IPA response to the BIS call for evidence in respect of Consumer Credit and Personal Insolvency

The following responses concentrate on the views of the Association and its members, in part taking into account discussion and feedback from a Personal Insolvency Conference held on 16th November 2010, attended by Nick Howard of the Insolvency Service. Our response concentrates on Questions 14 onwards, as these are the questions primarily addressing insolvency issues.

Our comments largely revolve around a response to Question 31 of the Call for Evidence, but other questions have some bearing on the comments offered.

The following specific points are relevant to questions raised in the Call for Evidence:

Question 14. What impact would a £25,000 threshold have on your ability to enforce unpaid debts by means of 1) charging orders and 2) orders for sale? What alternative action might you take?

We consider that a threshold of £25,000 in respect of enforcement of debts by means of a Charging Order is too high and that £10,000 would be more appropriate, but we do agree that a minimum level should be applied, as the number of Charging Orders at present taking up Court time is significant – we understand some 170,000 per annum. We are however concerned that any new provisions introducing a threshold in relation to Charging Orders and Orders for Sale should not impact on a Trustee in Bankruptcy's ability to realise assets below that level for the benefit of creditors collectively in a Bankruptcy process. Some consideration should be given though to the possibility that such an arrangement could increase bankruptcy numbers.

Question 15. How can debtors be encouraged to seek early support to help manage their debt problems?

We think that in part the answer to the way in which debtors might be encouraged to seek earlier support to help manage their debt problems lies in the proposals we set out below addressing we believe some of the current differences in approach between the different solutions that might be offered. Fair treatment for debtors and ensuring that debtors are not disadvantaged if they can and choose to pay their creditors are all factors in contributing to the choices that are made and the sense amongst insolvent debtors that they will find an appropriate solution that doesn't disadvantage them unduly if they make the right choice.

Question 16. Do the current debt relief options strike the right balance between the needs of the debtor and the rights of creditors?

This is central to the whole issue about 'Can pay, will pay'. At present a debtor can choose bankruptcy whether or not that provides the best solution for creditors, and therefore arguably the current relief options do not strike the right balance between the needs of the debtor and the rights of creditors. Protection for debtors, rehabilitation and the relief obtained through different debt solutions can be made available by any of the solutions offered. The central question therefore becomes one of ensuring that creditors receive a fair return and that bankruptcy becomes the last resort. This requires some shift away from the present position where the debtor chooses his or her preferred solution, but the alternative we propose should ensure that there is improvement for unsecured creditors – something that should fit well with the findings and recommendations of the Office of Fair Trading in its Report of June 2010 (where its concerns for creditors, albeit in that context in respect of corporate insolvency procedures, are appropriate in this context also).

Question 17. What problems are encountered with the current range of debt solutions and how could they be improved to ensure all debtors have an option and that the choices are clear?

The problems with the current range of debt solutions is that they do not operate on the same basis e.g. the methods used for assessing surplus income are different in a bankruptcy to those that may be found in an Individual Voluntary Arrangement (an example by way of evidence being the treatment of school fees), the costs of the processes are also different as are the durations of the different solutions offered. Is there, for example, a logic to an Income Payments Agreement/ Order in a bankruptcy lasting for only 3 years, whereas in an IVA the usual expectation is that a debtor will contribute for 5? There should therefore be some harmonisation across the different solutions offered so as not to provide inappropriate incentives for the use of bankruptcy? A further consideration is the impact of the voting habits of creditors; under the present rules, creditors with anything more than 25% of the total indebtedness can (and often will) vote against an IVA if a DMP suits their purposes (which may have more to do with internal accounting treatment than genuine prospects for full recovery of debt), whether or not the debtor can realistically pay his/her debts over a reasonable period (say ten years).

Question 18. Is there sufficient flexibility within the current range of debt solutions to allow for debtors changing circumstances?

There should be relatively little need for debtors to move between different solutions, if the most appropriate solution is offered in the first place, though it is not uncommon currently for debtors to be 'parked' in a DMP pending resolution of a short term difficulty. There may be circumstances where the needs of the debtor change but where that happens in an IVA there should be sufficient flexibility afforded to the supervisor to allow, for example, for an extension of the duration of the term of the arrangement so as to provide a breathing space where appropriate, to cope with those changes in circumstances e.g. temporary loss of or reduction in income. Where a debtor fails to honour an agreement entered into, then appropriate enforcement measures should be sought via bankruptcy. There is also a point regarding the move from IVA into bankruptcy, where for example a debtor cannot meet his/her obligations (perhaps for reasons beyond the debtor's control); present Protocol standard terms require the supervisor to convene a meeting of creditors to gauge creditors' wishes, and the debtor to pay the usual petition fee/deposit – measures that are, respectively, unnecessary and

unaffordable – and some consideration should be given to making the move to bankruptcy easier in these circumstances.

Question 19. Do the current options allow and encourage those who are in a position to repay their debts to do so? If not, why not, and how might any incentives be improved?

The options currently available do not really provide for significant incentives for debtors to enter into long-term arrangements and contribute from their income over a long period when the alternative is a 1 year bankruptcy with a maximum 3 year Income Payments Order or Agreement. There might be some benefit to a debtor with property (e.g. a home with equity) in seeking to enter into an IVA, rather than give up control of how those assets are dealt with through alternative procedures (e.g. bankruptcy). However, short of that there is little incentive for an individual with some spare income but no assets of value to surrender him or herself to a 5 or potentially even 6 year agreement, when at any stage during that process he or she might suffer the effects of bankruptcy if (even for reasons beyond the debtor's control) circumstances do not allow them to continue to make payments and honour the original agreement. One way of addressing the disparity would be to ensure that Income Payments Orders or Agreements in bankruptcy are for the same 5 year term that usually applies in IVAs.

Question 20. Do the current options allow a person to deal effectively with a temporary income 'shock' and if not, what is needed?

As noted above, and as currently being explored through the IVA Standing Committee and its sub group, there has been a call for greater flexibility within standard protocol compliant IVAs to afford the supervisor more flexibility to cater for circumstances where there is an income shock so that, in the interests of creditors and the debtor, IVAs that are capable of being completed (albeit with an extension of the duration of the arrangement) can be kept on track.

Question 21. Is some form of moratorium on creditor action required to a) allow a short time period for a debtor to seek and act on advice from a qualified advisor and b) allow a more extended period for a debtor suffering from a temporary difficulty to recover and start making repayments once more. If so, how might such an arrangement work, and what safeguards are required to ensure that creditor rights are protected?

We suggest that the appropriate moratorium would be a Personal Insolvency Order (see our single gateway proposals in response to Question 31) which would effectively provide for a stay on creditor action pending appropriate advice being given and an appropriate solution being sought. If such a moratorium were to seek to cater for individuals who are insolvent by reference to their ability to pay their debts as and when they fall due but who believe that in the long run (say up to 10 years) they may be able to pay their debts in full, then it might be appropriate to bring within the jurisdiction of the statutory solutions or formal insolvency procedures some form of Debt Management Plan, similar to the Debt Arrangement Scheme now operating in Scotland.

Question 22. How does a person find out where to go for debt advice and assistance? What are the advantages and disadvantages of each method?

There is presently an inappropriate leaning towards debt advisors who are considered to be operating on a charitable or free advice basis. In practice many commercial providers (as we believe the OFT acknowledges) do give initial advice to debtors without charge, even if their subsequent services (i.e. administration of an IVA or DMP) are subject to certain charges. There are therefore many operators, holding Consumer Credit licences and Insolvency licences, who are well able to provide advice, and we would argue impartial advice, and whose activities are regulated. Widening the pool of those to whom government agencies and others might direct insolvent debtors for advice would help to alleviate the bottleneck presently experienced not least through the CAB. There is a case to be made for all such advisors being subject to some form of 'audit' or monitoring inspection not unlike that to which members of the DRF and DEMSA subject themselves.

Question 23. How does a person know that he/she has been given the 'right' advice?

The existing requirement on IPs to give debtors leaflets explaining the pros and cons as between bankruptcy and IVA, and the availability of the broader leaflet setting the different options for debt solutions, should help to ensure that debtors can cross check the information given by an advisor and satisfy themselves that they have been given the right advice. Debtors may also take comfort from the fact that those giving the advice are regulated individuals or entities. There would be merit in ensuring that the obligations on all advisors are the same as for IPs in respect of the above. Debtors can also of course seek a second opinion. The standards to which advisors operate, or aspire to meet, and inspection regime to which they are subject could also be publicised by each operator, highlighting for example any qualifications held by those giving the advice (e.g. an insolvency licence), and thereby encouraging greater take-up (in the interests of raising standards) of voluntary specialist training programmes for examinations such as the Certificate in Debt Resolution and the Certificate of Proficiency in Personal Insolvency.

Question 24. What evidence do you have to suggest that debtors end up in the 'wrong' solution and what is the scale and impact –for the debtor, the creditors, and the economy?

The biggest issue around debtors ending up in the wrong solution is simply that many who could pay do not and that some of those who can pay end up doing so through bankruptcy, which will not return as much to their creditors as will be the case through an IVA. By way of evidence in support of this contention please see the attached table.

Question 25. Is it clear in all circumstances what the 'right' solution should be?

The right solution for each debtor of course depends on their individual circumstances and therefore requires consideration case by case. The right solution is one that provides the debtor with the debt relief he or she seeks, the protection from creditors, some debt forgiveness where appropriate and provides creditors with their best prospect of a reasonable return, given the debtor's insolvent circumstances. So it is a question of balance between the interests of the debtor and the creditors and that balance has to be assessed by a professional who is capable of weighing up the pros and cons and taking

into account the broader picture, not just acting on the debtor's (client's?) instructions or in accordance with a stated preference.

Question 26. How often do debtors move from one remedy to another and could the costs be reduced in any way?

One of the common circumstances in which debtors move from one solution to another is where he or she starts off by making payments through a Debt Management Plan, and later moves to an IVA. This might occur where the advisor considers that an IVA would not receive the requisite support from creditors if proposed initially, depending on the preferences of certain creditors and the criteria laid down by them or their agents. There might be circumstances in which is appropriate to establish a track record of payment, before entering into a formal insolvency procedure, provided that the information gained for the purposes of the first procedure is used for the second and therefore the costs are not doubled.

Question 27. Should there be more consistency on how a debtor's income, assets and expenditure are calculated and treated in different procedures?

We do believe strongly that there should be consistency on the assessment of a debtor's income and expenditure and the surplus that is therefore available for contribution into an IVA or by way of an Income Payments Agreement or Order in a bankruptcy, and that similar considerations should apply to Debt Management Plans. There is a widespread feeling at the moment that the criteria used in bankruptcy cases is different (and perhaps more lenient) than that used in relation to an IVA, so that through a bankruptcy process a debtor might keep more of his or her income and have to pay less. This cannot be appropriate and provides perhaps an incentive for individuals to seek to make payments through bankruptcy rather than an IVA. As illustrated above, that does not necessarily produce the best result for creditors, particularly when taking into account the fact that an IPO/IPA lasts for a maximum of 3 years, whereas contributions (perhaps at a higher level) through an IVA would generally be for 5. There is no logical reason for the criteria applied in assessing the debtor's surplus income to be different in the different solutions.

Question 28. Should any changes be made to investigation and enforcement action in relation to debtors entering insolvency procedures?

We believe the current bankruptcy process in terms of enforcement action is satisfactory and we see no reason to change the present procedures.

Question 29. What outcomes should such investigations be looking to achieve – for example, should they just relate to restrictions on future conduct or should they also impact on a debtor's discharge from his/her liabilities?

Ditto (per Q28 above).

Question 30. Are the practical effects of entering the different debt remedies satisfactory e.g. future access to financial services? Should this be influenced by the outcome of any investigation/enforcement?

There is an issue regarding Credit Reference Agencies and the extent to which information about an individual's insolvency remains on the public record and for how

long. Differences of treatment for individuals entering into different debt solutions should be looked at to ensure that there are no inappropriate disincentives for those seeking to pay as much as they can and contribute from their income.

Question 31. Is there a role for a "gatekeeper" to provide a common entry point to all formal insolvency procedures? If so, what would be the benefits and costs, who would perform such a function and how would the system operate?

We do believe that a single gateway, a common entry point for all insolvency procedures, would provide some benefits. It would ensure that the personal insolvency system is modern and appropriate to ensuring that debtors find the solution most suited to them and that creditors receive a fair return from the resources available.

The information gathered from debtors at the outset of any of the present procedures is essentially the same and the protection/relief offered is largely the same. The central question here is about ensuring that appropriate advice is sought, (e.g. from an IP) at an early stage and that the most suitable solution (taking into account the interests of the debtor and his or her creditors) is offered. This might mean, in addition to ensuring that debtors have all the information to enable them to make a sensible decision, taking some of the choice away from the debtor, so that for example debtors who can pay do so through a process that is likely to be the most efficient for returning a fair amount to creditors. A licenced Insolvency Practitioner is well placed to act as the gatekeeper in such circumstances.

One of the criticisms in the past, if only from the point of view of perception rather than reality (as it is not something that has been borne out through monitoring of IPs) is that there has always been the potential for IPs to skew advice in favour of the solutions that they most favour, e.g. IVAs. One of the reasons for thinking that this might be an incentive for the IP is that whereas the IP would act as supervisor in an IVA, the same IP would not necessarily act as Trustee in that individual's bankruptcy. But there is little logic to a system that sends a debtor, for whom bankruptcy is the most appropriate solution, away to the Court and the Official Receiver, when in most other forms of insolvency (both corporate and personal) the debtor individual or entity will look to the person from whom they are taking advice to act in respect of their chosen solution once that advice has been taken. Is there therefore a good reason why an IP, advising a debtor that bankruptcy is the most appropriate solution for that individual, should not accompany that individual to the Court and obtain both a Bankruptcy Order and an Order for the appointment for that same Trustee? This would remove any perception of inappropriate skewing of advice towards other solutions. Appropriate safeguards can be built into any new framework to ensure that creditors who wish to express a preference for a particular trustee have an opportunity to do so.

Our single gateway proposal is therefore that an individual, once acknowledging insolvency and apparently in need of a debt solution, files for the protection of a Personal Insolvency Order. The present bankruptcy deposit sum of £450 could then be paid to the intermediary, who would provide advice on the range of solutions available and gather from the individual the information needed to steer that individual towards the most appropriate solution both for the individual and his or her creditors. We would be pleased to provide further information on how we envisage this working in practice.

24th December 2010