

# **Debt management guidance compliance review**

November 2003

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# 1 EXECUTIVE SUMMARY

- 1.1 The purpose of this document is to report on the compliance review of *Debt management guidance* for credit licensees (published December 2001). The compliance review is the first of its kind that the OFT has carried out.
- 1.2 The purpose of the guidance was to set minimum standards to be met by fee charging debt management companies (DMCs) if they are to be judged fit to hold a consumer credit licence. By clarifying the issues we consider in relation to fitness in this area, DMCs would:
- understand what behaviour we expect of them; and
  - comply with the guidance or be subject to speedy enforcement action under the Consumer Credit Act 1974 (the Act).
- 1.3 The compliance review was launched on 26 September 2002. Its purpose was to enable OFT to check how effective our guidance has been in removing problems from the market and identify where further action is needed.
- 1.4 When the guidance was issued in December 2001 we warned that we would take action against any DMC that did not comply with the guidance. We repeated this message at the time the compliance review was launched.
- 1.5 The main finding of the review is that the guidance has led to a significant reduction in consumer complaints – a 70 per cent reduction in complaints received by OFT. This is good evidence that the guidance has been successful in reducing consumer detriment in the debt management sector. The review has also enabled us to identify a substantial number of smaller DMCs. The guidance has been distributed to these companies.
- 1.6 Our monitoring of advertising in newspapers and on the Internet has revealed that while there has been a general improvement in advertising, a number of advertisements contain breaches of the guidance. In these cases we have been and are continuing actively to seek full compliance through advice, and where appropriate, warnings. Those who have responded so far have on the whole viewed our advice positively and are making the necessary alterations to ensure compliance. Some new problems have also emerged, eg lack of clarity about the nature of the services being offered. We are considering the scope for additional guidance on this problem.

- 1.7 As a direct result of the review we have identified a number of licensees where evidence has cast doubt on their fitness to hold a licence. Investigations continue and further enforcement action is likely to follow.
- 1.8 We would like to thank all those who have contributed to the review, including Citizens Advice, Advice UK, Money Advice Scotland (MAS), and the consumers, companies and other organisations who have provided us with complaint information, or have provided feedback on the effect of the guidance. We also thank the Consumers Association for providing us with information it had collected prior to its publication of the *Which?* Report on Debt Management Companies, and the Scrutiny of Advertising Group (ScrAG) which has provided information on debt management advertising. A list of participants and respondents to the review is at Annexe A.

## 2 INTRODUCTION

- 2.1 All those who provide debt management services, whether they charge a fee or not, are required to be licensed under the Act. The OFT has a duty under the Act to ensure that applicants for licences are fit to engage in the activities for which they wish to be licensed, and to monitor the fitness of those to whom licences have been granted.
- 2.2 The debt management guidance, which was issued in December 2001, was identified as a priority for guidance following representations to the OFT from a range of bodies including lenders, trade bodies, and consumer organisations. Particular concerns were expressed about the way in which the services were advertised. During consultation with the industry and advice community further concerns emerged about a number of matters including a lack of transparency over the nature and cost of the services provided, the quality of advice and information given to the consumer and the handling of client money.
- 2.3 The guidance sets down minimum standards that the OFT expects of fee charging DMCs. Companies were warned that they could lose their consumer credit licence, which they need to operate, if they did not comply with it.
- 2.4 The principles that underlie the DMC guidance, e.g. the need for transparency about the service that is being provided, have a wider application. In our view they apply equally to those who provide advice and a similar range of negotiation and payment services for no direct charge to the 'free sector'. They are also relevant to credit repair services or advice and assistance with individual voluntary arrangements (IVAs) or personal bankruptcy.
- 2.5 In April 2002 we supplemented the DMC guidance by issuing a commentary on its application to the free sector. Both sets of guidance can be downloaded from the publications section of the OFT website at [www.oft.gov.uk](http://www.oft.gov.uk). (It can also be ordered by telephoning 0870 60 60 321 and quoting reference OFT 366).
- 2.6 The guidance also sets out views on some fitness issues that have arisen in relation to the conduct of lenders, creditors and credit brokers in their dealings with DMCs, for example creditors having a blanket policy of refusing to enter into negotiations with DMCs, or refusing to accept payments sent by DMCs on behalf of consumers. We made it clear in our guidance that where a consumer appoints a representative to negotiate on their behalf it is an unfair and

improper business practice on the part of the creditor to operate a policy, without reason, of refusing to consider such requests.

- 2.7 The purpose of the compliance review has been limited to checking whether fee charging DMCs are complying with minimum standards on dealing fairly and openly with customers. The review has not attempted to assess compliance by other organisations or individuals.

### **3 DEBT MANAGEMENT COMPANIES**

#### **What is a DMC?**

- 3.1 DMCs offer a service to individuals in debt for a payment. They provide advice to the consumer and negotiate with creditors on their behalf to set up a payment plan for the individual that typically involves a reduction in monthly payments and a freeze on interest charges. The individual consumer makes one payment to the DMC, which is then distributed to each creditor. DMCs do not usually act as lenders.
- 3.2 Most DMCs charge a percentage of the monthly payments as a fee. Others charge a percentage of the monthly saving. In addition, the entire first month's payment may be kept as a deposit or a charge for setting up the payment plan. Some DMCs offer a refund of the first payment when the individual has paid off their debt on the payment plan. Fees are usually taken from the monthly payment, before payments are distributed to creditors.
- 3.3 The OFT has no objection to DMCs charging for, or consumers choosing to pay for, debt management services. The consumers using these services will, however, often be vulnerable because of the nature of their financial problems and, almost by definition, have the least available financial resources. It is therefore, particularly important that the services provided by DMCs are carried out with due care, skill and fairness.

#### **Debt consolidation**

- 3.4 During the review it has become apparent that there is some confusion regarding debt management and debt consolidation. Debt consolidation is typically used as a means of seeking to manage a debt problem by using a new single loan to consolidate a number of existing debts. The existing creditors are paid the balance of the debt out of the loan amount. The provider of the consolidation loan becomes the new creditor. Such loans often take the form of a second mortgage and it is estimated that 60 per cent of second mortgages are for this purpose. Debt consolidation may, however, also take the form of unsecured loans or transferring credit card balances to a new provider. Where the consolidation loan attracts a lower rate of interest than the loans it replaces there are obvious advantages to the consumer. There are also potential risks if, for example, this involves a move from unsecured loans to a loan secured on property.

3.5 On 17 June 2003 the OFT launched a fact-finding study into the debt consolidation sector. The study is due to report early next year.

### **What alternatives are there for consumers seeking advice and help with debt matters?**

3.6 In addition to fee charging DMCs there are a range of advice and help services available to consumers for no charge. CAB – Citizens Advice/Citizens Advice Scotland, members of Northern Ireland Association of Citizens Advice Bureau, Advice UK (formerly the Federation of Information and Advice Centres, or FIAC), and some local authorities National Debtline. All provide free and confidential advice on debt. In 2002 over two million consumers sought debt advice from these organisations.

3.7 Consumer Credit Counselling Service (CCCS) and Payplan provide a full range of debt management services at no charge to the consumer. Funding is provided by the credit industry in the form of a levy on the money paid over to the creditor. In 2002 these two organisations assisted in excess of half a million consumers in debt.

3.8 Other options open to those with debt problems include IVAs and bankruptcy. In 2002, some 6,295 consumers with debt problems entered into IVAs and 24,292 bankruptcy orders were reported.<sup>1</sup>

### **Fee charging debt management services**

3.9 Fee charging debt management services are not a separate licensable activity under the consumer credit licensing regime but fall within the more general category of debt adjusting and debt counselling. There is no comprehensive information available about the scale of activity or number of businesses that provide these services. Around 8 or 9 larger established businesses are judged to account for at least 90 per cent of their business activity with a much longer tail of some 50 to 60 small and sole trader enterprises. Most of the larger DMCs belong to the Debt Managers Standards Association (DEMSA). We estimate that in recent years DMCs have provided services to something in excess of 100,000 individuals a year.

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<sup>1</sup> DTI Statistics and Analysis Directorate.

3.10 Fee-charging debt management services have grown rapidly since the mid 1990s. A number of factors have been identified as fuelling this growth:<sup>2</sup>

- increasing levels of indebtedness - over the last 10 years total consumer credit has increased in real terms from around £66bn to £168bn.<sup>3</sup> CABs report a near 50 per cent increase in consumer credit enquiries over a five year period
- funding constraints on the free debt advice sector resulting in an unmet need for money advice
- the lack of awareness of the existence of free money advice
- the ability for fee-charging DMCs to advertise their services.

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<sup>2</sup>'Fee or Free? The role of fee-charging debt advice companies in money advice provision' by Claire Whyley and Sharon Collard - Research funded by AdviceUK

<sup>3</sup> Bank of England statistical release 29 Oct 2003 'Lending to individuals'.

## 4 THE DEBT MANAGEMENT GUIDANCE

### Aims of guidance

- 4.1 The purpose of the guidance is to set out minimum standards to be met by DMCs if they are to be judged fit to hold a consumer credit licence. The guidance does not, however, set out a comprehensive checklist. Not all of its elements will apply to every DMC. It is not exhaustive and conduct or omissions not included in the guidance may be taken into account by the OFT in determining fitness. DMCs are expected to abide by the spirit as well as the letter of the guidance.
- 4.2 Some of the practices highlighted in the guidance are clearly unfair or improper, for example, lack of transparency about the services to be provided. In those cases DMCs should have been aware even before the issue of the guidance of the risk of licensing action if they engaged in such practices or allowed their employees, agents, or associates to do so. In other cases the position might have been less clear, and the guidance is intended to be helpful in outlining the kinds of business practice to which the OFT is likely to object.
- 4.3 The key requirements of the guidance are:
- advertisements and marketing must be accurate, clear and not misleading. Any reference to 'savings' on repayments must make it equally clear that debt rescheduling will usually lead to an increase in the size of the sum to be repaid, the period of repayment and may potentially affect the consumer's credit record
  - no cold calling by personal visit
  - consumers must be given adequate information before entering into an agreement. Contracts should specify the nature of the services provided, total cost to the consumer, amount to be repaid and duration of the contract. Contract terms should be fair, legible and in plain language
  - a realistic assessment of the customer's financial circumstances must be made before advice is given, including verification of income and regular outgoings. Any advice must be given in the best interests of consumers

- DMCs must inform clients of the outcome of negotiations with creditors, as well as any developments with creditors such as the issue of default notices or the threat of legal action
- payments from consumers should normally be passed on to creditors within five working days of receipt of cleared funds.

## 5 THE COMPLIANCE REVIEW

- 5.1 Although the guidance applied to the market as soon as it was published, it was decided not to conduct a formal compliance review until DMCs had time to implement all the practical changes needed to meet the detailed requirements. During the period between the publication of the guidance and the compliance review the OFT did, however, monitor reaction to the guidance through contacts with the advice and trading standards community and by responding to queries from DMCs questions about the interpretation and application of the guidance.
- 5.2 From October 2002 to March 2003 we conducted trawls of newspaper and TV advertising to formally review compliance. In all 32 printed advertisements in four national newspapers were identified and reviewed as well as TV advertisements for four DMCs. During this period monthly internet sweeps of DMC web sites were conducted. Throughout this process 61 web sites were identified and monitored.
- 5.3 In order to assess compliance with other elements of the guidance we gathered information from a number of sources including consumers and providers of free debt advice and trade associations. To facilitate the collection of complaint information a standard complaint form was produced for consumers and organisations.
- 5.4 The OFT does not at present have the power to require information from licensed DMCs for the purpose of reviewing compliance with guidance. Standard compliance questionnaires were sent to DMCs to gather information on a voluntary basis and reminders used where a response was not received. In view of the voluntary nature of this aspect of the compliance review it was structured so that responses were, as far as possible, not critical to the outcome.
- 5.5 The compliance questionnaires sought information about the business activity of DMCs, and the impact of the guidance on the way the business is operated and any aspects which require further clarification.

5.6 Although in numerical terms the response rate to the DMC questionnaires was low the responses account for about 90 per cent of DMC activity. The market leaders are included in the 11 responses we received of a total of 67 questionnaires issued. Some of those we approached have told us that they no longer carry out debt management activity. Where a response has not been received we have informed the relevant TSD and asked them to alert us to any emerging problems with these businesses. We also have close contact with advice agencies which also enables us to identify businesses causing consumer detriment.

## 6 REVIEW FINDINGS

### Overview

- 6.1 Our main finding is a 70 per cent reduction in the number of consumer complaints we have received since the guidance was issued. Citizens Advice has also reported a significant decline, which supports this finding. In this respect we, and the advice agencies we consulted, regard the guidance as being successful in its primary objective of reducing consumer detriment.
- 6.2 The review has identified areas of the guidance that are being breached and some new and emerging problems. Most of the breaches we have found relate to advertising, marketing and promotion. We have found several cases where the OFT's name has been used in an inappropriate way to support advertising. We have warned companies to amend their advertising accordingly and have generally received a good response to this action. We shall remain vigilant in this area to ensure continuing compliance with this guidance.
- 6.3 In addition we have found that a number of advertisements do not make it clear what service they are offering. This arose in the context of advertisements for IVAs and debt management services. This is a new problem and has also recently been highlighted in another review of advertising in this market.<sup>4</sup> We are considering the scope for further guidance on this issue.
- 6.4 The review has provided us with valuable information on new and emerging activities in the industry where there may be problems if there is a lack of transparency, for example the provision of ancillary services such as client bank accounts and payment protection insurance. We are also considering the scope for further guidance on these points.

### Complaints

- 6.5 The level of complaints received by the OFT about fee charging DMCs has fallen by 70 per cent since the publication of the guidance. Advice agencies also report a significant reduction in complaints about these businesses.

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<sup>4</sup>Against our Interests: Illegal advertising in the consumer credit sector' – October 2003 Consumer Credit Counselling Service

	Mar 01-Dec 01 (10 months)	Oct 02-July 03 (10 months)	% Reduction
Complaints received	217	65	70

6.6 Around half of the complaints received concerned DMC services engaged before the guidance was issued. Experience has shown that some of the issues that lead to complaints do not surface until the contract has been underway for months or even years. For example the full cost of the service and its impact on the speed with which the outstanding debts are being paid off may not be recognised until the contract has been underway for some time. The elements of the guidance which concern the conduct of the DMC in its continuing relationship with the consumer apply in these cases. These include the requirement to act in the best interests of the consumer, keeping individual circumstances under review and consumers informed of developments and responding to consumer complaints.

### **Advertising – general**

6.7 The review found that the main area where DMCs are not fully compliant with the guidance relates to advertising of services. There has been some improvement, for example we have found very few examples of advertisements that state or imply that the service will free the consumer of the need to meet their debts. This was a particular concern at the time the guidance was issued.

6.8 The most common part of the guidance being breached is the requirement to provide information which consumers need to be aware of, for example the effect the debt management plan might have on the amount to be repaid, period of repayment and credit rating. These problems came to light in the review as a result of the direct monitoring of advertisements. Few direct complaints were received from consumers - probably because consumers are generally unaware of the requirements the guidance imposes on DMCs.

6.9 The key breaches<sup>5</sup> identified relate to parts of the Marketing, Promotion and Advertisements section of the Guidance (clause 18) which require that advertising and other forms of marketing and promotion by DMCs should not:

- include or emphasise statements about the savings to be made by rescheduling debts (for example by means of a reduction in monthly

<sup>5</sup> CCCS report identified similar breaches.

payments) without, for example, making it equally clear where there may be an increase in the sum to be repaid or the period of repayment

- fail to include warnings and caveats as required by the guidance
- claim or imply that the DMC can guarantee an outcome favourable to the consumer in negotiations with creditors.

6.10 In these cases we have been and are continuing actively to seek full compliance through advisory letters and, where appropriate, warnings or formal action. Those who have so far responded have on the whole viewed our advice positively and have confirmed that they have or are making the necessary alterations to ensure compliance. A further targeted review of advertising will be undertaken in the new year.

### **Internet advertising**

6.11 On the whole, the 61 websites reviewed provide most of the information required by the guidance. For example, they provide information about debt management plans and how they operate; the fees payable; and consequences of entering a debt management programme. In some cases this information could be more prominently displayed or made more accessible to the consumer. For example, where this information is in the 'frequently asked questions' it may be overlooked and it would be more desirable to have it set out in the main body of the website. Accessibility has, however, to be considered in relation to other features of the site and it is not appropriate to make hard and fast rules on this issue. The presentation of the information has to be judged in its circumstances.

6.12 In addition, we found that some DMCs are now providing access to their terms and conditions of trading on their websites.

6.13 Although the areas of compliance with the guidance were welcome our review identified problems – 85 per cent of the websites (53 out of 61) included at least one breach. Examples of the common breaches are failing:

- to provide warnings about the likely effect on credit rating
- to accompany claims about reducing monthly out-goings with balancing statements about the likely consequent increase in payment period and amount to be repaid.

## **Newspaper advertising**

- 6.14 The monitoring of newspaper advertisements was targeted on the tabloid newspapers as DMC advertisements are more common in these. The newspapers trawled were the *Sun*, the *Mirror*, the *Express* and the *Star*. We analysed in excess of 32 different advertisements in relation to 24 DMCs.
- 6.15 We found that 15 out of 24 DMCs provided very little information about the service on offer, but gave a telephone number to contact for further information. Generally these advertisements were compliant.
- 6.16 Nine out of 24 were more specific by claiming to be able to either provide a saving or write off a percentage of debt, but did not adequately explain how this would be achieved. They did not include warnings about fees payable, extension of the repayment period, increase in the amount to be repaid and effect on credit rating. As such they were not compliant with the guidance.

## **TV advertising**

- 6.17 Cable and terrestrial TV were reviewed regularly during the period October 2002 and March 2003 and around 80 hours of footage were viewed. We found advertisement for four DMCs including regular advertisements for the largest company. Three out of the four provided very little information, merely directing people to contact telephone numbers and/or website addresses. One provided more information, including warnings at the foot of the screen. In general these advertisements were compliant.

## **Compliance questionnaires**

- 6.18 The compliance questionnaire responses from DMCs suggest that these companies have changed a number of administrative procedures and working practices to provide greater transparency in the way they provide their services, and to ensure compliance with the guidance. One DMC has commented that the initial consultation with the client is now more focused on client need and the provision of appropriate solutions rather than exclusively debt management services. Another now informs potential clients in writing of the total cost of using the service based on the assumption that the programme will be used until the debt is discharged in its entirety.

6.19 Overall the consensus was that our guidance has been a helpful tool in setting out minimum standards OFT expects from DMCs. DMCs commented that the guidance:

- provided a framework for fair practice and provided an opportunity to review their own procedures
- had a positive effect on relationships with creditors
- was helpful in advising clients and provided clarity
- promoted transparency
- was a useful training tool.

6.20 Responses from the free sector as well as trading standards indicated that the guidance was a useful document for the following reasons:

- it provided information to include in client information packs
- all the information is in one document outlining what procedures are appropriate
- the guidance is a useful tool to send or quote to complainants.

6.21 A trading standards department with a high concentration of DMCs in their area has reported that they have found the guidance a useful tool in approaching problem companies. It has been reported that the guidance has led to an improvement in the relationship between DMCs and creditors.

6.22 Among the responses we received from trade associations, the general view is that the guidance clarifies:

- the position of DMCs and how they operate
- how the OFT views the way lenders should relate to DMCs.

### **Enforcement action**

6.23 As a direct result of the review we have identified a number of licensees where their fitness to continue to hold their licences has been called into question.

## **New DMCs**

- 6.24 Throughout the review we have identified and are continuing to identify a significant number of smaller DMCs that we were not previously aware of. As a result we have been able to distribute the guidance to a larger proportion of the debt management industry. For many of these companies, the guidance may be relatively new. We will continue to check on their compliance with the guidance.

## 7 CONCLUSION

- 7.1 The review has been the first of its kind that the OFT has carried out. It has been useful in providing a precedent for future reviews of guidance. The main and most encouraging finding is the 70 per cent reduction in consumer complaints that are being made about DMCs. We believe the guidance has contributed significantly to this reduction. We have found that DMCs are generally more transparent about the services they provide than they were pre-guidance and have changed procedures and practices in order to comply. Trading standards services have also reported an improvement in relations with DMCs and compliance with the guidance.
- 7.2 The review has highlighted the need for us to consider expansion and amplification of the guidance, specifically in the section that deals with advertising, marketing and promotion.
- 7.3 We shall continue to seek full compliance from DMCs who are breaching the guidance in respect of advertising and will monitor this sector of the credit market in accordance with the OFT's duty under the Consumer Credit Act 1974.
- 7.4 More generally the review has demonstrated that the use of guidance can be an effective pro-active approach to ensuring that those who are issued with a consumer credit licence conduct their business in a 'fit' way.
- 7.5 A review of the Consumer Credit Act was announced by the DTI in 2001. The OFT has welcomed the opportunity to modernise the Act and have contributed our views in response to a series of consultation papers on different aspects of the proposals. Among other things we have urged the DTI to give us better investigation powers to require licence holders to provide information, where at present we can only do this with applicants for licences. This would enable us to carry out more pro-active investigations into licence holders who are suspected of causing widespread consumer detriment. This would also make it easier to carry out future compliance checks on businesses to which guidance has been issued.

# ANNEXE

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## A RESPONDENTS TO THE COMPLIANCE REVIEW

### Trade associations

1. Consumer Credit Association
2. Debt Managers Standards Association
3. Consumer Credit Trade Association
4. Credit Services Association

### Free advice sector and trading standards

5. Dumfries and Galloway Citizens Advice Bureau
6. Fife Trading Standards Service
7. West Dumbarton Trading Standards Department
8. Aberdeen City Council
9. Birmingham Settlement
10. National Debtline
11. Citizens Advice
12. Advice UK
13. Consumer Credit Counselling Service

### Debt managers

14. Baines & Ernst Limited
15. APEX Debt Counselling & Management Limited
16. Debt Management Associates Limited
17. Debt Restructuring Services Limited
18. Gregory Pennington Limited
19. Chiltern (UK) Limited
20. Harrington Brooks (Accountants) Limited
21. DebtAid Limited
22. Langley & Partners
23. Chase Saunders Limited
24. Gemstone Financial Services Limited