

BANKRUPTCY AND DILIGENCE ETC. (SCOTLAND) BILL

[AS AMENDED AT STAGE 2]

SUPPLEMENTARY FINANCIAL MEMORANDUM

INTRODUCTION

1. As required under Rule 9.7.8B of the Parliament's Standing Orders, this supplementary Financial Memorandum is published to accompany the Bankruptcy and Diligence etc. (Scotland) Bill as amended at Stage 2 and should be read in conjunction with the original Financial Memorandum (printed separately as SP Bill 50-EN). It has been prepared by the Scottish Executive in order to assist the reader of the Bill and to help inform debate on it. It does not form part of the Bill and has not been endorsed by the Parliament.

PURPOSE

2. This supplementary Financial Memorandum has three purposes. They are to clarify the estimated cost to the Scottish Administration of bankruptcy reform as a result of—

- a rise in insolvencies caused by underlying trends in the UK economy,
- the introduction at stage 2 of 'low income, low asset' sequestration, and
- the changes proposed to be made to protected trust deeds by secondary legislation made under the Bill.

General rise in insolvency numbers

3. Paragraph 692 of the original Financial Memorandum provides an estimate of the costs to be incurred by the Accountant in Bankruptcy (AiB) in implementing bankruptcy reform in 2006/07. The AiB is an agency of the Justice Department of the Scottish Executive, so the costs incurred by that office are costs on the Scottish Administration.

4. The take up of sequestration and other insolvency measures is affected by wider economic trends such as ease of access to consumer credit. Insolvency numbers have risen in the recent past as discussed below. The AiB registers all Scottish sequestrations and trust deeds, and administers many sequestrations. Any rise in the number of insolvencies will therefore have an effect on the costs on the Scottish Administration.

5. Any such rise will also have an effect on the costs of implementing the Bill, to the extent that the Bill introduces new procedures. This is because the cost of the changes will depend in

part on the number of insolvency cases being administered by the AiB at the date of implementation. The Executive therefore allowed for a rising trend in insolvency numbers when estimating the costs of reform.

6. The Financial Memorandum does not set out how exactly the Executive had made an allowance for the impact of rising insolvency numbers. However, the Finance and Enterprise and Culture Committees both heard in evidence that AiB had assumed in mid 2005 when estimating costs for the Financial Memorandum that sequestration numbers would rise by 25% between the introduction of the Bill in 2005/06, and the start of implementation in 2006/07.

7. Not all the costs of reform are sensitive to changes in insolvency numbers. For example, information technology costs are relatively fixed. The Executive therefore wrote to the Enterprise and Culture Committee on 5 May 2006 to clarify that the 25% assumption was applied in three areas:

- The estimate of the number of sequestrations at implementation for the purpose of managing the new bankruptcy restrictions regime (section 2 of the Bill),
- The estimate of the number of debtor applications for sequestration that will be transferred at implementation from the courts to the Accountant in Bankruptcy (section 14 of the Bill), and
- The corresponding savings for Scottish Court Service from a lower number of sequestration applications.

8. The Executive also clarified that in its view sufficient funding had been secured to meet the costs of bankruptcy reform, even although it was expected in May 2006 that sequestration numbers would rise by about 50% in 2005/06.

Low income, low asset sequestrations

9. New section 14A of the Bill as inserted at stage 2 provides for a new route into sequestration for low income low asset (LILA) debtors. People who are not 'apparently insolvent' under section 7 of the Bankruptcy (Scotland) Act 1985 will be able to apply to the Accountant in Bankruptcy for sequestration, provided they meet the criteria specified in the Bill.

10. The criteria in section 14A are that the debtor has income of £100 or less, assets of £1000 or less, and does not own land. The basis on which income and assets are calculated will be further specified in regulations that it is proposed will be made under the 1985 Act. For example, the Executive is considering whether income based state benefits should be counted towards the calculation of the £100 figure.

11. Apparent insolvency is thought to be a significant barrier to debt relief through sequestration for people who do not have enough income or assets to make diligence worth the expense. Such people are still caught in a debt trap with all the unpleasant consequences that follow, and the purpose of LILA sequestration is therefore to enable them to get debt relief.

12. It is thought that significant numbers of people will be able to take advantage of debt relief for the first time when the LILA provisions come into force. This reform is therefore expected to lead to a significant rise in sequestrations as a ‘backlog’ of cases is cleared in the first and second years after implementation.

13. A rise in sequestrations due to the LILA change does not necessarily mean that the number of insolvent people has risen. Reform will rather lead to a better match between the number of people needing debt relief, and the number who are able to go bankrupt. It is expected therefore that the number of sequestrations resulting from LILA cases will level out after that backlog is cleared.

Protected trust deed reform

14. Section 18 of the Bill provides a new enabling power in Schedule 5 to the Bankruptcy (Scotland) Act 1985. That power can be used to prescribe the conditions under which debtors who grant trust deeds for creditors can become protected from enforcement action or sequestration.

15. The Executive consulted on draft regulations and a partial regulatory impact assessment between January and April 2006. It is now considering responses to the consultation by creditors, and comments made about the impact of reform from stakeholders such as the insolvency practitioner profession. A final decision on the changes will of course not be made until such time as Parliament agrees the proposed changes.

16. It is all the same clear that the Executive intends to make significant changes to protected trust deeds (PTD) using such powers as are agreed. The Finance Committee made the point that the Financial Memorandum should have made some reference to the costs of PTD reform in order to enable proper scrutiny, and this supplementary Memorandum makes good that oversight.

BANKRUPTCY – COSTS ON THE SCOTTISH ADMINISTRATION

Changes in take up of insolvency measures affected by the Bill

17. Year end figures from the AiB confirm that there was a 54% rise in sequestrations during 2005/06. The number of sequestrations has levelled out since then, and on current trends it is expected that there will be only a small rise in sequestrations during 2006/07.

18. The AiB is responsible for administering PTD. It is expected that reform will increase the level of oversight exercised by the AiB, and administration costs can be expected to rise accordingly. PTD numbers rose by 17% during 2005/06, and are expected to rise by 20% during 2006/07.

19. The AiB is responsible for administering the Debt Arrangement Scheme (DAS). Current take up is low. The Bill therefore makes (or enables) significant changes to the Scheme that are expected to improve take up. The changes include providing for freezing of enforcement on

seeking creditor agreement to a debt payment programme, and for freezing of interest and charges on approval of a debt payment programme by the AiB.

20. It is thought that overall insolvency numbers will continue to rise until at least 2009/10 as a result of general economic factors, including rising interest rates and excessive consumer borrowing. For example, there has been about a 50% rise in bankruptcies in England and Wales in the year to date.

21. The take up of particular insolvency measures will however be affected by changes in the Bill, or in secondary legislation under the Bill. For example—

- LILA sequestration is expected to lead to a sharp initial rise in sequestrations,
- Ensuring higher payments to the creditors in a PTD is expected to lead to a rise in sequestration and DAS numbers,
- Freezing of interest and charges is expected to lead to an increase in DAS numbers.

22. Table 1 therefore shows actual or estimated take up rates in the period from April 2005 to April 2010 for ‘standard’ sequestration, LILA sequestration, PTD and DAS. Table 2 shows the percentage rates of change from year to year using those figures or assumptions as appropriate, although it should be noted that DAS numbers start from a very low base.

Table 1 - Projected change in insolvency numbers 2005 to 2010

Type	2005/06	2006/07	2007/08	2008/09	2009/10
Sequestration	5423	5500	6750	13000	16000
LILA	0	0	5625	7500	3750
PTD	7199	8650	10400	3000	3600
DAS	200	300	500	3350	4300
Total	12822	14450	23275	26850	27650

Table 2- Percentage change in insolvency numbers 2005 to 2010

Type	2005/06	2006/07	2007/08	2008/09	2009/10
Sequestration	54	1.5	22	92	23
LILA	-	-	-	33	(50)
PTD	17	20	20	(70)	20
DAS	-	50	66	570	28
Total	30	13	60	3	0

Costs on the Scottish Administration

23. The Financial Memorandum estimated the cost of bankruptcy reform in 2006/07 at £1.442 million. That figure has now been reviewed to take due account of the costs of PTD, DAS and LILA reform. A revised estimate of costs for 2006/07 has therefore been prepared along with an estimate of costs in 2007/08.

24. The estimated cost in 2006/07 is £1.250 million, comprising—
- £107,100 for 16.5 additional staff,
 - £33,000 for training and recruitment,
 - £64,000 for administration costs, and
 - £1,046,000 for IT development
25. The estimated expenditure in 2007/08 is £1.902 million, comprising—
- £742,000 for 38 additional staff (including 16.5 from 2006/07),
 - £164,000 for temporary staff
 - £43,000 for training and recruitment,
 - £299,500 for administration costs, and
 - £653,400 for IT development

The total cost in 2007/08 will however be reduced by fee income and administration savings estimated at £461,000. The overall cost in that year is therefore estimated at £1.441 million.

SUMMARY TABLE OF COSTS ON THE SCOTTISH ADMINISTRATION

Proposal	Reference (paragraph numbers refer to the original Financial Memorandum)	2006/07	2007/08	2008/09 and subsequent years	Comment
BANKRUPTCY Accountant in Bankruptcy	Para 692	1.25m*	1.44m*	536,000	
Student Award Agency	Para 697	-102,213	-102,213	-102,213	Based on assumptions using historic write off
Scottish Court Service	Para 698	-60,000	-60,000	-60,000	Saving on court costs
FLOATING CHARGES Registers of Scotland	Para 705-709	375,000*	462,500*	175,000*	

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SCOTTISH CIVIL ENFORCEMENT COMMISSION	Para 716	27,000*	868,000*	632,000*	
Scottish Court Service	Para 721		-15,000	-15,000	15,000 savings to SCS
Messengers of the court	Para 721		-17,000	-17,000	17,000 income from fees
DILIGENCE	Para 730	0	141,725*	566,900*	Based on quarter year 2007/08
Scottish Court Service			10,000		
Information Disclosure Orders	Para 734	0	0	967,500	Based on middle range of applications
Implementation by the Scottish Executive	Para 689 and 690	0	253,251* 110,000*	253,251* 110,000*	Staff costs Programme costs

* Denotes resources secured

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BILL**
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Produced and published in Scotland on behalf of the Scottish Parliamentary Corporate Body by Astron.

ISBN 1-4061-2847-3

