Bankruptcy Law Reform Consultation Response

Bankruptcy Law Reform

Consultation by the Scottish Government

Response from the Association of British Credit Unions Limited (ABCUL)

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Executive Summary

The Association of British Credit Unions Limited (ABCUL) welcomes the Scottish Government's consultation on Bankruptcy Law Reform, and we are grateful for this opportunity to convey the views of Scotland's credit union movement.

ABCUL welcomes many of the Scottish Government's proposals for reforms which could deliver a debt advice, debt management and debt relief service fit for the modern era and fairer to creditors and debtors alike. In particular, we welcome the stated principle that those who can pay their debts should do so. We believe it is very important that we step back from the culture of heavily marketed debt relief for commercial profit which has grown up, and better consider the adverse impact this can have on creditors and the wider Scottish economy, not least credit unions.

In this regard, we are greatly encouraged that the Scottish Government is considering whether credit union debts should be excluded from discharge in Protected Trust Deeds (PTDs) and bankruptcies in recognition of the unique position of credit unions among lenders and other creditors in Scotland. We firmly support this proposal and will expand upon the justification for this in our response.

Following input from credit unions across Scotland, this submission outlines the views of our movement on a number of key issues considered in the consultation, including:

- All applications for the Debt Arrangement Scheme (DAS) or debt relief must be submitted by properly regulated and monitored authorised money advisers;
- A new Scottish Common Financial Tool should be developed with broad stakeholder input to serve as the industry-standard budgeting tool;
- DAS should be the default option whenever it is assessed that an individual could repay their debts in full over a period of 8 years;
- There should be a minimum debt level of £10,000 for entry into a PTD, since lower debts should be repayable through DAS;
- There should be a minimum dividend of 50p in the pound for any Trust Deed to become protected, with trustees' fees being cut – not returns to creditors;
- PTDs should be allowed to run for at least five years relative to the debt to allow for a greater amount of funds to be ingathered and distributed to creditors;
- The new range of bankruptcy products are to be welcomed, with strict criteria dictating which product each debtor can access – because "debtor choice" must not supersede fairness for creditors;
- A debtor who does not co-operate with his/her bankruptcy should not be discharged from their debts, since debt relief is a right which must be earned and not an automatic entitlement;

- All debts to credit unions should be excluded from discharge in PTDs and bankruptcies because credit unions are impacted disproportionately by debt write-off, damaging their ability to pay a dividend to savers or to lend to others in need;

- All debts incurred within 12 weeks of applying for debt relief should be excluded from discharge as it is reasonable to assume that the debtor probably knew the debt would never be repaid;

- The Accountant in Bankruptcy should have a more proactive role in supervising and intervening in all debt management and debt relief products, and a tighter regulatory regime for insolvency practitioners must be established and maintained.

Introduction

The Association of British Credit Unions Limited (ABCUL) welcomes the opportunity to submit a response to the Scottish Government's consultation on Bankruptcy Law Reform. ABCUL is the main trade association for credit unions in Scotland, England and Wales. As a co-operative itself, ABCUL is owned, funded and democratically controlled by its member credit unions. The majority of Scotland's credit unions are ABCUL members, and they in turn serve the majority of Scotland's individual credit union members.

Credit unions are not-for-profit financial co-operatives owned and controlled by their members for whom they provide safe savings and affordable loans. Credit unions provide inclusive services to the whole of their communities rather than simply the better-off. Increasingly, some credit unions can offer more sophisticated products such as pre-paid debit cards, current accounts, cash ISAs and mortgages.

Scotland has a thriving credit union movement which continues to grow year on year. There are currently 109 credit unions in Scotland serving around 280,000 members, with combined assets of over £300 million. The UK Department for Work and Pensions (DWP) has recently announced a Credit Union Expansion Project which seeks to more than double credit union membership across Britain over the next seven years.

Although the proportion of all debt written off in PTDs and bankruptcies which is owed to credit unions is low compared to the losses incurred by the major banks and other large scale creditors, the amount is very substantial to credit unions and can have a serious impact on their operations.

ABCUL is greatly encouraged that the Scottish Government is considering sweeping reforms of bankruptcy law. Credit unions have had serious concerns about various aspects of debt relief for a number of years. As a movement rooted in the values of thrift, trust and honest borrowing, we are particularly concerned that an "easy debt relief" culture has grown up in recent times. There must be a better balance possible between the old shame and stigma of insolvency and the apparently blasé and routine attitude to debt relief widely promoted today. When we see debt relief products so extensively advertised on television, radio, online, in print and in public spaces, it is quite clear that in these very challenging economic times, selling debt relief is a hugely profitable business for some practitioners.

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ABCUL welcomes the Scottish Government's objective to reform bankruptcy law so that people have access to fair and appropriate debt solutions, underpinned by the principle that those who can pay their debts should do so and better recognising the rights and importance to the economy of creditors' receiving a more reasonable return from debt relief products.

In what are difficult economic times for individuals, small businesses and social enterprises alike, we welcome the Scottish Government's stated intention to develop a "Financial Health Service" to minimise the impact of debt relief on the wider Scottish economy and to facilitate the financial rehabilitation of individuals forced to seek debt remedies. As local, ethical co-operatives often prepared to serve people whose only other option would be high cost alternatives, credit unions are especially well placed to support this financial rehabilitation, and we hope the Scottish Government will recognise the unique and positive role credit unions play in Scotland's economy and in communities across the country.

Alongside our completed questionnaire, this submission outlines in greater detail the views of Scotland's credit union movement on the main questions asked in the consultation.

Part 6. Advice

Q6.1 ABCUL welcomes the proposal that money advice should be compulsory for all individuals considering any form of statutory debt relief. With this currently the case for anyone seeking to enter DAS or a PTD, then especially given the implications of bankruptcy for a person's current and future financial wellbeing, it makes perfect sense that money advice should be compulsory for bankruptcy too.

Q6.1a However, we have serious concerns about the quality and neutrality of the advice given to individuals at present, especially when credit unions report examples of a debtor who could have repaid their debts through DAS instead entering a PTD which significantly enriches the trustee at the creditors' expense. Similarly, our member credit unions have reported many cases where a debtor in a PTD does not understand that their credit union debt is no longer being repaid despite the payments they are making to their trustee, and that their options to access credit in future are severely restricted as a result.

We therefore support the proposal to require that an authorised money adviser provides this advice before any debt management or debt relief product can be accessed. This should ensure that every debtor is given consistent and high quality advice and that they pursue the option which is genuinely most appropriate and fairest for their circumstances. This should also end situations where a debtor is apparently encouraged to choose the debt solution which is most profitable to his/her insolvency practitioner rather than the one that is truly most appropriate for them.

Q6.2 We believe there is a potential role for the Accountant in Bankruptcy (AiB) as the awarding and monitoring body of this authorised money adviser status. This must be conducted to strict criteria so that the abuses we wish to see eliminated from the sector are genuinely addressed.

We are also comfortable with the idea of the AiB taking on a money advice provision role, although we are wary of the risk of duplicating the services currently offered by other providers, potential conflicts of interest with the AiB's other functions in the debt management and debt relief process, and the potential resource implications for the AiB taking on this additional function.

Q6.3 We support the proposed "triage" system to signpost individuals towards the most appropriate debt management or debt relief option for their circumstances, and a technology-enabled system accessed online, through a smart phone app or by telephone would seem the most practical way to deliver this. However, we believe it is important that an individual does receive one-to-one money advice from an authorised money adviser before they can actually apply for debt relief.

Part 7. Education

Q7.1 ABCUL agrees that financial education should be an integral part of any Scottish statutory debt relief option. Indeed, we firmly believe that measures to improve financial capability in the wider population should be a key policy priority for the Scottish Government. A more financially capable society could see fewer instances of irresponsible spending or irresponsible borrowing and fewer insolvencies as a result, which would fit the Scottish Government's renewed focus on preventative spending.

Q7.1a We are satisfied that existing providers could tender to deliver any mandatory financial education for individuals accessing debt relief.

Q7.2 While correctly to be seen as an integral part of the debt relief and "debtor rehabilitation" process, we would not be inclined to make financial education training mandatory in all cases, as there are situations where a person has become insolvent due to a sudden and unforeseeable financial shock. In such cases, compulsory financial education could seem patronising or insulting and do more harm than good.

Q7.3 We instead believe that financial education should be mandatory when a debtor meets certain criteria, namely having accessed statutory debt relief previously or where their insolvency is due to poor money management or reckless spending. In these cases, a need for financial education can be clearly identified and it may help facilitate the desired behavioural change in the debtor. We believe the value of credit union membership to help encourage a savings habit, provide affordable credit and generally help build a greater sense of financial responsibility could potentially be included as part of such education.

Q7.4 If we are seeking to engender a greater understanding and respect for financial obligations, then we believe it is right that where assessed to be necessary, participation in financial education should be linked to discharge from debt. This is particularly important where insolvency was brought about by reckless spending and creditors are left feeling like they have been "taken for a ride". The debtor's co-operation and participation in financial education training can at least be seen to indicate a willingness to learn and change behaviour. It is corrosive to allow a situation where an individual can write off their debts and be automatically discharged regardless of their intentions and behaviour.

Q7.5 The effectiveness of such financial education could be measured by reviewing rates of "repeat insolvencies" and monitoring the financial capability and behaviour of a sample group over time.

Part 8. Common Financial Tool

Q8.1 ABCUL agrees that a common financial tool should be used to calculate an appropriate contribution from individuals towards their debts, and that the same tool should be standard in all DAS, PTDs and bankruptcies.

Q8.2 ABCUL believes that there are flaws in the calculations used for both the CCCS guidelines and the Common Financial Statement (CFS) which uses "trigger figures" devised by the British Bankers' Association (BBA) and the Money Advice Trust. We would therefore like to see a new Scottish Common Financial Tool established by the AiB in conjunction with key stakeholders, including credit unions.

In this new Scottish Common Financial Tool, ABCUL would like to see a contribution to a credit union account established as one of the categories in recognition of the value of credit union membership and access to an ethical financial services provider, especially for people in need of "financial rehabilitation" who are seeking to rebuild their finances from insolvency.

While of course no-one wants anyone to be forced into hardship, there is nonetheless a moral imperative for the law to recognise that being unable to pay back what you owe is a very serious situation, that it necessarily will involve a squeeze and cutbacks to your standard of living, and that it must absolutely never appear to be an "easy" or appealing option to escape debts.

Credit unions therefore feel that when a person is unable to pay their debts, there has to be an expectation that some luxuries must be forfeited so that they can pay as much of what they owe as possible. A situation which allows people to write off debts with no tangible impact upon their standard of living – especially in cases where an unaffordable lifestyle led to insolvency – sends out a very dangerous and morally corrosive message that essentially "repaying debt is optional" – a situation which is not only bad for creditors, but is socially and economically unsustainable.

Many existing financial statements which credit unions receive are slanted very unfairly in favour of the debtor, and often appear to be "maxing out" the allowances in each category so that little or nothing is actually available to pay to creditors. Not only is this a failure of the debt relief process to deliver a fair return for creditors, but there have to be questions about whether the statements presented really paint a true picture of that person's lifestyle, and whether it is really appropriate that, for example, the preservation of a heavy smoking habit or satellite television or the choice to drive to work should take precedence over the repayment of debts.

We believe there should be a requirement to compare the income and expenditure declared in the debtor's loan application with that presented in the financial statement with their trust deed, since if both have been completed honestly with no major change in circumstances occurring, there should be no significant difference between the two. Any discrepancies there may be should be addressed appropriately, with a formal facility for creditors to challenge the allowances and figures in the financial statement.

Q8.2b If the Scottish Government instead decides to introduce a system where contributions are simply based on a percentage of the debtor's income regardless of expenditure, we believe a sliding scale based on that individual's income would be the most appropriate way to measure this as a fixed percentage could easily prove unreasonably high for some debtors and too low for others on higher incomes. We would therefore prefer to see a new Common Financial Tool developed, and when a debtor's surplus income has been calculated from that, the view of credit unions is that 100% of that surplus must be paid for distribution to creditors, as the message must be clear that debtors must pay back as much as they can afford.

Q8.3 ABCUL agrees that the law should be changed to allow an assessed contribution to be deducted directly from an individual's wages as this should reduce the instances of payment programmes failing.

Part 9. Application Process

Q9.1-2 As outlined in our responses to Part 6 above, ABCUL believes that all applications for statutory debt relief should follow advice from an authorised money adviser. It therefore follows that only authorised money advisers should be able to submit applications, and it seems reasonable and most practical that this should be done through an electronic web portal.

Q9.3-4 We are satisfied that having been assessed by an authorised money adviser, there should be no need for the debtor to submit evidence of apparent insolvency. However, we believe the adviser should still be required to certify that the individual cannot pay their debts as they become due, and should it be subsequently established that this was not the case and that the debtor has accessed debt relief when they should have repaid their debts, the adviser should be held accountable for this and could ultimately lose their authorised status.

Q9.5-6 ABCUL is content for the proposed moratorium period to be introduced for bankruptcy as already exists for DAS, as we recognise that the requirement for applications to be submitted by an authorised money adviser (which we support) may lead to some delays in accessing debt relief, and it is fair that an individual who formally notifies their intention to enter bankruptcy should have protection from creditors from that stage. We believe standardising the moratorium period for both DAS and bankruptcy at 6 weeks is the most reasonable option. While we support this policy, we are nonetheless keen that the moratorium is not open to abuse by individuals using multiple moratoriums to avoid creditor enforcement without addressing their debt problem. We therefore believe that there should be a limit of one moratorium period in a 12 month period.

Q9.7 ABCUL believes that as soon as an individual notifies their intention to apply for bankruptcy and enters the moratorium period, their details should be displayed in a public register. It would make most sense for this information to be included in the Register of Insolvencies (ROI) as creditors and lenders are already used to checking that source, and the moratorium period has been entered precisely because the individual is proceeding towards bankruptcy. By using the ROI, the information is available to prospective lenders including credit unions, which is very important in case such an individual was to approach a lender that is not already a creditor and may otherwise be unaware of his/her imminent bankruptcy if not disclosed.

Part 10. Solutions for Individuals

The Debt Arrangement Scheme

Q10.1 ABCUL has long argued that it should be compulsory for the suitability of DAS to be assessed in all cases where an individual cannot afford to pay their debts as they become due, and only if DAS is inappropriate should debt relief options be considered. We therefore enthusiastically support the proposal that DAS should be the default option for all cases where debts can be repaid over a fixed period. We are satisfied that the fixed period should be 8 years based on the experience of the average DAS case, and it should be clear that a PTD or bankruptcy cannot be an option for a debtor in these circumstances.

Q10.2-3 We are neutral regarding how the AiB's fee-charging for DAS is structured, provided there is no disincentive created which pushes debtors towards less favourable options or a reduction in the 90% of debt recovered by creditors.

Q10.4 ABCUL believes it is important that there should be an appeals process by which creditors or individuals can dispute a decision of the DAS Administrator without requiring an expensive and potentially off-putting court process. Appeals should be heard by an independent panel.

Q10.5-7 ABCUL recognises the potential benefit of allowing an option of composition for individuals in DAS programmes, provided the programme has successfully run without missed payments or complications for a fixed period of time, a minimum percentage of the debt has been repaid, and creditors have agreed to allow composition at that time. We believe 12 years and 70% of the debt repaid are reasonable thresholds to set.

While credit unions naturally wish to see the full value of the debt repaid, as member-focused co-operatives, they may be more inclined to look favourably upon an application for composition from a member who has kept up agreed restructured payments and repaid the bulk of their debt than they would a notice of a trust deed or bankruptcy. However, composition must be a debt write-off agreed by the creditors once at least 70% is repaid, otherwise any automatic revocation means DAS would simply become another debt relief product rather than a debt management programme.

Protected Trust Deeds

Q10.8 ABCUL firmly believes that there should be a minimum debt level for entry into a PTD. Credit unions have brought a number of cases to our attention where a debtor has entered a PTD with a low level of debt. Almost inevitably in these cases, the trustee recovers close to the full amount of debt owed over the course of three years, but these funds ingathered are almost entirely claimed by the trustee as fees with nothing or next to nothing paid to creditors.

Q10.8a To reduce such instances of abuse, we would propose a higher minimum debt level than that considered in the consultation. We believe the minimum debt level for entry into a PTD should be £10,000. In arriving at this proposal, we have considered the fact that the average debt in a PTD is much higher than this figure; £28,100. Furthermore, if the stricter rules governing the determination of the appropriate debt management or debt relief option for an individual (which we support) are implemented, then this should be taken into account too. Therefore, with DAS as the first port of call, if an individual is unable to repay up to £10,000 over 8 years at up to £100 per month, then it may be that one of the proposed new bankruptcy products would be more appropriate for them.

Q10.9 We agree that provision should be made for a statutory notice to be issued to an individual's employer allowing payroll deduction of the agreed contribution. This should help reduce the number of PTDs where the debtor does not comply with their obligations. We are relaxed about the trustee notifying the employer if it is felt that this is the best option, although in this case, we would like there to be a clear cap on the fee that can be charged to the PTD for this.

Q10.10 ABCUL strongly believes there should be a minimum dividend proposed in a trust deed for it to be eligible for protection, and that this minimum should be 50p in the pound. We recognise that this proposal will meet with objections from many insolvency practitioners. However, credit unions have seen countless examples over the years of PTDs which are quite clearly of primary benefit to trustees who collect a very healthy profit at the expense of creditors who see next to nothing of the debt they are owed.

If the trustee is supposed to act in the interests of creditors, then for a PTD to deliver a zero return is completely unacceptable. Even the average dividend of around 14p in the pound is thoroughly unsatisfactory and begs the question of why a PTD was the chosen debt relief option rather than bankruptcy. It is our view that in far too many cases, a PTD has been presented because it provides a profit for the trustee and not because it serves the interests of creditors, or even the debtor in some cases.

When a debtor enters DAS, creditors know that they should ultimately recover 90% of the debt outstanding before interest. Similar certainty that when a debtor enters a PTD, the creditor will recover 50p in the pound would be greatly welcomed.

If this were to lead to a situation where some PTDs saw little or nothing left for the trustee to claim in fees, then so be it, as this would demonstrate a failure on the trustee's part to recommend and administer the most appropriate debt remedy, and it is right that they – and not the creditors as at present – should suffer as a result of this failure. It is totally unacceptable that a trustee can profit from a PTD which fails to pay a dividend to creditors.

If this reform means that PTDs become less appealing to insolvency practitioners and the number of PTDs declines significantly, then this is to be welcomed. We believe PTDs have become widely abused by the insolvency industry and should rightly be boxed into suitability in a much smaller number of cases, with DAS being used far more frequently and the proposed suite of new bankruptcy products being accessed where neither DAS nor a 50p in the pound PTD is possible.

Q10.11 ABCUL believes that the 3 year contribution period of a PTD is too short and that this should be extended. We believe an ordinary maximum period of 5 years should be established, but that this should not be a fixed maximum term.

Q10.12 A number of credit unions have experienced PTDs where it appears a significantly greater dividend could have been achieved for creditors had the contribution period been allowed to continue beyond 3 years, especially when the amount owed was a relatively large sum of which only a fraction could ever possibly be recovered in 3 years. Allowing PTDs to run for a longer period of time would allow for a greater and fairer amount of funds to be ingathered and distributed to creditors. Particularly high value PTDs should be allowed to run beyond 5 years to ensure a dividend of 50p in the pound is realised.

Q10.13 ABCUL believes the current process of "deemed consent" to a trust deed becoming protected is not satisfactory and should be reformed. While credit unions may often be owed a fraction of the total debt in a trust deed, this can have a disproportionately severe impact on that credit union's operations. However, a credit union's objection to what it may regard as an unreasonable PTD proposal is frequently deemed irrelevant when larger creditors do not respond and they are deemed to have given consent.

This is particularly frustrating when in the case of lenders, the largest creditor may be a bank whose lending policy is restricted in order to protect against default and they are prepared to accept 10p in the pound from any PTD, or a high cost lender whose business model expects high levels of default with very high interest charged to cover this cost. A credit union lends at affordable rates in the expectation of being repaid, yet is disadvantaged by the actions of creditors who either restrict lending or charge high interest.

Q10.14 Instead of "deemed consent", the AiB should be required to apply the "fair and reasonable" test to any proposed PTD to which any creditor, regardless of the value of their debt, has objected. This process has been established for DAS, and should be extended to cover PTDs as well.

Q10.15-16 ABCUL believes a debtor's behaviour should be an important factor in determining their treatment in debt relief, so non-compliance with a PTD should impact upon a debtor's discharge and it should be mandatory that the trustee applies to make such a debtor bankrupt.

<u>Bankruptcy</u>

Q10.17 If the proposal to require an authorised money adviser to assess an individual's need for debt relief and the appropriate option (which we support) is implemented, then we agree that the requirement for the individual to prove apparent insolvency should be removed.

Q10.18 We agree that the minimum debt threshold for an individual to be awarded bankruptcy should be increased, and we believe £5,000 would be a realistic and reasonable figure. If it was shown to be genuinely impossible for a lower debt than this to be repaid through DAS over 8 years, then we would be prepared to see exceptions made in such cases for the individual to access the proposed Low Income or No Income bankruptcy products.

Q10.19-21 ABCUL supports the proposal to introduce a new suite of bankruptcy products, and we believe the criteria for entering each should be clearly laid out and strictly adhered to, as in the terms outlined in the flowchart on page 86 of the consultation document. Accordingly, we agree that there should be different minimum debt thresholds for the different debt relief products, and that the minimum debt threshold for individual applications and creditor applications should be the same; in our opinion, £5,000.

Q10.22-24 ABCUL supports the introduction of a new No Income bankruptcy product for debtors whose only income is social security benefits and who cannot make any contribution to their debts. We agree that the maximum level of assets to access this product should be limited to £2,000 and that it should not be available to an individual who owns heritable property, as this option should only be open to individuals demonstrably unable to make any contribution and without any caveats or flexibility which could potentially lead to the product being abused.

Q10.25-26 Given that the debtor can make no contribution to creditors, we are satisfied that in No Income bankruptcies, the debts should be discharged after 6 months – provided they co-operate fully with their trustee. Since this product offers total debt write-off and discharge in 6 months, we believe there should be a maximum debt level in order to access it and that this should be set at £10,000. We appreciate this is significantly lower than the Government's proposal of £17,000, but since we are dealing with individuals who cannot afford any repayment to creditors at all, it is important that we do not give out any signals which could encourage irresponsible spending or borrowing.

Q10.27 We agree that individuals discharged from a No Income bankruptcy should be subject to a default credit restriction, since their insolvency is evidence of their difficulties in maintaining any repayments of credit. However, people on fixed incomes often have no savings for emergencies or unforeseen expenses and may from time to time need to borrow small sums. If banned from accessing any credit, we would be very concerned that a vulnerable individual could feel they had no choice but to turn to illegal lenders. The credit restriction should not therefore be a blanket ban on accessing credit, but rather a limit on the amount that can be borrowed for a period of 12 months. We believe consideration should be given to the option of specifying that such an individual should join a credit union, since this could help build their financial skills, encourage them to save and give them access to affordable small sum credit if assessed to be appropriate.

Q10.28 If a maximum value of credit is attached to the credit restriction, this must be strictly policed. Any lender knowingly breaching such a restriction should be held properly accountable, and similarly, an individual making a dishonest application for credit when subject to a credit restriction should also be dealt with appropriately for what amounts to a fraudulent attempt to obtain credit.

Q10.29 It should be recognised that the fact this No Income product would enable an individual to write off all debt and be discharged in 6 months is something of a privilege for a debtor in serious trouble in this situation. In keeping with the principle that the right to debt relief must be earned and not automatic, this bankruptcy product should be seen as a one-off opportunity to shed debt and make a fresh start. Accordingly, an individual who again runs up unsustainable debts should not be able to access this product for a second time until at least 10 years have passed. Given the proposed financial education element in debt relief, it may even be reasonable that this product should only be available once in a person's lifetime.

Q10.30 We believe a principle should be established that subsequent bankruptcies, using any of the products, should be treated differently from a first bankruptcy. We therefore agree that discharge from a subsequent bankruptcy should be delayed for a period of 3 years as a clear disincentive to anyone who might regard the repayment of debt as optional or bankruptcy as an easy solution to debt problems.

Q10.31-35 ABCUL also supports the proposed new Low Income bankruptcy product for those on low incomes who cannot afford to make any contribution. Our thinking around this product is along the same terms as those outlined above for the No Income product. We believe this product should only be available to individuals who own no heritable property, have assets no greater than £10,000 and owe no more than £20,000. We believe a maximum unsecured debt limit of £20,000 is in keeping with the findings of Citizens Advice Scotland's *Drowning in Debt* report, and we would again be concerned about allowing total write-off of higher debts than this. If they fully co-operate with their trustee, the debtor should be discharged after 12 months.

Q10.36-37 We accept the need for a last resort debt relief product where a debtor does not fulfil any of the criteria for the other products but is genuinely unable to repay their debts. However, in order to protect the right to debt relief from abuse, we believe the discharge period from this bankruptcy should be 5 years where the individual has already accessed debt relief in the previous 5 years.

Q10.38-40 ABCUL also supports the introduction of a Payment product which could provide a return for creditors in a bankruptcy where the debtor is able to make contributions. It is very important, however, that such a product includes restrictions on fees charged by insolvency practitioners to avoid it falling victim to the same abuses which have discredited PTDs as a fair debt solution. We agree it is reasonable that this product should be restricted to individuals with debts up to £500,000.

Q10.41-42 We feel a fixed contribution period of 5 years should provide a reasonable return to creditors, although as with PTDs, we believe a longer period should be available for debts nearer the maximum level. It is important that monies ingathered should be paid to creditors on a regular basis, ideally quarterly, as such regular payments not only assist creditors' recovery of the debt but also help build and maintain faith in the trustee and in the overall process.

Q10.43-45 We have no problem with both insolvency practitioners (IPs) and the AiB acting as trustee in Payment product cases. However, we are very keen that the fees claimable by IPs should be capped and returns for creditors maximised. Accordingly, there should be a fixed charge for administering this product to protect it from the abuses of charging structures so often seen in PTDs. We believe it is reasonable that where monies ingathered are insufficient to pay a dividend to creditors, the debtor's discharge should be delayed until the fixed administration charge is at least met.

Q10.46-48 As with the above products, ABCUL supports the introduction of a High Value bankruptcy product where an individual owes more than £500,000, with payments to be made for a period of 5 years or longer if deemed appropriate.

Q10.49 We welcome the proposed new suite of debt relief products because we believe it is important that a debtor accesses the most appropriate option for their circumstances. There should also therefore be a mechanism to transfer an individual between products when their circumstances change.

Part 11. Solutions for Sole Traders and Partnerships

Q11.1-4 The Legislative Reform (Industrial & Provident Societies and Credit Unions) Order 2011 passed by the UK Parliament and brought into force from January 2012 enables credit unions in Scotland to serve corporate members including businesses for the first time. However, this is not yet a significant part of any credit union's business. Albeit from this limited experience, we are satisfied that the proposals regarding Business DAS appear reasonable.

Part 12. Removal of Non-Contentious Creditor Petitions from Court

Q12.1-4 ABCUL recognises the saving that could be made to the public purse from bringing more administrative bankruptcy procedures out of the court system and within the remit of the AiB, so we are happy to support these proposals. We feel 14 days is a reasonable period for a debtor to either contest a creditor petition or seek a resolution with the creditor.

Part 13. Debtor Co-operation

Q13.1-5 ABCUL is concerned that a corrosive culture of irresponsible spending and borrowing and "easy debt relief" has grown up in recent times. We therefore believe it is important that in a reformed bankruptcy system, debtor behaviour must be a relevant factor in determining an individual's right to benefit from debt relief. If a debtor does not co-operate with their bankruptcy or cannot be located, their discharge should be deferred indefinitely. This deferral due to non-co-operation should be the default and not the exception, and the onus should therefore be on the debtor to raise an appeal at an independent tribunal if they feel they have been treated unfairly.

Q13.6-8 ABCUL has previously called for all debts incurred a certain period prior to an individual seeking debt relief to be excluded from discharge, and we are very happy to take this opportunity to repeat that call.

A number of credit unions have reported examples of a person taking a loan from the credit union only to enter a trust deed within a matter of weeks or sometimes even days. These cases lead to very strong suspicions that the person concerned probably knew they were in financial difficulty, withheld relevant information in their loan application, and possibly already planned on seeking debt relief when they applied for a loan they had no intention of ever repaying.

In such situations, we would like to see a presumption introduced that the debtor must have known they could not afford the loan and withheld their true financial situation to the detriment of the lender. There should therefore be an "exclusion period" of 12 weeks established. We believe this is reasonable and follows some international examples of a 90 day period. We believe all debts incurred during this period should be excluded from discharge regardless of their purpose, although the debtor should have the option to appeal and demonstrate that their insolvency was in fact caused by an unforeseeable sudden financial shock.

Furthermore, where there is evidence that a debtor has effectively committed fraud in supplying false information about their ability to repay a loan, credit unions would like to see tougher action taken, including a refusal by the AiB to allow a trust deed to become protected and a lengthy deferral from discharge.

Q13.9 Although not a main area of policy interest for ABCUL, we share the concerns of other organisations that child maintenance arrears are discharged in bankruptcies and PTDs. We believe that credit unions are unfairly impacted by debt write-off, and this unfairness must also apply where the parent with care never receives the money the other parent owes for the upbringing of their child. As part of a wider goal of encouraging greater responsibility by debtors to their obligations, we believe child maintenance arrears should not be discharged.

Q13.10 ABCUL firmly believes that all credit union debts should be excluded from discharge in bankruptcies and PTDs. Credit unions occupy a unique position in Scotland's financial services landscape as – while still making appropriate checks to ensure responsible lending – they are often prepared to lend to people who may not be able to access credit from other sources, and do so at ethical and affordable rates of interest. As responsible financial services providers regulated by the Financial Services Authority (FSA), credit unions of course make provision for bad debt. However, the long term sustainability of credit unions' business depends on borrowers repaying their debts in full.

This may seem an obvious statement regarding any lender. However, considering that high cost lenders charge exceptionally high rates of interest precisely because they expect a substantial number of borrowers to default, and many banks restrict their lending only to those they regard as the most credit-worthy customers, the credit union model of lending based on the ability to repay – including to the financially excluded – in the expectation of full repayment is actually different.

Credit unions do of course recognise that sometimes people fall upon hard times and are genuinely unable to repay all their debts on time. As co-operatives and ethical lenders, credit unions have a proud track record of helping people restructure their debts and maintain payments at an affordable level. Indeed, over the years, Scotland's credit unions have helped hundreds if not thousands of people who were at real risk of losing their homes.

Increasing losses to bankruptcies and PTDs could have the consequence of forcing credit unions to review their lending policies and be less prepared to lend to the people in need many currently serve. We believe the value of credit union services for people in communities across Scotland is such that there is a clear justification for making a special case to exclude credit union debts from discharge.

Credit unions are also unique in that they are the only lenders in the UK that operate under an interest rate cap. Credit unions cannot charge more than 2% per month on a reducing balance (26.8% APR), and in truth, many of Scotland's credit unions choose to charge 1% per month (12.7% APR) or sometimes even less. Lending a relatively small amount at an affordable rate means that the income generated from the loan is fairly small – precisely the reason why many mainstream lenders simply do not offer low value, short term loans. Yet income from loans is crucial to the sustainable running of credit unions.

To give an example, a loan from a credit union for £1000 over a year, charged at 1% per month on a reducing balance, will generate around £65 in income from interest for the credit union. If that debt is written off, then the credit union will have to make a further 16 such loans just to recover the full amount of capital lost. That may not sound like a lot, but when you consider that a number of credit unions are based in small communities with just a few hundred members, the impact of this loss on the credit union is very significant and can have a real effect on the credit union's capacity to pay a dividend to savers or to lend to other people in need.

It is also worth noting that many of Scotland's credit unions provide free life insurance for their members, with their savings acting as a bond for that insurance. When a member defaults on a loan, many credit unions' loan agreements allow them to claim the savings towards the outstanding debt, thus breaking the link between savings and life insurance and effectively wiping out that member's life cover. If all credit union debts were excluded from discharge in bankruptcies and PTDs, then this vital life insurance – often for individuals who have no other life cover or funeral payment plans – could be maintained since there would not be the same need to claim the member's savings.

Q13.11 Yet credit unions – responsible lenders – are frequently "collateral damage" in bankruptcies and PTDs where the vast majority of the debt is to an irresponsible lender who gave the borrower money they could never repay and often did not report to any credit reference agency to make the debt visible to other lenders. This is why we believe all credit union debts should be excluded from discharge and not only those incurred during the proposed pre-debt relief "exclusion period", since the debtor may have been an "iceberg bankrupt" for a considerably longer period than 12 weeks, with loans from payday and doorstep lenders rolling over yet invisible in credit reports.

Part 14. Modernisation of Legislation

Q14.1-2 We are happy for the Scottish Government to take the necessary measures to implement the reforms to bankruptcy law required.

Q14.3 Credit unions are satisfied for a fixed timescale for the submission of claims by creditors to be introduced, and for that timescale to be set at 120 days as proposed. However, credit unions want it to be clearly established that the 120 days starts from the date the creditor is first contacted by the trustee, and not from the date of publication of the PTD in the ROI/Edinburgh Gazette. As with other responsibilities around the administration of the PTD, credit unions are keen that the onus is clearly placed upon the trustee to identify and contact creditors, and his/her failure to do so does not create an obligation upon that creditor to stop collecting repayments as usual or disqualify them from making a claim.

Q14.3b Where the trustee has contacted the creditor and 120 days have passed, we are satisfied that the trustee should be allowed to reject claims submitted after this time. However, it is important that creditors have the right to appeal to the AiB if a trustee rejects a claim. If the creditor was never contacted by the trustee, there should be no penalty placed upon them and they should be entitled to their dividend.

Q14.4 We believe a habitual residence test is reasonable for individuals applying for debt relief in Scotland, and the location of their creditors should be a factor considered in judging whether they should be entitled to access the available products.

Q14.5-9 We agree that the ROI should be updated to show a debtor's current address if they move home after the award of bankruptcy. Credit unions have expressed the view that an individual's National Insurance Number would be a helpful additional piece of information to be visible on the ROI, although we recognise that there may be potential problems with placing this on a public register. We accept that current address details of a person at genuine risk of violence should rightly be withheld from the ROI, but we welcome the caveat that the AiB will consider applications for more information from creditors who demonstrate a potential interest in such an individual.

Q14.14-15 While understanding the arguments made for doing away with the prescribed rate of interest and freezing post-procedure interest and charges on all statutory debt relief products, it is our view that bankruptcy cases where 100p in the pound is realisable are so rare that should such a return be possible, it is reasonable for creditors to expect interest to be paid as well, and at a rate which better reflects the true cost of lending than the current Bank of England base rate.

Q14.18-21 We support the introduction of a standardised 6 month payment holiday option in all debt relief products where a genuine need for this is demonstrated. If granted, the payment holiday period should be added onto the length of time before discharge.

Q14.22-26 As noted in Part 12 above, we are relaxed about the AiB taking responsibility for more administrative processes from the Sheriff Court, albeit with a mechanism in place for disputed cases to be referred to a sheriff.

Part 15. AiB Role and Powers

Q15.1-2 Credit unions are comfortable with the AiB acting as trustee in a majority of bankruptcy cases, and we note that the costs incurred by the AiB are often much lower than private sector trustees' fees for similar or even simpler cases. It is reasonable that the AiB's fees should be set at a level which allows it to cover the costs of all the bankruptcies it administers, with those that can make contributions subsidising those that cannot. We do not believe that maintaining a "healthy and competitive insolvency sector" should be a concern of the Scottish Government as the purpose of debt relief is to provide help to those who genuinely cannot pay their debts in a way that is fair to creditors, and surely not to create and maintain a profitable insolvency industry.

Q15.3-4 ABCUL believes it is essential that the AiB has a more proactive role in the supervision of all debt management and debt relief products. In particular, credit unions feel strongly that the AiB should have increased powers over the fees that can be claimed in a PTD and the power to censure or remove a trustee from a case where he/she is clearly acting against the interests of creditors.

A number of credit unions have experienced examples of PTDs where the trustee's fees seem extraordinarily and unjustifiably high, and we believe action must be taken to cap or at least control fees which at present appear open to abuse to the extreme detriment of creditors.

While appreciating that many IPs are seeking to cover costs and generate a fair profit from their administration of PTDs, the Scottish Government should consider introducing a cap on the hourly fee which trustees and third parties carrying out work for the trustee are allowed to charge, and for all fees and charges to be more tightly controlled.

Q15.5-7 ABCUL firmly believes Scottish Ministers should have new powers to regulate IPs. There is significant frustration that complaints by credit unions regarding the conduct of IPs rarely make any progress. The number of examples of poor practice seen by credit unions, especially regarding PTDs, means we are unconvinced that the Recognised Professional Bodies are performing their regulatory function satisfactorily, so we believe firmer regulation of the industry by the Scottish Government is essential.

Other issues for credit unions

In addition to the comments above in relation to the questions asked in the consultation, there are some other suggestions from the credit union movement which we would ask the Scottish Government to take the opportunity to consider as it undertakes this root and branch review of bankruptcy law.

There is of course a duty on creditors to ensure they lend responsibly to minimise the risk of being defrauded or suffering losses. However, it is significantly more difficult for creditors to access a full picture of a person's financial circumstances when a number of creditors do not report to all – or in some cases any – of the credit reference agencies. A credit union could pay the fee for a credit check from Callcredit or Equifax or Experian or all three, only for thousands of pounds-worth of debt to high cost lenders or even public bodies to remain invisible because those creditors have not reported the debt.

A single national credit reference report would allow lenders to see a true and comprehensive picture of a prospective borrower's circumstances when making lending decisions. While we appreciate that this may not be something the Scottish Government would be in a position to deliver, we believe the AiB should at least urge all creditors to report debts to the credit reference agencies, and in particular public bodies including local authorities should be required to report

Credit unions would also appreciate clarification from the Scottish Government to IPs of the fact that an individual in a PTD *can* retain their credit union membership, as a number of credit unions have experienced cases of IPs wrongly insisting that the debtor must give up their credit union membership – even though no such claim is ever made about their right to hold an account with any other financial services provider. Credit unions would also appreciate clarification of the rules around providing additional emergency credit to debtors in PTDs, as there is presently some uncertainty about whether this can be done, the maximum amount that can be borrowed and the requirement for written approval from the trustee.

Conclusion

ABCUL welcomes the Scottish Government's recognition of the need to reform bankruptcy law and to establish a "Financial Health Service", and we broadly support many of the measures outlined in the consultation which we believe will help deliver the vision of a debt advice, debt management and debt relief service which is a world leader fit for the 21st century.

We believe the guiding principle should be that debt relief is for individuals who genuinely cannot repay their debts and will appreciate and co-operate with the system, paying back what they can afford to give a fair return to creditors. Debt relief should not be a business opportunity for sharp debt management companies and IPs, and the myth of "debtor choice" should be dispelled in favour of a suite of fair and appropriate debt management and debt relief products with clearly defined criteria for entry into each.

We hope our views will be taken on board in this process, and we look forward to seeing the outcome of this consultation.