Insolvency Proceedings: Debt relief orders and the bankruptcy petition limit

Response by the Association of Business Recovery Professionals ('R3') to the call for evidence document issued by the Insolvency Service, August 2014

1. Introduction

R3, the insolvency trade body, is the trade body for the insolvency profession. We represent approximately 97% of the UK's insolvency practitioners (IPs) and another 1,500 insolvency professionals and students. R3 represents IPs working in firms of all sizes, from the 'Big 4' through to smaller, local firms. R3 promotes best practice and provides a detailed programme of insolvency courses, conferences and technical information.

IPs are highly regulated, licensed professionals and officers of the court and are experts in personal and corporate insolvency. They are the only professionals who are licensed to take formal insolvency appointments across all personal and corporate insolvency procedures. As such, they are able to offer a unique perspective on the UK's insolvency regime.

R3's interest in the call for evidence stems from our members' expertise in personal insolvency procedures and assisting financially indebted individuals. Our proposals for reform of personal insolvency procedures are comprehensively set out in our *Personal Insolvency Landscape* policy paper (published in January 2014), a copy of which is annexed to this response.

In our *Personal Insolvency Landscape* paper, we point out that the debate about the rising cost of living and the pressures facing those living at the edge of their means in England and Wales has already been well documented. However, little attention has been given to what happens to those individuals who fall into insolvency. The dramatic increase in the number of people struggling with their debts has led to a personal insolvency explosion: in the last ten years, the number of new personal insolvencies has almost trebled – from 35,600 in 2003 to 102,000 in 2012/13.

R3 is concerned that the England and Wales personal insolvency regime has developed piecemeal over the past three decades and needs reform to ensure that it keeps up with the dramatic change in personal debt and insolvency levels. In order to do so, R3 has set out various recommendations in our *Personal Insolvency Landscape* paper in order to frame the debate about reform to the personal insolvency framework which would achieve balance for both creditors and debtors.

2. Executive summary

R3 believes that a successful personal insolvency regime must strike the right balance: on the one hand it should allow people to get back onto their own two feet by relieving their indebtedness and providing better access to debt relief, whilst on the other hand, it should better protect creditors from those recklessly accumulating debt and seek to return to creditors what is owed to them.

Fail to get this right and there is a risk that indebted people will end up trapped in a vicious cycle of debt, without protection from creditors, financially dependent on others and potentially pushed into inappropriate debt solutions for their financial situation. On the other side of the coin, creditors may be unable to lend or trade with confidence and will soon become more cautious about doing so – the cost of borrowing and goods then increases for everyone.

The problem is manifold. It could be argued that our personal insolvency regime is too lenient when, for example, England and Wales has one of the shortest bankruptcy terms in Europe. However, this contrasts starkly with the fact that many ordinary British adults cannot afford to access bankruptcy, even though this would be the most appropriate debt relief solution for their circumstances. This is just one example of inconsistencies in the current framework where R3 believes reform is needed. R3's *Personal Insolvency Landscape* paper explores the problems facing England and Wales' personal insolvency solutions and recommends ways to achieve a balance which benefits the whole of society.

a) Debt Relief Orders

A number of R3's recommendations within the *Personal Insolvency Landscape* paper relate to Debt Relief Orders (DROs). We therefore welcome the opportunity to respond to the call for evidence to set out our members' views on the DRO eligibility thresholds and other elements of the DRO process:

- The current DRO asset and debt thresholds unduly act as barriers to entry into a DRO. R3 believes that the debt threshold should be increased to £30,000 and the asset threshold to £2,000 in order to ensure that those individuals who need access to debt relief are able to enter the most appropriate debt relief solution for their circumstances.
- The DRO surplus income threshold should be maintained at a maximum of £50 per month.
- Where an individual's circumstances change, such as an increase in salary or an asset windfall, and they no longer fulfil the DRO eligibility criteria, they should be offered the option to transfer into bankruptcy.
- Revocation of a DRO should apply retrospectively where the individual has provided false information or deliberately sought to mislead or leave out information on their DRO application form.
- A DRRO should only be imposed for reasons of an individual's behaviour prior to the DRO and should not be applied simultaneously with the revocation of the DRO.

b) Bankruptcy creditor petition limit

- R3 members have long held the view that the bankruptcy creditor petition limit, first set in 1986, is overdue for review. The relatively low value of debt for which an individual can be made

bankrupt by a creditor risks debtors being placed in an insolvency procedure that is not suitable for their circumstances.
- R3 believes that the creditor's bankruptcy petition threshold should be raised to £3,000. This level would both cover the creditor's petition costs and ensure an element of legislative 'future-proofing' against inflation.

We have focused our detailed response below on those questions in the call for evidence where we can provide answers based on our members' expertise, their experience of the personal insolvency market and assisting indebted individuals with their financial difficulties. Questions which are unanswered reflect the fact that we have no opinion on the point at issue.

Whilst R3 welcomes the opportunity to respond to this call for evidence, it is regrettable that this review risks being another missed opportunity: despite stakeholders, including R3, making the case for a comprehensive update to the personal insolvency regime, the government's current review focuses only on isolated parts. R3 believes that the government must go far further and faster on personal insolvency reform than it has done so far.

3. Consultation questions

Question 1 – when responding can you please indicate the size of your organisation (not applicable to individuals). This will be useful for any impact assessment.

As of March 2014, the breakdown of employees by firm in R3's membership was as follows:

- 14% of members said that their firm has 4 or fewer employees;
- 15% of members said that their firm has 5 to 9 employees;
- 17% of members said that their firm has 10 to 49 employees;
- 23% of members said that their firm has 50 to 249 employees; and
- 32% of members said that their firm has 250 or more employees.

R3 itself employs 24 members of staff and would therefore be classified as 'small' for the purposes of the size of organisation.

Debt Relief Orders

Question 2 – what level do you think the maximum debt amount should be set to and why?

R3 accepts that DROs are a unique formal insolvency procedure in the respect that there is no 'estate' in a DRO and hence no distribution of asset realisations to creditors. In view of this and the fact that DROs are a streamlined, administrative process with little investigation into the debtor's affairs leading up to the making of the order, we accept that the use of entry thresholds may be required in order to ensure that individuals who have significant assets and could make a contribution to their creditors are denied entry to a DRO so that they can instead seek an alternative debt relief procedure in order that they can repay a proportion of their debts to their creditors.

However, whilst there is a case for the existence of the DRO thresholds, R3 believes that the asset and debt thresholds of £300 and £15,000 respectively unduly act as barriers to entry into a DRO.

The problem of access to debt relief solutions is one which R3 urges government to review as soon as possible. As we have argued in our *Personal Insolvency Landscape* paper, the current £705 cost of bankruptcy prevents a significant number of indebted individuals, with modest levels of debt and few assets, from accessing bankruptcy. A report[1] by Christians Against Poverty (CAP) published earlier this year estimated that around 315,000 people are unable to access bankruptcy each year because they cannot afford the bankruptcy fee. Indeed, CAP's research indicates that based on CAP's client base alone, 35% of their clients need some form of bursary assistance from CAP in order to pay the bankruptcy fee.

Related to this problem, R3 is concerned that a proportion of those individuals who cannot access bankruptcy are also unable to access a DRO due to the current entry thresholds. There are large numbers of bankruptcy cases – over 50% according to statistics from the Insolvency Service[2] - which have few or no assets. These are deemed to be cases where the individual's assets are insufficient to meet the Official Receiver's cost of administering the case, meaning that there is no possibility of a distribution of funds back to creditors. R3 believes that subject to the need for debts beyond a certain amount to be subject to investigation, it would be preferable for such cases to go through the DRO procedure, involving less of a cost to the indebted individual, the Insolvency Service and therefore the taxpayer.

According to Insolvency Service data, the median unsecured debt in bankruptcy in 2013/14 was £38,000[3]. Given that over 50% of bankruptcies involve individuals with few or no assets, R3 believes that it is reasonable to assume that a significant proportion of financially distressed individuals have few assets but debts of between £15,000 and £30,000. It is also reasonable to assume that, given their low level of assets, it is this group of individuals who are most likely to be prevented from accessing debt relief by the current bankruptcy fee on the one hand and the current DRO debt threshold on the other. By way of example, CAP's research indicated that of the 35% of their clients who needed bursary assistance in order to pay for their bankruptcy fees, 78% were excluded from the DRO process only because their debts exceeded £15,000.

R3 believes that the DRO debt threshold should be increased to £30,000 in order to enable debtors to access debt relief at a more feasible cost and to ensure that the potentially large proportion of debtors who cannot afford the bankruptcy fee on the one hand, but who are currently ineligible for a DRO on the other, are able to access a debt relief solution which would be the most suitable for their circumstances.

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[1] 'Too poor to go bankrupt – a report on CAP's insolvency demographic and the problems posed by the current Debt Relief Order (DRO) eligibility criteria', 2014

[2] Insolvency Service Annual Report 2010/11

[3] http://www.publications.parliament.uk/pa/cm201314/cmhansrd/cm130516/text/130516w0001.htm#13051676001424

Whilst the call for evidence details the number of historic bankruptcy cases which would fall within the DRO eligibility criteria were the debt threshold to be increased to £30,000, we believe the more pertinent concern surrounds those debtors whose problems and status are not evidenced in the formal insolvency statistics – those people who cannot access either bankruptcy or DROs due to the current barriers to entry and who may therefore enter informal or unregulated procedures or not address their debts at all.

The statistics detailed in the call for evidence also suggest that increasing the debt threshold in line with inflation would put the threshold at close to £19,000. R3 believes that an increase to £30,000 would provide a more appropriate increase. A scheduled review process should also be implemented, for example every five years, in order to ensure that the debt threshold is 'future proofed' against further inflation increases.

Our suggestion to increase the debt threshold to £30,000 is supported by debt advice organisations, such as CAP, who by virtue of acting as competent authorities for the purposes of the DRO application procedure, are at the coalface of assisting indebted individuals who are currently unable to address their debts due to their inability to access either bankruptcy or a DRO. The Centre for Social Justice, in its report published in July 2014[4], has also endorsed an increase to the DRO debt, asset and surplus income thresholds.

Question 3 – do you think there should be a minimum limit of debts?

No, R3 does not believe that there should be a minimum threshold of debts for entry into a DRO. We have previously expressed our concern that the current DRO entry criteria could act as a barrier to entry for debtors and we would be concerned that a minimum limit of debts would act as a similar restriction to entry for those debtors who need to access debt relief.

Question 4 – what level do you think the maximum asset amount should be set at and why?

As previously detailed in our response to question 2, R3 believes that the asset and debt thresholds of £300 and £15,000 respectively unduly act as barriers to entry into a DRO.

In view of the current cost of bankruptcy at £705, we have previously articulated our concern that a large proportion of debtors are currently unable to access bankruptcy due to the cost but may also be ineligible to access a DRO due to the current asset and debt thresholds. Such debtors are therefore stuck in a financial 'limbo', potentially unable to address their debts and at risk of accruing more debt, avoiding paying their creditors and being pursued by those creditors to whom they owe money.

R3 therefore proposes that the asset threshold for a DRO should be increased from £300 to £2,000. At present, £2,000 is the point at which the Official Receiver begins to apply the Secretary of State fee to bankruptcy cases. This fee assists in subsidising the Insolvency Service to administer bankruptcy cases where the level of assets is insufficient to cover the cost of the case's administration. Increasing the DRO asset threshold to £2,000 would therefore have two effects: increasing access to DROs for those debtors

[4] 'Restoring balance – tackling problem debt', The Centre for Social Justice, July 2014

who are currently unable to access bankruptcy or a DRO whilst also reducing the number of bankruptcy cases requiring cross-subsidy funding from those cases with realisable assets.

It is also worth noting that the Centre for Social Justice has also endorsed an increase to the asset threshold for DRO[5] in order to expand access to DROs.

Question 5 – what level do you think the surplus income amount should be set at and why?

R3 believes that it is appropriate for the DRO surplus income amount to remain at a maximum of £50 per month. Whilst the call for evidence suggests that the argument for increasing the DRO surplus income threshold is weaker than possible changes to the other entry thresholds (due to the fact that an Income Payments Agreement/Order (IPA/O) in bankruptcy would currently be put in place to cover the whole of a bankrupt's surplus income above £20 per month), we believe that it is the Official Receiver's policy on surplus income in the case of IPA/Os which needs review.

IPA/Os clearly fulfil a useful function within the bankruptcy regime as they permit surplus income over and above the bankrupt's reasonable domestic needs to be claimed for the benefit of the estate. However, R3 believes that this must be balanced with the need to make the process of making a contribution towards the costs of the process and creditors work for bankrupt individuals.

Under the current IPA/O system, R3 believes that the £20 limit is set so low that it could severely jeopardise individuals' ability to cope with financial shocks or emergencies. Whilst the system does permit the individual to retain £10 per month for each family member to cover emergencies and contingencies, R3 is concerned that £10 per month is very little to cover emergency expenses and it could take individuals several years to save up sufficient money to fix fairly common household problems, such as broken boilers or household repairs.

It is our understanding that prior to 2010, the threshold for payment towards an IPA/O was £100 per month, at which point half of this money would be used to make payments to the estate, leaving the individual with £50 per month as surplus money. R3 believes that the inconsistency between bankruptcy and DROs is unhelpful and to achieve consistency and a more appropriate balance between debtors' and creditors' interests, we believe the permitted level of surplus income for IPA/Os should be brought back into line with the £50 limit set for DROs.

Question 6 – do you think additional costs of the competent authorities should be covered by the application fee? If so, how much and why?

R3 is the insolvency trade body and is not a competent authority for the purposes of the DRO application process. The cost to competent authorities associated with administering the DRO process is therefore outside of our direct knowledge and expertise.

However, whilst we do not have direct experience of the case administration processes required of DRO intermediaries, we believe that it is fundamentally important that debtors are able to access the most

[5] Ibid

appropriate debt solution for their circumstances and are not prevented from doing so. For this reason, we have suggested increases to two of the DRO entry thresholds for the reasons set out previously.

Should the DRO thresholds be increased in line with our proposals, it is likely that there would be a consequent increase in the number of debtors entering DROs. In order to cope with the increase in demand for DROs, the Insolvency Service would need to facilitate increased resources for the competent authorities and their intermediaries in order to assist them in administering an increased number of DRO applications.

Question 7 – do existing payment systems provide sufficient coverage to enable debtors to pay the fee? If not, what other payment systems should be added?

No view

Question 8 – do you consider the six year restriction is appropriate? If not, please provide reasoning for an alternative.

No view

Question 9 – do you consider the competent authority/intermediary model is working well? How could it be improved? Would another model be better?

No view

Question 10 – are debtors who are suitable for DROs aware of their existence?

No view

Question 11 – do debtors know to contact a competent authority to pursue a DRO application?

No view

Question 12 – is there any issue with the geographical coverage of the competent authority networks?

No view

Question 13 – is there any issue with the speed of DROs applications? If yes, how can it be improved?

No view

Question 14 – is there any issue with the number of intermediaries? If yes, is this a funding issue?

No view

Question 15 – do you think that the revocation system is working effectively? If not, what changes should be made?

The Official Receiver may revoke a DRO where an individual's circumstances change during the period of the DRO or for more 'culpable' behaviour, where, for example, an individual deliberately omitted information from their application form in order to falsely demonstrate that they met the entry criteria or provided false information to the Official Receiver about their eligibility for a DRO.

Whilst R3 believes that revocation of a DRO is a deterrent to behaviour which seeks to mislead the Official Receiver at the time of the DRO application process, we believe that there is scope for the deterrent effect to be increased.

Where an individual has provided false information or deliberately sought to mislead or omit information from their application form, R3 believes that the deterrent of revocation could be achieved by the revocation applying retrospectively without any limitation period. This would mean that where, for example, an individual owned an undeclared asset worth more than the asset threshold at the time of obtaining their DRO but this fact did not come to light until after the DRO had come to an end, the Official Receiver would still be able to pursue revocation of the DRO. R3 suggests that the relevant date for revocation would be the date on which the debtor provided the false information.

R3 believes that the prospect of being made liable once again for all of their debts included within the DRO, even in cases where the DRO period has already come to an end, would act as a strong deterrent to those individuals who consider lying or omitting information from the DRO application. Where the DRO is revoked in such circumstances, other debt relief options would still remain available for the individual.

Question 16 – is the current treatment of increases in income and asset windfalls appropriate?

R3 believes that there is scope to reform the DRO revocation system to ensure that individuals are not discouraged from improving their financial situation by seeking employment or better-paid work during the terms of their DRO.

Under the current system, if an individual's circumstances change during the period of their DRO where, for example, their monthly surplus income increases above the £50 threshold due to a salary increase or a new job, or they obtain further assets, such as an inheritance or a windfall, they will no longer fulfil the DRO eligibility criteria and the Official Receiver will then need to decide whether or not to revoke the DRO.

R3 believes that the prospect of a DRO being revoked could act as a deterrent to an individual seeking employment or better-paid work during the term of their DRO, which was also recognised by the Insolvency Service in its report on DROs in 2010[6]. The threat of revocation may also discourage individuals from notifying the Official Receiver of increased income or newly acquired assets.

To combat this disincentive, R3 believes that there is a strong case for introducing a mechanism whereby individuals who declare a change in their circumstances, which would enable them to make a contribution towards their creditors, are able to do so without losing the benefit of debt relief. This

[6] Debt Relief Orders – interim evaluation report, the Insolvency Service, 2010

would recognise the difference between individuals who do the right thing and declare any extra income or assets whilst retaining the deterrent of DRO revocation for those individuals who seek to abuse the system.

R3 suggests that individuals who declare changes in their circumstances are given the option to move from the DRO into the bankruptcy system, making them subject to a bankruptcy order and the protection from creditors under that order. We suggest that in such circumstances, the relevant date of discharge for the bankruptcy would be the anniversary of the date on which the DRO was made, not the date of the subsequent bankruptcy order.

R3 recognises that bankruptcy involves a higher entry fee than a DRO and therefore one way in which the burden on the individual of any requirement to pay the increased fee could be alleviated is by allowing the individual to pay the increased fee by instalments over the term of their bankruptcy, or for example, by postponing their discharge from bankruptcy until they had made all of the required payments. The individual would therefore still benefit from debt relief over the period of their bankruptcy whilst the requirement to pay the bankruptcy fee would also be met, albeit over a longer period of time.

Question 17 – do you consider that the DRO restriction system is working well to deter reckless behaviour? What changes should be made, if any?

Unlike a Bankruptcy Restrictions Order/Undertaking, R3 understands that a Debt Relief Restrictions Order (DRRO) can be applied to an individual who has also had their DRO revoked, albeit this may occur infrequently. In such circumstances, the individual would be made subject to the DRO restrictions for up to 15 years but with no debt relief – they would still be liable for all of their existing debts which had been included under the DRO prior to its revocation.

Whilst R3 accepts that revocation or a DRRO may be appropriate in certain circumstances, R3 believes that it is an inequitable discrepancy that both could be applied simultaneously. R3 believes that revocation of a DRO should be reserved for those who are ineligible for the order because, for example, they have misrepresented their position on their application form or have failed to inform the Official Receiver about a change of circumstances.

On the other hand, R3 believes that DRROs should, as with BROs, be based on the prior behaviour of the individual and should only apply to individuals who are still subject to a DRO, thereby granting them access to debt relief but extending the restrictions that accompany it.

Question 18 – do you consider that the DRO regime has encouraged debtors to seek debt relief at an earlier stage? If yes, please explain how this has been a benefit including any case study evidence.

The introduction of a new debt relief solution, whilst welcome, does not guarantee that debtors will take advice at an earlier stage. In R3's view, early advice is important but it is also the quality of that advice and ensuring that the advice covers all possible options available to the debtor which is key in order to ensure that debtors enter the most appropriate debt solution for their circumstances.

Question 19 – what is an appropriate length of time for discharge?

R3 believes that the current 12 month period of discharge from a DRO is reasonable and should be retained.

Whilst it has been suggested that the discharge period for the MAP route in Scotland is six months, the early discharge provisions for bankruptcy were recently repealed and we would suggest that it is preferable that the DRO period remains at 12 months to ensure symmetry with the bankruptcy process.

Question 20 – do you think the length of discharge and the length of DRO restrictions should be the same or different? Please provide your reasoning for your response and indicate what an appropriate time for both is?

In R3's *Personal Insolvency Landscape* paper, we set out our proposals for how the bankruptcy process could be more sensitive to the reasons why debtors accrue debts and enter bankruptcy.

Whilst the current bankruptcy system permits reckless or blameworthy individuals to be made subject to a Bankruptcy Restrictions Order/Undertaking (BRO/U) to extend the restrictions of bankruptcy for up to 15 years, creditors have no claim on any assets acquired after the 12 month term of bankruptcy has ended.

R3 also believes that the current bankruptcy system lacks a middle ground. Prior to 2003, the standard term of bankruptcy was three years. This was reduced to 12 months on the grounds that doing so could help to promote entrepreneurship through allowing entrepreneurs whose initial business ventures had failed to be swiftly rehabilitated and in a position to try again. Whilst it is unclear what effect this has had on entrepreneurship, the number of trading-related bankruptcies as a proportion of overall case numbers has fallen significantly since 2003. The vast majority of cases continue to be consumer bankruptcies.

In order to address inconsistencies within the bankruptcy process, R3's suggestion is the introduction of a three-tier bankruptcy process as follows:

Three year standard term of bankruptcy – this would restore the balance between debtors and creditors to the situation before 2003, on the basis that the vast majority of bankruptcies continue to be amongst consumers. Whilst a return to a three year standard term may reduce instances of 'bankruptcy tourism', where foreign debtors seek to be declared bankrupt in England and Wales in order to benefit from a reduced term of bankruptcy, this would mean that England and Wales would still have one of the lowest standard terms of bankruptcy in the world. By way of comparison, the term of bankruptcy in Germany is seven years and in Ireland the term has recently been revised to three years.

Three to 15 year term of bankruptcy for 'most culpable' individuals – individuals judged to have accrued debts in a reckless or otherwise blameworthy fashion can already be made subject to BRO/Us. However, allowing the bankruptcy term to be extended when applying a BRO/U would allow any assets acquired during the extended bankruptcy period to be claimed for the benefit of creditors. This would increase

returns to creditors and would act as a more robust deterrent to the individual concerned and others who may consider behaving in a similar reckless or blameworthy manner.

12 month term for 'least culpable' individuals – the Official Receiver (OR) could reduce the standard three year term to 12 months for those who have arrived at their financial situation through little fault of their own. Given that the indebtedness of such groups will, in many cases, be unavoidable, there seems little to justify the 'deterrent effect' of a more robust process. However, at the time of obtaining their discharge at 12 months, debtors could be informed by the OR or their Trustee (by a letter which is placed on their court file) that, should it come to light in the two years following their discharge that they have provided misleading information about their circumstances or provided other false information to the OR or Trustee, either the OR or Trustee could issue an application to court to restore the bankruptcy and impose a discharge period of three years. This precaution would act as a safeguard against those individuals who seek to mislead the Court, the OR or their Trustee about their circumstances in order to benefit from the reduced discharge period.

Turning specifically to DROs, R3 has not previously considered whether the length of discharge from a DRO and the length of DRO restrictions should be the same or different due to the fact that there is no 'estate' within the DRO process. In our opinion, there is no benefit to increasing the discharge period of a DRO in line with the period of the DRO restrictions imposed under a DRRO as there is no estate in a DRO and therefore no scope to realise assets for the benefit of creditors. By way of contrast and as described previously, aligning the bankruptcy discharge period with any increase in the length of bankruptcy restrictions imposed under a BRO/U increases the scope for the Trustee in bankruptcy to realise any assets acquired during the extended bankruptcy period, thereby increasing returns to creditors and acting as a more robust deterrent to the debtor and others who may consider behaving in a similar reckless or blameworthy manner.

Question 21 – do you think DROs impose any barriers on employment or self-employment? If yes, how could this be mitigated?

Yes – see response to question 16.

Question 22 – Lenders/credit reference agencies only: what credit policies do you have for someone who has gone through the DRO process?

No view

Question 23 – what impact have DROs had on the wellbeing of debtors – please provide evidence?

No view

Question 24 – what would you consider an appropriate creditor petition level? Please provide evidence for this view, including any case study examples.

There are a number of examples in insolvency legislation where statutory monetary thresholds or limits have lagged far behind inflation or changes in circumstance – the creditor's bankruptcy petition threshold is one of the more egregious.

The minimum amount of money which a creditor must be owed before they are able to petition for an individual's bankruptcy (£750) has not been reviewed since 1986, meaning that creditors can still petition for a debtor's bankruptcy for what is, in today's terms, a relatively low level debt. The call for evidence document also recognises that, due to inflation, the static nature of the £750 threshold has given creditors an enforcement option over low level debts which Parliament did not originally intend them to have.

In addition, as Professor Elaine Kempson points out in her government commissioned report[7] published in 2014, the £750 threshold is worth far less than the petitioning creditor's fees (around £3,000) or the Official Receiver's deposit (£1,715) and equates to only two or three hours of an insolvency practitioner's time. R3 supported Professor Kempson's recommendation to increase the petition threshold to a level that 'at the very least covers the creditor and court fees'.

Although the difference between the cost of the procedure and the value of the debt that would be recovered should act as a disincentive to creditors to petition for bankruptcy over a low value debt, creditor petitions for debts less than £3,000 still account for almost one-in-ten such actions.

According to the 'call for evidence' document, there were 404 creditor petitions in 2013-14 for debts between £750 and £2,000 (3% of all 11,900 creditor petitions in that period). There were a further 575 creditor petitions for debts between £2,000 and £3,000 (another 5% of all petitions).

R3 believes that whilst bankruptcy may be an effective way to help a debtor deal with their debts, it is not an option that is suitable for all debtors. The relatively low value of debt for which an individual can be made bankrupt by a creditor risks debtors being placed in an insolvency procedure that is not suitable for their situation. A creditor petitioning for a debtor's bankruptcy is not a consensual process – it involves the imposition of a regime on one party on the application of another and has serious consequences for the debtor. This makes effective safeguards against abuse of the creditor petition debt threshold all the more important.

R3 believes that, at the very least, the threshold level should be raised to where it would be had it been pegged to inflation back in 1986 – just over £1,900. However, as the Insolvency Service's figures show, petitions are still fairly frequently used for debts below £3,000. In insolvency practitioners' experience, even when the creditor has no intention of issuing a bankruptcy petition for a debt below £3,000, their ability to do so is sometimes used as a 'threat' against debtors.

[7] 'Review of Insolvency Practitioner Fees – a report to the Insolvency Service', March 2014

R3 therefore believes that the creditor's bankruptcy petition threshold should be raised to £3,000. This level would both cover the petition costs and ensure an element of 'future-proofing' against inflation and accords with Professor Kempson's suggestion of an appropriate increase to the threshold. The threshold level should also be kept under far more regular review by the government than it has been to date.

Question 25 – is there any other aspect of DROs or the creditor petition limit you would like to comment on? Please do so here.

Whilst the UK is home to one of the world's most effective insolvency regimes – the world's 7th best, according to the World Bank – the scale and nature of personal debt in England and Wales has changed rapidly in the past decade, with insolvency numbers more than trebling in a short space of time. As demonstrated with the creditor bankruptcy petition threshold, R3 believes that it is important that the insolvency regime evolves with the personal debt landscape. Without reform, R3 is concerned that indebted individuals will struggle to access a debt solution that is right for their situation – this exacerbates the debtor's problems and is of no benefit to creditors.

As previously mentioned, we sparked debate about the health of the personal insolvency regime with the publication of our *Personal Insolvency Landscape* paper in January 2014, which contains proposals for reforming personal insolvency in England and Wales. Following discussions about our proposals with debt charities, insolvency practitioners and policymakers, R3 believes there are more changes that should be made to the existing personal insolvency landscape in addition to the changes to DROs and the creditor petition bankruptcy threshold set out in our response to this call for evidence.

It is unfortunate that the government's record on personal insolvency reform has, to date, been one of missed opportunities. The 2011 call for evidence in support of the consumer credit and personal insolvency resulted in only minimal changes – despite calls from the insolvency profession, debt charities and wider stakeholders for wider reform.

Whilst R3 welcomes the opportunity to respond to this call for evidence on DROs and the creditor bankruptcy petition threshold, we believe that the review risks being another missed opportunity: despite stakeholders, including R3, making the case for a comprehensive update to the personal insolvency regime, the government's review focuses only on isolated parts.

We have summarised below where we believe further review is needed to ensure that the personal insolvency regime can fulfil its potential for decades to come.

1) <u>Additional R3 Personal Insolvency Landscape proposals</u>

R3 believes that its *Personal Insolvency Landscape* proposals would have a significant positive impact on indebted individuals' ability to resolve their debts and on creditors receiving some form of repayment of their debts. A copy of this paper is annexed to this response but by way of summary of the paper's further proposals on bankruptcy and Individual Voluntary Arrangements, please see the following table.

Debt relief procedure	The problem	R3's proposals
All procedures	• Lack of consistency in calculating income and expenditure	• Universal use of the Common Financial Statement or similar across all debt relief solutions to calculate an individual's surplus income
Bankruptcy	• Cost of entry is a barrier to entry (£705)	• Payment by instalments • Increase Debt Relief Order thresholds
	• Current system doesn't adequately consider and deal with an individual's behaviour in run up to bankruptcy	A three tier bankruptcy process: • Three year standard term (rather than current 12 months) • Three to 15 year term for the 'most culpable' individuals • 12 month term for the 'least culpable' individuals
	• Minimum income threshold for Income Payment Orders/Agreement is too low, jeopardising individuals' ability to cope with financial shocks or emergency expenditure	• Increase the minimum income threshold to £50 per month
Debt Relief Orders (DRO)	• Entry thresholds for assets (£300) and debts (£15,000) are too low, needlessly acting as a barrier to entry	• Increase the asset threshold to £2,000 • Increase the debt threshold to £30,000
	• There is a disincentive for individuals to improve their financial situation or declare a change in their circumstances whilst subject to a DRO	• Offer individuals the option to transfer into bankruptcy if their circumstances change such that they are no longer eligible for a DRO
	• Revocation of the order is not a strong enough deterrent to individuals who seek to mislead or leave out information on their application form	• Retrospective effect of revocation of the order where the individual has provided false information or deliberately sought to mislead or leave out information on their application form
	• An individual can be made subject to a Debt Relief Restrictions Order (DRRO) at the same time that their DRO is revoked, subjecting them to the DRO restrictions for an extended period but without any debt relief	• A DRRO should only be imposed for reasons of the individual's behaviour prior to the DRO and not simultaneously with revocation of the DRO
Individual Voluntary Arrangements (IVA)	• Creditor modifications are a barrier to entry	• Introduce simplified IVAs
	• Lack of incentive for individuals to enter this solution to repay a proportion of their debts	• Reduce the impact of an IVA on the individual's credit rating in comparison to bankruptcy or a DRO

2) Introduction of statutory referrals for advice for individuals subject to a creditor bankruptcy petition

Section 273 of the Insolvency Act 1986 allows the court to refer a debtor with low level debts to an insolvency practitioner to assess whether a voluntary arrangement might be a better option for them than bankruptcy. However, this can currently only take place where the debtor has petitioned for their own bankruptcy.

R3 agrees with Professor Kempson's suggestion, set out in her report earlier this year, that section 273 should be extended to cover cases where the debtor is subject to a creditor's bankruptcy petition. As the review notes, common reasons why debtors may struggle to understand the fees and costs associated with their bankruptcy include a lack of knowledge about the process and non-cooperation with the Trustee. These can be problems in cases where the debtor has petitioned for their own bankruptcy – it is almost guaranteed to be a problem (to some degree) where the debtor has been made bankrupt by someone else.

Further, as R3 has repeatedly argued, debtors need to be in an insolvency procedure appropriate to their situation; bankruptcy may simply not be suitable for someone subject to a creditor's bankruptcy petition and there must be an opportunity for the debtor to consider their options with the help of a qualified professional.

Whilst we understand that the Insolvency Service may propose to repeal section 273 once reform of debtor petition bankruptcies is implemented (whereby the debtor petition process will be removed from the court process), R3 believes that the extension of section 273 should go further than Professor Kempson's suggestion. R3 recommends that the section should be amended so that a report may be produced on *any* alternative to bankruptcy, including statutory and non-statutory debt solutions. Currently, section 273 requires only that an insolvency practitioner assess whether a voluntary arrangement would be more appropriate for the debtor. Such a binary choice is unnecessarily reductive and ignores other viable debt solutions.

R3 also suggests that section 273 should be amended so that a debtor can be referred to any regulated debt advisor rather than just an insolvency practitioner.

Anecdotal evidence from insolvency practitioners suggests that section 273 is barely used in its current form (some insolvency practitioners report seeing only one or two Section 273 referrals in the past three decades) and consequently has a limited impact on insolvency practitioners' time. However, in 2013, there were just under 5,400 bankruptcies started by creditor petitions. R3 therefore believes that it would be prudent to expand the pool of advisors to whom debtors can be referred to ensure there are no unnecessary backlogs in processing bankruptcy petitions and to ensure the provision of free advice via such referrals does not become a disproportionate burden for insolvency practitioners.

3) Better advice from the Insolvency Service for bankrupts

Professor Kempson's review also argues that debtors may not fully understand the implications of bankruptcy, the work involved in administering their bankruptcy estate, or the costs that may be incurred as part of that administration. The review argues that the Insolvency Service should provide an information sheet for bankrupts that details the work a Trustee will need to do in order to administer their bankruptcy estate, and which explains to debtors that, where they do not co-operate with the Trustee, there may be increased costs associated with their bankruptcy.

The review also recommends that creditors should be required to make debtors aware of the facts about bankruptcy before initiating bankruptcy petition proceedings.

R3 agrees with the Kempson Review that the Insolvency Service should provide an information sheet for bankrupts to explain the work involved in administering a bankruptcy and the implications of not co-operating with their Trustee. Creditors should also be required to provide information to debtors before initiating a bankruptcy petition.

R3 believes there are three key points to consider:

a) If a bankrupt feels the fees they have been charged for administering their estate are excessive, they can challenge what has been charged through the courts. While debtors already receive information about their rights in this regard when they are declared bankrupt, there is merit in this information being reiterated to debtors in any new guidance produced by the Insolvency Service.

b) Guidance is provided to debtors after they have been declared bankrupt, but not necessarily before. Debtors could be provided with information about the consequences of bankruptcy at the same time as they are served with a statutory demand for repayment of a debt or other instances where creditors are taking action to recover a debt.

c) Information about bankruptcy should be provided to debtors at all possible opportunities in the bankruptcy process. Information could be provided when: a bankruptcy petition is made by a debtor or creditor; when the bankruptcy order is made; when the debtor is interviewed by the Official Receiver as part of the initial enquiry into the bankrupt's affairs; when the Trustee reports to creditors about the bankrupt's affairs or any time the bankrupt receives a letter from their Trustee.

We would be happy to discuss any of the points raised in this response in greater detail if it would be of assistance

R3, Association of Business Recovery Professionals
7th October 2014