

Proposed Reforms to Part 14 of the Bankruptcy (Scotland) Act 2016

By Alan McIntosh

Background

The background to this paper, is to contribute to the inquiry by the Economy, Energy and Fair Work Committee of the Scottish Parliament into Protected Trust Deeds.

That inquiry has been launched because several Stakeholders have raised their concerns with Protected Trust Deeds, a form of personal insolvency in Scotland.

The concerns primarily relate to:

- The way that Protected Trust Deeds are marketed and a view by some that they are being mis-sold;
- A view that some consumers would have been better using another formal debt solution;
- The failure rates in Protected Trust Deeds and the consequences that this has for the consumer; and
- Finally, a view by some smaller creditors that Protected Trust Deeds have a disproportionate effect on them, and Insolvency Practitioner Fees lead to poor returns for them.

In response to this, although accepting there is no consensus within the sector, the Accountant in Bankruptcy has mooted several proposals.

These can be summarised as:

- Increasing the minimum level of debt, a consumer has before they can enter a Protected Trust Deed;
- Extending the duration of the Protected Trust Deed;
- Amending the rules how Protected Trust Deeds are approved to increase Creditor engagement and to allow AiB more power to refuse a Trust Deed Protection; and
- Finally, requiring a Trustee to set a fixed fee at the point of proposing the Trust Deed;

Concerns with Proposals

I have a few concerns in relation to these proposals.

First, they are unlikely, in themselves to significantly reduce the number of Trust Deeds becoming protected and even if they were, this is not necessarily a desirable outcome.

Trust Deeds levels are not actually at a level that they should be causing undue concern. Even if they were to rise to 2009 levels, of just under 10,000 per year, that would still only represent one-tenth of one percent of the entire Scottish population.

For an advanced consumer credit-based society, I would argue that such levels of personal insolvency are not a matter of concern. There is always going to be consumers who are not able to repay their debts, or even repay them with a reasonable period of time, so personal insolvency will be an appropriate solution for many and this is healthy if it addresses historic problem debts that people have. The key question is are those solutions appropriate for the consumer and is

the level of consumer insolvencies across Scotland rising to a level that could pose a risk to the health of the wider economy?

Second, by just making it harder for people to enter Protected Trust Deeds, we may inadvertently drive people into less appropriate solutions such as bankruptcy, or even the Debt Arrangement Scheme, where the failure rate is believed to be currently twice what it is for Protected Trust Deeds in their first five years.

Thirdly, changing the voting arrangements for Protected Trust Deeds is not likely to reduce the number of Trust Deeds becoming protected, as due to the engagement of many commercial creditors through Creditor Agents the outcome is not likely to change in most cases and the smaller creditors are still not going to be able to object to Trust Deeds becoming Protected.

Finally, in relation to the AiB having increased powers or scope to refuse protection to a Trust Deed, this is likely to be problematic. First it will require guidance to be published to indicate when Trust Deed protection is likely to be refused. If this doesn't happen, it will be harder to advise consumers on when Trust Deeds may be a suitable option for them.

The decision of the AiB will also have to be subject to review and appeal and even where a Trust Deed is Protected, but later fails, resulting in the consumer possibly losing out, it could be argued the AiB could be subject to complaints that they made the wrong decision and didn't consider affordability etc. and as result the consumer has suffered harm and loss.

Understanding the Problem

The primary problem with Protected Trust Deeds is that many feel that from the perspective of being a creditor, or a consumer, who they don't work for, is they are not fair.

However, personal insolvency is by its nature unfair to most Parties that are affected by it. The essential purpose of a Trust Deed is to wind up the financial obligations of a consumer whose can no longer meet their financial obligations.

By implication this means their creditors will be losers. It also means the consumer themselves will often be losers, as they will be denied access to further credit for several years, will have to pay over almost 100% of their disposable income for 4 years and may even have to realise and surrender assets.

However, occasionally, it is possible when looking at Trust Deeds, to see in certain cases that the solution was not appropriate for the consumer at the outset, or their circumstances have changed, so it is no longer appropriate.

When this happens the AiB, who have supervisory and regulatory powers, have not been known for being pro-active in making interventions in cases, even though they have had the power to do so for several years.

This often leads to consumers either being refused a discharge and having their debts returned to them or becoming a Trust Deed prisoner with no easily accessible process for reversing what may have been the consequences of bad advice in the first place, or their own misfortune.

Thirdly, even when creditors feel that the proposals being made are so fundamentally unjust, they feel powerless to influence the process or represent their interests and are often outvoted by larger creditors who can weather the insolvency process better.

All this has led to Trust Deeds becoming discredited as a solution.

Proposed Solution

As a solution to these problems, I would like to suggest some amendments to the Bankruptcy (Scotland) Act 2016, which won't require primary legislation and could be achieved by regulations made by the Scottish Ministers.

The primary legislation that governs Protected Trust Deeds is the Bankruptcy (Scotland) Act 2016.

The specific part of the Act that deals with Protected Trust Deeds is Part 14 and Section 194 of the Act allows the Scottish Minister to make Regulations that modify or add to Part 14, providing the change that could be made could have been made by the Minister under paragraph 5(1) of Schedule 5 of the Bankruptcy (Act) 1985.

This is below :

Protected trust deeds

- [5.— (1) The Scottish Ministers may by regulations make provision as to —
- (a) the conditions which require to be fulfilled in order for a trust deed to be granted the status of a protected trust deed;
 - (b) the consequences of a trust deed being granted that status;
 - (c) the rights of any creditor who does not accede to a trust deed which is granted protected status;
 - (d) the extent to which a debtor may be discharged, by virtue of a protected trust deed, from his liabilities or from such liabilities or class of liabilities as may be prescribed in the regulations;
 - (e) the circumstances in which a debtor may bring to an end the operation of a trust deed in respect of which the conditions provided for under subparagraph (a) above are not fulfilled;
 - (f) the administration of the trust under a protected trust deed (including provision about the remuneration payable to the trustee).
- (2) Regulations under this paragraph may—
- (a) make provision enabling applications to be made to the court;
 - (b) contain such amendments of this Act as appear to the Scottish Ministers to be necessary in consequence of any other provision of the regulations.]

The primary legislation that governs Trust Deeds, therefore, can be amended by way of a Scottish Statutory Instrument, using I believe the negative procedure.

The proposals avoid changing the essential characteristics of Trust Deeds, that if done out with a full review of all formal debt solutions in Scotland could have unintended consequences, such as denying people options, but also increasing the number of people forced into applying for their own bankruptcy.

The proposal instead would introduce three new provisions into the 2016 Act, which arguably AiB have already powers under section 179(1) they could use to achieve the same effect (the power to issue directions to Trustees), but would also introduce new procedural processes for applying and making these directions and would make a political statement that AiB must increase its regulatory role in how they supervise and regulate Trust Deeds.

The proposed provisions are:

Creditor application to not be bound by the Discharge of the Debtor or the Trustee

This provision would allow a creditor that has objected to a Trust Deed becoming protected to make an application to AiB that they should not be bound by the effects of the Debtor or the Trustee receiving a discharge from the Trustee.

The creditor would have to show that the Trustee's proposed intromissions with the Trust Deed estate would be unduly prejudicial to their interest.

This would not be a judicial process and so, therefore, would be quicker and less expensive than the Creditors having to use any existing powers the 2016 Act gives them.

However, Creditors would only be able to apply where they had notified the Trustee of their objection to the Trust Deed before it became protected and providing the application was made within 28 days of the Trust Deed becoming protected.

It would also, if successful not be fatal for the Trust Deed, so the Debtor and Trustee could decide whether or not to continue with the Trust Deed or whether the Trustee or the Debtor should be able to apply for the Trust Deed to be terminated and another option used.

There would be a right to review of any decision on any application for all parties, with an ultimate right to appeal to the Sheriff on a point of law.

Trustee to seek Approval from AiB to Refuse a Debtor a Discharge

Currently, a Trustee must seek the approval of AiB to provide a Debtor with a Discharge, but not to refuse a Discharge.

This provision would introduce a new provision into the 2016 Act that would require the Trustee to seek the approval of the AiB if they wish to refuse a Debtor a Discharge.

AiB as part of this process would have to allow the debtor and the creditors to make representations as part of this proposal and have the power to refuse the Trustee's

application. They would also be able to issue directions to the Trustee as part of their decision.

It is not specified in the provision what these directions may be, but it could include reducing the contribution the Debtor is to pay or even directing the Trustee to apply for the Discharge of the Debtor.

It is hoped this would tighten up protections for consumers in Protected Trust Deeds, and have a cautionary effect on Trustee's refusing Debtors a Discharge, and would also require AiB to ensure that the interests of all concerned are considered before a Debtor is refused a Discharge.

Debtor Application to seek Early Termination of a Trust Deed without a Discharge

This provision would allow a Debtor to seek an early termination of their Protected Trust Deed without a Discharge, but only through a Money Adviser.

Again, this would be an administrative process where the application is made to the AiB, so should be faster and less expensive than any existing court procedures that are available.

It is hoped this provision would allow a consumer, where they believe they have mis-sold or mis-advised a solution to seek remedial action that restores them, to the extent that is possible, back to the position they were in prior to granting the Trust Deed.

It would also allow AiB to issue directions, as it is appreciated terminating a Trust Deed early could leave many matters unresolved, such as what to do with funds already ingathered or what happens when assets have been sold or are in the process of being sold and what happens to contributions that have already been made or possibly have been taken from benefits, when they should not have been.

Equally, it is appreciated that some consumers may try and use this process when they anticipate they are about to come into possession of assets that could be used to pay their debts. In such cases, AiB could refuse the application or could agree to grant it only on compliance with a direction.

The power to issue a direction would, therefore, allow AiB to address any unresolved issues to help restore the consumer back to the position they were in prior to granting the Trust Deed and end the problem of Trust Deed prisoners where a Trust Deed is no longer the appropriate solution for a consumer.

It would also require the Debtor, on the Advice of a Money Adviser, to state how they intend to address their over-indebtedness, whether that is through sequestration or a Debt Arrangement Scheme.

The provision would be subject to a right of review or appeal to the Sheriff on a point of law only.

Conclusion

I believe these proposals would avoid any fundamental changes to Protected Trust Deeds, which for the reasons mentioned above, I believe are likely to have unintended and undesirable consequences and should only be considered as part of a full review of all formal debt solutions.

However, in recognition, there are genuine concerns by many stakeholders, I believe the above proposals could begin to address some of the concerns that have been raised and allow remedial action to be taken on a case to case basis.

I also believe, the accumulated effect of these provisions on Trust Deeds and the Trust Deed market will be to improve current practices, as providers will be reluctant to take cases that pose a risk of being reviewed under the above provisions or applying for a Debtor to be refused a discharge, without exhausting all options first.

I also believe as such they will help restore confidence in Protected trust Deeds, that is overdue and necessary, without restricting their availability where they are an appropriate solution for consumers.

Finally, whereas I don't believe there is any consensus for the AiB's proposed amendments, I believe there could be consensus across the sector for these proposed amendments.

Proposed Amendments

Below are draft versions of the proposed amendments to the 2016 Act that I believe should and can be made.

These draft versions are for illustrative purposes only (not being a legal draftsman), however, I believe they are helpful in considering the proposals, in that they focus attention on what procedures should be used and hopefully, will help others contribute to the discussion.

After s178 insert S178A

178A Creditor's application to not be bound by the Debtor or Trustee's discharge

(1) A creditor who has notified the trustee of their objection to the trust deed within the relevant period may apply to AiB under this section within 28 days of the Trust Deed's Protection being registered on the Register of Insolvencies

(a) On receipt of an application by a Creditor, AiB must notify the other creditors, the Debtor and the Trustee and provide them with a copy of the Application that has been made and invite them to make representations to AiB within 28 days of receipt of the notification.

(b) After the time allowed under (a) for representations to be made, AiB, if satisfied, on grounds other than those on which a petition under section 177(1)(b) has been or could have been presented by the creditor, that the Trustee's proposed intromissions with the estate of the debtor will be so unduly prejudicial to the creditor's claim that the creditor should not be bound by the debtor or trustee's discharge, AiB may order that the creditor is not to be so bound.

(c) On deciding the application under (b), AiB must send a copy of their decision, with reasons to the trustee, the Creditors and the Debtor.

(d) Any party to the Trust Deed can request a review of AiB's decision within 14 days of receipt of their notification of the decision

(e) On receipt of a request for a review AiB should notify the other parties to the Trust Deed of the request and complete the review within 28 days of the request being received. AiB must notify all parties to the Trust Deed of the outcome of the review.

(h) In completing a review of their decision, AiB must either decide to uphold their original decision or amend their decision as if they were deciding an application under (b).

(i) Any Party to the Trust Deed can appeal AiB's decision under (h) to the Sheriff within 14 day of being notified of that decision. Appeals are on a point of law only. The Sheriff's decision is final.

Replace section 184 (8) with:

Section 184 Protected trust deed: discharge of debtor

(8) If, on request by the debtor or as soon as reasonably practicable after the end of the period for which payments are required under the trust deed, the trustee believes the debtor should be refused a discharge, the trustee must make an application to AiB for the Debtor to be refused a discharge and

(a) inform the debtor and the Creditors that an application has been made by notice in writing—

(i) of the facts and the reason why a refusal should be granted,

(ii) that the debtor will not be discharged from their debts and obligations in terms of the trust deed if the application is granted, and

(iii) of their right to make representations to AiB within 28 days of receipt of the notification as to why the application should or should not be granted

(iv) The Trustee must advise the Debtor they can seek independent advice from a solicitor or from a Citizen Advice Bureau or Local Authority Money Advice Service and provide details of free money advice services within the local authority area the Debtor resides

(b) The Application will be in the form of a statement (being a statement in such form as may be prescribed for the purposes of this paragraph) and must specify:

(I) The reasons why the Trustee believes the Debtor has failed to meet their obligations under the Trust Deed and failed to co-operate with the administration of the Trust Deed;

(II) Whether the Debtor has consented to the Application being made;

(III) Outline what funds have been ingathered

(IV) What the fees and outlays of the Trustee are at the date of the application;

(V) What dividends have been paid to Creditors and are likely to be paid in any final distribution by the Trustee

(c) AIB must not decide whether any application should be granted or rejected until 28 days have passed from receipt of the application

(d) In considering the application AiB must decide and have regard to any representations that are made, whether it is fair and reasonable to grant the application having regard to the interests of the Trustee, the Debtor and the Creditors.

(e) In deciding the application AiB can only:

- (I) Grant the application
- (II) Grant the application and issue a direction to the Trustee under section 179 (1)
- (III) Reject the application
- (IV) Reject the application and issue a direction to the Trustee under section 179 (1)

(f) AiB decision on the application must be notified to the Trustee, the Creditors and the Debtor with a statement as to the reasons for their decision and a copy of any direction issued.

(e) Any party to the Trust Deed can request a review of AiB decision within 14 days of receipt of their notification of the decision

(g) On request for a review AiB should notify the other parties of the request and complete the review within 28 days of the request being received. AiB should notify all parties to the Trust Deed of the outcome of the review.

(h) In completing a review of their decision, AiB must either decide to uphold their original decision or amend their decision as if they were deciding an application under s184 (8) (e).

(i) Any Party to the Trust Deed can appeal AiB's decision under (h) to the Sheriff within 14 day of being notified of that decision on a point of law only. The Sheriff's decision is final.

(j) The status of a Trust Deed should not be amended on the Register of Insolvencies until the review and appeal process has been completed or the time allowed to seek a review or appeal has lapsed.

Insert after s184 (8)

(8A) A Money Adviser may make an application on behalf of a Debtor to AiB for the early termination of their Trust Deed (without a discharge from their liability to repay their debts), if that Money Adviser is a Money Adviser for the purposes of section 9.

(a) The Application will be in the form of a statement (being a statement in such form as may be prescribed for the purposes of this paragraph) and must be sent to the Trustee in the Trust Deed at the same time as the application is made to AiB and specify:

- (i) The Name of the Money Adviser and their employers contact details
- (ii) The reasons why they believe the Debtor should be released from their Trust Deed, including any information they believe relevant as to how the Debtor entered the Trust Deed and how it has been administered
- (iii) How the Debtor proposes to deal with their debts should they be released from their obligations under the Trust Deed

- (b) On receipt of the Application AiB must contact the Trustee and invite them to indicate within 28 days whether they support the Application and to make any representations they believe AiB should consider in determining whether to grant the application or reject it.
- (c) On being notified of the Application, the Trustee should have regard to the interests of general body of Creditors to the Trust Deed.
- (d) AiB should decide the application only after the Trustee has had 28 days notification of the application
- (e) In deciding the application AiB must either:
 - (i) Grant the Application
 - (ii) Grant the application and issue a direction to the Trustee under section 179 (1)
 - (iii) Reject the Application
 - (iv) Reject the application and issue a direction to the Trustee under section 179 (1)
- (f) AiB's decision on the application must be notified to the Trustee, creditors and the Debtor with a statement as to the reasons for their decision and a copy of any direction issued
- (g) Any party to the Trust Deed can request a review of AiB decision within 14 days of receipt of their notification of the decision
- (h) On request for a review AiB should notify the other parties of the request and complete the review within 28 days of the request being received. AiB should notify all parties to the Trust Deed of the outcome of the review.
- (i) In completing a review of their decision, AiB must either decide to uphold their original decision or amend their decision as if they were deciding an application under s184 (8A) (e).
- (j) Any Party to the Trust Deed can appeal AiB's decision under (h) to the Sheriff within 14 day of being notified of that decision on a point of law only. The Sheriff's decision is final.
- (k) The status of a Trust Deed should not be amended on the Register of Insolvencies until the review and appeal process has been completed or the period allowed to seek a review or appeal has lapsed.