



HM Treasury Call for Evidence: Breathing Space

Response by the Association of Business Recovery Professionals ('R3') to the consultation issued in October 2017

Introduction

1. R3 is the trade association for the UK's insolvency, restructuring, advisory, and turnaround professionals. We represent insolvency practitioners, lawyers, turnaround and restructuring experts, students, and others in the profession.
2. Insolvency practitioners play a vital role in providing advice to those in financial difficulty. In 2013-14, insolvency practitioners assisted more than 60,000 individuals through an insolvency procedure, advised more than 135,000 individuals, and started work on cases that will help individuals repay £5bn of debt to creditors within five years.¹ Most insolvency practitioners also offer one hour free advice to indebted individuals.
3. We have focused our response on those questions in the consultation where we can provide answers based on our members' expertise, including their experience of the personal insolvency market and in assisting indebted individuals with their financial difficulties.
4. Members' views on the questions contained within the Call for Evidence were sought via meetings and email communication.
5. Please contact Caitlin Powell, R3's Committees and Policy Manager, if you have any questions at caitlin.powell@r3.org.uk or on 020 7566 4206.

Executive Summary

6. R3 welcomes the call for evidence on introducing a six-week breathing space and statutory debt repayment plan. It is hoped that the call for evidence will enable the government to implement a breathing space which balances the needs of indebted individuals and their creditors and to gather evidence to consider whether a statutory debt repayment plan is necessary throughout the UK.
7. R3 emphasises the importance of recognising that a statutory breathing space and statutory debt repayment plan are two distinct processes, either of which could be implemented without the other. While R3 strongly supports introducing a short statutory breathing space, it is not apparent that a new *statutory* debt repayment procedure is needed in England, Wales and Northern Ireland, either to address a gap in personal debt solutions or to ensure tighter regulation of current non-statutory debt management plans in those countries. Consideration to implement either procedure, whilst it could be undertaken concurrently, should not be undertaken as part of a joint exercise which views them as interlinked.
8. If a new form of statutory repayment plan is to be proposed, a separate consultation should be undertaken which examines the current procedures and considers what gaps (if any) there are in the available procedures – see our more detailed comments at paragraph 36 below.

¹ R3 Value of the Profession to the UK economy report (statistic from R3/Com Res member survey) (May 2015)

Response

Question 1: In your opinion, how should the government decide who is eligible for a breathing space? In particular:

- *How should the government define serious problem debt in the context of a breathing space?*
- *Should eligibility be determined by a set of defined characteristics, or should there be some discretion to determine eligibility?*
- *If there is some discretion, who should be tasked with exercising it – a regulated debt adviser, or some other person?*
- *Are there any other entry criteria and / or exemptions the government should consider?*
- *Who should be responsible for regulating and enforcing access to a breathing space and how can disputes be resolved?*

9. A breathing space ensures that people who are experiencing financial distress are able to seek debt advice in an environment free from creditor pressure which enables them to enter into an appropriate debt “exit strategy”, whether or not this involves a formal insolvency procedure or debt repayment agreement. Given the desirability of making the breathing space readily accessible and its relative brevity, any eligibility criteria that the government uses should be minimal. As such, R3 recommends that the breathing space should only be unavailable to:

- a. Individuals currently subject to a formal insolvency procedure under the *Insolvency Act 1986*;
- b. Individuals who were subject to a formal insolvency procedure under the *Insolvency Act 1986* in the preceding 12 months; and
- c. Individuals who have entered into a breathing space procedure in the previous 12 months.

Any additional criteria would risk making access to the breathing space difficult for those likely to benefit from it.

10. Responsibility for regulating and enforcing access to a breathing space should sit within the Insolvency Service with an Adjudicator holding responsibility for granting a breathing space. The online bankruptcy application process could potentially be adapted for these purposes, which would enable individuals to self-select to enter this process. Adapting the existing Adjudicator process used for bankruptcy could also assist in reducing any costs associated with establishing the breathing space. If there are concerns about the use of the breathing space, then creditors will still have recourse to the courts if they wish to undertake enforcement action.

Question 2: What should be the trigger point for a breathing space? In particular:

- *Should a breathing space only be available for a person who seeks regulated debt advice?*
- *Should individuals have demonstrated they have already taken steps to try to manage their debt?*

- *If so, at what point should the six weeks start – for instance: once a breathing space has been requested, when the first advice session has occurred, or once adviser has confirmed a breathing space would be appropriate?*
 11. A breathing space should be made available for a person to seek debt advice from a regulated adviser (either by an FCA-authorized debt adviser or, preferably, by an insolvency practitioner licensed by one of the Recognised Professional Bodies (RPB)). It is important that the moratorium is only available to those seeking advice from a regulated source to ensure that the advice given is appropriate and to prevent unregulated sources of advice from being established. As the purpose of the breathing space proposals is to encourage as many people as possible to seek regulated advice at an early stage, and the short length of the proposed breathing space, there should be no requirement for individuals to demonstrate that they have already taken steps to manage their debt.
 12. The breathing space period should start from when the breathing space period has been requested by the individual, unless the Adjudicator subsequently rejects the request for a breathing space in which case it will immediately come to an end.
 13. This will enable the individual the full six weeks to obtain appropriate financial advice. The individual could be provided with details on how to find a source of regulated debt advice at the same time as receiving confirmation that the breathing space has commenced. There will need to be some form of communication with the individual explaining what the breathing space is, how long it lasts for and what the individual should do during the breathing space. The individual should also be provided with some form of evidence of the breathing space that they can show to creditors seeking to take enforcement action.

Question 3: Should all debts be eligible for a breathing space?

- *How should multiple debts be treated; is there a priority order of debts which should be included as part of a breathing space arrangement?*
 - *Should some types of debt be exempt? In particular, where the debt is the late payment of a fine or penalty?*
 - *In particular, should debt owed by self-employed / microbusinesses be included?*
14. In order to provide an effective breathing space from debts, all debts should be included. The breathing space should provide a stop on enforcement action. Unless all debts are included there will not be an effective six week stay. There is an important role for the regulated adviser to play during the breathing space to ensure that the individual understands that ongoing liabilities will still fall due during the breathing space period and the consequences of non-payment of debts, such as mortgages, rent, child maintenance etc.
 15. R3 considers that interest should continue to accrue on debts during the breathing space (in order for creditors not to be disadvantaged by the breathing space). Creditors should not be allowed to add penalties for late payment or non-payment of debts during the breathing space or after the event, particularly where these could be considered as a penalty for the individual having entered into a breathing space.
 16. The breathing space should cover all personal debts, including any trading debts for which an individual has personal liability. This would enable sole traders to take appropriate advice on all of their debts. R3 believes that corporate debts should be dealt with by a separate moratorium, as proposed by the government in May 2016.

Question 4: Should all interest, fees and charges be frozen throughout the breathing space period?

17. All fees and charges arising due to non-payment of debts during the breathing space period should be frozen throughout the breathing space period. The purpose of the breathing space is to allow individuals to seek debt advice in a timely fashion. Individuals should not feel pressured (by continued creditor enforcement action or the escalating cost of non-payment) into making a rash decision. Such pressure may result in them entering into an insolvency procedure or other debt management plan which is not the most appropriate for their circumstances. It may even result in the individual avoiding a debt solution altogether. In order to avoid creditors being disadvantaged by the breathing space, interest should still be allowed to accrue on debts during the breathing space.

Question 5: What activities must the breathing space participant continue with to remain eligible? For instance:

- *Should they be required to attend advice sessions?*
- *Should they be required to make any repayments during a six-week breathing space, if their financial situation allows it?*

18. The purpose of the breathing space should be to enable an individual to seek debt advice from a licensed insolvency practitioner or an adviser regulated by the FCA. As such, individuals during a breathing space should have to have sought regulated advice.
19. Individuals should be advised by the regulated adviser of the consequences of not making continued repayments in respect of their debts. If an individual's financial situation allows it, they should be encouraged to continue to make repayments on ongoing liabilities. There should be no statutory requirement for individuals to continue to make repayments during a breathing space period.

Question 6: Are there circumstances in which a breathing space period could end before six weeks, such as if an appropriate solution is found? Who could be responsible for enforcing this?

20. Yes, if an appropriate personal debt solution is found, then the breathing space should end as soon as this arrangement is entered into. It should be the responsibility of the relevant debt adviser to contact the Insolvency Service to advise them of the end of the breathing space period and its outcome so that the central debt register can be updated (refer to the response at paragraph 23). The breathing space could also potentially end if clear evidence came to light that the breathing space was being used as a time wasting tactic or if the regulated adviser determines that the individual's financial situation is not such as to require a breathing space. The breathing space could also potentially end if clear evidence came to light that the breathing space was being used as a time wasting tactic (which could be dealt with by the courts) or if the regulated adviser determines that the individual's financial situation is not such as to require a breathing space. The latter situation would require a decision by the Adjudicator to end the breathing space.
21. The end of a breathing space period would not require enforcement as such. Once the breathing space has ended then, depending on the circumstances of the individual, creditors will either be able to resume enforcement action or will be barred from doing so if the individual has entered into a formal personal insolvency procedure.

Question 7: Should breathing space protections only cover debts existing at the outset, or also include new debts arising during the six-week period?

22. It is to be hoped that instances of individuals having new debts arise during the six-week period would be minimal, although individuals may necessarily incur new liabilities such as utility liabilities. In such cases, new liabilities should also be subject to the breathing space, provided that the breathing space is recorded on the individual's credit file and it is recorded on a central debt register as per paragraph 23. As previously noted, the purpose of the breathing space period is to enable an individual to seek debt advice in a pressure free environment, which would not be the case if the individual is still being subject to creditor enforcement action from new debts. Care would need to be taken, though, to ensure that this is not abused and the adviser should be expected to inform the individual of the consequences and appropriateness of taking on new debts. For example, it may be that the most appropriate solution for an individual to manage their debts is to replace existing debts with a consolidation loan. A ban on taking on new debt would preclude this solution, meaning that an individual may end up in a debt procedure that leaves them (or their creditors) in a worse position. A central register of the breathing space moratorium would allow potential lenders to make an informed decision on whether or not to lend to an individual.

Question 8: Should a breathing space be noted on a person's credit file?

23. Yes. As noted above, in the interests of creditor fairness, particularly if any new debts would have any charges or fees frozen, a breathing space should be noted on a person's credit file. It should also be included on a central personal debt register, maintained by the Insolvency Service (the current Personal Insolvency Register could be re-named the Central Debt Register or similar and be adapted for this purpose), which creditors should be required to check before undertaking any enforcement action against an individual to ensure that the individual is not currently part of a breathing space. This could also serve as notification to creditors of an individual entering into a breathing space, which would help reduce any costs associated with the breathing space (compared to, for example, a requirement for letters to be sent to all creditors).

Question 9: How frequently should a debtor be able to access a breathing space, and what criteria should control the frequency of access?

24. Only one moratorium should be available per individual in a 12 month period to avoid it being used as a tool to avoid repaying their debts (rather than facilitating advice and entry into an appropriate debt solution). Whilst there should be the option to extend a breathing space period by an additional 28 days if the regulated adviser deems that this is absolutely necessary or for as long as necessary if an individual is entering into a formal debt solution which has a creditor approval voting period (which would not otherwise be covered by the breathing space), it should not be possible for an individual to enter into a breathing space period more than once during any 12 months period.

Question 10: What challenges would creditors face in implementing the scheme?

25. This question would best be answered by creditors. However R3 considers that, due to the short length of time of the breathing space, and the ongoing application of interest to debts, any challenges for creditors arising from implementing the scheme would be minimal.

Ensuring that the central breathing space register (as per paragraph 23) is up to date and easy to access would minimise any challenges faced by creditors.

Question 11: Who would be responsible for notifying creditors that a customer has entered a breathing space? What updates are required during the breathing space period?

26. As per paragraph 23, a central breathing space register, maintained by the Insolvency Service (the current Personal Insolvency Register could be re-named the Central Debt Register or similar and be adapted for this purpose) should be established. Entry onto this register should serve as notification to creditors of an individual entering into a breathing space, which would help reduce any costs associated with the breathing space (compared to, for example, a requirement for letters to be sent to all creditors). As the responsibility would rest with creditors to check the register to ensure they are not acting contrary to the restrictions placed on them by the breathing space, it should be sufficiently easy for creditors to access and search in order to minimise the burden of having to do so. Individuals could be provided with a standard notification of the breathing space to provide to any creditors who seek to take enforcement action during the process. Any further additional notification to creditors should be discretionary.

Question 12: Would a breathing space scheme impact on business revenue or have any other significant detriment?

27. R3 would assume that, due to the short length of time of the breathing space, that any detrimental impact on creditors would be minimal, particularly if interest is not frozen during the breathing space period. There is a potential benefit to creditors if a breathing space does increase the likelihood of individuals ending up in an appropriate debt solution and consequently being able to pay back more of their debt. However, R3 does not represent creditors and this information would be better sought elsewhere.

Question 13: Should any creditor be exempt due to the size of their business?

28. No, all creditors and all debt should be included in the breathing space. Please refer to the response at paragraph 14.

Question 14: What benefits could creditors see as a result of a statutory breathing space scheme?

29. As noted previously, it is anticipated that a statutory breathing space scheme will enable individuals to seek regulated debt advice and to give careful consideration to their options rather than rushing into the first solution offered, regardless of its suitability, simply because it will halt enforcement action. This should result in more individuals dealing with their debts appropriately and should increase creditor confidence and potentially creditor returns over time.

Question 15: How could the government ensure that a breathing space works with and adds value to existing support structures?

30. The Government should ensure that there is information available to indebted individuals about the availability of a breathing space and the criteria that need to be met to be eligible for the scheme. The Government will need to work closely with the insolvency profession,

debt advice sector, and trade bodies such as R3 to ensure that any scheme will be fit for purpose and complements the existing support structures. Funding for debt advisers should also be reviewed to ensure that any additional demand for debt advice can be met. Responsibility for administering the breathing space should rest with the Adjudicator and the Insolvency Service.

Question 16: What safeguards are needed to prevent the scheme being abused?

31. To prevent abuse, the breathing space scheme should be subject to the limitations set out in paragraph 9.
32. Applying for the scheme should be through the Adjudicator/the Insolvency Service who should ensure that the individual has not entered into a breathing space in the twelve months preceding, is not currently subject to a formal insolvency procedure, and has not been subject to a formal insolvency procedure within the past twelve months. Creditors should also be able to have recourse to the courts, in case there are instances of abuse of the scheme.
33. The short timeframe for the breathing space of only six weeks should act as a safeguard in and of itself to prevent abuse, as would only allowing an individual to enter into a breathing space once in a twelve month period.
34. An additional safeguard should be put in place to prevent potential abuse by an individual who may be tempted to use the period to move assets prior to entering into bankruptcy. If an individual enters into bankruptcy following a breathing space period, then the period for taking action by the trustee in bankruptcy in respect of void dispositions of assets should begin from the time of the application for a breathing space, rather than from the time of the petition for bankruptcy.

Question 17: Should a breathing space be extended to Wales and Northern Ireland as well as England?

35. Yes. This type of scheme should be available to all individuals, regardless of location.

2.8 After a breathing space: statutory debt management plans

Question 18: How could a statutory debt repayment plan be administered?

36. It is not apparent that there is a gap in the personal debt solution regime in England, Wales and Northern Ireland. Scotland already has such a scheme, but market conditions in Scotland are specific to that country, and are not necessarily replicated throughout the rest of the UK, so care needs to be taken not to assume that a debt solution which is needed there is necessarily required elsewhere. If there are concerns that the current non-statutory debt management plans are not achieving their purpose, or require greater scrutiny, then tighter regulation of these (which the FCA has already begun to implement) and a central Debt Management Plan register (which R3 has been calling for since 2010) would be most effective. In the absence of evidence, it is impossible to identify how it would address any perceived gaps in the market: for example, how it would differ in practice to an Individual Voluntary Arrangement, which can also provide a return to creditors of 100p in the £1 with regular repayments over an extended period of time?
37. It is important to remember that England, Wales and Northern Ireland already have three effective statutory personal insolvency procedures:
 - a. Bankruptcy. Bankruptcy is the administration of the affairs of an insolvent individual by a trustee in the interests of their creditors. When a person becomes bankrupt,

the control of all their assets, with certain exceptions, passes to the trustee whose role is to realise them and distribute the proceeds to the creditors. In England and Wales, an individual can petition for their own bankruptcy through an online portal, which requires a £680 up-front fee (£130 Adjudicator's fee + £550 bankruptcy deposit fee). An individual is automatically discharged from bankruptcy after 12 months, from which the individual is debt free, apart from certain excluded debts such as student loans, child support payments, fines and debts incurred through fraud.

- b. Debt Relief Orders (DRO). To be eligible for a DRO, an individual must be unable to pay their debts; have unsecured debt of less than £20,000; assets worth less than £1000 (except a car which can be worth up to £1000); and disposable income of less than £50 a month after normal household expenditure. Individuals complete an application and apply for the order online, through an authorised intermediary. The intermediary will be a regulated expert in debt advice. A DRO can only be obtained with the assistance of the intermediary. There is a £90 fee for the application, which can be paid in instalments. The orders are made by the Official Receiver, who has the power to refuse the order or delay it pending further information from the applicant. The DRO will prevent enforcement action being taken against the individual by their creditors. The order will last for 12 months after which time the debts will generally be written off.
 - c. Individual Voluntary Arrangements. An IVA is a contract between an indebted individual and their creditors through which the indebted individual pays off their debts (or an agreed proportion thereof) over a set period of time, typically five years. IVAs can follow a standardised format when the indebted individual's financial affairs are relatively simple or can be specialised and specifically tailored contracts where an indebted individual's circumstances are more complex. On the successful completion of the IVA, any remaining debt liability is written off.
38. If statutory debt repayment plans were to be found necessary and subsequently introduced, then it could be administered through the relevant Government body (similar to in Scotland), which would likely be the FCA (as the current regulator of debt management plans).
39. As there is not currently clear evidence supporting the introduction of a statutory debt repayment plans, R3 has chosen not to respond to questions 19-31 of the call for evidence. R3 would recommend HM Treasury consider the Scottish experience with DAS, outlined in the response from the R3 Scottish Technical Committee.

2.9 Evaluating the impact of a breathing space and statutory debt management plan

Question 32: For each of (1) a six-week breathing space, and (2) a statutory debt management plan, please describe in detail, and with supporting evidence, the positive impact expected through:

- *Improved access: How will it encourage more people to seek debt advice earlier?*
- *Better support: How will it improve outcomes for customers who are already in problem debt?*
- *Increased repayments: How will it increase the amount of debt repaid to creditors?*

40. As detailed earlier, a breathing space should encourage more people to seek debt advice earlier as a period free from creditor enforcement action is likely to act as an incentive to seek debt advice. This should improve outcomes for customers who have debt problems as they will be able to both seek advice and also take sufficient time to consider that advice, and decide on an appropriate course of action, without the pressure of creditor enforcement action. Individuals entering into an appropriate course of action (which should

be determined by the extent to which it fairly balances the interests of indebted individuals and creditors) has already been proven to increase returns to creditors, and a breathing space should enable more individuals to seek advice and enter into an appropriate debt solution, thus resulting in higher returns to creditors.

41. As detailed in paragraph 36, R3 believes that there is no evidence to show that a statutory DRP is a necessary debt solution for England, Wales and Northern Ireland. As such, R3 cannot identify how introducing such a procedure would result in improved access, better support and increased repayments. R3 recommends referring to the Scottish experience with DAS, outlined in the R3 Scottish Technical Committee response.

Question 33: Once implemented, how could the government determine whether the breathing space and statutory repayment plan have been successful? What metrics would be appropriate to use?

42. Once implemented, the government could determine whether the breathing space scheme has been successful by gathering statistics in relation to whether:
 - d. The number of individuals seeking debt advice has increased;
 - e. The time it takes for individuals to seek debt advice when in financial distress has decreased;
 - f. The uptake and popularity of the breathing space scheme; and,
 - g. The repayments to creditors by those individuals who have entered into a breathing space before entering into a debt solution is generally higher than for those individuals who have not.
43. As detailed in paragraph 36, R3 believes that there is no evidence to show that a statutory DRP is a necessary debt solution for England, Wales and Northern Ireland. As such, R3 cannot currently advise how on appropriate metrics to use to determine whether any such scheme is successful. R3 recommends referring to the Scottish experience with DAS, outlined in the R3 Scottish Technical Committee response.