StepChange Debt Charity response to Insolvency Service call for evidence: Review of the personal insolvency framework

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StepChange Debt Charity London Office
Floor 3, 27 Queen Anne's Gate, London SW1H 9BU
Policy contacts: ed.mcdonagh@stepchange.org

Introduction

StepChange Debt Charity is the largest specialist debt advice charity operating across the UK. In 2021, 500,000 people contacted us for advice and information on problem debt.

Question 1: What should be the fundamental purpose of the personal insolvency framework? Does the current framework meet that purpose?

The purpose of the personal insolvency framework should be to ensure that everyone who needs it can access effective debt relief that delivers good long-term outcomes. Key outcomes include:

- relief from unaffordable debt repayments;
- relief from collections and enforcement action and spiralling interest and charges;
- improved health and wellbeing (with the latter returning towards national average scores);
- regaining budget stability; and
- building financial resilience and being able to plan for the future.

The current mix of insolvency solutions can work well and provide a safe route out of problem debt. However, the current framework also falls short in a number of respects:

Access to appropriate insolvency solutions is limited by low awareness and the stigma associated with financial difficulty and insolvency.

Recent StepChange client research highlighted a number of significant barriers that prevent people seeking help to deal with their debts, including embarrassment and uncertainty about outcomes. Clients told us that ‘legalistic’ terminology created fear and discouraged engagement.[1] StepChange clients made similar comments in a survey for this call for evidence. We are concerned that worries about stigma and uncertain outcomes are preventing people from taking up appropriate insolvency solutions where this is in their best interest. This perception of stigma stems at least in part from the assumption that a key role of insolvency is to discipline ‘reckless’ consumer behaviour, despite little evidence that irresponsibility is the primary driver of need for insolvency. Indeed, there is growing evidence

[1] StepChange Debt Charity and Amplifi (2022) *Mixed Messages: Why communications to people in financial difficulty need to offer a clearer, better route to help*

that debt problems are most often driven by underlying financial vulnerability, life events and vulnerable situations including poor mental health and addiction.

The route to an appropriate insolvency solution for financially vulnerable people is not consistently safe.

There is not currently a common advice requirement for people seeking to enter a personal insolvency or other statutory solution. There are well-reported concerns about online promotions for Individual Voluntary Agreements (IVAs), the quality of advice from some intermediaries (debt packagers) and insolvency services providers, and the poor incentives created by the present IVA fee structure. These problems have contributed to an insolvency landscape distorted towards IVAs at the cost of more appropriate solutions and good outcomes for financially vulnerable consumers. Our answer to question 17 highlights variable awareness of different debt solutions among StepChange clients before seeking advice.

There are gaps and discontinuities in the insolvency framework.

Across the three personal insolvency procedures there are discrepancies in the treatment of income, assets and changing circumstances. It is not clear why different solutions require income payments to be made over different periods, nor why the assets of homeowners with low incomes should be treated differently across IVAs and bankruptcy. (Here we also note the inconsistent treatment of pension assets for those unable to repay their debts pre- and post-insolvency.) A small change in circumstances in the DRO moratorium period can terminate the solution, while quite large variations can be accommodated in IVAs. While there are circumstances where a person may need to move from one insolvency solution to another (such as a change in circumstances), it is difficult or even impossible to move between insolvency solutions in a way that preserves continuity of protection and consumer outcomes. These issues make it harder to map insolvency solutions onto need, creates cliff edges between solutions and incentivise consumers to risk a solution that may not be sustainable.

The impacts of insolvency can be disproportionately punitive.

Insolvency solutions have long-lasting effects through credit reporting, loss of assets, restrictions on budgeting and credit access, and the public register. All of these effects have social consequences and costs that are not sufficiently factored into the design of the insolvency framework. This includes, for example, contributing to stigma and incentives for consumers to avoid accessing insolvency when it is an appropriate route to address problem debt. The consequences of insolvency are particularly problematic in light of the housing challenges faced by financially vulnerable households, where negative credit reporting or losing a home held as an asset makes it more likely people will experience housing insecurity and/or quality problems, particularly in the private rented sector.[2]

The insolvency framework has not kept pace with the changing social and financial services landscape.

The need for, and role of, insolvency must be understood in the context in which unaffordable debt is accumulated. A substantial body of evidence points to a combination of low financial resilience, driven by structural factors including the precarity of household incomes and the high cost of essentials, and life events such as unemployment and illness as the primary drivers of problem debt.

These factors mean that vulnerability to problem debt closely reflects structural inequalities. Notably, women are significantly more likely than men to access debt advice or an insolvency solution, while vulnerability to debt problems also reflects wider factors such as care responsibilities or types of social exclusion more likely to be experienced by those who belong to an ethnic minority.

A majority of StepChange clients have a vulnerability in addition to financial difficulty, such as a mental health problem, reflecting the close relationship between financial difficulty and health and wellbeing. An increasing body of evidence points to the pressures and behavioural bias to which consumers in difficulty are subject.[3] Our research highlights how this can result in people using credit as a safety net to keep up with essentials and existing credit commitments, which creates further harm and leaves people more likely to end up in problem debt.[4]

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[2] StepChange Debt Charity (2018) *Locked out: Examining the impact of problem debt on people's housing situations*
[3] Financial Conduct Authority (2013) *Occasional Paper No. 1: Applying behavioural economics at the Financial Conduct Authority*
[4] See StepChange Debt Charity (2019) *Life happens: Understanding financial resilience in a world of uncertainty* and StepChange Debt Charity (2022) *Falling behind to keep up: The credit safety net and problem debt*

Poor lending decisions, product design and forbearance practices by creditors can all contribute to financial difficulties. The Financial Conduct Authority (FCA) has intervened repeatedly in recent years in the consumer credit market to address systemic failures of product design and firm conduct, most recently through the new Consumer Duty. Recent research commissioned by the FCA shows that the extent and effectiveness of creditor support for those struggling with debt repayments is variable.[5] Even where firms know (or should know) consumers are struggling, those consumers often do not receive the effective early support they need to prevent their problems getting worse.

There are a number of specific problems with individual insolvency solutions.

Debt Relief Orders (DROs) are not meeting the needs of the group they seek to serve well enough:

- The DRO fee is prohibitively expensive, so people who would benefit from a DRO are unable to access this solution, or experience delays because they cannot afford the fee. In 2021, almost half of StepChange clients suitable for a DRO had a negative budget, illustrating the barrier any upfront fee represents.
- Eligibility criteria are too restrictive; in particular, the maximum £2,000 car value is too low to be a practical option for many households.
- Inflexibilities such as the limited scope to increase income while maintaining the solution lead to DROs failing and may discourage people from taking steps to improve their financial situation such as increasing their income from work.
- DROs are designed for financially vulnerable people who are not always able to remain debt-free. It is not clear why DROs should have a rule restricting a subsequent DRO within six years when bankruptcy does not.

The number of people in financial difficulty applying for bankruptcy has fallen hugely over the last decade or so. Bankruptcy appears to be in terminal decline as a mainstream individual insolvency solution despite its potential to help many to a fresh start without the risks, costs and difficulties associated with the IVA market. In addition to the 'push factor' of the commercial IVA market:

- Bankruptcy fees are unrealistically high with no means-tested reduction for those 'priced out' of the solution.

[5] Yonder Consulting (2022) *Borrowers in Financial Difficulty*

- Bankruptcy is not attractive for many because the treatment of housing assets means that accessing the solution would carry unacceptable consequences like the risk of housing insecurity. The contrasting flexibility in the treatment of assets in IVAs creates a bias towards the latter, even if it is less suitable and carries the risk of not delivering debt relief and a fresh start.

In addition to mis-selling risks, further aspects of IVAs are not working well:

- When an IVA fails early, repayments largely offset IP fees rather than debt, leaving consumers worse off than if they had not accessed the solution.
- When an IVA fails, those leaving commercial solutions are often not well-supported through advice and assistance, and may not have sufficient resources to meet the fee of an alternative solution.
- When someone with an IVA can no longer make repayments, the treatment of a closed IVA as completed by creditors is inconsistent.

A simpler and better joined-up personal insolvency framework

The problems we have outlined mean too many people struggling with debt do not access a sustainable solution, or access a solution and do not have a good outcome. These weaknesses of the insolvency framework contribute to the high social cost of problem debt.

This review should seek to surface the common public policy objectives underpinning the personal insolvency landscape and address the sometimes inconsistent and unhelpful features and objectives embedded in current insolvency solutions and procedures.

In the short- to medium-term we would like to see the Insolvency Service prioritise a number of measures.

Alongside the proposed new regulator, the Insolvency Service should address high failure rates and poor client journeys in the IVA market:

- A fee structure in which fees are paid pro-rata over the course of an IVA and IPs only receive their full fee when an IVA completes, so repayments reduce debt earlier in the IVA and firms are incentivised to ensure agreements are viable and clients are supported throughout an agreement.
- A clear and consistent set of provisions around supporting IVA consumers to get debt relief when IVA payments have become unaffordable. This should include a policy intervention to clarify practice standards for treating an IVA as completed early on

funds paid (if IPs, creditors and agents do not move forward on this issue) to increase the number of people who do not unnecessarily need to re-enter a new debt solution. It should also include a clearer requirement for IPs to support people to transition to a DRO or bankruptcy where appropriate, including effective advice referrals and retaining funds to meet DRO or bankruptcy fees.

- The Insolvency Service should begin to publish firm level data on key metrics (such as termination rates) to increase transparency about provider practices and IVA outcomes across the market.

Access to insolvency should be improved and made safer and less stigmatised:

- People should be required to have FCA-regulated debt advice before they enter a personal insolvency solution.
- Bankruptcy and DRO application fees should removed for those receiving means tested benefits and/or those accessing solutions should be able to pay fees ‘as they go’ after entering a procedure.
- People should be allowed to access a DRO for a second time within six years (when they are not subject to a debt relief restriction order).
- The maximum value of a car within a DRO should be increased to at least £5,000.
- Thresholds across all insolvency agreements should be linked to an appropriate inflation index.
- Insolvency restrictions should be informed by a clearer and more informed view of vulnerability: in particular, the public insolvency register should be made a closed user register like that used for the Breathing Space scheme.
- The Insolvency Service should consider the branding of insolvency and ensure it is fit for purpose.

Flexibilities within DROs and bankruptcy should be increased:

- Missing or overlooked debts should be eligible to add to a DRO within the moratorium period.
- The Insolvency Service should consider how tenants with rent arrears can be better protected against the threat of eviction after entering insolvency, for instance by treating rent arrears payments as an allowable budget expense within a DRO application.
- The Government should review the treatment of housing and pension assets within insolvency to consider broader public policy aims that might outweigh maximising

returns to unsecured creditors such as preventing housing insecurity and homelessness, and future housing affordability.

More generally, the broader aim of this review should be a simpler and better joined-up personal insolvency framework to reflect a world with highly developed consumer credit markets and significant consumer financial vulnerability. This would require the Insolvency service to broaden the policy rationale for personal insolvency framework beyond the 'fresh start' and 'can pay, will pay' focus to a more holistic focus on outcomes. In turn, this would require simplifying the solution mix, rethinking discrepancies in treatment of income, assets and changing circumstances, and a more coherent approach to application fees and funding (including funding of scheme providers).

We would also like to see the Insolvency Service entrusted with a wider consumer protection mandate to ensure positive outcomes for those who seek to access insolvency solutions, intervening quickly when there is evidence of harm or malpractice. This would mean monitoring customer journeys into insolvency to ensure consistency, assessing where certain groups were not accessing the best solution for their needs and then tracking consumer outcomes for those who successfully complete insolvency or those who fall out of their solution.

As part of this mandate, the Insolvency Service should seek to continually improve the extent to which the insolvency framework supports and improves the financial resilience of those accessing procedures. It should particularly use its insight into need for debt relief for those with deficit budgets that cannot be met through insolvency, particularly those with deficit budgets, to help foster cross-government dialogue and inform wider public policy solutions for this group.

Question 2: If 'fresh start' and 'can pay, will pay' are the right objectives for the personal insolvency regime, does the current framework get the balance right?

'Fresh start' and 'can pay, will pay' are sensible objectives for the personal insolvency framework. However, these objectives can be interpreted and applied in different ways. They do not of themselves provide the insolvency framework with a clear purpose against which its performance can be assessed.

‘Fresh start’ implies that insolvency provides a route to relief from unmanageable debt. In practice, insolvency allows for debts to be written down or sometimes written off. But this is only one element of providing people struggling with debt with a fresh start. The manner in which debts have been accumulated has often had serious impacts not only on a client’s financial situation but their wider life, their family and social network, and their health and wellbeing. People often arrive at debt advice severely distressed by the burden of their debts. Moving forward from the experience of problem debt is not a simple matter of clearing debt, but of dealing with these wider impacts and seeking to rebuild financial resilience. As this consultation further explores, insolvency solutions themselves are a process that can be burdensome and long running and are not consequence-free. The narrow nature in which ‘fresh start’ has been conceived affects the design of insolvency solutions and the support that exists around those solutions. For example, the credit reporting impact of insolvency takes little account of the imperative to provide a route to a fresh start.

The concept of ‘can pay, will pay’ is far from unproblematic. The aim of maximising returns for creditors should be tempered by an understanding of the context in which debts were incurred and the individual and wider societal costs of repayment. Our surveys repeatedly suggest high numbers of StepChange advice clients have experienced at least some degree of unaffordable lending that has contributed to their debt problems or ineffective support from creditors after financial difficulty has emerged that has extended and/or deepened their experience of problem debt. For instance, a recent survey of StepChange clients research found almost a quarter of respondents saying that they had responded to creditor communications by borrowing more money to deal with payment requests. Almost 40% of these were vulnerable consumers who said they had not sought debt advice earlier because they were “not in a fit state” to help themselves.[6] In seeking to maximise returns for creditors, the insolvency framework pays too little attention to the action of creditors that contribute to unmanageable debt, the nature and behavioural dynamics of financial difficulty (particularly in relation to mental health) or the outcomes for consumers who go through insolvency.

The ‘can pay, will pay’ framework also tends to overlook the needs of people who have a budget deficit and typically cannot be recommended an insolvency procedure (or other formal solution). Outcomes for this group are often poor because, while they can benefit from budgeting advice support dealing with priority and non-priority debts, they do not have

[6] StepChange Debt Charity and Amplifi (2022) *Mixed Messages*

access to a means of resolving debt problems and are left in limbo without a meaningful fresh start. Good public policy solutions for this group are hard because the underlying problem is most often that of a low income. However, the needs of this group for debt relief are being given insufficient attention.

While 'fresh start' and 'can pay, will pay' are sensible objectives for the insolvency framework, a better balance can be achieved by linking the former to the aim of achieving good outcomes for those accessing insolvency procedures. Here we note the new FCA Consumer Duty gives an example of an alternative regulatory approach that balances creditor returns against a broader frame of good consumer outcomes.

Question 3: Please provide any evidence to show how well the objectives of 'fresh start' and 'can pay, will pay' are being met.

StepChange conducts research tracking client outcomes following debt advice, which provides evidence as to how well the objective of 'fresh start' is being met.[7]

Our *Theory of Change* lists the following outcomes we hope to see in clients after debt advice:

- Continued improvement to wellbeing
- Increased confidence
- Continued budget stability
- Building financial resilience
- Planning for financial future

Outcomes for those who take up an insolvency solution are, on average, significantly better than those who do not.[8] For example, three months after debt advice:

- 67% of those taking up an insolvency solution say their debt is completely sorted out or that they have made 'a lot' progress compared to 12% of those who do not take up a solution;

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[7] StepChange Debt Charity (2019) *Measuring Client Outcomes: Why debt advice matters*, StepChange Debt Charity (2020) *Paths to recovery: Understanding client outcomes 15 months after debt advice* and StepChange Debt Charity (2022) *Client outcomes during Covid 19: Understanding client outcomes during the Covid 19 pandemic*

[8] For the figures provided, we have compared those who took up an insolvency solution, or say they plan to, against those who took up no solution (that is, excluding temporary payment plans and debt management plans).

- 22% of those taking up an insolvency solution report they have fallen behind on household bills compared to 59% of those who do not take up a solution; and
- 12% of those taking up an insolvency solution report ongoing credit use compared to 33% of those who do not take up a solution.

These figures must be contextualised by the differences between these two groups: those who take up an insolvency solution typically have a positive budget while those unable to access a solution typically have a deficit budget. Those unable to take up a solution may also be affected by other factors, such as a lack of stability in finances, relationships or employment, which influence outcomes.

Evidence from our debt advice outcomes monitoring research also suggests the current insolvency solutions are reasonably effective in improving people's sense of wellbeing compared to people who say they have little or no chance of becoming debt free. The table below shows *life satisfaction* and other wellbeing scores for StepChange clients across the different insolvency solutions. (By comparison, people who said that their chances of becoming debt free is poor had an average life *satisfaction score* of 3.5 out of ten. Those who said they had no chance of becoming debt free had an average *life satisfaction score* of only 2.3.[9])

	Bankruptcy	DRO	IVA	UK Average
Overall, how satisfied are you with your life nowadays?	5.39	5.95	6.79	7.71
Overall, to what extent to you think the things you do in your life are worthwhile?	5.51	6.18	6.66	7.89
Overall, how happy did you feel yesterday?	5.31	5.76	6.96	7.55
Overall, how anxious did you feel yesterday? (Lower is better)	4.79	4.71	4.14	2.9

All of the insolvency solutions result in better wellbeing outcomes than reported by people saying they has little or no chance of becoming debt free. While this is encouraging, the outcomes data suggests that this does not quite amount to a fresh start. In all cases the wellbeing scores are still below national average wellbeing scores. It is noteworthy that people who said they had an excellent chance of becoming debt free had an average life satisfaction score of 7.1, higher than for any of the individual insolvency solutions.

[9] StepChange Debt Charity (2020) *Paths to recovery*

Our client data shows that 49% of clients recommended a DRO as a suitable debt solution had a negative budget at the time of advice. This was also true for 38% of people selecting bankruptcy as a suitable solution. The advice outcomes data highlights how clients with negative budgets and additional vulnerabilities at the time they received debt advice had much worse anxiety scores 15 months after advice (5.2 compared the national average score of 2.9). The ongoing financial vulnerability of DRO and bankruptcy clients is likely to contribute to these lower wellbeing scores, even though their debts may have been written off.

This might also explain why IVA clients show better wellbeing scores even though very few will have received debt relief after 15 months—IVA clients do not have negative budgets. However, wellbeing scores for IVA clients are still below the national average and the score of people saying they had an excellent chance of becoming debt free. This might reflect the uncertainties and risks inherent in IVAs. To inform this submission, we conducted a survey of StepChange clients: 28% of respondents who had taken up an IVA told us they found keeping up with repayments either difficult or very difficult. Comments from clients highted pressures from rising living costs and fairly tight Standard Financial Statement budget requirements:

> *“It's been difficult as cost of living had gone up so much .. so [I] had to cut down on food etc which has been difficult as I have a underlying medical condition and eating less has made me lose a stone and half in weight which is worrying.”*
>
> *“I have had to go without some basic needs as I can’t afford them” [because of the rising cost of living*
>
> *“Some months I had to go without or ask my sister to buy me food so I didn't miss a payment [because of] unforeseen expenses, car, things going wrong e.g. washing machine.”*
>
> *“In an IVA, you are in a strict situation. All of your money is accounted for so if something happens with your car, your pet or a household appliance, you have no funds to sort this out.”*

These comments show how an approach to ‘can pay, will pay’ that over-emphasises maximising returns to creditors affects the sustainability and beneficial consumer outcomes of solutions and undermines ‘fresh start’. In fact, there is evidence that people struggling with essentials are forced into treating debt solutions much like the credit agreements with which they have previously struggled in terms of coping strategies to keep up with payments (for example, by borrowing or going without essentials to keep up).

More generally, the design of solutions (for example, in the very narrow flexibility to accommodate changes of circumstances within DROs) also speaks to the way that concerns are tilted towards repayment over sustainability and good consumer outcomes. Our client survey found 25% of clients reporting that keeping up with a solution was very difficult, while 15% said they were not able to keep up with essential bills.

To address this imbalance, we would like to see the Insolvency Service put more emphasis on ensuring insolvency budgets support a reasonable standard of living and allow for greater flexibility to accommodate changes of circumstances.

Wider evidence from our survey of clients points to some further specific factors that can confound the aim of a ‘fresh start’. When asked what were the main negatives associated with their insolvency solution:

- 24% of the respondents to our client survey said feelings of stigma;
- 21% said the restrictions that were placed on them;
- 19% said debts not being completely written off; and
- 26% of clients had been contacted by creditors requesting repayments (and 12% of this group had agreed to make repayments to creditors).

While the majority of those who are able to access an insolvency solution see practical and wellbeing benefits, those benefits are not universally felt and are undermined by factors such as stigma, comparably low wellbeing (compared to the national average), difficulty sustaining repayments and continued creditor repayment pressures. Our outcomes data and client survey suggests that there is some way to go to meet the fresh start objective.

Question 4: Please explain whether there should be different objectives for different personal insolvency procedures.

We have argued in our responses above that public policy underpinning the framework of personal insolvency needs to be clearly and consistently focused on delivering good outcomes for people entering insolvency solutions. While this suggests a single set of policy objectives, the patchwork nature of the current personal insolvency landscape raises a number of different concerns and needs. For instance:

IVA conduct issues

The contractual nature of IVAs embeds significant default risks that fall on financially vulnerable consumers. The IVA market is dominated by highly commercialised volume providers who are not sufficiently incentivised by the fee structure or regulatory oversight to mitigate these risks to consumers. Solutions to concerns about problems in the IVA market could be resolved by a change in regulatory structure (as proposed by the Insolvency Service), but also by changes to the IVA product itself to better recognise the risks that IVA present to financially vulnerable consumers. ***Problems in the IVA market also suggest that the Insolvency Service needs to add a more specific consumer protection objective to its policy objectives for the personal insolvency landscape.***

Discrepancies in treatment of income, assets and changing circumstances

There are a number of discrepancies in the way that personal insolvency solutions treat key parameters like income, payments and assets. For instance, a small change in circumstances in the DRO moratorium period can terminate the solution, while quite large variations can be accommodated in IVAs. We have previously mentioned issues with the different treatment of assets like housing and pension wealth in different solutions at different times. It is also not clear why different solutions require income payments to be made over different periods.

The DRO repeat use restriction

It is not clear why DROs should have a rule restricting a subsequent DRO within six years when bankruptcy does not. Our client evidence presented above suggests that clients suitable for DROs are more likely to remain financially vulnerable after completing a DRO and are less able to find the higher bankruptcy fees should they need to enter an insolvency solution again. It is not clear what objective this DRO rule serves and we would urge the Insolvency Service to re-consider it.

Lack of common advice requirements and standards

There is not currently a common advice requirement for people seeking to enter a personal insolvency or other statutory solution. Breathing Space and the SDRP schemes require people to take advice from FCA-regulated debt advice providers (or debt advisers with a specific exemption). DROs require an application to be made through an approved intermediary while bankruptcy does not. IVAs can be delivered both by FCA-authorised debt advice providers and IVA providers or IPs taking advantage of the FSMA exemption.

This means there is not a common standard about the advice people should receive before entering a personal insolvency solution, and there is not a common regulatory standard for the advice that people get for some solutions. ***We would suggest that the quickest and most effective solution to this problem would be require people to have FCA regulated debt advice before they enter a personal insolvency solution.*** This would necessitate removing the current FSMA exemption for IPs and/or aligning regulatory oversight for IVA providers to FCA standards, sanctions and independent supervision.

A simpler and more joined up personal insolvency solution framework

There are several circumstances where a person may need to move from one insolvency solution to another, such as a change in circumstances in a DRO moratorium, or an IVA termination. However, it is difficult or even impossible to move between insolvency solutions in a way that preserves continuity of protection and consumer outcomes. A simpler and better joined up personal insolvency framework should be an aim of this review.

It is possible to imagine a restructuring of the debt personal insolvency solutions landscape where there was a single payment solution and a single debt relief solution, or perhaps even a single solution with different options depending on the applicant's circumstances to balance good consumer outcomes with a fair return for creditors. This would require rethinking some of the discrepancies in treatment of income, assets and changing circumstances in the current solution framework, which perhaps implies a different mechanism for case-by-case decision making on these issues. It would also require a different approach to application fees and funding (including funding of scheme providers).

All this in turn raises the need to review the basic policy underpinning of personal insolvency to better reflect a world with highly developed consumer credit markets and the ongoing financially vulnerability of a significant proportion of households. This should include fresh consideration of better protection for housing and pensions wealth and the affordability of income payments (especially with respect to meeting unpredictable or unexpected expenses) as key building blocks of financial resilience and reducing future debt vulnerability. This suggests the need for the Insolvency service to broaden the policy rationale for personal insolvency framework beyond a simple fresh start / can pay, will pay focus to a more holistic focus on outcomes.

Access is still a pressing concern

A key objective of the personal insolvency framework should be to ensure that everyone who needs the protection of an insolvency solution is able to access one. But that is not currently the case. Fees are a significant barrier to access, and here we note the discrepancy between DROs and bankruptcy, where the fee must be paid before an applicant can enter the scheme and IVAs, where a person can enter the scheme while paying provider fees as they go. As we note elsewhere, the Insolvency Service should consider reducing bankruptcy and DRO fees, including removing the DRO application fee for people on means tested benefits, and/or allowing people to pay bankruptcy and DRO 'as they go' after entering the scheme.

A stronger, clearer focus on vulnerability

We welcome the concern for aspects on consumer vulnerability shown in statutory debt solutions like Breathing Space, where a closed user register replaced the idea of an open public register. We would urge the insolvency service to consider a similar reform to turn the public insolvency register to a closed user register.

We would also urge the Insolvency Service to consider how prior creditor conduct can be better reflected in insolvency solutions. We highlighted above how consumers can be pushed into problem debt by 'safety net' borrowing driven in part by the quality of communication and support offered by creditors to people in earlier stages of financial difficulty. Poor lending decisions, product design and forbearance practices by creditors can all contribute to financial difficulties in a way that should question whether maximising returns to creditors is always in the public interest.

Likewise, the current use and positioning on bankruptcy and DRO restrictions is overly judgmental on people in financial difficulty and contributes to the stigma that holds people back form seeking help. As an example of this, the Insolvency Service bankruptcy and debt relief restrictions outcomes list shows a number of cases where the Insolvency Service has held 'gambling losses materially contributed' to a person's bankruptcy. However, a recent report by the Personal Finance Research Centre at Bristol University on the experiences of StepChange clients with gambling related debt highlights how mental health and addiction, poor practices of gambling service providers and poor consumer lending decisions all contributed to these debt problems.[10] We ask the Insolvency Service to re-consider the approach to bankruptcy and debt relief restriction to include a clearer and more informed view on vulnerability.

In summary, we believe this review should seek to surface the common public policy objectives underpinning the personal insolvency landscape and address the sometimes inconsistent and unhelpful features and objectives embedded in current insolvency solutions and procedures.

Question 5: Please consider whether there should be different options for trading and consumer debtors. If so, how would the features differ?

We have no response to this question at this time.

Question 6: How effective are the current safeguards (public records, public registers, restrictions, and sanctions on debtors) at protecting the integrity of the personal insolvency framework?

Please see our response to question 4 on public registers and sanctions.

While we do not have comment on the safeguards referred to in this question, we would highlight the lack of transparency regarding fees and completion rates in the IVA market prevents consumers from making an informed decision about which firms to use.

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[10] University of Bristol Personal Finance Research Centre (2022) *Exploring the links between gambling and problem debt*

We also note the IP 'reasonable contemplation' exemption from providing debt advice is out of date and has been used a loophole in the regulatory framework by large corporate IP firms. This has contributed to mis-selling of IVAs, high failure rates and consumer harm.

Question 7: To what extent does the current enforcement regime (BROs/DRROs and criminal sanctions) adequately achieve the aims of deterring future misconduct (both individual and general) and protecting the public?

We have no response to this question at this time.

Question 8: How, if at all, should the personal insolvency framework distinguish between honest/unfortunate and dishonest/reckless debtors?

The notion that those struggling with debt are 'honest' or 'dishonest', or 'unfortunate' or 'reckless', is problematic. We note elsewhere in this response evidence that speaks to the complex nature of problem debt (such as the interplay of mental health problems and financial difficulty), wider social drivers and the role of product design and financial services firms. In light of these factors it seems unlikely the concepts referred to in this question are a useful prism through which to consider questions of regulation and policy design.

Question 9: Are there any features of other regimes that would be beneficial to consider for England and Wales and how effective are these features? For example, debt counselling and rehabilitation programmes.

Excluding fee levels and funding (which we touch on elsewhere), there are two features from other regimes we think would be beneficial in England and Wales:

- In 2015, the Scottish Government introduced debt advice as a mandatory requirement in accessing any of Scotland's statutory debt solutions. FCA-regulated debt advice should similarly be a requirement of accessing insolvency solutions in England in Wales and, as we have noted, would particularly help address consumer detriment in the IVA market.
- The consultation document highlights the additional flexibility in Irish Debt Relief Notices compared to DROs, which allow for a positive change of circumstances

without revocation of the solution. This flexibility would seem likely to increase stability for financially vulnerable households that may experience a positive change of circumstances but benefit from the continued progress of an insolvency solution.

Question 10: Who should bear the costs of entering and administering personal insolvency procedures?

As we state in the introduction to our response, our starting point is the principle that everyone should be able to access appropriate insolvency solutions. Barriers to access due to unaffordable fees are undesirable and create wider social costs that offset the ‘full cost recovery’ principle. While it is reasonable for those who can afford to do so to contribute to the cost of administering insolvency solutions, we also see a strong public policy case for public funding to ensure that cost is not a barrier to access for those who cannot afford a fee.

At present, DROs and bankruptcy are often prohibitively expensive for heavily indebted individuals who have minimal disposable income, while the design of IVA fees, while not paid up-front, also restrict access (because there are weak incentives for IPs to set up an IVA if the fees they can are insufficiently high) and create incentives that contribute to poor conduct in the IVA market. We set out further below how we suggest costs should be distributed for each insolvency procedure taking into account the principle that everyone should be able to access appropriate insolvency solutions.

The consultation document notes (5.2) the current framework has evolved over time; this means that there is a weak relationship between fees and the objectives of the insolvency framework. Meeting the administrative costs of insolvency solutions should be understood in the wider context of the public benefits of insolvency and the public costs of unresolved problem debt. Policy makers should not take an unnecessarily narrow view of the scope to develop alternative approaches to funding the administration of insolvency solutions.

<u>Debt Relief Orders</u>

DROs were designed to address a gap in the insolvency landscape and offer an insolvency solution with lower administrative costs than bankruptcy in cases where individuals have minimal income or assets and bankruptcy would lead to limited returns for creditors. DROs are likely to result in large savings in public funding through preventing the ongoing social costs of problem debt. However, these savings have not resulted in affordable fees. With this in mind, we believe there is a strong public policy case for public funding to meet DRO fees.

Recent changes to DRO eligibility criteria reinforced the need to give more people with low-levels of assets and low income who are in problem debt access to a suitable and proportionate option for debt relief.[11] However, the £90 fee is a barrier to many seeking to access a DRO and StepChange advisers regularly complete applications with clients who then require four to five months to raise the fee.

Bankruptcy

For individuals with minimal (or no) disposable income, the bankruptcy fee of £680 is prohibitively expensive. For example, with a budget surplus of £51 it would take someone 13 months to raise the fee. Even with a surplus of £101 it would take over six months to raise the fee. One-third of StepChange clients have a budget deficit and are unable to raise the fee without unacceptable consequences for their ability to meet essential living costs. During the time in which these groups save towards the fee or are excluded from insolvency, costs can escalate and they may be subject to enforcement action.

The consultation document notes the current insolvency fee framework is designed to comply with the principles of Managing Public Money (5.2). The Principles of that guidance are clear, however, that there is scope for charging more or less than the full cost of recovery provided that ministers choose to do so and Parliament consents.[12]

Cross-subsidy is an established principle of the bankruptcy fee framework.[13] The present deposit framework makes no distinction between those who have sufficient assets to refund the deposit and those who do not. Nor does it distinguish between those who can afford to make the deposit and those who cannot—the key barrier to accessing bankruptcy. The charging framework acknowledges the imperative to reduce barriers to access. For example, in setting the present framework, ministers argued against full cost recovery for those without assets because it would prevent access to bankruptcy. We therefore consider that there is reasonable scope to further reduce the deposit charge for those who wish to make a petition for bankruptcy who do not have assets and cannot raise the deposit within a reasonable period and make payment more flexible through a 'pay as you go' approach.

Insolvency Voluntary Agreements

The IVA fee framework is contributing to bad commercial incentives for marketing, client acquisition and advice that lead people to pursue unaffordable IVAs; for example, the

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[11] The Insolvency Service (2021) *Debt Relief Orders: Consultation on changes to the monetary eligibility criteria*
[12] HM Treasury (2022) *Managing Public Money*, p. 40
[13] The Insolvency Proceedings (Fees) Order 2016 Impact Assessment

Insolvency Service found evidence of mis-selling in 2018, with budgets manipulated to put consumers onto IVAs when another solution would have been more appropriate.[14] As a result, people who have sought to resolve their debt problem find themselves in a worse position because of poor advice and questionable commercial practices.

There is substantial evidence of the harms caused by inappropriate IVAs. Over one in four IVAs registered in 2018 had terminated by the end of 2021.[15] When an IVA fails within the first few years, all or a significant proportion of repayments will have gone towards IP fees meaning consumers will have paid the cost for a solution for which they do not see the benefits. In many cases they are left in a worse position than they were at the outset. This has serious financial implication and wider negative impacts on health and wellbeing.

The fee structure of IVAs was designed for a lower volume market of small providers and, over time, has incentivised the growth of a significant commercial market in which that structure is no longer appropriate. Over 81,199 IVAs were registered last year, the largest single year figure on record and more than double the number registered in 2015. Regulatory arrangements have not provided adequate to ensure good conduct across this market; IVA fees remain central in creating the incentives that lead to poor practice.

At root, these problems occur because the current fee structure does not incentivise IVA firms to ensure IVAs are viable or provide the support to keep them on track when individuals begin having payment difficulties.

Question 11: How should the costs of entering and administering personal insolvency procedures be paid and structured between the different parties?

There are four changes to the present arrangements we would highlight:

- The prohibitive cost of access to DROs should be addressed. The proposition that a fee is necessary to prevent misuse simply does not square with the typical underlying financial vulnerability of applicants. One solution is therefore to end DRO fees entirely. In the scheme of the debt advice and insolvency funding landscape, this step would have significant benefits at a proportionate cost. We note below the alternative

[14] The Insolvency Service (2018) *Review of the monitoring and regulation of insolvency practitioners*
[15] The Insolvency Service (2022) Individual Voluntary Arrangements Outcomes and Providers 2021

option of maintaining the fee but working with government to provide access to grants for those unable to afford the fee.

- Bankruptcy deposits should be significantly reduced—we suggest to the same level or below the sequestration fee of £150 in Scotland—and this fee should be waived for those receiving means-tested social security payments.
- Alternatively, the Insolvency Service should explore the potential for DRO and bankruptcy fees to be paid on a 'pay as you go' basis within a procedure (excluding those who receive means-tested benefits).
- For IVAs, we propose a DMP-style fee structure in which fees are paid pro-rata over the course of an IVA and treated as part of the debt repaid. This means that an IP will only see the full benefit of an IVA if it successfully completes and those repaying debts would be at less risk of being 'out of pocket' if an IVA fails. This will significantly re-align the structure of an IVA in favour of those repaying debts and create incentives that should encourage more responsible IVA market conduct.

Reducing or waiving DRO fees and bankruptcy deposits raises a question about how the underlying administrative costs of insolvency should be funded. In the Woolard Review, the FCA acknowledged these problems suggesting there should be an effort to work with government on the provision of an emergency fund to cover the cost of the DRO application fee for people who cannot afford it.[16]

Question 12: What options are available to debtors and creditors who are unable to afford the cost of bankruptcy, IVA or a DRO?

There are limited options available to such debtors. For clients with deficit budgets unable to afford fees, StepChange attempts as far as possible to reduce or remove a client's budget deficit, access any grants and otherwise save towards a fee. More generally, StepChange seeks to provide effective, meaningful advice for these clients to help prevent similar difficulties from occurring in the future. StepChange's work to track client outcomes shows that this advice has meaningful wellbeing benefits for clients and can help reduce the harm of collections activity where the advice process prompts creditors to pause such activity.[17] However, where clients are unable to enter debt solutions there are limits to these benefits.

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[16] Financial Conduct Authority (2020) *The Woolard Review - A review of change and innovation in the unsecured credit market*, p. 7.

[17] StepChange Debt Charity (2019), StepChange Debt Charity (2020) and StepChange Debt Charity (2022)

Early findings from our evaluation of client experiences during the first year of the Breathing Space scheme show that protections from the harm caused by collections activity is a valuable outcome of the scheme.[18] For those who cannot afford the fee to enter an insolvency solution, such collections activity does not stop (either because they are ineligible to enter the Breathing Space scheme or exit the scheme without commencing a solution and activity resumes). The gap in the solutions landscape for those who cannot afford to make repayments is under-explored and should be a point of focus for the IS.

In 2021, StepChange conducted qualitative interviews with clients with negative budgets to better understand the challenges they faced.[19] A number of participants had been living with their debts for long periods (in one case over a decade) with little prospect of paying them off because they could not accept the consequences of bankruptcy. For example, one client noted:

> *"I've got a 14-year-old that lives with me and I have a mortgage on that property. To declare myself bankrupt I would have to forfeit my house [and] I would have nowhere to live, which would then mean my daughter having to go to a different school." (Male participant)*

Clients in this situation may continue to live with creditor actions such as persistent communications even after informing lenders they are unable to meet repayments. Participants expressed a wish for a solution to this impasse so that they did not continue to experience anxiety linked to unresolved debts and the pressure and distress caused by creditor actions.

Some clients may benefit from forbearance or debt write-off outside of insolvency agreements. However, there is limited data available on the extent of informal debt relief for those who are excluded from insolvency solutions and are unable to repay unsecured or priority debts. We hear examples of clients being asked to repay debts following years of silence from the original creditor, suggesting that debtors can live with considerable uncertainty about their situation. The lack of good options for those who cannot afford fees reinforces the importance of rethinking fee levels (and other access criteria).

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[18] StepChange Debt Charity (2022) *One year of Breathing Space: Initial findings from StepChange*
[19] StepChange Debt Charity (2022) *Making ends meet: insights from debt advice clients*

Question 13: What are the main consequential costs of the different insolvency procedures?

Insolvency solutions are far from consequence-free:

- Mandatory repayments restrict spending for the duration of the procedure. Comparisons of the Standard Financial Statement maximum budget item thresholds and the Minimum Income Standard suggest that insolvency budgets provide less in some areas than the public would generally consider a minimum amount on which to live.[20]
- Limits on access to credit (the £500 limit on access in an IVA and requirement to disclose if borrowing above this amount in a DRO or bankruptcy) may constrain the ability of households to manage fluctuating expenses. Proportionate restrictions on access to credit are sensible during an insolvency procedure, not least because access is more likely to be restricted to high cost credit options, but the £500 figure is not pro-rated (equivalised) for household size, which could cause problems for those responsible for a higher than average number of dependents.
- While evidence suggests there are wellbeing benefits for most people in addressing problem debt through an insolvency procedure or otherwise, there remains a stigma attached to insolvency that can undermine wellbeing, health and confidence. Feelings of embarrassment and shame are a constant theme of the qualitative feedback we receive in our research with StepChange clients.[21] This is likely to be particularly acute for those who enter bankruptcy or access a DRO and are placed on a public register.
- Significant demand for repeat debt advice (excluding planned annual checks and changes of circumstances) arises from the ambiguous situation in which those struggling with problem debt and unable to access a debt solution are left. Such clients, typically those with deficit budgets, inherently tend to be in more uncertain and unstable situations. As their situation changes or more challenges arise, such as new arrears or renewed collections pressures, they need fresh debt advice. While repeat advice provides a benefit to such clients, it impacts the capacity of advice providers to

[20] Internal StepChange calculations.
[21] For example, see StepChange Debt Charity (2022) *Mixed messages*

meet demand for advice. Wider access to solutions for this group would benefit the capacity of the advice sector to meet demand.

Question 14: How can we reduce the stigma of insolvency to both encourage early action by those in financial difficulty and to support a 'fresh start' from debt relief?

We have highlighted in Q1 our recommendations to develop the insolvency framework to achieve better consumer outcomes. This includes making changes such as limiting the role of the insolvency register and turning it into a closed register to reduce stigma.

The Insolvency Service should also consider how it can develop the branding of insolvency. The present framework still utilises terminology with historical stigma like bankruptcy, while DROs and IVAs appear to reflect industry or statutory terminology rather than a consideration of the needs of those for whom they are designed to appeal. StepChange's recent work to understand how clients respond to creditor communications illustrates how sensitive consumers are to terminology.[22] The Insolvency Service can usefully reflect on how solution branding can be made fit for purpose in a context in which it is critical solutions appeal to vulnerable and sometimes wary consumers.

Another area where the Insolvency Service can help reduce stigma is in credit reporting. Several pieces of recent StepChange research highlight the role of credit reporting in putting people off seeking help when they are struggling to keep up with credit repayments and moving from advice to a debt solution.[23]

At present credit reporting can be an unfortunate combination of inflexible and inconsistent: one person accessing informal creditor forbearance may not have that forbearance recorded, or recorded using a 'special arrangement' flag, while in contrast another person in a similar situation who chooses to access an insolvency solution will always have that solution recorded. The result is that much of the nuance of underlying circumstances is lost when people enter insolvency and reach a credit reporting cliff edge. There is then limited scope for those making insolvency procedure payments to rebuild their credit record within a restricted budget despite evidencing consistent repayment.

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[22] Ibid.
[23] Ibid. and StepChange Debt Charity (2022) *Problem debt and the credit safety net*

We recognise the importance of capturing serious financial difficulty accurately in credit reporting to support effective affordability assessments, but would like to see more nuance in this reporting to minimise unnecessary credit 'scarring'. We would also like all stakeholders to explore the scope to use debt solution repayments as a positive metric in credit reporting to help those accessing solutions rebuild a positive credit record.

We would also like to see the Insolvency Service work with other stakeholders to help address misconceptions about credit reporting. Consumers in financial difficulty are not necessarily in a position to weigh costs and benefits well. We see clients who are reluctant to access appropriate debt solutions because they are concerned about potential financial exclusion, even when such risks are likely to be outweighed by the positive benefits of addressing unmanageable financial distress and the risks of worsening credit status.

Question 15: Please provide any evidence to show whether consequential costs serve a useful purpose or whether they produce unintended consequences for different stakeholder groups.

Problem debt carries severe consequences regardless of the costs built into insolvency procedures. While we recognise the need for safeguards against misuse, designed consequential costs principally service to discourage people from accessing support when they need it and undermining recovery from problem debt. This is reflected, for example, in the long delays that occur before most consumers in financial difficulty access help: the majority of StepChange clients wait a year or more before accessing advice, during which harms are prolonged and deepened.[24] The unintended consequences of insolvency solutions for wellbeing and financial resilience are also reflected in the slow and sometimes turbulent journey of those accessing debt solutions to recovery.[25]

Question 16: Do you believe the current insolvency procedures are working as intended? Please provide any evidence you have.

We comment below in turn on the three insolvency procedures:

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[24] StepChange Debt Charity (2022) *Mixed Messages*
[25] StepChange Debt Charity (2019) *Measuring client outcomes*, StepChange Debt Charity (2020) *Pathways to recovery* and *StepChange Debt* Charity (2022) *Client outcomes during Covid-19*

DROs

DROs were intended to offer debt relief for those with a low income with little or no assets. However, there are serious administrative and cost barriers that limit access and the benefits of the solution for the demographic it was intended to benefit.

To support the call for evidence, StepChange participated in a cross-sector survey of debt advisers. Advisers cited the following as the most common barriers to clients accessing a DRO (base = 438):

They have a car worth more than £2,000 and need to be able to keep this	59%
Their income fluctuates so cannot be sure they will be eligible for whole 12 months (e.g. unpredictable income, zero-hours contract, self-employed)	46%
They cannot afford the £90 fee	45%
They have too much debt to be eligible	31%
There is a lack of capacity in the free debt advice sector to process DROs	22%
They have already had a DRO in the past 6 years	21%
Other (please specify)	19%
They have too much disposable income to be eligible	16%
They have assets worth more than £2,000	11%
They are worried about the stigma of having a DRO	10%

Fee

As we have noted, the £90 fee for DRO is prohibitive for many. This was the third most common barrier to accessing a DRO cited by advisers and is regularly a barrier to access for clients recommended a DRO at StepChange. In our client survey, 21% of clients recommended a DRO said the cost of the solution was the biggest difficulty for them in accessing the solution, the highest proportion of any solution.

Our DRO advisers regularly complete applications with clients who then need four to five months to raise the fee. The Woolard Review the FCA acknowledged these problems, suggesting an emergency fund to cover the cost of the DRO application fee for people who cannot afford it. As we have argued, as a long-term solution the fee itself should be waived, at minimum for those receiving means-tested benefits, or payment could be made more flexible through a ‘pay as you go’ model.

Debt and asset limits

We welcomed the changes made to the eligibility criteria earlier this year, but current thresholds still limit access for those DROs are intended to support. In the advisor survey, the £2,000 car value asset limit was the most frequently cited reason for clients being unable to access a DRO. This is very low given the price of used cars (and clients fear high maintenance costs for cars with a lower value). Used price car inflation has been exceedingly high and in excess of CPI in recent years. Raising the limit to £5,000 would more realistically reflect market conditions and without bringing those with luxury vehicles into scope.

Going forward we recommend that the limits are index-linked. It was seven years between the initial DRO limits and the first increase this year, during which time inflation and household debt levels rendered them outdated. Pegging debt and asset limits to real values would ensure they adjust regularly and do not go out of date.

Missed debts

Missed debts can lead to a DRO being revoked. In these cases, considerable resource will have been wasted without resolving an individual's debt problems. We would like to see some discretion allowed where missed debts that push an individual over the DRO limit do not lead to revocation, pushing individuals out of a solution (while the costs of administration still fall on intermediaries). A minimum 10% margin above the debt limit in which discretion could be applied without automatic revocation would be welcome and reasonable.

Change of circumstances

Currently, when someone experiences a positive change in circumstances during the DRO, it can be revoked. The most common barrier to accessing a DRO, cited by 46% of advisers, was income fluctuations that make clients unsure of their eligibility during the 12 month DRO period. Causes of income fluctuations are common, such as zero hours contracts, changes in hours worked or fluctuations in social security payments. Advisers report clients becoming ineligible because of backdated Universal Credit payments or Employment and Support Allowance following a mandatory reconsideration decision.

Withdrawing debt relief from individuals who experience modest changes of circumstances after accessing an insolvency procedure does not make sense. The consultation document highlights the additional flexibility in Irish Debt Relief Notices compared to DROs, which allow for a positive change of circumstances without revocation of the solution. This flexibility would seem likely to increase stability for financially vulnerable households that may experience a positive change of circumstances but benefit from the continued progress of an insolvency solution.

IVAs

In our adviser survey, 52% of advisers say they often speak to people who have either a failed IVA or who have been put into an IVA when this isn't suitable for them. Advisers most often believe clients who were placed inappropriately on an IVA should have been offered a DRO, followed by a DMP and bankruptcy.

Advisers cited the following reasons IVAs had not been appropriate for clients (base = 409):

	Net: Often	Sometimes	Net: Not often
The client wasn't given advice about alternative debt options	72%	18%	10%
The client chose an IVA based on claims made in advertisements	68%	20%	13%
The client had a low income or benefits-only income	66%	19%	15%
The client's income & expenditure exaggerated their real surplus income	64%	20%	16%
The client was in a vulnerable situation which wasn't taken into account	57%	22%	21%
The client had urgent or priority debts that weren't taken into consideration when setting up their IVA	46%	26%	29%
The client rejected alternative debt options based on misleading advice about their consequences or eligibility	42%	28%	30%
The client had a foreseeable change of circumstances which wasn't taken into account when setting up their IVA	31%	35%	34%

Advisers were asked how often they saw the following impacts from unsuitable or failed IVAs (base = 399):

	Net: Often	Sometimes	Net: Not often
Stress / anxiety	83%	11%	6%
Worsening mental health	79%	14%	7%
Difficulty affording essentials due to IVA payments	74%	18%	7%

Delay in accessing a more suitable solution such as a DRO	74%	15%	11%
Loss of money paid in fees, following IVA failure	74%	15%	11%
Incurring priority debts due to IVA payments	64%	24%	12%
Delay in obtaining a failure certificate after an IVA failure	64%	20%	17%
Incurring non-priority debts due to IVA payments	46%	31%	22%

Individuals who are forced to terminate their IVA early find that more of their repayments have gone on paying these fees while their debt burden has hardly reduced. They may even find interest and charges have been backdated, with creditors chasing them once again for debts they thought they had resolved. There is no mechanism for them to be transferred onto another solution, so they are forced to find help again or face creditor petitions for bankruptcy.

Client acquisition practices driven by the commercial incentives of high fees has led to a situation where IPs often receive clients direct from lead generators or debt purchasers who have not provided holistic debt advice and in some cases have manipulated client budgets to make them suitable for an IVA. The above figures show that over half of advisers (52%) often see clients who have been put on an IVA when it is not suitable. The most common reason cited by advisers for clients ending up in this situation was that clients had not been given advice about alternative solutions: nearly three quarters (72%) often see clients who have not been properly advised, while two-thirds (66%) often see clients recommended an IVA when on low or benefit-only income. In most cases where clients should have been on another solution advisers report a DRO would have been more suitable. This chimes with Insolvency Service evidence of clients with low incomes having their budgets manipulated to allow for an IVA to be recommended.[26]

FCA rules on debt advice and counselling require firms to present a full range of potential options for clients and recommend the most suitable option.[27] The current system allows for regulatory arbitrage, with some providers taking advantage of the exemption while others come under the FCA regime. The benefit of FCA oversight on consumer outcomes is clear. Delivering IVAs through our IVA subsidiary, StepChange VA, StepChange only offers IVAs to people for whom a full, FCA-authorised debt advice process has shown this to be the best

[26] The Insolvency Service (2018) *Review of the monitoring and regulation of insolvency practitioners*
[27] FCA Handbook, Consumer credit sourcebook (CONC): CONC 8.3.2R, 8.3.4R and 8.3.7R.

option for them. We re-check our advice during the IVA set-up process to confirm that an IVA is affordable and sustainable for an individual over the long-term. As a result, our break rates are significantly below industry averages.[28]

Feedback from advisers confirms the poor advice and lack of support provided by IVA providers operating outside of FCA regulation. Over half of advisers said providers most often respond poorly, are difficult to contact or refuse or are reluctant to reduce payments when individuals run into difficulties. For example, one adviser noted:

> *"Providers other than Stepchange are very inflexible, they won't consider amendments to an IVA. Clients are not given advice on how to deal with their change of circumstances/additional debt etc."*

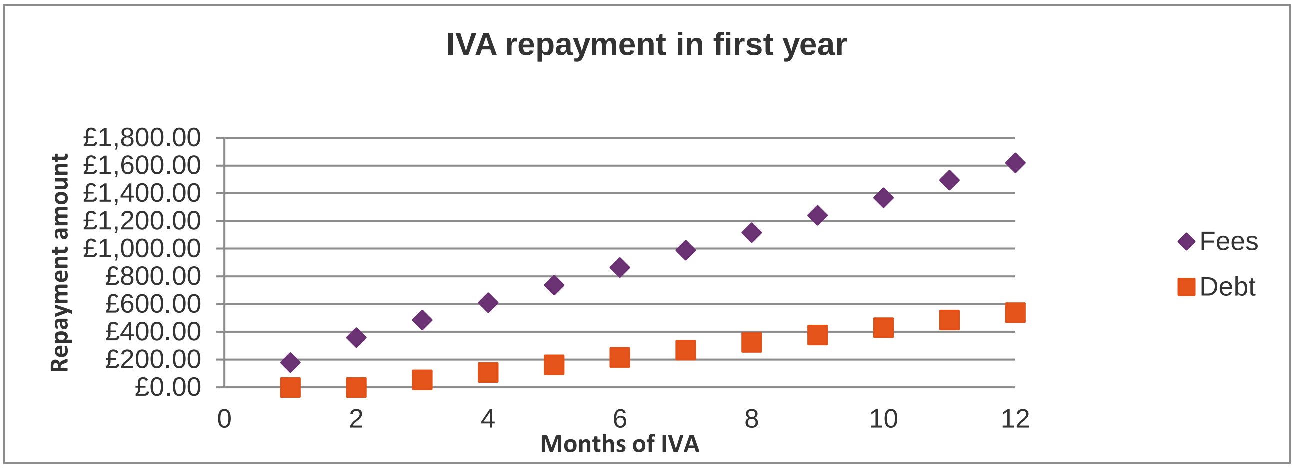
The impacts of a failed IVA for a consumer are significant. 83% of advisers said they often see clients suffering stress and anxiety because of struggles maintaining an IVA, while nearly three-quarters (74%) see clients struggling to afford essentials because of repayments. If an IVA fails, the individual becomes liable again for their full amount of outstanding debt (less any payments made through the IVA). Individuals also lose their protection from creditor action and will not qualify for any of the debt write-off that would potentially have occurred at the end of a successful IVA. In cases where an IVA fails within the first two years, individuals can find their debt balance has hardly changed as most of their repayment has gone towards paying the fees of an IP.

The fees they have paid to an IVA provider to set up and run the IVA are effectively wasted. Fees are 'front-loaded', in that they are recouped from the monthly payments as a priority, ahead of money going towards repaying debt. This means that firms are not incentivised to support individuals through an IVA. It also means that, since monthly repayments are not paying off debts, no matter how close to the end of its term an IVA fails, consumers can find a large proportion of their repayments have been wasted on fees as they only realise the debt relief element of the IVA if it completes successfully.

Client profile	Illustrative case[29]
Debt level	£38,800

[28] www.stepchange.org/media-centre/press-releases/stepchange-comments-on-insolvency-service-data.aspx
[29] Debt level and budget surplus are based on averages for StepChange VA clients in 2020. We have a policy of only placing individuals on an IVA if they have a minimum disposable income of over £180 with the average being above £200.

Budget surplus	£205.20
Monthly repayment	£180.00
Debt level if IVA fails within two years	£38,275



In this case, if the consumer's IVA was to fail after 12 months, they would find their debt had reduced by just £525 with nearly £1,500 having gone towards fees. This means they would still be facing £38,275 of debt without protection against renewed interest and charges.

This is an illustrative case of the impact of a failed IVA, but it will not be unfamiliar picture for consumers who have been poorly served by the IVA market. An IVA is an agreement in settlement of the debt and there will be cases where more generous terms are negotiated between providers and creditors. However, there will also be cases where consumers with much lower levels of disposable income are put onto an IVA meaning their repayments will be lower and they will be left in an even more precarious position in the case of failure.

We would like to see the fee structure of IVAs changed so that IPs only receive their full fee when an IVA successfully completes. Fees could be made pro-rata, similar to the structure used with DMPs (perhaps with some front loading to reflect the greater amount of work required to set up an IVA).

A final problem with the way IVAs are currently functioning is fair resolution and effective support when IVAs fail. There are three issues we would highlight particularly:

- There is a lack of meaningful support for customers in these circumstances

- When an IVA fails, customers lose the fees they have contributed to the IVA but may then be asked to pay for access to an alternative insolvency solution
- Failed IVAs are sometimes treated as completed by creditors, but whether this happens appears to be inconsistent.

The failure of an IVA is a key intervention point. Too often, it appears that IPs simply advise clients to get a DRO. Alongside addressing issues that drive unsustainable IVAs, we would like the Insolvency Service to look more closely at what can be done to support people when their IVAs is no longer suitable or effective. In particular, this could mean:

- Strengthening expectations of IPs in supporting customers when an IVA fails.
- IPs could be required to hold the £90 cost of a DRO as a contingency should the IVA fail.
- Creating more consistency around the treatment of ‘failed’ IVAs as completed to increase the number of people who do not unnecessarily need to re-enter a new debt solution.

Bankruptcy

Bankruptcy has become a very low volume solution following the introduction of DROs and the explosion of IVAs. This is not to say that bankruptcy cannot be a useful solution for people as it provides a quick way of becoming debt free with less onerous repayment demands than an IVA. However, take-up of the solution is currently limited by the high fee, concern about assets and stigma.

Advisers cited the following as the most common barriers to bankruptcy (base = 435):

They cannot afford the £680 fee	94%
They could lose assets such as their home or a valuable vehicle	52%
The uncertainty of how their home or other assets will be treated is too much to cope with	43%
They are worried about the stigma of going bankrupt	37%
Going bankrupt would affect their job/ employment	26%
They do not want to be on a public register	8%
Their debts are not eligible under bankruptcy	8%
They are self-employed and worried about business assets	6%
Other (please specify)	6%

There remains a significant amount of stigma associated with bankruptcy. Over a third (37%) of advisers cited this as a barrier to people accessing this solution. With this in mind, there is an argument for changing the name of the solution and removing some of the more punitive elements of the restrictions in place, and particularly making the public register a closed register and reducing its scope.

Question 17: How well do those in financial distress navigate the current regime and could this be improved? Please provide evidence to support your answer.

People often face serious problems navigating the current insolvency regime, including inconsistent and poor customer journeys into insolvency and problems transitioning to alternative arrangements when solutions fail.

In our client survey, before coming to advice 80% were aware of bankruptcy, 62% IVAs, 55% DMPs, 32% DROs and 14% token payment plans. The most common route of awareness was word of mouth, followed by online information (primarily the StepChange website). These figures, and the mismatch between awareness of insolvency options and the recommended solutions, illustrates the importance of high quality debt advice as a gateway into assistance rather than the push factors of marketing.

We have noted that the commercialised IVA market undermines the integrity of the insolvency framework because IPs can deliver this product without providing FCA-regulated debt advice. Individuals can experience a range of journeys before reaching an IP but are often persuaded to follow the IVA route by impersonator firms imitating debt advisors who are incentivised to refer people for IVAs. In this context, it is unsurprising that 43% of advisers did not agree that client journeys are consistent and accessible compared to 35% who agreed. Steps to address these problems include removing the IP FSMA exclusion and mandating FCA-regulated debt advice as a requirement of accessing an insolvency procedure.

There is very little provision in the current framework for individuals to move between solutions, despite the considerable instability of existing products. Nearly a third of IVAs are terminated early, while advisers report frequently seeing clients at risk of losing a DRO because of a change of circumstances. 46% of advisers do not think it is easy to move onto another solution if one fails compared with 27% who think it is. We have seen cases where individuals are approaching the end of an IVA but are struggling to maintain repayments fall out of the insolvency framework when it would be in everyone's interest for them to transition to a DRO. This issue can be mitigated by stronger requirements for IPs to support clients whose IVA is no longer sustainable but also illustrates the case for simplifying insolvency solutions so that changes of circumstances do not put the sustainability of an insolvency arrangement at risk unnecessarily.

In respect of experiences navigating debt advice, in our recent client survey 64% of StepChange clients reported they found the process of applying for a solution through StepChange fairly or very easy and 25% neither easy nor difficult. Among the 11% who reported the process was difficult, the most common reasons for difficulty given were understanding what they needed to do, getting the information from the creditors they owed money to, being put off by stigma associated with the solution they were recommended and ongoing enforcement action. These reasons help give a sense of the aspects of insolvency people find difficult, which include perhaps unsurprisingly administrative requirements, stigma and coping with ongoing collections activity. (In interpreting these figures, it should be borne in mind respondents to the client survey were largely those who had accessed a debt solution.)

Question 18: Are the current personal insolvency procedures the right products to service the needs of both debtors and creditors today or are new procedure(s) needed to serve debtors and creditors better?

Beyond the changes that can be made to the present procedures, a broader aim of this review should be a simpler and better joined-up personal insolvency framework. This would require the Insolvency Service to broaden the policy rationale for personal insolvency framework beyond the 'fresh start' and 'can pay, will pay' focus to a more holistic focus on outcomes. In order to meet this aim and fully address access barriers and discrepancies in treatment of income, assets and changing circumstances, it appears likely that a simplified insolvency procedure that can respond more dynamically to the needs of those struggling with debt is the best long-term solution.

There are two groups whose needs are particularly not being met by the present procedures. A third of advisers stated that the current suite of products do not serve clients with negative budgets. While the solution for this group may lie outside with insolvency regime, given they make up a growing proportion of the debt advice client base it's important to recognise this unmet need. Over one in four (27%) StepChange clients had a negative budget last year.[30] These clients may be eligible for a DRO but recommending this solution is not always helpful as it restricts individual's access to credit, which they may be reliant on for survival. Breathing Space can give these clients respite from creditor enforcement and communication, but is not a long-term solution. Given the stress and anxiety caused by creditor action, we think there is a case for lengthening Breathing Space for clients with a negative budget. We would also like to see the Insolvency Service take a more proactive role in gathering and sharing data and insight with policy makers on this group to help foster wider interventions and improve outcomes.

The second most common group advisers cited as being unable to access insolvency are those with assets but on low incomes. This group are most often reticent to access bankruptcy for fear of losing their homes but cannot afford the repayments of an IVA. It does not make sense to force this group, who typically hold solely or primarily unsecured debts, to choose between continuing to live with unmanageable debt or housing insecurity, each of which carries high risks of poor outcomes. As it stands, the only solution for this group is often long, low contribution DMPs which keep them tied to their debts and creditors for years. It would be beneficial for individuals to be given a fresh start and for providers and creditors to save the costs of administering long-term solutions. This can be achieved by reviewing the treatment of housing and pension assets within insolvency to consider broader public policy aims that outweigh maximising returns to unsecured creditors.

Question 22: What are the main factors which influence an individual's decision to enter a particular procedure?

Understandably, in a survey of StepChange clients 'clearing my debts' was the most important thing people hoped to get from their solution. This was closely followed by 'getting back in control of my finances' and 'stopping unaffordable payments'. The results below demonstrate that people are keen to establish financial stability, not just clear their debts. However, the current framework does not prioritise this aspiration.

What were the three most important things you hoped to get from the solution you followed? (Select up the three options) (base = 366)

[30] StepChange Debt Charity (2022) *Statistics Yearbook 2021*

Clearing my debts	56%
Getting back in control of my finances	48%
Stopping unaffordable payments	40%
Repaying my debts	35%
Stopping enforcement action from the people I owed money to	34%
Stopping my debts growing from interest and charges	33%
Stopping excessive contact from the people I owed money to	24%
Protecting my assets	10%
Accessing a solution that was free or low cost	3%
Protecting my credit rating	3%
Other	1%

Question 23: How could an individual's decision to enter a particular procedure be better informed?

Everyone accessing an insolvency procedure should be required to undergo full FCA-regulated debt advice to ensure they receive high quality advice and understand their options and the most suitable route for their circumstances.

Question 24: What evidence do you have of the impact that a public register has on an individual's decision to choose a particular insolvency route?

In the joint debt advice survey of advisers, 8% of advisers said they had seen individuals unwilling to access bankruptcy due to the public register. However, 37% cited the stigma associated with the solution as an additional barrier (the fourth biggest barrier to this solution). It is likely that the public nature of bankruptcy feeds this stigma. In our client survey 17% of respondents who had accessed bankruptcy cited stigma as a difficulty in accessing the solution, the most of any solution.

These figures illustrate the need to reduce the stigma associated with bankruptcy, especially given the way IVAs are promoted aggressively as a route to easy debt relief by lead generators when there may be other, better options for those struggling with debt.

Question 25: What impact does professional debt advice have on debtors when choosing a personal insolvency solution? Please provide evidence to support your answer.

The impact of professional debt advice is well-illustrated by the difference in break rates between StepChange administered IVAs and the rates of failure in the rest of the market. Advice is essential to choose an appropriate insolvency solution and the most glaring problems created by the present regulation and insolvency framework occur because people have not accessed effective advice.

Those struggling with problem debt are extremely vulnerable to poor advice. They are often desperate for a solution and exhausted by the process of handling creditors. This means, commercial providers that offer seemingly attractive solutions and minimise information gathering and difficult decisions about budgeting or assets are likely to make an initially favourable impression on potential customers.

The not-for-profit advice sector works hard to design an advice process that achieves the necessary level of engagement and support for clients while being open about difficult decisions and the benefits and downsides of different insolvency and informal solutions. The regulatory framework should ensure everyone making an important decision about insolvency has the high level of advice and support regulated debt advice should provide.

Question 26: Please explain any other barriers to entry to personal insolvency which are not included in this call for evidence, highlighting any particular groups that are affected.

In 2021, 56% of StepChange clients were in a vulnerable situation at the point of advice. The most common vulnerability affecting clients is having a mental health condition (39%). A body of evidence, including research we have conducted with clients, tells us that mental health problems affect the ability of those in financial difficulty to cope with their situation. If the insolvency framework is to work for those struggling with debt, it must work for those experiencing mental health problems. The Breathing Space scheme gave special recognition to those in mental health crisis. We would like to see the Insolvency Service pick up this recognition and ensure it informs the design of insolvency procedures and administration. This aim is central to some of the calls we have set out in this response, such as ensuring those who enter solutions have accessed high quality advice because they are particularly vulnerable to poor advice, but can also inform more subtle aspects of the insolvency framework such as how insolvency is branded, framed and administered.

A second vulnerability we would particularly draw attention to is those who are affected by economic abuse. In recent work understanding the experiences of single parents experiencing problem debt (who make up one in four StepChange clients) 48% reported at least one indicator of economic abuse by a former partner.[31] In addition to difficulties arising from recovering from abuse, and sometimes coping with ongoing abuse, those in this group may face barriers to accessing insolvency such as contested debts and assets. In light of the high prevalence of economic abuse among those struggling with debt, taking account of the needs of survivors of abuse should be central to understanding whether the insolvency framework is working well. The argument made elsewhere in this response (Q4) that the current insolvency mix could be re-envisioned in future could also particularly provide an opportunity to better meet the needs of those in this situation.

Question 27: How could the personal insolvency framework be improved, for example, to make access easier or movement between procedures easier? Please provide evidence to support your answer.

Please see our summary of recommendations in question 1 and our specific responses to questions 4, 9, 10, 11, 14, 16 and 17. In brief, the Insolvency Service should:

- improve access to insolvency by removing poorly designed fee, eligibility and asset liquidation barriers;
- improve the sustainability of insolvency solutions by increasing flexibilities to accommodate changes in circumstances; and
- address problems in the most common ‘transition’ between insolvency solutions by improving the experience of those whose IVAs are no longer sustainable.

We have also highlighted that a broader, longer-term aim of this review should be working towards a simpler and better joined-up personal insolvency framework to reflect a world with highly developed consumer credit markets and significant consumer financial vulnerability.

[31] StepChange Debt Charity and Gingerbread (2021) *The single parent debt trap*

Question 28: Which elements of other national regimes could improve the personal insolvency framework in England and Wales?

Please see our response to question 9.