creditaction
Better thinking about money

Debt management (and credit repair services) guidance: A consultation (OFT1338con)

A Response by Credit Action

<u>Background</u>

Credit Action is a national money education charity (registered Charity in England & Wales No. 1106941) established in 1994.

In January 2009 we also created our dedicated Welsh arm, Credit Action Cymru.

We offer a range of resources, tools and training to help everybody handle their money well, and to inform consumers so that they can make informed decisions about their personal finances.

Credit Action operates at a national level through advocacy, collaboration and partnerships with various groups and companies as well as at a local level through a variety of targeted projects, with a particular emphasis on those most vulnerable to financial difficulties and over-indebtedness. Through its work Credit Action reaches over 650,000 UK citizens every year.

We try and help as many people as possible avoid the pain of debt. However we recognise many contacting us will be in trouble already, so we work in partnership with the major debt counselling charity the Consumer Credit Counselling Service (Registered Charity No. 1016630).

Opening Comments

As an organisation which takes a keen interest in regulatory and consumer affairs, Credit Action welcomes the opportunity to comment on the Office of Fair Trading's draft guidance for debt management and credit repair services providers. Having had a long and close association with the Consumer Credit Counselling Service (CCCS), we have an understanding of the environment in which debt management firms operate, and of the importance of good quality debt management services to consumers.

In general we feel that the OFT's draft guidance provides a thorough and robust update of the existing Debt Management Guidance. We therefore find little to criticise in the draft guidance itself. However, on a broader level, Credit Action feels strongly that the presence of commercial fee-charging debt management companies within the sector can result in significant consumer detriment. We believe that much greater action is needed on the part of regulators to address some of the problems caused by such firms. These will not be fully resolved by the implementation of the new draft guidance, improved though it may be.

We would therefore like to take the opportunity provided by this consultation to do two things. Firstly, we wish to highlight a fundamental problem that we believe exists with regard to advertising within the sector, in that fee-charging debt management companies possess significantly greater resources than not-for-profit providers. We feel that this places not-for-profits at a competitive disadvantage, and believe that regulators should take action where possible to address this.

Secondly, we are also calling for the introduction of a cap on debt management fees. In our view, this is the only method by which consumers can be adequately protected from the unnecessary and at times predatory practices of some fee-charging firms. Evidence on the effectiveness of fee capping in the U.S. State of California has previously been put forward by CCCS, and we will review this in greater detail in the course of our response.

Given that our submission predominantly concerns the issues of advertising and of charging and capping, we have decided to focus our response around the sections of the consultation which deal with 'Advertising and other communications' and 'Charging for debt management services', and in particular on Questions 17 and 25.

Advertising and other communications

Question 17: Do you consider that there are any significant omissions?

We note that the provisions around advertising and other communications in the draft guidance represent a considerable extension of the standards set out in the existing guidance, and recognise that the OFT has made a genuine effort to enhance these. In themselves, we do not see the changes that have been made as problematic.

However, we believe that there is a deeper issue with regard to advertising within the sector which is not addressed in the guidance. Specifically, fee-charging debt management companies possess significant advertising and marketing budgets which are simply not available to not-for-profit providers. In our view, the playing field is therefore not a level one, and not-for-profit providers are placed at a significant disadvantage in terms of their ability to build brand recognition and consumer awareness.

While we understand that this issue is in part the result of commercial decisions made by individual firms over which regulators themselves have little control, this is nonetheless a major issue, and one which has a highly significant impact on the way in which consumers behave.

As we will discuss in greater depth in our response to Question 25, there is a strong suggestion that consumers in the debt management sector do not see themselves as operating within a marketplace. They often accept the services of the first provider that they see or that offers them help, rather than shopping around effectively. In this context, a particular firm's capacity to advertise to potential consumers and build name recognition is likely to exercise a significant influence over whether consumers utilise that firm's services, regardless of whether or not it offers the most appropriate solution for their circumstances.

We feel that it is important that this issue is highlighted, as in our view it has a major impact on the landscape of the sector, and means that consumers who may be otherwise inclined to seek free advice from non-profit providers are potentially not doing so. We would therefore urge regulators to look very seriously at this, and if possible take action to help address the problem.

Charging for debt management services

Question 25: Do you consider that there are any significant omissions?

Once again, we have little criticism to make of the draft guidance itself. Both the section on 'Charging for debt management services' and the draft guidance in general build comprehensively on the existing guidance, which is laudable on its own terms.

However, we have a broader contention in that we do not believe that improving the guidance will in itself be sufficient to provide consumers with an adequate level of protection from some of the problems caused by fee-charging debt management companies. We believe that regulators must be prepared to intervene to a much greater degree via the implementation of a cap on debt management fees. Therefore, we feel that the absence of any provision for a cap within the draft guidance represents a significant omission in itself, and is something that will contribute to continued consumer detriment within the sector.

The overall aim of improving the existing guidance is to enhance consumers' ability to engage successfully with the market by, for example, ensuring that marketing and contractual materials are sufficiently transparent about the level of fee charged (paragraph 3.29a) so that consumers can take an informed decision about the debt management option they select. However, we question whether this overall aim adequately reflects the actual experience of those who seek support from debt management companies.

In late 2009, CCCS responded to a joint consultation from the Insolvency Service, the Ministry of Justice and the Department for Business, Innovation and Skills entitled *Debt Management Services – delivering effective and* *balanced solutions for debtors and creditors*. In their submission, CCCS made what we feel is an important point about the motivations of consumers who utilise the services of debt management companies. They stated that:

> People with debt problems are looking for help. They do not see themselves as in a marketplace, buying a product or service. There is almost no price sensitivity, with debtors generally going with the first debt management company they find, or who makes contact with them.[1]

Credit Action believes that those who seek help from a debt management company are in a unique and often profoundly difficult situation. Ultimately, if a consumer's primary concern is simply to find help from somewhere, rather than to find help from the most cost-effective or appropriate provider for their specific circumstances, it means their ability to drive improvement within the market will be limited. This makes them particularly vulnerable, and potentially in need of a greater degree of protection.

Given that free debt management solutions are available from certain providers, we believe that it is unnecessary for consumers to be placed in a position where they are paying excessive fees to a commercial company for services which cost nothing elsewhere. Introducing a fee cap is, in our view, the ideal way of mitigating the possibility of such situations occurring. Consequently, we see the implementation of such a mechanism as essential to ensuring that consumers get a fair deal.

Evidence that a fee cap can be implemented effectively and make a valuable contribution to improving the consumer environment has previously been identified by CCCS, with particular regard to the introduction of price controls in the U.S. State of California. According to CCCS's research, California's

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[1] Consumer Credit Counselling Service, *Response to Ministry of Justice/ BIS/ Insolvency Service Consultation on Debt Management Schemes (2009)*, p. 5

regulatory regime is underpinned by 'the intent to deter get-rich-quick firms and limit the amount of money people can lose if they fall into dubious hands. To achieve this, it demands stringent business standards and imposes strong price control by capping front-end fees.'[2]

California's regulatory structures are the result of a particular historical experience. The State had faced significant problems in its debt management sector for a number of years, particularly given the proliferation of firms which were effectively profit-making but which managed to exploit State regulations to become licensed as non-profit companies. These firms were subsequently able to use their non-profit status to avoid the more onerous regulatory burden faced by for-profit firms, and mislead consumers.

In the early 2000s, California introduced a number of measures to address these problems, including harmonising the rules governing for-profits and non-profits and implementing a cap on fees. The California Financial Code (division 3 starting with section 12000) caps the fees charged by counselling agencies at either 8% of the amount paid to creditors or $35 (whichever is the less). Meanwhile, fees for a debt settlement plan (where agencies negotiate with creditors to forgive the debt by accepting less than is owed) are limited to 15% of the amount forgiven. Credit counselling agencies are also forbidden from paying fees to people or third parties who refer clients, and must not ask debt management plan holders to use ancillary services.[3]

We recognise that the debt management sectors in California and the UK are different, and that there will be specific characteristics particular to each. However, what the California model does illustrate is that it is possible to successfully integrate a fee cap into a wider regulatory structure which delivers improved outcomes for consumers.

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[2] Consumer Credit Counselling Service, *Response to Ministry of Justice/ BIS/ Insolvency Service Consultation on Debt Management Schemes (2009)*, p. 29

[3] Consumer Credit Counselling Service, *Response to Ministry of Justice/ BIS/ Insolvency Service Consultation on Debt Management Schemes (2009)*, p. 29-31

Recent research undertaken for the Federal Reserve Bank of Philadelphia also supports the view that consumers do not shop around effectively for debt management solutions, and that this can cause market distortions that regulatory interventions may be necessary to address.

In an August 2011 paper discussing developments in the demand for debt relief in the U.S., Stephanie Wilshusen has characterised debt relief services as an example of 'credence goods'. She notes that consumers do not shop for debt relief services regularly, and face a complicated range of options and diverse set of providers when they do. As a result 'consumers may not know what they really need, but they will eventually learn the value of what they get. Unfortunately, this learning occurs too late to inform a good choice in the first place'.[4]

Wilshusen continues that 'Without some form of mitigation, markets for credence goods can perform poorly'. In the case of debt relief services, this may result in overtreatment (where costly or unnecessary solutions are provided), undertreatment (where and easy solution is provided that does not actually solve the problem), or simply overcharging. Consequently, these 'potential market failures suggest a role for government intervention'.[5]

With respect to current U.S. policymaking in this arena, Wilshusen points to the creation of the Consumer Financial Protection Bureau (CFPB) in 2010 as an instance of a more interventionist approach on the part of government, a body which she suggests 'could potentially rely more heavily on rulemaking to deter opportunistic behaviour' than its predecessors'.[6]

In broad terms, this latest U.S. research suggests that a more active regulatory approach can be necessary in the likes of debt management markets in order to ensure consumers are properly protected against the impact of potential distortions. We would endorse this, and believe that evidence from California

[4] Stephanie M. Wilshusen, 'Meeting the Demand for Debt Relief' (August 2011), p. 13-14

[5] Stephanie M. Wilshusen, 'Meeting the Demand for Debt Relief' (August 2011), p. 14

[6] Stephanie M. Wilshusen, 'Meeting the Demand for Debt Relief' (August 2011), p. 34

suggests that a cap on fees can be part of successful regulatory interventions which are ultimately beneficial for consumers. We would therefore call on regulators to learn lessons from the U.S. experience, and seek to introduce a fee cap in the UK.

Contact

For further information on any of the suggestions made in this response, please contact John Davies or Liz Dunscombe by email at office@creditaction.org.uk or by telephone on 0207 380 3390.