High level proposals for an FCA regime for consumer credit

Response by the Association of Business Recovery Professionals ('R3') to the consultation document CP13/7 issued by the Financial Services Authority, March 2013

1. Introduction

R3 represents insolvency practitioners authorised to practise in all jurisdictions of the UK. R3's membership comprises licensed insolvency practitioners (IPs), lawyers and other professionals involved in the insolvency and turnaround industries. Over 97% of authorised IPs are members of R3.

IPs are highly regulated, licensed professionals and officers of the court, having been deemed fit and proper to hold an insolvency licence by the Secretary of State or by their own regulatory body. They are experts in personal and corporate insolvency, including pre-insolvency advice and are the only professionals who are licensed to take formal insolvency appointments across all personal and corporate insolvency procedures. As such, they are able to offer a unique perspective on the UK's insolvency regime.

R3's interest in the consultation stems from the impact of the proposals on the regulation of IPs' activities outside of their formal insolvency appointments, in particular the provision of pre-appointment advice, debt counselling and debt adjustment services. Whilst we welcome the Government's proposal, set out in its separate consultation, to exempt IPs from requiring authorisation by the Financial Conduct Authority (FCA) for debt related activities when they have been formally appointed as an IP, we strongly disagree with the proposal that IPs should require FCA authorisation for any consumer debt related activities falling outside of a formal insolvency appointment. In view of the fact that IPs are already highly regulated for their pre-appointment work and advice and are monitored for this work by their regulatory bodies, we fail to see why a distinction has been drawn between pre-appointment/non formal appointment activities and those taking place after the IP has formally been appointed. Both types of work are regulated and are subject to sanction by the IP's regulatory body if the IP fails to meet statutory and regulatory requirements. R3 believes that there is a risk that IPs will become over-regulated and the market will contract if they are also required to obtain FCA authorisation for relevant activities other than formal insolvency appointments.

Whilst we appreciate that under the current system IPs require a consumer credit licence for pre-appointment advice, R3 have long held the view that IPs should be fully exempt from requiring authorisation for their pre-appointment advice, debt counselling and debt adjusting services, which are

necessary parts of their function, as well as their formal insolvency appointments in order to avoid increasing the burden of regulation on an already highly regulated profession.

R3 are also concerned at the suggestion that prudential standards for debt management firms may include firms whose members undertake individual voluntary arrangements for the reasons set out in detail in [answer to Question 11].

We have focused our response below on those proposals which we believe will have an impact on IPs. Questions which are unanswered reflect the fact that we have no opinion on the point at issue.

2. Consultation questions

Question 1 – do you agree that our proposals strike the right balance between proportionality and strengthening consumer protection?

No, R3 believes that the Government's proposal that IPs will require authorisation for their debt-related activities outside of formal insolvency appointments is disproportionate.

IPs are licensed professionals and officers of the court, often having qualified as an accountant or lawyer before spending a number of years gaining wide-ranging experience and knowledge of insolvency and taking a set of specific insolvency examinations to obtain their insolvency licence. The licensing process also requires that IPs must be deemed fit and proper by the Secretary of State or by their own regulatory body. IPs are highly regulated individuals, required to comply not only with insolvency legislation, but also rules imposed by their regulatory bodies, by whom they are also regularly monitored to ensure their strict compliance with their statutory and regulatory duties.

Whilst R3 welcomes the Government's proposal to exempt IPs from requiring authorisation for their formal insolvency appointments, our concern is that the proposal does not exempt IPs from requiring authorisation for their pre-appointment advice and debt related activities outside of formal appointments. This is likely to mean that IPs who may be required to advise individuals as a result of their appointment in respect of a company insolvency as well as those dealing exclusively with personal insolvency will be required to comply with two separate regulatory regimes – the insolvency regime for which they are formally licensed and the FCA regime relating to consumer credit. IPs are already monitored by their regulatory body for the quality and appropriateness of their pre-appointment advice and can be sanctioned if their advice breaches any regulatory requirements or statutory obligations. Regulatory inspections of an IP's practice also often place a great deal of emphasis on the quality of the pre-appointment advice given and the evidence thereof. In addition, the provision of pre-appointment advice falls within the scope of the specialist insolvency exams that all IP are required to take and as such IPs are appropriately trained in this area. In R3's view, therefore, regulation of this area of an IP's role by the FCA would constitute a disproportionate increase in red tape and regulation on a profession which is already highly regulated and has stringent safeguards in place to ensure that IPs provide expert advice, subject to very high standards, to debtors and distressed companies.

In R3's view, imposing a second tier of FCA regulation on IPs runs counter to one of the stated aims of the new regime, which is proportionality. We are also concerned that further regulation of IPs may have the unintended consequence of stifling the market. The changes would be particularly burdensome for smaller IP firms with fewer resources, who may struggle to meet the increased costs associated with unnecessary FCA regulation, in addition to the costs associated with their insolvency licence and compliance with insolvency legislation and regulation. If smaller IP firms cannot meet the increased costs of an unnecessary second tier of regulation by the FCA, they may be forced to exit the personal insolvency market or to rely on introducers for formal personal insolvency work. In addition, these changes would have a particular impact on firms which predominately provide corporate insolvency solutions, but on occasion may be asked to provide advice to a director on their personal affairs. In this situation, it is likely that the IP would no longer be willing to provide this, forcing the consumer to seek additional advice at an added cost. This would lead to a consequent contraction of the market, which may reduce the number of insolvency professionals able to take formal insolvency appointments and a detrimental impact on consumer choice. As IPs are the only individuals licensed to carry out the whole range of informal and formal insolvency and debt procedures, there is a real risk that this would reduce the quality and range of advice available for consumers.

In order to avoid the proposed two tiers of regulation for IPs, R3 suggests that IPs should be exempted from FCA regulation for all of their debt-related activities outside of formal insolvency appointments in the same way that, under the Government's proposals, they will be exempted from formal appointments. IPs are experts in providing debt advice, having taken specific examinations in personal insolvency as part of their formal training to become an IP. As we have previously stated, IPs are also already monitored for their pre-appointment work and can be sanctioned if this work does not meet the regulatory standards set by their regulatory bodies. As such, if a full exemption for IPs were put in place, there is no danger that the IP's debt related activities outside of formal appointments would go unregulated. The ongoing monitoring activities of the IP's regulatory body already ensure that consumers are protected from the risk of detriment associated with incorrect advice.

R3 strongly believes that the proposed balance between proportionality and consumer protection, in respect of IPs, is incorrect. Given the arguments outlined above, IPs should benefit from a full carve-out from FCA authorisation for all of their debt-related activities.

Question 2 – do you agree that we have included the right activities in the higher and lower risk regimes?

R3 does not believe that the scope of the 'limited permission' regime is correct and that the right activities have been included in the higher and lower risk categories. We do not agree that not-for-profit organisations providing debt counselling and debt adjusting should be subject to a different, lower risk regulatory regime and a different level of regulatory intervention to the regime put in place for profit-seeking organisations. We have set out previously why we believe that IPs should be fully exempted from FCA authorisation for all of their debt related activities. Whilst this would be R3's strong preference, at the very least we consider that IPs should be made subject to the 'limited permission'

regime, thereby sitting alongside not-for-profit organisations who it is proposed will benefit from this less onerous regime.

Our rationale for these suggestions stems from the fact that IPs are already highly regulated and licensed for debt-related work. Conversely, not-for-profit organisations are not regulated or qualified in the same manner or to the same level as IPs and are not able to offer experience of the full range of debt solutions to the same degree. In view of revenue cuts within the not-for-profit sector, there may also be a risk that such organisations can no longer provide the scale of debt advice services that they once did. It is therefore arguable that debt-related activities undertaken by these organisations should be subject to the same, if not a higher, level of regulatory scrutiny to ensure that the advice given is appropriate and correct and the risk of harm to consumers through well-intentioned, albeit incorrect, advice is minimised. In addition, we understand that the Government is keen to promote free debt advice to consumers. Such advice should be regulated to the same standards as paid for advice.

The Government has expressed concern that consumers should be able to obtain the best possible debt advice. R3 agrees with this concern and believes that in order to achieve this aim, there needs to be a level playing field relating to the quality and level of regulation of debt advice across the market, covering both for-profit and not-for-profit organisations. In our view, it is the future detriment caused to the consumer if the advice given is incorrect or misinformed, however well-intentioned, which has the most negative impact on the consumer, irrespective of whether the advice was paid for or not. R3 therefore believes that not-for-profit organisations should be subject to the same regulatory regime as for-profit organisations. We would therefore urge the FCA to reconsider the proposals for a different level of regulation for not-for-profit organisations providing debt adjusting and counselling.

Question 3 – do you agree that our proposals minimise the impact on competition within the regulated consumer credit market.

No, R3 does not agree that the proposals minimise the impact on competition within the market. As we have previously indicated, there is a risk that imposing a further tier of regulation on IPs may have the unintended consequence of contracting the insolvency market. This will particularly be the case where smaller IP firms, with fewer resources, may struggle to meet the increased costs associated with unnecessary FCA regulation, in addition to the costs associated with their insolvency licence and compliance with insolvency legislation and regulation.

R3's concern is that IP firms may exit the market if they cannot, or do not see the merit in meeting the increased costs of additional FCA regulation. This may have the unintended consequence of reducing the number of insolvency professionals able to take formal insolvency appointments, which would have a consequent detrimental impact on the treatment and choice of consumers who may require the services of IPs in administering debt solutions.

Question 4 – do you have any comments regarding our proposals for the interim permission regime?

Under the current OFT regime, IPs whose firms fall under the regulatory remit of regulatory bodies such as the Institute of Chartered Accountants in England and Wales, the Association of Chartered Certified Accountants, the Institute of Chartered Accountants in Scotland, Chartered Accounts Ireland or the Law Societies of England and Wales, Scotland and Northern Ireland will generally fall under the OFT group licences held by those regulators. IPs regulated by the Insolvency Practitioners' Association or the Secretary of State for Business, Innovation and Skills require either their own individual consumer credit licences or their firm to hold an applicable licence, as their own regulatory bodies do not currently hold group licences under the OFT regime.

Under the proposals for interim permissions, those IPs who hold existing individual licences or whose firms hold existing licences will be able to apply for interim permission to stage their entry into the FCA's full regulatory remit.

However, there is a discrepancy for those IPs whose firms currently fall under a group licence. On the assumption that the circumstances of some of these firms may mean that they do not meet the criteria for the professional firms' exemption, in particular the 'incidental' test, and that they may therefore require direct FCA authorisation, the Government's proposal in its consultation at paragraph 6.19.1 indicates that they will not be able to apply for interim permission.

In R3's view, this will mean that, for example, two IPs doing similar work and giving the same advice, but whose firms happen to fall under different regulatory bodies' control, will be subject to different regulatory requirements. Not only would this create a further administrative burden on the regulatory bodies to administer, but there would be no level playing field across the insolvency profession. The lack of availability of the interim permissions, or a similar regime, in the circumstances described above will have cost and timing implications for a large proportion of IPs whose firms currently benefit from the group licence regime but who may not meet the criteria for the professional firms' exemption. By reducing the availability of interim permission, or a similar regime, there is also the risk of a detrimental impact on smaller IP firms, many of whom have fewer resources to pay for the increased regulatory fees associated with full FCA authorisation within the short timeframe before the regime comes into force in April 2014.

R3 therefore believes that where IP firms currently fall under a group licence under the current regime but for whatever reason will not be able to fall under the professional firms' exemption under the FCA regime, they should be permitted to apply for interim permission. If this is not possible, those who fall under the current group licence structure should be given a longer period in which to comply with the changes. Given the Government has not yet decided how the 'incidental' test will apply to Insolvency Practitioners and is unlikely to do so until the Autumn, it is vital that the profession is given this additional time in order to assist their transition into the new regime.

Question 5 – do you agree that we should apply the Threshold Conditions as proposed?

No view.

Question 6 – do you agree that it would be proportionate for the FCA to apply the approved persons regime activities as proposed?

No. Insofar as DPBs are concerned, we cannot see why there is a requirement for an approved person. The members of such a firm are by definition professionals who should be well aware of their duties and obligations and in particular should understand when relevant activities are no longer 'incidental'.

Question 7 – do you agree with our proposal not to apply a customer function to any consumer credit activity, particularly debt advice?

No view

Question 8 – do you agree with our proposed approach to appointed representatives and multi-principal arrangements?

No view

Question 9 – do you agree with our proposed approach to self-employed agents?

No view

Question 10 – do you agree with our approach to professional firms?

We have previously indicated that under the current OFT regime, debt related activities undertaken by IPs which require a consumer credit licence may either be covered by a regulatory body's group licence or by an individual or firm licence.

R3 agrees with the proposal that IPs in firms who currently fall under one of the applicable regulatory bodies' group licences may be able to be exempted from authorisation under Part 20 of FSMA by virtue of their membership of a 'designated professional body' (DPB) and the professional firms' exemption. However, R3 has concerns relating to the approach to this exemption, in particular the meaning of 'incidental' in the stipulation that an IP's debt related activity must be 'incidental' to their business as an IP. We would question how this test for 'incidental' is to be defined. The question arises as to whether any form of pre-appointment work or advice leading up to a formal insolvency process would be classified as 'incidental' to the IP firm's work, bearing in mind that the scale of such work in general and in comparison to the firm's overall business will vary greatly between IP firms of different sizes and specialisms, including insolvency-specific firms or mixed practices where the insolvency department is only one part of a larger accountancy or legal practice. R3 notes that various factors are currently set out in the FCA handbook to be taken into account when determining whether activities are 'incidental' but

we feel that further clarification is urgently required about the meaning of 'incidental' as it will apply to IPs and their pre-appointment work.

R3 also has concerns about how the 'incidental' test would be applied in practice. There is a real risk that, if the test is applied on a case-by-case (and hence subjective) basis dependent on the circumstances of each IP's business, this may lead to two tiers of regulation for IPs – those whose circumstances fulfil the 'incidental' test and therefore may benefit from the professional firms' exemption and those whose circumstances fail the test and therefore mean that they must obtain full FCA authorisation. This would lead to inconsistency of authorisation within the same industry, leading to different standards of regulatory compliance to be monitored by the regulatory bodies, not to mention increased costs for those firms who cannot benefit from the exemption. In order to mitigate this risk, R3 strongly believes that IPs should be fully exempted from requiring FCA authorisation for any of their debt related work, whether inside or outside of formal appointments.

There is also a potential issue with insolvency firms who are not currently registered under the DPB regime administered by certain regulatory bodies. We would question whether IP firms will automatically be included within the DPB regime if they are already covered by a group licence under the current regime or whether they will have to reapply to their regulatory body for entry into the DPB regime and meet new regulatory criteria. If the latter, we envisage that this will create an administrative nightmare for those regulatory bodies that currently have DPB status, one of which has over 12,000 members who fall under the group licence regime.

R3 is concerned that the FCA has also not fully considered the issues as they relate to mixed practices, where IPs within the practice can be regulated by different regulatory bodies. We would like further clarification on how the new regime will apply in such circumstances.

Question 11 – do you agree with our proposal to apply prudential standards to debt management firms only?

Yes. R3 welcomes further regulation of debt management plan (DMP) providers in order to build consumers' confidence in this industry and ensure that safeguards are put in place to mitigate any risk to consumers. However, we were surprised to learn at a recent meeting with the Treasury and the FCA (30.04.13) that the FCA takes the view that debt management providers would include firms whose members undertake individual voluntary arrangements (IVAs). There is no clear indication of this in the consultation document, and we believe that such a proposal is inappropriate and based on a misunderstanding of the IVA process.

We can understand the need for minimum capital requirements in the case of DMP providers, which may not be subject to any regulatory regime beyond the consumer credit licensing regime itself, and whose activities may involve the mixing of moneys due to third parties (what might loosely be termed 'client monies') with the firms' own funds. However, the IVA procedure is fundamentally different, and does not present the same risks.

Unlike DMPs, which are contractual in nature, IVAs are a statutory insolvency process governed by a comprehensive legislative code and ultimately under the control of the court. Like all other formal insolvency processes, IVAs are governed by the provisions of the Insolvency Act 1986 and related legislation. They are supervised by qualified insolvency practitioners, who have to be licensed to carry out their function, who are subject to a rigorous regulatory regime, and who are answerable to the court and to their professional body. They are required to carry full professional indemnity insurance, and to be bonded to the full value of the assets included in the arrangement, as explained below. In all IVA cases, the arrangement funds are required to be kept separate from the supervisor's firm's own funds.

In the event of the failure of an IP's firm or the inability of a supervisor to continue to act, there are systems in place for the transfer of cases to other firms, and the appointment of a replacement supervisor.

All the safeguards which Parliament considered necessary for the protection of parties to an IVA are therefore already built into the process.

Moreover, if IVAs are subject to minimum capital requirement there is a risk that it will have a detrimental impact on the industry and it could effectively limit the range of debt solutions available to those in financial difficulty. In recent years, many Insolvency Practitioners have left the IVA market and it is now predominantly made up of 'IVA factories' who are able to administer a high volume of relatively simple IVAs and boutique firms who undertake more complex, specialist IVAs. It is the latter who will be seriously affected by capital requirements. It is likely that this burden would force many of these firms to leave the market, leaving a considerable gap in the procedures available to consumers. This may force many individuals down routes inappropriate for their circumstances, such as bankruptcy.

Question 12 – are there any difficulties in collecting data on the size of debt contracts being negotiated and/or the amount of client money held (as the basis for our prudential standards)?

No view

Question 13 – are there other measures that would ensure our prudential regime for debt management firms targets the firms that pose the greatest risk to consumers?

As indicated at question 11, R3 believes that bonding would be a more effective alternative.

Question 14 – do you agree with our proposals that the new high-level conduct requirements should apply from 1 April 2014?

No view

Question 15 – do you agree with our proposed approach to financial promotions?

No view

Question 16 – are there provisions within industry codes that you think should be formally incorporated into FCA rules and guidance?

No view

Question 17 – do you agree with the different standards that we propose to apply to different types of debt advice?

The proposals suggest that where an advice provider both gives debt advice and identifies or recommends a particular debt solution for the borrower to enter into, the provider should be subject to comprehensive 'conduct of business' rules, incorporating parts of the OFT's debt management guidance. We welcome the FCA's proposals that in such instances, both profit-seeking and not-for-profit organisations providing debt counselling and/or debt adjusting should be subject to the same rules. However, as we have previously indicated, IPs are experts in personal and corporate insolvency and pre-insolvency advice and are highly regulated for both their pre-appointment and formal insolvency work. R3 therefore believes that they should be exempt from requiring authorisation for all of their debt-related activities. In R3's view, further regulation of this area of an IP's role by the FCA would be over-regulation and a disproportionate increase in red tape and regulation on a profession which is already regulated to a very high standard.

We would also reiterate our view that the term 'debt management firms' should not encompasses those IP firms which undertake IVAs as DMPs are informal procedures and are therefore fundamentally different to IVAs.

Question 18 – do you agree with our proposed approach to applying client asset rules to debt management firms?

No view

Question 19 – do you have any comments regarding our proposed approach to peer-to-peer platforms?

No view

Question 20 – do you agree with our proposed approach to authorised firms which outsource the tracing of debtors to third party tracing agents?

No view

Question 21 – do you have any comments regarding our proposed approach to supervision and regulatory reporting?

No view

Question 22 – do you have any comments regarding our proposed approach to enforcement?

No view

Question 23 – do you have any comments regarding our proposed approach to complaints and redress?

No view

Question 24 – do you have any comments on our proposed approach to tackling financial crime?

No view

Question 25 – do you have any comments on our proposed interim permission fees?

The fees set out for sole traders and other organisations appear to be reasonable.

Question 26 – do you agree with our proposed approach for the FOS general levy for firms with an interim permission?

No view

Question 27 – do you agree with our market failure analysis?

No view

Question 28 – do you agree with the costs and benefits identified?

No view

Question 29 – do you have any comments regarding our proposed approach to second charge lending?

No view

Question 30 – do you agree with our initial assessment of the impacts of our proposals on the protected groups? Are there any others we should consider?

No view

We would be happy to discuss any of the points raised in this response in greater detail if it would be of assistance

R3, Association of Business Recovery Professionals
1st May 2013