase capacity by increasing their budget for debt advice 70% to £94.6m in 2021-2022.[17]

72. Debt packagers' active presence in the debt advice market allows them to act as factfinders for consumers and increase awareness of the debt support available. There is a risk that if debt packagers exit the market, consumers that would have been engaged through debt packagers advertising may not seek advice. While debt packagers may be effective at engaging these customers, we are concerned that they are not providing them with a service which meets their needs. As noted in Chapter 2, there is ongoing work to increase consumer awareness of debt advice which should help reduce the risk of consumers missing out on receiving any debt advice as a result of any debt packager firms exiting the market.

73. There is a risk that the capacity in the NFP sector may struggle to facilitate a potential increase in demand caused by the exit of debt packagers, on top of an expected rise in demand as a result of the pandemic. This may result in longer waiting times for individuals hoping to access debt advice. However, of the 54,000 consumers that get referred by debt packagers, around 45% of people are already referred to the NFP sector. This means the increase in demand for NFP services is small relative to the size of the market. In 2020, MaPs estimate that 1.7 million people received debt advice, implying debt packagers serve around 3% of the debt advice market.[18]

74. We consider the quality of advice provided by the NFP is better than the advice service offered by debt packagers and therefore would be a net benefit to consumers through accessing advice through NFPs.

75. We are aware that a small proportion of customers (10%) are not signposted to NFP or referred to IVAs, PTDs, DMPs or DASs. We have found a few examples of debt packagers receiving referral fees for these solutions. As outlined in paragraph 2.23, we are not able to give a view on how the firms made these recommendations or whether they give rise to any concerns. Nevertheless, we consider the risk of harm to the other 90% of customers to be unacceptable. As outlined in paragraph 73, we believe that there will be enough capacity for all customers (including the 10% of who receive other recommendations) who currently seek advice from debt packagers to seek advice elsewhere.

76. **Although we are aware of a number of potential costs to consumers, we believe that overall, the impact of this intervention is unlikely to generate any material costs.**

Costs to the FCA

77. There are no expected additional costs to the FCA.

17 https://maps.org.uk/2021/03/23/debt-advice-budget-update/
18 UK Strategy for Financial Wellbeing 2020-2030, MaPs

Benefits

78. As outlined in paragraph 52, we do not consider the loss of revenue from providing advice below acceptable standards as a cost to firms. We expect the £11.7m of firms' lost revenue to be redistributed to consumers and the rest of the supply chain.

79. We are unable to estimate how this revenue would be redistributed as there are a range of different potential outcomes. As discussed in paragraphs 58-63, the impact on lead generators and solution providers is uncertain.

80. The following section explores the potential benefits to consumers and creditors.

81. We note that the benefits of this intervention may exceed the £11.7m revenue lost by firms as there are wider benefits to society (or positive externalities) from the provision of good quality debt advice. This is explored in the wellbeing section below.

82. **We estimate benefits of up to £11.7m would be redistributed from debt packagers referral fee income.**

Benefits to consumers

83. We expect consumers would benefit from the provision of debt advice that is unbiased, compliant and based on a sufficiently full assessment of individuals' circumstances, including vulnerability triggers. As outlined in paragraph 2.18, we identified concerns that debt packager firms appeared to fall short of these standards.

84. First, this intervention would reduce the risk that a consumer would be advised into an inappropriate solution and pay more than necessary for a solution that is not appropriate for them. Second, ensuring consumers get quality debt advice would reduce the likelihood that a solution will terminate early. Both are discussed below in more detail using illustrative examples. Finally, we believe there are also benefits to an individual's well-being through accessing compliant debt advice which is beneficial on both an individual level and to society.

85. As discussed in chapter 1, where appropriate, these solutions can help consumers to deal with their debts, but they can be harmful for people who are not able to afford the repayments, or where another solution would be more suitable.

Consumers do not pay more than necessary for a solution

86. Our phase 2 work found evidence that some debt packagers appeared to have manipulated consumer details to meet the criteria for IVA/PTDs. The following example explores the financial consequences of this practice on an illustrative consumer. In this example, we consider a consumer who is eligible for a DRO but has received biased advice from a debt packager and had their disposable income information manipulated to be eligible for an IVA.

87. We chose this example as we expect this is the situation that poses the biggest harm to consumers. Another example of non-compliant debt advice which could lead to consumers paying more than necessary for a solution is when a customer is steered to an IVA due to the negative impact of bankruptcy, when in reality bankruptcy may have been the most appropriate option and would have had little or no more impact on the individual than an IVA.

88. Without accurate details of a consumer's financial position (level of debt, type of debt, preference for holding certain assets) it is not possible to provide an accurate estimate of the harm from being referred to an unsuitable solution. The example below illustrates the potential benefits of being recommended a DRO instead of an IVA for a representative consumer, if their disposable income has been manipulated to make it more likely that they would be accepted onto an IVA.[19]

Illustrative example 1: Benefits of a suitable solution recommendation
An individual with the following circumstances may be eligible for a DRO:

- Maximum debt of £30,000
- Spare income between £50-75 per month
- No home owned
- No assets worth over £2,000 (Excludes certain items such as a motor vehicle (up to £2,000), approved pensions and basic belongings such as clothes, bedding and furniture)

89. The completion of a DRO costs an individual one-off fee of £90 and results in all the remaining debt being written off after 12 months. If after having their disposable income information manipulated, the same individual was placed onto an IVA and completed the contract lasting 60 months, this would cost them £4,800 (60 monthly payments of £80). Upon completion of the IVA, the remainder of the debt is written off. Thus, an individual who is recommended to a DRO over an IVA, when the DRO may be more suitable, would be £4,710 better off and achieve the same outcome significantly quicker.

90. Without accurate consumer level data showing the income distribution of those engaging with debt packagers and the level of assets they own, we are unable to estimate how common it is that individuals who are recommended IVAs may also have been eligible for a DRO.

91. As of June 2021, the maximum level of debt included in a DRO rose from £20,000 to £30,000. The Department for Business, Energy and Industrial Strategy estimate that in England and Wales, 13,200 more people who previously would not be eligible would take out DROs a year (roughly 50% more than 2019 DRO applications).[20] Not all these customers would get this advice from debt packagers. Nevertheless, as more people are eligible for a DRO, we expect there to a be a small increase in the number of people who could face this harm.

Reduced risk of increased and prolonged indebtedness from early termination

92. We expect compliant debt advice to reduce the risk of an unsuitable recommendation and reduces the risk of early termination. Early termination occurs when individuals are unable to meet the agreed terms of their contract due to a change in circumstances or because it was never affordable. A DRO can be revoked from a rise in income (pay rise or benefits entitlement) or arrival of a lump sum which means the individual is no longer eligible. However, failure of an IVA occurs when the individual cannot maintain the agreed monthly payments. Whilst an IVA could also fail for reasons that are not related to the initial advice, a thorough assessment of the individual's position lowers the risk. It is not possible to establish the number of IVA failures and resulting harms from poor debt packager advice. This is because it is not possible to attribute the failure of a solution

19 The IS told us that in practice most IVA providers have a minimum surplus of £80.
20 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/992216/Changes_to_debt_relief_orders_criteria_impact_assessment.pdf

wholly to the advice that is provided when there are a number of reasons a solution could fail that is not related to the initial advice. Instead we have illustrated the harm of increased indebtedness that could be avoided by improved quality of debt advice.

Illustrative example 2: Costs of early solution termination

93. If a DRO were to be cancelled due to a change in circumstances such as an improvement in income or receiving a lump sum, the cost to the individual of the solution would still be the total amount paid into the solution, the one-off fee of £90.

94. The cost of early IVA termination is much higher. The fee structure of an IVA means that most fees within the first six months go towards paying the fees of the solution provider rather than going to creditors.[21] This means consumers may not start paying off their debts until month six. A termination within this time may result in the consumer being left worse off than when they started the IVA because of the payments that are made towards IVA fees, the delay in resolving the debt, and the interest that creditors can back-date over the period of the IVA.

95. The structure and scale of Insolvency Practitioner (IP) fees varies substantially. IVA fees are comprised mainly of two types of fee to the IP: nominees fees and supervisors fees. Nominee fees cover the income and expenditure assessment needed for the IVA proposal and can range from £1000-£2000. This can be paid up front, or with the first 5 monthly payments into the IVA. In the example below we assume the latter. This is a lower bound of the harm as nominee fees are on average £1,500 per IVA which exceeds the first 5 payments for all 3 scenarios outlined below.[22] Supervisor fees fund the cost of running and managing the IVA. These can also be fixed from £1,200-£1900 (upfront or over the first few payments), and in some cases are 15% of on-going monthly payments. In the example below we have also assumed the latter i.e. from month six, 15% of payments fund supervisors' fees. Some providers also charge disbursements costs which cover additional costs to third parties (e.g. insurance) of up to £1,000, which have not been included in the example below. The size of the repayments made into an IVA are agreed by the creditors but generally take into account the initial size of the debt and the individual's disposable income.

96. Table 5 below provides an estimate for the increased costs of a failed IVA in terms of the total amount paid in fees in three illustrative examples.

21 IVA fees are taken from the individuals' monthly payments and vary according to each provider.

22 This is an average of fee's charged by 11 Insolvency Practitioner firms representing 61.4% of the IVA market (by new consumer registrations in 2020).

Table 5: Breakdown of payments to creditors and IVA fees*

	Termination after			
	6 months	Year 1	Year 2	Year 3
£75/mth				
Payment to IVA fees	£390	£450	£600	£720
Payment to creditors	£60	£450	£1,200	£1,980
Total Paid	**£450**	**£900**	**£1,800**	**£2,700**
£150/mth				
Payment to IVA fees	£770	£900	£1,180	£1,400
Payment to creditors	£130	£900	£2,420	£4,000
Total Paid	**£900**	**£1,800**	**£3,600**	**£5,400**
£300/mth				
Payment to IVA fees	£1540	£1,820	£2,350	£2,900
Payment to creditors	£260	£1,780	£4,850	£7,900
Total Paid	**£1,800**	**£3,600**	**£7,200**	**£10,800**

* These estimates are based on the following assumptions: 1) the nominee fees are paid with the first 5 payments into the IVA and 2) the supervisor fees are 15% of all ongoing monthly payments once the nominee fee has been paid. All figures in the table above have been rounded to the nearest 10.

97. The table below shows how the average contribution made by a consumer are split over the first 3 years of an IVA.

Table 6: Consumer payments to IVAs

	6 months	Year 1	Year 2	Year 3
Payment to IVA Fees	86%	50%	33%	27%
Payment to Creditors	14%	50%	67%	73%

98. The above scenarios imply the benefit from avoiding being wrongly recommended into an IVA and having to terminate early at year 3 begins at around £720 and increases depending on the size of the monthly payments.

99. Table 7 below shows the illustrative cost of early termination (fees for DROs and IVAs) that could be avoided for each solution for the three individuals in the above example. This benefit arises as the ban would remove the incentive debt packagers have to provide biased advice and more consumers will be placed in suitable solutions.

Table 7: Illustrative cost of early termination (fees for DROs and IVAs)

	Illustrative cost of early termination		
	£75/mth payment	£150/mth payment	£300/mth payment
Debt Relief Order	£90	£90	£90
IVA (terminate in year 3, not including backdated interest)	£720	£1,400	£2,900

100. The harm faced by consumers could be exacerbated if a consumer that is inappropriately recommended to a debt solution through non-compliant advice from a debt packager, also terminates their solution early. In such circumstances, we expect the consumer will be paying more than necessary (if referred to and started an IVA when was eligible for a DRO), potentially struggling to maintain the on-going payments and facing the risk of backdated interest payments if the IVA were to terminate early due to an inability to make the agreed monthly payments.

Improved well-being from quality debt advice

101. We expect consumers' well-being would increase through referral to an appropriate solution that is more likely to increase their likelihood of resolving their problem debt. Consumers who are recommended a solution that is maintainable given their circumstances are less likely to experience a downward spiral in psychological well-being to keep up with the solution.

102. Research by MaPS found people seeking debt advice are more likely to suffer from depression, anxiety and from panic attacks/phobias as a result of debt. The study shows debt advice contributes towards an improvement in mental wellbeing by alleviating the incidence of depression, anxiety and panic attacks. This implies the provision of quality debt advice is likely to help alleviate the decline in life satisfaction caused by debt arrears.

103. There are also benefits to society (or positive externalities) through improving the health of individuals as this puts less stress on the health care system. The study estimated that for everyone seeking debt advice (1.5 million people), reduced mental health care costs from receiving good quality advice could benefit society between £50 million and £93 million each year.[23]

Impact on creditors

104. Our analysis of data from firms found that the number of customers that are referred and accepted onto a solution by debt packagers is relatively small, around 14,000 per annum (see paragraph 2.19) for IVA/PTDs and around 5,000 for DMP/DAS. This is a small number of the customers who receive debt advice each year and other sources of advice are available to customers who would otherwise approach a debt packager. As a result, we do not expect this policy to have a significant impact upon creditors.

105. The provision of compliant debt advice increases the likelihood a consumer will be successful on their chosen path to recovery. The impact upon creditors will vary according to where customers who were accessing advice through debt packagers now end up:

- Bankruptcy/DROs: These solutions have little/no payments to creditors and result in the debt being written off.
- DMP/DAS: Creditors benefit from monthly payments towards non-priority debts (examples of non-priority debts are bank loans, credit cards and loans).
- IVAs: Payments into an IVA are split between fees and creditors (see Table 5 for the illustrative examples of this split).

23 Economic Impact of debt advice (MaPS)

106. However, research by MaPS has indicated there are benefits for creditors by recovering debt through solutions such as IVAs and DMPs, rather than personally pursuing debtors. Research suggests it is more efficient and cost effective for creditors to recover problem debt through these means. From the Economic Impact of Debt Advice (2018), MaPS estimated the present value of the benefit for creditors from these solutions as:

- £1,760 – £2,610 for each insolvency solution (IVA or PTD)
- £2,020 – £3, 670 for each debt management plan per annum

107. Given the non-compliant advice from debt packagers increases the risk of early termination and increased indebtedness, we expect the impact on creditors to be minimal because we do not expect creditors recover a high proportion of problem debt through debt packagers. Overall, we expect there to be a net benefit to creditors with the size of the benefit depending on the new route consumers take to recover their debt.

Lower supervision costs for the FCA

108. The implementation of these proposals would reduce the amount of supervisory resource required to prevent and mitigate harm associated with the debt packager business model. We also expect to see a reduction in applications from debt packagers to become authorised to offer debt advice. We note that Recognised Professional Bodies might face increased supervision costs.

Risks and unintended consequences

109. Debt packagers may also seek to move to become unregulated lead generators and provide leads to debt solution providers but not debt advice. We would remind firms consider this of our guidance in PERG 17 and to be aware that passing on leads to firms which only provide a limited number of debt solutions could constitute regulated debt advice. We are also aware that the Insolvency Service has issued guidance for large IVA providers which requires them to only accept customers from firms which are FCA-regulated for debt counselling.

Annex 3
Compatibility statement

Compliance with legal requirements

1. This Annex records the FCA's compliance with a number of legal requirements applicable to the proposals in this consultation, including an explanation of the FCA's reasons for concluding that our proposals in this consultation are compatible with certain requirements under the Financial Services and Markets Act 2000 (FSMA).

2. When consulting on new rules, the FCA is required by section 138I(2)(d) FSMA to include an explanation of why it believes making the proposed rules is (a) compatible with its general duty, under s. 1B(1) FSMA, so far as reasonably possible, to act in a way which is compatible with its strategic objective and advances one or more of its operational objectives, and (b) its general duty under s. 1B(5)(a) FSMA to have regard to the regulatory principles in s. 3B FSMA. The FCA is also required by s. 138K(2) FSMA to state its opinion on whether the proposed rules will have a significantly different impact on mutual societies as opposed to other authorised persons.

3. This Annex also sets out the FCA's view of how the proposed rules are compatible with the duty on the FCA to discharge its general functions (which include rule-making) in a way which promotes effective competition in the interests of consumers (s. 1B(4)). This duty applies in so far as promoting competition is compatible with advancing the FCA's consumer protection and/or integrity objectives.

4. In addition, this Annex explains how we have considered the recommendations made by the Treasury under s. 1JA FSMA about aspects of the economic policy of Her Majesty's Government to which we should have regard in connection with our general duties.

5. This Annex includes our assessment of the equality and diversity implications of these proposals.

6. Under the Legislative and Regulatory Reform Act 2006 (LRRA) the FCA is subject to requirements to have regard to a number of high-level 'Principles' in the exercise of some of our regulatory functions and to have regard to a 'Regulators' Code' when determining general policies and principles and giving general guidance (but not when exercising other legislative functions like making rules). This Annex sets out how we have complied with requirements under the LRRA.

The FCA's objectives and regulatory principles: Compatibility statement

7. The proposals set out in this consultation are primarily intended to advance the FCA's operational objective of securing an appropriate degree of protection for consumers. In considering the proposals set out in this consultation, we have had regard to the 8 matters listed in s.1C(2)(a)-(h) FSMA on consumer protection.

8. The proposals are intended to protect consumers from the risk of seeking debt help from biased, non-compliant sources of debt advice. We want to reduce the harm to consumers from being wrongly recommended debt solutions and in particular IVAs and PTDs as a result of such advice. We want to protect consumers by enabling them to access compliant debt advice more quickly, reducing the risk of disengagement from their debt recovery journey.

9. We consider these proposals are compatible with the FCA's strategic objective of ensuring that the relevant markets function well because they aim to remove a business model which delivers a consistently poor quality service. Consumers face considerable barriers in their capacity to assess the quality of the service provided, including information asymmetry. This is explained in further detail in our CBA. For the purposes of the FCA's strategic objective, "relevant markets" are defined by s. 1F FSMA.

10. In preparing the proposals set out in this consultation, the FCA has had regard to the regulatory principles set out in s. 3B FSMA.

The need to use our resources in the most efficient and economic way

11. As well as delivering the appropriate degree of consumer protection, our proposals to tackle the underlying business model risks of debt packager firms will enable us to avoid a resource-intensive cycle of supervision and enforcement activity. We can focus our resources on addressing issues in debt advice firms which do not have the same underlying incentives driving non-compliance but could benefit from our intervention to raise their advice standards.

The principle that a burden or restriction should be proportionate to the benefits

12. As we explain in Chapter 3, although this measure is highly interventionist, we consider it to be proportionate given the evidence of poor practice and misaligned incentives seen in this sector and absence of effective alternatives. We explain our assessment of the costs and benefits of intervention more fully in our CBA.

The desirability of sustainable growth in the economy of the United Kingdom in the medium or long term

13. We do not consider that these proposals are relevant to sustainable economic growth. The debt packager sector is too small to have any significance to economic growth.

The general principle that consumers should take responsibility for their decisions

14. To take responsibility for their decisions in relation to debt solutions, consumers need to be provided with appropriate, compliant advice. These proposals support the principle that consumers should take responsibility for their decisions by reducing the risk that consumers access poor quality advice that fails to properly inform them of their choices.

The responsibilities of senior management

15. We warned the senior management of debt packager firms in our Dear CEO letter that they needed to ensure they managed the conflict of interest inherent in their business. Our subsequent evidence gathering has led us to conclude that the incentives created by referral fees are too strong for senior management to ensure these risks are effectively managed.

The desirability of recognising differences in the nature of, and objectives of, businesses carried on by different persons including mutual societies and other kinds of business organisation

16. We explain in Chapter 3 why we are excluding not-for-profit debt advice organisations from the scope of our proposals.

The desirability of publishing information relating to persons subject to requirements imposed under FSMA, or requiring them to publish information

17. This is not relevant to these proposals.

The principle that we should exercise of our functions as transparently as possible

18. This consultation paper sets out our evidence and rationale for the proposals.

Expected effect on mutual societies

19. The FCA does not expect the proposals in this paper to have a significantly different impact on mutual societies.

Compatibility with the duty to promote effective competition in the interests of consumers

20. In preparing the proposals as set out in this consultation, we have had regard to the FCA's duty to promote effective competition in the interests of consumers.

Equality and diversity

21. We are required under the Equality Act 2010 in exercising our functions to 'have due regard' to the need to eliminate discrimination, harassment, victimisation and any other conduct prohibited by or under the Act, advance equality of opportunity between persons who share a relevant protected characteristic and those who do not, to and foster good relations between people who share a protected characteristic and those who do not.

22. As part of this, we ensure the equality and diversity implications of any new policy proposals are considered. The outcome of our consideration in relation to these matters in this case is stated in paragraphs 2.37-2.39 of the Consultation Paper.

Annex 4
Abbreviations used in this paper

Abbreviation	Description
DAS	Debt Arrangement Scheme
DRO	Debt Relief Order
DMP	Debt Management Plan
FCA	Financial Conduct Authority
IP	Insolvency Practitioner
IVA	Individual Voluntary Arrangement
MAP	Minimum Asset Process
MaPS	Money and Pension Service
NFP	Not for profit
PTD	Protected Trust Deed

Appendix 1
Draft Handbook text

CONSUMER CREDIT (DEBT PACKAGER REMUNERATION FROM DEBT SOLUTION PROVIDERS) INSTRUMENT 2022

Powers exercised

A. The Financial Conduct Authority ("the FCA") makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):

(1) section 137A (General rule-making power);
(2) section 137T (General supplementary powers); and
(3) section 139A (Power of the FCA to give guidance).

B. The rule-making provisions listed above are specified for the purposes of section 138G(2) (Rule-making instruments) of the Act.

Commencement

C. This instrument comes into force on [*date*].

Amendments to the Handbook

D. The Consumer Credit sourcebook (CONC) is amended in accordance with the Annex to this instrument.

Citation

E. This instrument may be cited as the Consumer Credit (Debt Packager Remuneration from Debt Solution Providers) Instrument 2022.

By order of the Board
[*date*]

Annex

Amendments to the Consumer Credit sourcebook (CONC)

In this Annex, underlining indicates new text.

8 Debt advice

…

8.3 Pre contract information and advice requirements

…

Prohibition on debt packager remuneration from debt solution providers

Scope

8.3.9 R (1) *CONC* 8.3.11R to *CONC* 8.3.15R:

(a) apply to a *firm* with respect to *debt counselling* where the *firm* does not itself provide *debt solutions*; and

(b) do not apply to a *firm* that is a *not-for-profit debt advice body*.

(2) A *firm* is treated as not itself providing *debt solutions* for the purposes of *CONC* 8.3.9R(1)(a) where the *firm*:

(a) provides *debt solutions* on a single or occasional basis; and/or

(b) receives only an insignificant amount of its total annual revenue from providing *debt solutions*.

Context, purpose and anti-avoidance

8.3.10 G (1) *Firms* are reminded that when referring *customers* to *debt solution* providers, or carrying on related services, a *firm* must comply with its obligations under:

(a) *Principle* 6 (Customers' interests) to pay due regard to the interests of its *customers* and treat them fairly; and

(b) *CONC* 8.3.2R(1) to ensure that all advice given and action taken by the *firm* or its agent or its *appointed representative*:

(i) has regard to the best interests of the *customer*;

(ii) is appropriate to the individual circumstances of the *customer*; and

(iii) is based on a sufficiently full assessment of the financial circumstances of the *customer*.

(2) The purpose of the prohibition in *CONC* 8.3.11R is to remove the conflict of interest between a debt packager's obligations under *CONC*, including those referred to in *CONC* 8.3.10G(1), and the financial incentive to act in a way which generates revenue in the form of referral fees from *debt solution* providers.

(3) The effect of *CONC* 8.3.9R(2) is that *firms* will not be able to avoid the prohibition in *CONC* 8.3.11R by starting to provide a small number of *debt solutions* for that purpose.

Prohibition

8.3.11 R (1) A *firm* must not (and must take all reasonable steps to ensure that none of its *associates*, or its *appointed representatives*):

(a) enter into an agreement to receive;

(b) solicit or accept; or

(c) seek to exercise, enforce or rely on rights or obligations under an agreement to receive,

any commission, fee or any other financial consideration, directly or indirectly, from a *debt solution* provider in connection with the *firm* referring *customers* to a *debt solution* provider, or any other related services, except as provided in *CONC* 8.3.14R.

(2) *CONC* 8.3.11(1)(b) and (c) do not apply where the *firm* has completed the referral, and related services, in relation to a *customer* prior to the coming into force of *CONC* 8.3.11R(1).

8.3.12 R 'Related service(s)' for the purposes of *CONC* 8.3.9R to *CONC* 8.3.11R includes:

(1) recommending a *debt solution* provider;

(2) providing *debt counselling* services to *customers* prior to those *customers* being referred to a *debt solution* provider or entering into a *debt solution*; and

(3) providing *debt counselling* services to *customers* who have been referred to the *firm* by a *debt solution* provider.

8.3.13 R '*Debt solution* provider(s)' for the purposes of *CONC* 8.3.10G to *CONC* 8.3.12R includes such providers' *associates* and *appointed representatives.*

8.3.14 R *CONC* 8.3.11R does not apply to payments made:

(1) pursuant to a statutory provision;

(2) in relation to the administration by a 'money adviser' approved under The Debt Arrangement Scheme (Scotland) Regulations 2011 of a *customer*'s application for a Debt Arrangement Scheme under those Regulations; or

(3) by an officer of:

(a) (in relation to England and Wales) The Insolvency Service;

(b) (in relation to Scotland) the Accountant in Bankruptcy; or

(c) (in relation to Northern Ireland) the Insolvency Service.

Record keeping

8.3.15 R *Firms* are reminded of their obligations in *SYSC* 9.1.1R to keep orderly records, which must be sufficient to enable the *FCA* to monitor the *firm*'s compliance with the requirements of the *regulatory system*.

Application of the prohibition to appointed representatives

8.3.16 R *Principals* which have an *appointed representative* to whom *CONC* 8.3.9R(1) would apply if the *appointed representative* were an *authorised person*, must take all reasonable steps to ensure that such an *appointed representative* complies with *CONC* 8.3.11R as if the references in that *rule* to '*firm*' applied to such an *appointed representative*.

8.3.17 G The purpose of *CONC* 8.3.16R is to prevent a debt packager *firm* from becoming an *appointed representative* in order to avoid *CONC* 8.3.11R applying to it and continuing to be conflicted by the financial incentive to act in a way which generates revenue from *debt solution* providers.

Pub ref: 007639

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