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Bankruptcy and Debt Advice (Scotland) Bill

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The Bankruptcy and Debt Advice (Scotland) Bill is a Scottish Government Bill. It proposes to make a number of changes the personal bankruptcy regime in Scotland, including:

- providing for compulsory money advice
- requiring financial education in certain circumstances
- introducing a “common financial tool” to be used to calculate the payment a debtor may be expected to make to their creditors
- introducing a new route into bankruptcy for those with little by way of income and assets – the “Minimal Asset Process”
- extending the period for which the practical consequences of bankruptcy may be felt to four years
- removing automatic discharge from bankruptcy
- transferring a number of functions from the sheriff court to the Accountant in Bankruptcy

The Scottish Parliament
Pàrlamaid na h-Alba

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EXECUTIVE SUMMARY

The Bankruptcy and Debt Advice (Scotland) Bill was introduced on 11 June 2013 on behalf of the Scottish Government. It proposes to make a number of changes to the personal bankruptcy regime in Scotland. It is part of a suite of legislation reforming statutory debt solutions in Scotland. Other legislative initiatives include: new regulations covering the Debt Arrangement Scheme (DAS) and protected trust deeds; the creation of a “business DAS” for business-only debts; and a Bankruptcy Consolidation Bill.

The statutory debt solutions currently available to debtors in Scotland can be summarised as follows:

- **the Debt Arrangement Scheme** (DAS) is available to those who can pay their debts in full over a longer period of time. Debtors are protected from enforcement action by their creditors – and interest and charges on their debts are frozen – while they participate in DAS

- **a protected trust deed** is a voluntary agreement between a debtor and their creditors in which their income and assets are administered by an insolvency practitioner (known as a trustee) for the benefit of creditors. Protected trust deeds usually last for three years, during which time a trustee will collect payments from income and realise any non-essential assets owned by the debtor. The funds collected will be used to pay creditors. After a protected trust deed is completed, most outstanding debts are written off

- **bankruptcy** involves a debtor’s assets being administered by an insolvency practitioner (known as a trustee) for the benefit of creditors. It is also usual for trustees to seek a contribution from income (where appropriate). Bankruptcy usually lasts for one year, although contributions from income may continue for three. As with protected trust deeds, funds are collected during the bankruptcy to pay creditors and, at the end of the bankruptcy, most outstanding debt is written off

The Bill’s proposals mainly cover personal bankruptcy, although some extend to protected trust deeds and DAS. The key provisions are:

- **compulsory money advice** for those entering bankruptcy. As advice is already a requirement for those entering DAS or a protected trust deed, this would have the effect of making advice compulsory before entering any statutory debt solution

- **financial education** for those whose circumstances indicate that it may be beneficial. A trustee may be able to “require” certain debtors to undertake financial education

- a **“common financial tool”** – based on the Common Financial Statement used by the Money Advice Trust – to be used to calculate how much of a debtor’s income can be used to repay creditors. The Bill’s provisions will require the use of the “common financial tool” for bankruptcy and DAS, and regulations will extend this to protected trust deeds

- the **debtor contribution order** – to be used to require a debtor to make any payments from income which they are assessed as being able to afford. Where a debtor does not co-operate, it will be possible to collect sums directly from third parties such as employers. The Bill proposes that the Accountant in Bankruptcy (AiB), rather than the sheriff, will be able to make debtor contribution orders

- **introduction of a “Minimal Asset Process” bankruptcy** for those with little in the way of income or assets. The “Minimal Asset Process” will replace the “Low Income Low Assets” (or LILA) route into bankruptcy and will be available to those with assets worth not more than £2,000 and who have been assessed as not being able to make a contribution from income using the “common financial tool” (or who have been in receipt of certain social security benefits for at least six months)

- **a freeze on a creditor’s ability to enforce debts** (also known as a “moratorium on diligence”) for an initial period of six weeks where a debtor notifies the AiB that they intend to apply for a statutory debt option. Such a moratorium currently exists in DAS

- **removal of automatic discharge from bankruptcy** – instead of the current process, where discharge is automatic and usually occurs one year from the date of sequestration, the Bill would introduce a requirement to apply for discharge. Discharge would only happen where the trustee agrees that the debtor has co-operated with the bankruptcy, including making payments from income and undertaking any financial education. The Bill also introduced a statutory “statement of undertakings” which outlines a debtor’s obligations in bankruptcy

- **measures to help creditors** including a requirement for creditor claims to be submitted within 120 days and mechanisms to enable trustees to make payments to creditors from a debtor’s estate sooner, where appropriate

- **transfer of powers from the sheriff court to the AiB** which, in the Scottish Government’s view, will free up court time. A number of stakeholders have expressed concern that, taking into consideration the AiB’s many other roles, such a transfer may exacerbate conflicts of interest

The Bill’s proposals will also extend the practical effects of bankruptcy to four years. Where a debtor is assessed as being able to make a contribution from income, they will be required to do so for at least four years (unless they can pay off all their debts before then). In addition, any assets which come into the debtor’s possession within four years of their bankruptcy will become the property of their trustee.

A table summarising the changes the Bill proposes to the current personal bankruptcy regime is available at page 32 of this briefing.

INTRODUCTION

The Bankruptcy and Debt Advice (Scotland) Bill was introduced in the Scottish Parliament on 11 June 2013 by John Swinney MSP on behalf of the Scottish Government. A Policy Memorandum and Explanatory Notes (and other associated documents) are also available. The Economy, Energy and Tourism Committee (referred to henceforth as the "Economy Committee") has been appointed the lead committee for the purposes of Stage 1 scrutiny of the Bill.

The Bill proposes to reform procedures in relation to personal bankruptcy (also known as sequestration). It is part of a "suite" of legislation reforming statutory debt solutions in Scotland. Other parts of this programme include:

- the Debt Arrangement Scheme (Scotland) Amendment Regulations 2013 (SSI 2013/225), which came into force on 2 July 2013

- the draft Protected Trust Deeds (Scotland) Regulations 2013 (laid 13 September 2013)

- the introduction of a Debt Arrangement Scheme-type option for business debts (a "business DAS")

- consolidation of bankruptcy legislation as recommended by the Scottish Law Commission

BACKGROUND INFORMATION

CURRENT STATUTORY DEBT SOLUTIONS IN SCOTLAND

The term "statutory debt solution" is used throughout this briefing to describe the options provided for in legislation for someone who cannot pay their debts. There are three such options – the Debt Arrangement Scheme (DAS), a protected trust deed and bankruptcy. All three are described in more detail below. The same regime applies to sole traders and partnerships (although partnerships cannot access DAS), but companies are covered by different insolvency procedures which are partly reserved to Westminster.

It should be noted that many debtors rely on an informal agreement with their creditors to repay debts at a reduced rate (this can be known as a "debt payment/management plan"), rather than pursuing one of the statutory options[1]. The advantage of the informal approach is that it is very flexible. However, creditors are not bound to agree to – or stick to – proposals and can pursue full payment at any point. This makes it an unstable option. There are also other options for dealing with debts, such as remortgaging or taking out a consolidation loan.

Debt Arrangement Scheme

DAS is a statutory scheme enabling people to make reduced payments towards their debts under a "debt payment programme" while being protected from court action by creditors. It was introduced by the Debt Arrangement and Attachment (Scotland) Act 2002.

[1] A Citizens Advice Scotland report from 2008 ("Restricted Access – the Debt Arrangement Scheme") suggested that an informal arrangement was the most popular option for Citizens Advice Bureau clients, with money advisers reporting that the next step for 31% of money advice clients would be to "negotiate with creditors" (see Fig. 1 in the report).

DAS can be described as a debt management option rather than a debt relief option because debts are not automatically written off as a result of participation. Instead, DAS is designed to allow debtors to repay their debts in full over a longer period of time. As a result, those with insufficient disposable income to repay their debts in full (eg. because they have a low income or a high level of debt) are not usually able to use DAS and must consider another way to deal with their debt situation. When a debtor enters DAS, interest and charges accruing on their debts are frozen for as long as the programme remains in operation. In addition, the most recent regulations[2] allow for debts to be written off where creditors agree and a debtor has participated in DAS for 12 years and paid of 70% of what they owe.

DAS is administered by the Accountant in Bankruptcy (AiB). Access is free to debtors but both the AiB and the agencies responsible for distributing payments to creditors take a percentage of the funds distributed to cover their costs. Where creditors object to a debtor's repayment proposal, the AiB applies a "fair and reasonable" test to decide whether to give approval to the debt payment programme. Unlike other statutory debt solutions, debtors are not required to sell any significant assets (such as a home or valuable car) to participate in DAS.

A debtor must receive advice from an "approved" money adviser before they can enter a debt payment programme. Previously, the AiB had identified that access to an approved adviser was acting as a barrier to debtors' using DAS[3]. The law was therefore amended in 2011 to allow a wider category of people to act as approved money advisers, including insolvency practitioners and their staff (who charge for their services), Citizens Advice Bureau advisers and local authority staff.

Protected Trust Deed

A "trust deed" is a voluntary agreement between a debtor and their creditors in which their income and assets are administered by an insolvency practitioner (known as a trustee) for the benefit of creditors. It is a form of personal insolvency and is regulated by the Bankruptcy (Scotland) Act 1985. When a trust deed becomes protected, creditors are prevented from taking court action against the debtor. In order to become protected, a majority of creditors are required to consent to the proposals contained in a trust deed (although, in practice, such consent is often "deemed" because a creditor has not responded).

Protected trust deeds generally cover a period of three years (although the draft Protected Trust Deeds (Scotland) Regulations 2013 will extend this to four years), during which a debtor is expected to make contributions to their debts from income and assets. After the agreed period, if the debtor has co-operated with the trustee, any outstanding debt is written off[4]. This makes the protected trust deed a form of debt relief. The insolvency practitioner will usually sell any assets of value, including a family home[5].

The trustee will charge a fee for administering a protected trust deed which is paid out of the debtor's estate (income and assets). This reduces the money available to be distributed to creditors. It also means that a debtor has to have some disposable income (or other assets) to enter a protected trust deed, otherwise an insolvency practitioner will not be prepared to administer it as they will not get paid. Thus, those on low incomes may not be able to access protected trust deeds.

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[2] Debt Arrangement Scheme (Scotland) Amendment Regulations 2013.

[3] See, for example, the AiB's "Debt Arrangement Scheme Review" (2008).

[4] Not all debts are written off in this manner. For example, court fines and student loans survive both bankruptcy and a protected trust deed.

[5] Note that the Home Owner and Debtor Protection (Scotland) Act 2010 made it possible to exclude the family home from a protected trust deed in certain circumstances.

Bankruptcy

When a debtor cannot pay debts of £1,500 or more, and they meet other criteria specified in the Bankruptcy (Scotland) Act 1985, they are able to apply for personal bankruptcy. In addition, creditors can, in certain circumstances, force a debtor into bankruptcy. In either case, the debtor's assets are administered by a trustee (an insolvency practitioner or the AiB) for the benefit of creditors. It is also usual for the trustee to seek a contribution from income. Bankruptcy is regulated by the Bankruptcy (Scotland) Act 1985.

Bankruptcy currently lasts for a period of one year in most circumstances (although the Bill's proposals will increase the practical impact of bankruptcy to four years). A contribution from income is usually made for three years. The trustee can generally sell any valuable assets, including a family home in order to release funds to pay creditors.

The costs of administering a bankruptcy are met from the debtor's estate and, where there is insufficient money, by the trustee. Therefore, insolvency practitioners are unlikely to be willing to take the role of trustee unless they are sure that they can realise sufficient funds in the estate to meet their fees and costs. In most bankruptcies, the AiB is the trustee and any shortfall in administration costs is met by the public purse.

In the past, some debtors could not access bankruptcy because they could not demonstrate that they were "apparently insolvent" (which usually required a creditor to take court action against them). This meant that there was a group of predominately low income debtors who could not use any statutory debt solution. However, two new "routes" into bankruptcy have since been created which have opened up access to bankruptcy. These are:

- **the "Low Income Low Assets" route** – the Bankruptcy and Diligence etc. (Scotland) Act 2007 introduced the "Low Income Low Assets" (or LILA) route into bankruptcy. This is available to those in receipt of social security benefits or National Minimum Wage-level incomes who do not own land or buildings and who have minimal assets. The Bill proposes to replace the LILA route with a "Minimal Asset Process"

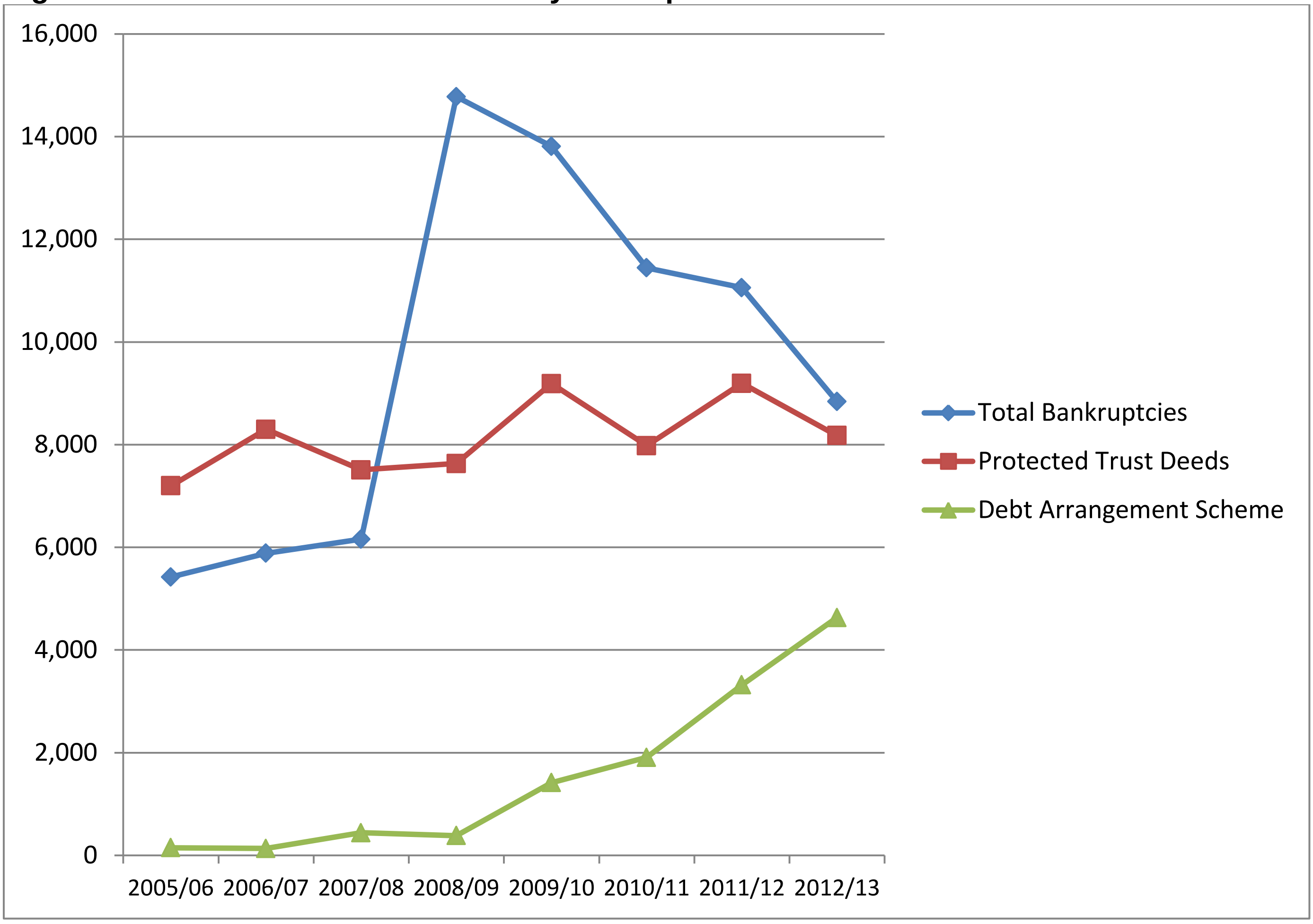
- **the "Certificate for Sequestration" route** – the Home Owner and Debtor Protection (Scotland) Act 2010 enabled money advisers and insolvency practitioners to issue a Certificate for Sequestration to debtors who could not pay their debts. This, in turn, allowed the debtors to apply for their own bankruptcy without the need to demonstrate apparent insolvency

Trends

The graphs below look at recent trends in the use of the three statutory debt options. Note that LILA bankruptcies were introduced in April 2008. This is likely to have contributed to the steep rise in bankruptcies at this time as there was believed to be significant pent-up demand for the LILA route into bankruptcy from debtors who had previously been unable to access bankruptcy.

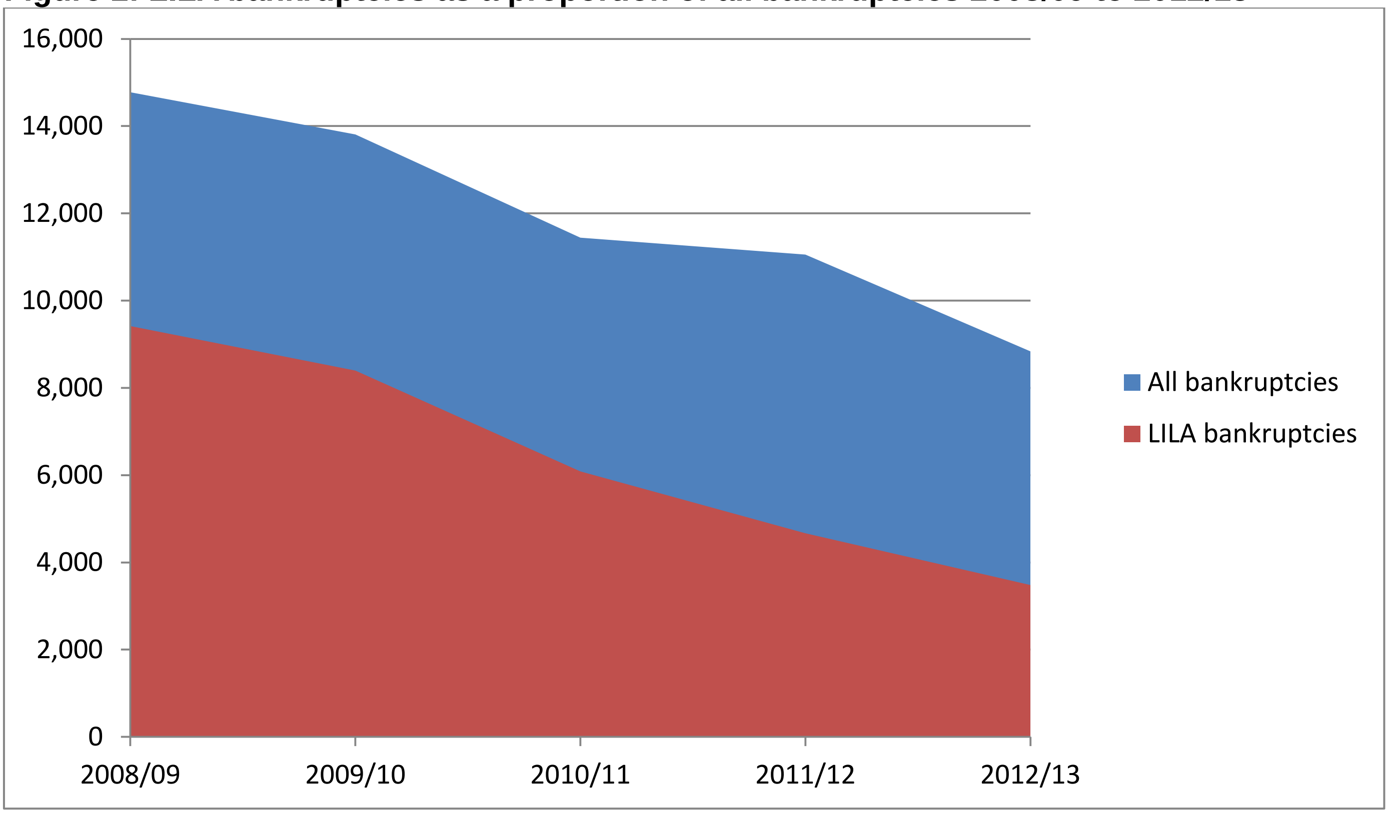
The second graph highlights LILA bankruptcies as a proportion of all bankruptcies since they were introduced in 2008.

Figure 1: Trends in the use of statutory debt options 2005/06 to 2012/13



Source: AiB

Figure 2: LILA bankruptcies as a proportion of all bankruptcies 2008/09 to 2012/13



Source: AiB

THE ROLE OF THE ACCOUNTANT IN BANKRUPTCY

The office of Accountant in Bankruptcy was created by the Bankruptcy (Scotland) Act 1856. The AiB's duty was to supervise all bankruptcy proceedings. In the intervening years, the office was merged with that of the Accountant of Court. However, the AiB was given new duties to act as trustee in cases where the debtor's estate was likely to be insufficient to cover the cost of administering the bankruptcy by the Bankruptcy (Scotland) Act 1993[6]. This led to the office being re-constituted as a separate person. The AiB remains an officer of the court, although the office also has executive functions conferred on it by Scottish Ministers. The current AiB is Rosemary Winter-Scott. The AiB appoints staff and agents to carry out work on her behalf.

The AiB currently has the following duties under the Bankruptcy (Scotland) Act 1985:

- the supervision of trustees and commissioners[7] in bankruptcy – and trustees in protected trust deeds – in carrying out their legal functions
- acting as trustee in certain bankruptcies
- auditing the accounts of trustees (in both bankruptcy and protected trust deeds) and fixing their fees and outlays where requested to do so
- the determination of debtor applications for bankruptcy
- applying to a sheriff for a bankruptcy restriction order to be imposed on a debtor (although the Bill proposes to give the AiB this power without the need to apply to a sheriff)
- maintenance of the Register of Insolvencies
- the provision of an annual report to the Court of Session and Scottish Ministers

Where the AiB has reason to believe that a trustee is not performing their legal duties, she must report the matter to the sheriff (who can take steps to censure or remove the trustee from office). If she suspects a criminal offence has been committed by a trustee, debtor or third party, she must report the matter to the Lord Advocate.

Under the Debt Arrangement and Attachment (Scotland) Act 2002, the AiB is responsible for the administration of DAS, including the approval of debt payment programmes.

EUROPEAN UNION INITIATIVE IN RELATION TO BANKRUPTCY

The European Commission has adopted a policy which aims to focus on the needs of small and medium-sized enterprises (SMEs) – broadly speaking, any business with less than 250 employees. As part of this initiative, the European Commission drew together experts nominated by 33 member and related states to look into how to reduce the impact of bankruptcy on entrepreneurship. Their report, "A Second Chance for Entrepreneurs" (European Commission 2011), made a number of recommendations. They concluded (page 4):

[6] The policy rationale was to reduce the cost of bankruptcy procedures to the public purse as, between the coming into force of the Bankruptcy (Scotland) Act 1985 and 1993, insolvency practitioners were able to claim their administration costs in such cases from the state.

[7] It is possible for creditors to elect representatives known as commissioners to oversee a bankruptcy. This is not thought to be common practice.

> "Fear of bankruptcy and its consequences acts as an effective deterrent to entrepreneurship. An effective second chance policy is fundamental to send a message that entrepreneurship may not end up as a 'life sentence' in case things go wrong."

The report's recommendations target different stages in a business's progression towards bankruptcy. The overall aim is to preserve as many viable businesses as possible while providing effective procedures for quickly winding up businesses which are not viable and allowing the rehabilitation of honest business people.

Of key interest, in terms of the current Bill, are the experts' conclusions in relation to rehabilitation of bankrupts. The report stated (page 11):

> "A modern system for discharge is paramount to reduce the stigma of bankruptcy. In this system discharge should be as automatic and as reasonably limited in time as possible. In principle one to three years could be a good target to aim for. Contribution beyond the period of discharge is not reasonable and all debts should be discharged after this time."

The Bill's provisions would mean that Scotland's system of bankruptcy no longer meets these requirements.

The report suggests the first priority for improving entrepreneurship should be in preventing business failure – through advice and support to businesses to restructure. It seems likely that the planned "business DAS" (see below) would contribute to this objective by linking business-focussed advice to a debt restructuring process.

PREVIOUS SCOTTISH PARLIAMENT REFORMS

The Scottish Parliament has passed a number of pieces of legislation (including regulations) which alter the way statutory debt solutions operate. The main legislative initiatives are described below:

- **the Debt Arrangement and Attachment (Scotland) Act 2002** – this created the Debt Arrangement Scheme as a mechanism to "repay [multiple] debt by instalment in a managed way, free from the threat of enforcement action" (Debt Arrangement and Attachment (Scotland) Bill Policy Memorandum, paragraph 3)

- **the Bankruptcy and Diligence etc. (Scotland) Act 2007** – this reduced the period of bankruptcy from three years to one year in most cases "to promote an entrepreneurial culture" (Bankruptcy and Diligence etc. (Scotland) Bill Policy Memorandum, paragraph 2). It also created the Low Income Low Assets route into bankruptcy

- **the Home Owner and Debtor Protection (Scotland) Act 2010** – this reformed the protected trust deed and bankruptcy processes, including enabling protected trust deeds to exclude a family home in certain circumstances and introducing the "Certificate for Sequestration" route into bankruptcy

RELATED LEGISLATIVE INITIATIVES

As described above, the current Bill is part of a suite of legislation designed to reform statutory debt solutions in Scotland. The other parts of the programme are described in more detail below. Proposals in relation to DAS and protected trust deeds were consulted on at the same time as the bankruptcy reforms in the current Bill as part of the Scottish Government's "Bankruptcy Law Reform" initiative.

Debt Arrangement Scheme (Scotland) Amendment Regulations 2013

The 2013 Regulations were approved by the Economy Committee at its meeting on Wednesday 19th June 2013. They introduce further flexibility into DAS. The main changes implemented by the 2013 Regulations are:

- freezing the amount owed by the debtor at the date of application for a debt payment programme (rather than the date a debt payment programme is approved as was the case previously)
- enabling the AiB to review decisions it makes in relation to DAS. The option of formal appeal to the sheriff courts can still be exercised after the review has been completed
- enabling debts to be written off where a debtor has made payments under a debt payment programme for 12 years and has repaid at least 70% of the money owed. This is subject to creditor consent
- allowing a debtor to have payment breaks of up to six months without breaching the terms of their debt payment programme (previously a payment break was only possible for a fixed period of six months)
- removing the requirement that participants in a "joint debt payment programme" are jointly and severally liable[8] for at least one debt in the programme. Joint debt payment programmes can be used by couples to deal with a shared debt problem

Draft Protected Trust Deeds (Scotland) Regulations 2013

The Scottish Government has also brought forward proposals to reform protected trust deeds. There has been concern among creditors that protected trust deeds do not, in some cases, offer an acceptable rate of return as most of the value in the debtor's estate is used to pay the trustee's fees. In its "Bankruptcy Law Reform Consultation" (2012, paragraph 10.5.6), the Scottish Government noted that, of the protected trust deeds which were completed in 2010/11, 36% paid no dividend at all to creditors, and the average dividend across the rest was only 16.2 pence in the pound.

The Scottish Government has consulted on a range of proposals to address the perceived problems with the protected trust deed system. It has, however, been difficult to build stakeholder consensus in this area. In its "Bankruptcy Law Reform Update" (2013), the AiB noted:

> "This engagement identified a number of key issues which the majority of stakeholders were unable to support. These issues mainly, but not exclusively, related to protected trust deeds."

The Scottish Government laid regulations before the Scottish Parliament to take forward their proposals to reform protected trust deeds on 13 September 2013 – the draft Protected Trust Deeds (Scotland) Regulations 2013. The draft Regulations are subject to affirmative procedure and will be dealt with by the Economy Committee.

[8] To be jointly and severally liable for a debt, debtors must be equally liable to make payments. This is commonly the case with shared credit cards and Council Tax as well as debts where both parties have been signatories.

The main changes proposed by the draft regulations are:

- a minimum debt level of £5,000

- an extension from three to four years of the period in which a debtor is expected to make contributions from income. The period in which assets gained by the debtor (“acquirenda) vest in the trustee is also extended, from one year to four years

- a new requirement preventing a trust deed from becoming protected where a debtor is able to pay their debts in full from contributions from income in four years or less. The Scottish Government is of the view that DAS (where significantly more of the payments made would go to creditors) is likely to be a more appropriate solution for debtors who are able to repay their debts in this timescale

- better systems in place to provide information to creditors. This, it is argued, will mean that creditors are more likely to object to trust deeds which do not serve their interests. There will be a requirement to provide standard information about the trustee’s fees and the expected dividend to the creditor when notifying a trust deed application. There will also be a requirement to update creditors regularly and provide further explanation for significantly reduced returns

- trustees will be required to charge a fixed fee (augmented by further payments based on a percentage of the funds released to creditors during the administration of the case), rather than an hourly rate

- where exceptional circumstances require further paid work by the trustee, they will have to seek active approval for this from creditors (with an option for the AiB to approve the fee increase if creditors do not engage)

In addition, it is proposed that no debtor contributions will be accepted from social security benefits and that equity in a home will be frozen at the date the protected trust deed is granted[9].

Business DAS

The Scottish Government also proposes to introduce a Debt Arrangement Scheme-type option for businesses, with the intention that, in certain circumstances, businesses would be able to repay their debts over a longer period while continuing to trade. Regulations creating a “business DAS” are expected to be introduced in early 2014 (AiB, DAS Newsletter Edition 4). It should be noted that a “business DAS” would only be open to sole traders and partnerships as companies have their own insolvency regime (which is mainly reserved to Westminster). The Scottish Government sees such an option as beneficial to the economy. It stated: (2012, paragraph 11.4):

> “The success of the Scottish economy depends on a thriving business sector. Providing an early intervention mechanism that delivers advice, guidance and debt management solutions will play a key role in avoiding unnecessary business insolvency.”

The Bankruptcy Law Reform Consultation (see paragraphs 11 to 11.8) described a vision for a business DAS which would:

- only be available to businesses which were viable (non-viable businesses should consider a protected trust deed or bankruptcy)

[9] The current system gives trustees considerable flexibility in how they chose to value a home.

- cover business debt only (although the option to take out a concurrent debt payment programme for personal debt would be available)

- include an option for writing off some of the debt (although this would be based on being able to demonstrate that this represented a better result for creditors than the other likely options such as bankruptcy)

- be linked to the provision of business and money advice

Consolidation of Bankruptcy Legislation

The Scottish Law Commission has undertaken a project to consolidate existing bankruptcy legislation. Its "Report on the Consolidation of Bankruptcy Legislation in Scotland" (2013) gives more details. It states (paragraph 1.1):

> ". . . that Act [the Bankruptcy (Scotland) Act 1985] has been so heavily amended, on so many occasions, that it has lost coherence and rational structure. Many of its provisions (whether sections, subsections or paragraphs) are inordinately long; and numbering has become complex and unwieldy."

The Scottish Law Commission has therefore published a draft Bill which would consolidate the Bankruptcy (Scotland) Act 1985 in a more accessible form. However, the Scottish Law Commission's proposals also contain recommendations for amending the text of the 1985 Act – which would therefore go beyond straight consolidation (see Chapter 2 of the report).

Most of those amendments have been included in the current Bill at schedule 3. It is envisaged that a straight consolidation of the 1985 Act – following the Scottish Law Commission's recommendations but incorporating the changes made by this Bill – can take place at a later date. The Scottish Government's intention to bring forward such a bill in the current parliamentary year was announced as part of the Scottish Government's legislative programme 2013/14 (2013a).

CONSULTATION

The Scottish Government consulted on many of the proposals which appear in the Bill in its "Bankruptcy Law Reform Consultation" (2012). A summary of responses to the consultation is also available (Accountant in Bankruptcy 2012a), as are the Scottish Government's response (Accountant in Bankruptcy 2012b) and a 2013 update on proposals.

The consultation received 129 responses. Broadly speaking, the Scottish Government is using this Bill to take forward those proposals which had majority support. However, some of the proposals in the Bill were not consulted on, and some proposals have been dropped because, although there was support, it has not been possible to gain consensus on how they could be implemented.

The Scottish Government consulted separately on more detailed proposals in relation to protected trust deeds in "Protected Trust Deeds – Improving the Process" (2011). In addition, several working groups are involved in the ongoing development of proposals. For example, the Scottish Common Financial Tool Working Group has been looking at the development of one standard "common financial tool" (a means of assessing the proportion of the debtor's income available to pay creditors) for use across all statutory debt solutions. In addition, a Scottish National Standards Working Group on Financial Capability is being brought together to support and advise on the development of the Scottish Government's plans for financial education (Financial Memorandum paragraph 57).

A "FINANCIAL HEALTH SERVICE"

The Scottish Government describes the current Bill as delivering a "financial health service" for Scotland. The Policy Memorandum states (paragraph 4):

> "The provisions of appropriate debt advice, management and relief should be seen as a 'Financial Health Service', providing rehabilitation to individuals and organisations in relation to their financial pressures. Within the 'Financial Health Service' there will be a focus on individual responsibilities with renewed emphasis on individual debtors' responsibilities to co-operate. There is also mandatory debt advice for all those entering a statutory debt management or debt relief product which will assist in the rehabilitation of individuals going through the bankruptcy process thereby helping them contribute to the economy."

THE BILL

The main initiatives included in the Bill are discussed below.

COMPULSORY MONEY ADVICE

Section 1 of the Bill proposes that those seeking to go bankrupt would have to obtain advice from a money adviser. Those wishing to access DAS must already receive advice from an "approved" adviser, and those entering into a trust deed must do so using an insolvency practitioner. The effect of this provision will therefore be to make advice compulsory when accessing any statutory debt solution.

The Bill provides for regulations to prescribe who can provide money advice. The Policy Memorandum suggests (paragraph 23) that such advice will be provided by those who are "approved" advisers for the purposes of the Debt Arrangement Scheme (Scotland) Regulations 2011.

"Approved" money advisers

When DAS was first introduced, there were problems recruiting sufficient, appropriately trained money advisers to ensure that debtors in all parts of Scotland could access DAS. In order to deal with this issue, the Debt Arrangement Scheme (Scotland) Regulations 2011 made it less complicated to become an "approved" money adviser. Previously specific training was required for individual money advisers. Under the 2011 regulations, broad classes of people can become approved money advisers, including insolvency practitioners and those who work for them, Citizens Advice Bureau staff and local authority staff. Those in the private sector are able to charge for their services (although they are required to highlight the availability of free advice to their clients).

Figures from the AiB's Debt Arrangement Scheme Review 2012 (Annexe A, paragraph 3.4) show that 59% of debt payment programmes in the year from July 2011 to June 2012 were put forward by private sector money advisers, as opposed to 14% in 2010/11. The table below shows the ten money advice organisations accounting for the highest number of debt payment programmes.

Table 1: Top 10 money advice organisations by approved Debt Payment Programmes (DPPs) July 2011 to June 2012

Organisation	Sector	No. of DPPs approved	% of DPPs approved
Wilson Andrews	Private	1,430	34.3%
Knightsbridge Insolvency Service Ltd	Private	401	9.6%
Carrington Dean	Private	288	6.9%
Citizens Advice & Rights Fife	Public	223	5.4%
South Lanarkshire Council – Money Matters	Public	120	2.9%
North Lanarkshire Council	Public	99	2.4%
Glasgow City Council, DAS Team	Public	97	2.3%
MLM CPS Ltd	Private	93	2.2%
North Ayrshire Council Money Matters	Public	78	1.9%
Begbies Traynor Central LLP	Private	76	1.8%

Source: Debt Arrangement Scheme Review 2012, page 17 (AiB 2012e)

Financial implications of compulsory advice

The Financial Memorandum states that the AiB expects the requirement for compulsory money advice when entering bankruptcy to have a "manageable impact" on money advisers (paragraph 53). This is because AiB research indicates that only 6% to 8% of current bankruptcy applications are made without a debtor having accessed money advice (paragraph 53).

The AiB notes that money advice is now available through a number of different channels, including via telephone and using online tools, which may diffuse any impact. In addition, the AiB is introducing an online application process for use by money advisers making bankruptcy applications. The AiB expects this to create some efficiency savings for money advisers which may off-set the costs associated with increased demand for advice (Financial Memorandum, paragraph 53).

However, those providing money advice are concerned about the impact of the additional demand. In its response to the bankruptcy consultation (2012), Citizens Advice Scotland said (page 6):

> "CAS is broadly supportive of mandatory advice for all those considering debt relief, although we are concerned that this will place additional pressure on advice services that are already operating at capacity. Mandatory advice must be matched with adequate support and resources for those providing the advice. Free advice providers are already working at capacity following the recession, continued economic problems and public sector spending cuts."

In its response (2012), Money Advice Scotland stated (page 2):

> "the [money advice] sector is shrinking and needs to be adequately funded given the potential for increased demand. All current research from the Money Advice Trust and the Money Advice Service points towards there being greater demand for free, independent services, which presently are struggling to cope in some cases."

The free money advice sector is generally supported by local authorities, either by direct provision of advice through council outlets or by funding to advice-giving organisations such as Citizens Advice Bureaux (although independent organisations may also receive support from a variety of other sources).

FINANCIAL EDUCATION

Section 2 of the Bill makes provision for debtors in certain circumstances to receive financial education. The policy objective is to provide support to debtors to help them avoid financial problems in the future. The AiB is currently developing its proposals for a national standard for financial capability education in partnership with Money Advice Scotland (Scottish Government 2013b). This will be considered by the Scottish National Standards Working Group on Financial Capability discussed above.

Financial education is different from money advice. While money advice aims to help a debtor deal with their immediate, problematic financial situation, financial education aims to help an individual understand finances more generally by promoting good money management.

The Bill will make it mandatory for a trustee to "require" a debtor to undergo financial education in the following circumstances:

- where undertaking the course would be appropriate for the debtor

and one of the following situations applies:

- a debtor has taken similar steps to deal with a debt problem in the preceding five years, including a previous bankruptcy, protected trust deed or any form of debt management plan (including DAS)
- the debtor is subject to – or under investigation in relation to – a bankruptcy restrictions order (these extend the restrictions applying to a bankruptcy where the debtor has conducted themselves in a dishonest or uncooperative way)
- the trustee considers that the pattern of a debtor's behaviour suggests they would benefit from financial education
- the debtor agrees to undertake such a course

The summary of responses to the consultation (Accountant in Bankruptcy 2012a) suggested that respondents were in favour of financial education being an integral party of any statutory debt solution, but they did not think it should be mandatory. Instead, respondents were in favour of financial education which was "optional based on specific criteria" (paragraph 2.8). In addition, respondents argued that participation in financial education should not be linked to discharge from bankruptcy (paragraph 2.8). In its response to the bankruptcy consultation (2012), the Money Advice Trust said (page 7):

> "We do not support a compulsory element of any kind even if someone has previously been bankrupt. For financial education to work, it will be important that the person taking part is a willing participant."

Financial implications of requiring financial education

The Financial Memorandum to the Bill envisages that the money advice sector will deliver financial education to those who require it (paragraph 56). The AiB argues that such debtors will already have an ongoing relationship with a money adviser. Therefore, while the proposal may result in money advisers spending more time with clients, it will not lead to a rise in caseloads (paragraph 64). The AiB states (paragraph 64):

> “it is the AiB’s position this this change in the amount of time that money advisers may need to spend with some of their existing clients will not have a material impact on their overall capacity and caseload.”

Organisations representing money advisers or local authorities did not comment directly on the financial implications of this proposal in their responses to the Bankruptcy Law Reform consultation.

A “COMMON FINANCIAL TOOL”

Section 3 of the Bill proposes to create what is described as a “common financial tool”. The purpose of this tool is to assess what (if any) contribution from their income a debtor is able to make to pay to their creditors. This is done by subtracting necessary expenditure (such as mortgage/rent, food shopping or fuel bills) from a debtor’s income to see what is left over. Any surplus can be used to pay creditors and is known as “disposable” income. By introducing the mandatory use of one tool, the Scottish Government hopes to create transparency and consistency in the way debtors are treated so as, regardless of which organisation they approach or which statutory debt solution they opt for, the assessment will be the same.

The Bill makes provision for the requirement to use the “common financial tool” to assess the income of a debtor applying for bankruptcy or to DAS. The details of the scheme will be contained in future regulations.

It is proposed that this requirement will also be extended to protected trust deeds. The draft Protected Trust Deeds (Scotland) Regulations 2013 make transitional provisions to use the Money Advice Trust’s Common Financial Statement (described below). However, it is expected that future regulations will create one common financial tool for all statutory debt solutions.

It is the Scottish Government’s intention that the “common financial tool” will also be used to assess which statutory debt solution is the most appropriate for the debtor (although there may be other factors which impact on the actual statutory debt option chosen). The use of the “common financial tool” will also ensure that the debtor pays the same contribution from income, regardless of the statutory debt option they chose.

Those with sufficient disposable income to pay their creditors in full over four years will, in most circumstances, be expected to access DAS. Following on from this, the draft Protected Trust Deeds (Scotland) Regulations 2013 propose to prevent a trust deed becoming protected if the debtor can repay their debts from income in less than four years.

Those who cannot pay their debts in full over four years will, in most circumstances, be expected to access a protected trust deed or bankruptcy. Only those who are assessed as unable to make any contribution at all will be able to access the “Minimal Asset Process” bankruptcy proposed in the Bill.

The Scottish Government argues that the use of a “common financial tool” will increase transparency (Policy Memorandum, paragraph 34). However, it will also remove the considerable flexibility money advisers and insolvency practitioners currently enjoy. In its response to the Economy Committee’s Call for Evidence on the Bill (2013), the Institute of Chartered Accountants of Scotland (ICAS), noted the following (page 4):

> “We are of the view that [insolvency practitioners] can add significant value to the process of assessing the ability of a debtor to contribute to pay and in ensuring that such contributions are sustainable. We believe that a common financial tool should assist in this process but that this is best used as guidance alongside the experience and

knowledge of a trustee and that the use of a common financial tool which is prescriptive in its outcome will be counterproductive to achieving a balanced approach to debtor responsibility and creditor outcome."

There are currently two financial tools used by the money advice sector to assess clients' disposable income. The Common Financial Statement is used by many money advisers and has the backing of the British Bankers' Association and the Finance and Leasing Association (representing most mainstream lenders which are not banks). The other tool is used by debt advice charity StepChange (previously the Consumer Credit Counselling Service). StepChange is one of the UK's biggest providers of debt advice and was set up and supported by the credit industry in the UK.

The Scottish Government has set up the Common Financial Tool Working Group (described above) to look into the most appropriate tool for Scotland. The Working Group has recommended that the Common Financial Statement is adopted by the Scottish Government as its common financial tool (Scottish Government 2013b).

Background to the Common Financial Statement

The Common Financial Statement was created as a result of an agreement between the British Bankers' Association and the Money Advice Trust (a charity which supports money advice) to improve the way negotiations to make reduced payments towards debts were carried out. It is seen as being mutually beneficial in that offers from money advisers are dealt with quicker and with greater consistency while creditors benefit from efficiency savings in having standard processes in place.

The Common Financial Statement contains standard headings for household expenditure. It uses figures (the "trigger figures") from the Living Costs and Food Survey (a UK Government survey carried out by the Office for National Statistics) which represent average low income household expenditure in certain categories. As long as the standard format is followed and the expenditure presented is not higher than the average in that area from the Living Costs and Food Survey, creditors agree to accept the calculation of disposable income without further enquiry. This speeds up the process for both debtors and creditors.

The Common Financial Statement as it is currently used provides for extensive flexibility. It is open to a debtor/money adviser to put forward expenditure above the average figures and provide an explanation for this. An example might be where a debtor spends money beyond what is average on a car which they need to travel to work. It is then up to the creditor whether they agree to accept the calculation on this basis. Debtors may also put forward expenditure which is below average in any area and use the surplus to make bigger payments to their debts. The Scottish Government states that it will retain this flexibility in designing the "common financial tool". In addition, consideration will be given to developing guidance which takes into account the cost of living in remote and rural parts of Scotland (2013b).

BANKRUPT DEBTOR CONTRIBUTIONS FROM INCOME

Current law

Under the current law, a debtor's income does not actually vest[10] in the trustee in a bankruptcy (except any income derived from assets, which does vest in the trustee- eg. share income). It is, however, usual practice for a trustee to request a contribution from income where the debtor

[10] The term "vest" describes the legal transfer of ownership from the debtor to the trustee. An asset will vest in the trustee regardless of any steps taken by the debtor to try to maintain possession of it.

has sufficient income to justify it. A trustee is also able to apply to a sheriff for an income payment order, requiring a contribution from income to be made should a debtor's co-operation not be forthcoming. The requirement to make payments from income cannot currently last for more than three years.

Debtor contribution order

Under the Bill's provisions, it is proposed that an appropriate contribution from the debtor's income during bankruptcy will be calculated using the common financial tool (see above). Section 4 of the Bill enables the AiB – rather than a sheriff – to make an order requiring a contribution from the debtor. This will be known as a debtor contribution order. The Policy Memorandum argues that this will be a mainly administrative process as a result of the use of the common financial tool to calculate appropriate payments (paragraph 44).

It is also proposed that a debtor contribution order will last for four years. This period can be shorter – but only where a debtor makes sufficient payments (from income or assets) to settle their debts in full. The period can also be longer, either because the debtor has taken a payment break (discussed below) or because the debtor agrees to make payments for a longer period. The draft Protected Trust Deeds (Scotland) Regulations 2013 propose to extend the requirement to make payments from income from three to four years for protected trust deeds.

Respondents to the consultation (Accountant in Bankruptcy 2012a) were not asked directly about whether the AiB should take on the function of issuing payment orders. However, they agreed broadly that the AiB should take over court functions which were "mainly administrative". The question of whether the repayment period should be extended to four years was not raised directly in the formal consultation. However, the AiB states that stakeholder views on this issue were probed in follow-up meetings.

In its response to the Economy Committee's Call for Evidence on the Bill (2013), Money Advice Scotland stated (page 3):

> "In the first instance we believe that the new period of 4 years (48 payments) is too long. We also question where the evidence is that the existing system isn't working for creditors and debtors. In this economic climate where wages are staying at levels of 2 years ago and more, inflation, and the general cost of living is difficult, it does not make economic sense to increase the period of bankruptcy."

In its response (2013), ICAS stated:

> "While we can see the initial attractiveness of the duration of debtor contributions being extended from 3 years (from the date of insolvency) to 48 months (beginning with the first payment), we would question whether there has been any analysis carried out of debtor contribution breakage timescales or the cost benefit to a sequestration estate of this extended time period."

Third party deductions

The Bill proposes that it will be possible to require a third party, including an employer, to make payment to the trustee of any money owed to the debtor. In the case of an employer, this is equivalent to an "earnings arrestment" where an employer is required to pay a proportion of the debtor's salary to a creditor.

In some types of employment (eg. certain financial services), it is possible to dismiss an employee if they have debt problems. Debtors in this situation will usually be keen to keep their financial problems hidden from their employer. Under the Bill’s provisions, it will only be possible for a trustee to require contributions to be deducted from the debtor’s salary by an employer if the debtor fails to make the contribution themselves on two occasions. The trustee will also have discretion in relation to whether to approach an employer directly.

It will be possible for a debtor to request that a debtor contribution order is varied because they have had a change of circumstances. It will be up to the trustee to decide whether to grant a variation. In most circumstances, the trustee will be the AiB (or someone acting on her behalf). However, it is also possible for the trustee to be an insolvency practitioner in private practice. It will be possible for the debtor, or any other interested party, to request that the AiB reviews any decision regarding a variation. Thereafter, it will be possible to appeal to a sheriff.

Payment break

The Bill will also enable debtors in bankruptcy to apply for a “payment break”. Payment breaks in the same style is currently permitted for those using DAS. The Policy Memorandum states (paragraph 65) that the majority of consultees agreed that a “payment break” should be available across all statutory debt solutions. The draft Protected Trust Deeds (Scotland) Regulations 2013 make no provision for a formal “payment break” in protected trust deeds. However, there is flexibility within the protected trust deed regime for such breaks to be agreed informally.

A payment break can be for up to six months and can be applied for, in certain circumstances, where the debtor’s disposable income (the income available to pay creditors) has been reduced by at least 50%. This will be calculated using the “common financial tool”. It will only be possible to apply for one payment break during the course of a bankruptcy.

The circumstances in which a payment break can be applied for are:

- where the debtor is experiencing a period of unemployment or a change in employment
- where the debtor is on leave from employment due to the birth or adoption of a child, or the need to care for a dependant
- where the debtor is ill
- where the debtor is going through a divorce or dissolution of a civil partnership
- where someone who shared the care of a dependant with the debtor has died

It will be up to the trustee to decide whether to grant a payment break if, in their opinion, it is fair and reasonable. The trustee will usually be the AiB (or someone acting on her behalf) but may also be an insolvency practitioner in private practice. The debtor, or any other interested party, may ask the AiB to review any decision in relation to a payment break. Thereafter, it will be possible to appeal the decision to a sheriff.

Where a payment break is granted, additional contributions will be expected at the end of the four year contribution period to cover the payments missed as a result of the break. Its effect will therefore be to extend the length of time a debtor is expected to make contributions towards their debts in bankruptcy.

“MINIMAL ASSET PROCESS” BANKRUPTCY

Current LILA process

Currently, debtors with little in the way of income or assets can use a special route into bankruptcy – known as the “Low Income, Low Assets” (or LILA) route. This was introduced by the Bankruptcy and Diligence etc. (Scotland) Act 2007. The policy rationale behind its introduction was that there were a group of low income debtors who could not, at the time, access bankruptcy because they could not demonstrate “apparent insolvency”.

Demonstrating “apparent insolvency” usually requires a creditor to take court action to enforce a debt. Creditors are often reluctant to take court action against low income debtors because, if the debtor has little in the way of income or assets, they will be unable to recover their debt or the associated costs of court action and enforcement.

The LILA route into bankruptcy is only open to debtors who meet certain criteria in relation to income and assets. There is no requirement to demonstrate “apparent insolvency”. The AiB is always the trustee in LILA cases. The number of LILA bankruptcies over the years since the route was introduced are highlighted in the “Trends” section above.

Bill’s proposals

The Bill proposes to replace the LILA route with a new “Minimal Asset Process” which is intended to be used by a similar group of debtors, although the entry criteria will be more restrictive. The Scottish Government believes that the criteria will, however, be clearer, ending alleged confusion among stakeholders. The Policy Memorandum states (paragraph 76):

> “The Scottish Government acknowledge that the criteria for the current Low Income Low Assets (LILA) route into bankruptcy are perhaps too broad and this has resulted in some stakeholders being confused or uncertain about what happens to an individual who is made bankrupt through this route.”

In the years since the LILA route was introduced, it has been necessary to transfer a number of cases from LILA to full bankruptcy because the criteria for accessing the LILA route were not met (see paragraph 77 of the Policy Memorandum).

The criteria for the new “Minimal Asset Process” are as follows:

- the debtor must be habitually resident in Scotland
- the debtor must receive money advice (in accordance with the Bill’s proposals at section 1)
- the debtor must pay the fee (this is currently £200 but it is expected that a reduced fee for the “Minimal Asset Process” will be introduced)
- the debtor owes at least £1,500 but no more than £10,000
- the debtor has not successfully applied for their own bankruptcy in the past five years
- the debtor has not been made bankrupt under the “Minimal Asset Process” in the past 10 years

- the debtor has been assessed by the “common financial tool” as having no disposable income with which to pay creditors or has been in receipt of certain social security benefits for at least six months

- the debtor does not have assets worth more than £2,000 (with no single asset being worth more than £1,000)[11]

- the debtor does not own any land or buildings

- the debtor has been granted a “certificate of sequestration”

- the debtor signs a “statement of undertakings” (in accordance with the Bill’s provisions at section 9)

A “Minimal Asset Process” bankruptcy will last for six months, although a debtor will be restricted in accessing further credit for an additional six months. The AiB will act as trustee in all such bankruptcies. The Bill’s provisions also minimise the administration requirements for such bankruptcies so, for example, the AiB will not have to contact creditors as there will be no dividends to distribute.

The Bill enables a “Minimal Asset Process” bankruptcy to transfer to a full bankruptcy (where the normal administrative requirements would apply) should this be necessary. Such action may need to be taken where, for example, it is discovered that a debtor has (or has acquired since the bankruptcy was originally dealt with) assets above the maximum value.

Those who cannot access bankruptcy using the “Minimal Asset Process” will usually be able to apply for full bankruptcy. The effects of full bankruptcy are, broadly speaking, the same. However, there will be a heavier administrative burden on the trustee as there may be income and assets which can be released for the benefit of creditors.

The “Minimal Asset Process” bankruptcy process contains more restrictions that the LILA route. Thus, fewer people will be eligible to use it. The table below compares the two processes.

[11] A car worth up to £3,000 which is “reasonably required” for the use of the debtor is excepted from this requirement.

Table 2: A comparison between the LILA route into bankruptcy and the proposed "Minimal Asset Process"

ENTRY CRITERIA	LILA	MINIMAL ASSET PROCESS
Minimum debt level	£1,500	£1,500
Maximum debt level	None	£10,000
Can the debtor own land?	No	No
Can the debtor own assets?	Assets of up to £10,000 with no single asset worth more than £1,000*	Assets of up to £2,000, with no single asset worth more than £1,000*
What are the income requirements?	Social security benefits or income below £247.60 (2012/13 levels) per week	Social security benefits (which must have been in payment for at least six months) or assessed as having no disposable income using the "common financial tool"
How is insolvency demonstrated?	No requirement to demonstrate insolvency	"Certificate for Sequestration" issued by adviser
Are there other restrictions?	• must be habitually resident in Scotland • must pay the fee • must not have successfully applied for own bankrupt in the past five years	• must be habitually resident in Scotland • must pay the fee • must not have successfully applied for own bankrupt in the past five years • must not have had a "Minimal Assets Process" bankruptcy in the past ten years • must have received money advice • must have signed a "statement of undertakings"
When will the debtor be discharged from bankruptcy?	After one year	After six months (although credit restrictions will remain in place for a further six months)

Source: Policy Memorandum (Bankruptcy and Debt Advice (Scotland) Bill 2013) and Accountant in Bankruptcy

*As described above, a car worth up to £3,000 which is "reasonably required" for the use of the debtor is excepted from this total.

FREEZE ON CREDITORS' ABILITY TO ENFORCE DEBTS

Section 8 of the Bill proposes to introduce what is referred to as a "moratorium on diligence". Diligence is the technical term for action a creditor can take (after they have been to court) to enforce a debt, such as seizing wages in the hands of an employer or money in a bank account. The Bill proposes that a creditor's ability to use diligence against a debtor will be frozen for an initial period of six weeks if a debtor intimates to the AiB that they intend to apply for a statutory debt solution. The policy intention is that the debtor will have time to get money advice and consider the most appropriate course of action without threat of their creditors taking action against them.

A moratorium on diligence currently exists for those applying for DAS. The Bill will introduce a similar facility for those applying for bankruptcy or a trust deed which may become protected. The provisions in the Bill will also apply to DAS (the intention is that current arrangements for DAS will be repealed when the provisions in the Bill come into force).

Where a debtor gives notice in writing to the AiB that they intend to apply for a statutory debt solution, the AiB must record this in the Register of Insolvencies[12] (or the DAS Register) so that creditors are able to check whether a debtor comes under the Bill's protections when considering enforcement action. A debtor will only be able to apply for one moratorium in any 12 month period. The Scottish Government's reason for this is to prevent a debtor being able to extend a freeze on creditor action indefinitely, thus defeating a creditor's right to payment (Policy Memorandum, paragraph 93).

Where a debtor applies for a statutory debt solution during the moratorium period, the freeze will be extended until the outcome of the application is decided. If, at the end of the process, the application is unsuccessful, a creditor will be able to take enforcement action once more. However, DAS, bankruptcy and protected trust deeds all work to prevent a creditor taking enforcement action while a debtor is participating in the arrangement. Thus, if an application is successful, protection from diligence will continue under whichever statutory debt solution the debtor has entered.

THE "STATEMENT OF UNDERTAKINGS"

Section 9 of the Bill proposes to introduce the requirement for debtors entering bankruptcy to sign a "statement of undertakings". The purpose of the statement of undertakings is to ensure that a debtor has a clear understanding of their obligations during bankruptcy. This is, in turn, linked to the Bill's proposals that discharge from bankruptcy should not be automatic but should depend on the co-operation of the debtor (discussed below). The policy intention behind the introduction of a statement of undertakings is therefore to ensure that the requirements of co-operation are clear to the debtor.

It is intended that the requirements contained in a statement of undertakings will be prescribed by regulations. A draft version of the statement is included at Annexe A to the Policy Memorandum. It contains the following obligations (among other statements):

- to provide the trustee with financial information and documents which may be legally required
- to make ongoing contributions from income (as assessed using the "common financial tool")
- to continue to pay "ongoing liabilities" (such as council tax and fuel bills) during the bankruptcy
- to fully disclose assets and to notify the trustee if additional assets are inherited, won or otherwise acquired during the bankruptcy

[12] The Register of Insolvencies is a publicly available register in which certain details about bankruptcies and trust deeds are recorded. Creditors and credit reference agencies use the information in the Register to update the details they hold in relation to individuals. The DAS Register performs the same function for DAS applications.

- to inform the trustee of any change of address or change in financial circumstances during the bankruptcy

DISCHARGE FROM BANKRUPTCY

Current discharge process

The current law allows automatic discharge from bankruptcy after one year. The effect of discharge is that the debtor is no longer subject to the restrictions which apply under bankruptcy (such as a limit on credit which can be sought and debarment from certain positions, such as being an MSP or a company director) and is relieved of the obligation to pay the debts covered by the bankruptcy (debt relief). At present, assets which the debtor acquires after discharge do not usually vest in the trustee (although the law in this area is complicated). However, the requirement to make payments from income (either by agreement or as a result of the court making an income payment order) can last for three years and therefore continue after discharge.

It is possible for a trustee or creditor to apply to the sheriff to defer a debtor's discharge. This could be considered where a debtor was not co-operating with the bankruptcy process – eg. by refusing to surrender assets – meaning that creditors had not received everything they should from the debtor's estate. A sheriff can defer discharge for up to two years (and a trustee/creditor can make further applications at the end of a discharge period if co-operation is still not forthcoming). However, the Scottish Government suggests that this process is not often used. It states (Policy Memorandum, paragraph 139):

> "This can be a costly and time consuming process and is not often used."

It is worth noting that, unless a trustee considers that assets of sufficient value to justify the expense of court action can be realised, they would be unlikely to consider applying for deferral to be worthwhile.

Bill's proposals

Sections 16 to 18 of the Bill propose changes to the discharge process to ensure that discharge is linked to debtor co-operation. It will therefore no longer be automatic. The process proposed in the Bill varies depending on whether the trustee is an insolvency practitioner or the AiB.

In the case of an insolvency practitioner, the process is as follows. A trustee is able to apply for the discharge of a debtor from 10 months after the date bankruptcy was awarded (although discharge would only be effective from 12 months after bankruptcy at the earliest) and must do so before applying for their own discharge[13]. A debtor may request that their trustee applies for the debtor's discharge but can only make one such request in any period of 12 months (unless exceptional circumstances apply). The trustee must then consider whether it is appropriate for an application to be made.

Any application for a debtor's discharge must be accompanied by a declaration (or, in circumstances where a declaration is not appropriate, a report) from the trustee stating that:

- the debtor has complied with any requirement to make contributions from income

[13] A trustee's discharge removes from them any liability for their dealings with the debtor's estate (except where their actions were fraudulent). A trustee can only apply for their own discharge when they have completed their administration of a debtor's estate and distributed any available funds to creditors.

- the debtor has co-operated with the trustee
- the debtor has complied with the statement of undertakings (discussed above)
- the debtor has surrendered all assets to the trustee (including any rights the debtor may have to claim against others)
- the debtor has given the trustee all relevant documentation relating to their financial affairs
- the trustee has fulfilled their functions, including realising the debtor's assets, distributing funds to creditors and ascertaining the reasons for the debtor's insolvency

The trustee, the debtor or creditors may make representations to the AiB. The AiB is responsible for making the decision as to whether discharge is appropriate. A trustee, debtor or creditor may request that the AiB reviews any decision and, thereafter, may appeal the matter to a sheriff.

Where the AiB is the trustee, the Bill proposes a similar process. "As soon as is practicable" after a bankruptcy has been in place for one year, the AiB must consider whether to discharge a debtor. She must inform the debtor and creditors of her decision and provide a report containing details of the debtor's financial affairs and conduct during the bankruptcy. The debtor or creditors may request that the AiB reviews any decision and, thereafter, may appeal to a sheriff. If the AiB decides not to discharge a debtor, she must reconsider the matter again in a year's time.

The proposals in the Bill place considerably more responsibility on the trustee to reach a decision as to the debtor's suitability for discharge. In its response to the Economy Committee's Call for Evidence (2013), ICAS states (page 5):

> "The proposals shall not only result in additional time and cost administering the discharge process by the trustee and the resultant lower return to creditors, but it is highly possible that debtors shall not receive their discharge until the end of their contribution period in order that the trustee can make the relevant declaration that the contribution order has been complied with and that the debtor has co-operated with the trustee."

The Bill also makes provision for situations where a debtor who has been made bankrupt cannot be found. Currently a debtor in this situation would benefit from automatic discharge after one year. Under the Bill's proposals, their discharge will be deferred indefinitely. The Bill also contains provisions which will allow a discharge to be granted subsequently if a debtor is traced or makes contact with their trustee.

A trustee who cannot trace a debtor must apply to the AiB for indefinite deferral of discharge between eight and ten months after the award of bankruptcy has been made. If the AiB is satisfied that it would not be practical for the trustee to continue to search for the debtor, she must issue a certificate deferring the discharge. Where the AiB is trustee, a similar process of considering whether it would be practical to continue to search for the debtor applies.

Once a trustee who is an insolvency practitioner has been granted an indefinite deferral of the debtor's discharge, they are able to resign from office. The AiB will take over as trustee. A trustee who resigns in this manner is not able to recover their fees and expenses except by claiming in the final distribution of the debtor's estate. This would require the debtor to either reappear at some later date or have assets which could be dealt with in their absence. In its response to the Economy Committee’s Call for Evidence on the Bill (2013), ICAS states (page 9):

> “We do not agree that where the AiB becomes the trustee when the debtor is untraced that the costs of the original trustee can only rank as a claim in the sequestration. This appears an attempt to encourage creditors to appoint the AiB as trustee as some IPs may not be willing to act speculatively.”

Repeal of discharge on composition

It is currently possible for a debtor to be discharged from their bankruptcy if their creditors accept an offer to pay at least 25 pence in every pound owed (an agreement to consider a debt satisfied when only a proportion is paid is known as “composition”). Such an offer is circulated to creditors and, if insufficient actively object, the proposal is deemed to be agreed to.

The Bill’s provisions will repeal discharge in this manner. The Scottish Government considers that there should only be two routes out of bankruptcy – full payment (allowing “recall” of the bankruptcy) or debt write-off. It states that discharge on composition is a “confusing” option (Policy Memorandum, paragraph 153). It also notes that there have been fewer than five applications in the past five years (paragraph 156).

CREDITOR MEASURES

The Bill contains several measures which, it is argued, will improve the bankruptcy process for creditors.

Creditor claims to be submitted within 120 days

Section 13 of the Bill would have the effect of decreasing the time period available to creditors to submit claims on the estate of a bankrupt debtor. Currently, in order to receive a payment within any 12 month “accounting period”, a creditor must submit a claim not later than eight weeks before the end of the accounting period. The Bill’s proposals would change this so that a claim would have to be submitted within 120 days of a creditor having received notice of their entitlement to make a claim.

The Scottish Government states that the intention behind this proposal is to ensure the best return for creditors (Policy Memorandum, paragraph 117). This view is explained further at paragraph 120:

> “Any delay in receiving a claim can impact on the calculation of dividends. If the evidence of debt claimed shows a different figure to that initially provided by the individual then a recalculation of a dividend would be required. This may mean that the trustee does not have the full information on which to base any decisions, such as whether to sell assets.”

Under the Bill’s proposals, it would still be possible for a creditor’s claim to be considered as long as it was submitted not later than eight weeks before the end of any accounting period, and the creditor provided a “reasonable explanation” as to why it was submitted late. It may also be noted that the current law (which would not be altered by the Bill) allows a trustee to pay dividends in relation to late claims (so that the creditor will not actually lose out) as long as there are sufficient funds to do so.

Shorter first accounting period

Section 14 of the Bill would make it possible to have a shorter first accounting period. This would have the effect of getting dividend payments to creditors more quickly in some cases.

The first accounting period currently lasts for one year from the date of becoming bankrupt. Under the Bill's provisions, it would be possible for this accounting period to be shortened where the trustee considered that there are sufficient funds to pay a dividend. Six months would be the minimum accounting period. Where the trustee is the AiB, she would be free to "determine" whether a period of less than one year is feasible. Where the trustee is an insolvency practitioner, a shorter first accounting period would be agreed between the trustee and the AiB (or commissioners where these have been elected).

There will be circumstances where it will not be appropriate to make an earlier payment to creditors. This may be because it has not been possible within a shorter timescale to establish the debtor's assets and liabilities. It may also be because insufficient funds have been gathered to make the distribution of dividends worthwhile (especially considering a trustee must make provision for likely future liabilities – such as the payment of their fees).

Extension of period in which assets vest in trustee

Any assets which the debtor acquires during their bankruptcy automatically vest in the trustee. Such assets – which were not owned by the debtor at the time they were made bankrupt but come into their possession before they are discharged – are known as "acquirenda". This could include things like money won in a lottery or a legacy paid out on the death of a relative.

The issue is particularly relevant at present because it may also include compensation paid to someone who was mis-sold payment protection insurance (which provided insurance against being unable to pay instalments of a loan if, for example, the debtor became unemployed). A number of banks and other lenders are currently being required to refund (and in some cases compensate) customers because payment protection insurance was mis-sold to them. In the case of someone who is bankrupt at the time a payment is made, the money can be used for the benefit of creditors.

Currently, any assets which are acquired during bankruptcy usually vest in the trustee. This period runs from the date a person is made bankrupt until the date they are discharged, which will usually cover the period of one year. Under the Bill's proposals, any assets which a debtor acquires within four years of their bankruptcy will automatically vest in the trustee (regardless of whether the debtor receives their discharge before this). The draft Protected Trust Deeds (Scotland) Regulations 2013 also propose to extend the acquirenda period to four years for protected trust deeds.

This proposal did not appear in the Scottish Government's consultation (2012). However, the Scottish Government reports that stakeholders were given an opportunity to comment during subsequent stakeholder events (Policy Memorandum, paragraph 134). In its response to the Economy Committee's Call for Evidence on the Bill (2013), ICAS notes the following (page 8):

> "We are concerned that the consequence of this is that debtors shall not be able to move on from their bankruptcy for a significant period of time. For example, they shall not be able to change their motor vehicle, purchase a house, etc. notwithstanding that they may be in a position to do so after taking into account their contribution or that they may be gifted such assets from family members. It appears that the proposed amendment seeks to act as a penalty to bankruptcy rather than having anything to do with debtors being able to pay doing so. Furthermore, we are concerned about the practicality of such a

lengthy period of co-operation and whether there will be any significant return to creditors arising from this change."

TRANSFER OF FUNCTIONS FROM COURTS TO AIB

The Bill makes provision to transfer a number of functions which are currently carried out by the courts to the AiB. The powers which may be gained by the AiB are:

- the power to grant a debtor contribution order (previously a sheriff would set required contributions from income if necessary)
- the power to deal with an application from an executor to make a deceased debtor's estate bankrupt
- the power to re-open cases where assets which should have vested in the trustee are discovered after the debtor has been discharged
- the power to discharge debtors (previously, discharge was automatic with trustees able to apply to the sheriff if they wished discharge to be delayed)
- the power to deal with applications by trustees for directions on how to deal with a case
- the power to recall a bankruptcy where a debtor can repay their debts in full (along with the administration costs of the bankruptcy). Recalls for other reasons (eg. errors in the original award) will remain with the sheriff
- the power to decide on any objections to the appointment of a replacement trustee
- the power to replace a trustee acting in multiple bankruptcies where that trustee dies or ceases to be qualified to act as a trustee (the current procedure requires an application to the Court of Session)
- the power to remove a trustee from office where the AiB is "satisfied that there are reasons to do so" or, specifically, where the trustee is unable to act or has conducted themselves in a manner which means they should no longer act
- the power to extend the time a trustee has to decide whether to continue with a contract entered into by the debtor. A trustee may choose to continue contracts where it would be beneficial to the interests of creditors. Where the AiB is trustee, an application must still be made to the sheriff
- the power to make bankruptcy restrictions orders (which extend the restrictions which apply during bankruptcy for a longer period). These are used where a debtor has behaved dishonestly or uncooperatively
- the power to convert a trust deed to bankruptcy where proceedings are underway in another European Union country
- the power to cure defects in the bankruptcy procedure where these relate to clerical errors or a failure to comply with any time limit laid down in the Bankruptcy (Scotland) Act 1985 (where no alternative procedure for dealing with the time limit is laid down in the legislation). The Sheriff will remain responsible for dealing with other defects in procedure including those relating to documents lodged with the court or time limits in court proceedings

- the power to value “contingent” debts (ie. debts which are dependent on some future event such as the outcome of a court case)

In each case, it will be possible to apply to the AiB for a review of any decision and, thereafter, appeal the matter to the sheriff.

As well as effecting the transfer of powers, the Bill makes further changes to some of the processes described above – although there are separate policy reasons for these. For example, the ability to have a bankruptcy recalled on the basis of providing “sufficient security” would be repealed, meaning that recall (other than for technical reasons) would only be possible where debts are actually paid in full. The Scottish Government states that it is not clear what sufficient security means (Policy Memorandum, paragraph 249).

Arguments in favour of the AiB taking on additional powers

The Scottish Government argues that removing these processes from court will reduce the courts’ workload, potentially resulting in quicker decision-making and a reduction in the duplication of work between the AiB and the Scottish Court Service (Policy Memorandum, paragraph 226). A number of the procedures above are characterised by the Scottish Government as “administrative”, and there was significant support in the consultation exercise (Accountant in Bankruptcy 2012a) for work which was “mainly administrative” to move from the courts to the AiB.

Arguments against the AiB taking on additional powers

However, a number of stakeholders have argued that it is inappropriate to remove the courts’ role in adjudicating over bankruptcy disputes. There is particular concern that the various roles the AiB plays in the bankruptcy process may result in a conflict of interest. The main reasons for objecting to the AiB taking on additional powers are discussed below.

The review process

The Bill introduces provision for decisions made by the AiB to be the subject of an internal review in most cases. Generally, parties must apply to the AiB to review her decision before they can take the matter to the courts. It has been argued that the introduction of a review process adds unnecessary cost and delay, especially where the situation requires a quick resolution. In its response to the Economy Committee’s Call for Evidence on the Bill (2013), the Insolvency Practitioners’ Association stated (page 5):

> “Adding an additional stage of self-review merely delays the outcome and increases costs. It also denies access to judicial processes to parties with a both legitimate right and reasonable expectation of access to them. Furthermore, for appeal to be to the decision making party is manifestly inappropriate.”

The AiB lacks expertise

Some stakeholders argue that the AiB has insufficient expertise in the areas of law or insolvency practice to take on some of the roles proposed. In its response to the Economy Committee’s Call for Evidence (2013), the Insolvency Practitioner’s Association stated (page 1):

> “We would query whether it is at all appropriate for a party without legal qualification, training, or experience, nor professional licensing and regulation, to be performing judicial tasks. We would also suggest that for any government body to be both policy setter, decision

maker and appeal body of first instance, is inherently unconstitutional and potentially contrary to the principles of natural justice."

In his response to the Call for Evidence (2013), Alan Adie commented (page 4):

> "Insolvency is a highly technical area, and the importance of experience and knowledge cannot be understated. Those in the legal and insolvency profession spend years in passing exams and have subsequent continuing professional educational requirements. Are we really to believe that these qualified practitioners should seek directions from a civil servant as opposed to a sheriff?"

The AiB has a conflict of interest

The AiB is responsible for policy development in relation to insolvency, general supervision of trustees and making a number of bankruptcy-related decisions, as well as acting as the trustee in the majority of bankruptcies. It is argued that the transfer of powers from the courts to the AiB will only exacerbate this conflict. While this is a general concern among some stakeholders, there are also specific concerns about particular areas. These include the AiB's role in supervising (and, under the Bill's provisions, giving directions to) trustees while also acting as a trustee and the AiB's role in investigating and then awarding bankruptcy restrictions orders.

In its response to the Economy Committee's Call for Evidence on the Bill (2013), the Law Society of Scotland argued (page 6):

> "Giving the AiB a 'quasi-judicial' role, as well as administrative functions, creates a conflict in the AiB's responsibilities between the legal rights and interests of debtor and creditors (which must have priority) and considerations of administrative efficiency (which must be subordinate). The Society considers that the AiB should be free to concentrate on administrative efficiency and not be put in the position of having to balance conflicting priorities."

It its response to the Call for Evidence, the Royal Faculty of Procurators in Glasgow stated (page 5):

> "It is submitted that from the point of view of natural justice it would be inherently unfair that the party who decides to seek a bankruptcy restriction order is also the party which considers counter representations by the debtor and is the party who ultimately decides whether or not to grant the restriction order."

The Bill gives the AiB wide powers

Some stakeholders have argued that the Bill's proposals give the AiB wider powers than those currently available to the courts or the professional bodies which regulate insolvency practitioners (although these will be subject to review by the AiB and appeal to a sheriff). In relation to the AiB's powers – under the Bill's provisions – to remove a trustee from office, the Insolvency Practitioners' Association states (2013, page 4):

> "a Trustee may be removed if he has *"so conducted himself that he should no longer continue to act in the sequestration"* or where *"cause has been shown"* on other circumstances. This is both vague and a draconian power to place in the hands of an executive agency. It would allow the removal of a Trustee, properly appointed by the court or the creditors, without reference to them and on unspecified grounds."

SUMMARY OF CHANGES TO FULL BANKRUPTCY PROPOSED IN THE BILL

The changes to the personal bankruptcy regime proposed in the Bill are summarised and compared to the current system in the table below. The table does not deal with the introduction of the "Minimal Asset Process", the effects of which are summarised above.

Table 3: Comparison between current bankruptcy process and proposals contained in the Bankruptcy and Debt Advice (Scotland) Bill

PROCEDURE	CURRENT LAW	BILL'S PROPOSALS
Level of debt necessary to go bankrupt	£1,500 for a debtor application; £3,000 for a creditor petition	No change
Other requirements to go bankrupt	• habitual residence in Scotland • insolvency – demonstrated either through "apparent insolvency" or "certificate for sequestration" • payment of fee • must not have successfully applied for own bankruptcy in past five years	• habitual residence in Scotland • insolvency – demonstrated either through "apparent insolvency" or "certificate for sequestration" • payment of fee • must not have successfully applied for own bankruptcy in past five years • receipt of money advice • must sign "statement of undertakings"
Contributions from income	A contribution (as assessed by the trustee) can be requested from income. The trustee can apply for an "income payment order" from sheriff lasting up to three years, but no further enforcement is possible if an agreement cannot be reached with the debtor.	A contribution determined by trustee using the "common financial tool". The AiB can issue a debtor contribution order requiring contributions for four years. An option to take payment directly from debtor's earnings is available. The debtor can apply for a "payment holiday" of up to six months in certain circumstances.
Contributions from assets	Most assets owned by the debtor at the time of bankruptcy or which come into their hands in the following year can be utilised for the benefit of creditors.	Most assets owned by the debtor at the time of bankruptcy or which come into their hands in the following four years can be utilised for the benefit of creditors.
Discharge procedure	Automatic discharge after one year (although trustee can apply to the sheriff to defer this).	No automatic discharge. AiB will grant discharge if debtor has complied with the requirements in the statement of undertakings. In the case of debtors who cannot be traced, discharge can be deferred indefinitely. Debtors may be expected to undergo financial education before discharge is granted.

Additional protections	No further protections.	A debtor considering bankruptcy is protected for six weeks from the date they notify the AiB of their position. Where they do actually apply for bankruptcy, protection is extended while the application is considered.

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