Managing borrowing and dealing with debt
Call for Evidence in support of the Consumer Credit and Personal Insolvency Review

Response by the Association of Business Recovery Professionals (R3) to the Call for Evidence issued by HM Treasury and the Department for Business, Innovation and Skills.

Section 1: Introduction

R3 is the insolvency trade body, representing 97% of licensed Insolvency Practitioners (IPs). IPs are experts in formal insolvency and pre-insolvency advice, acting as trustees in bankruptcy and as supervisors of Individual Voluntary Arrangements (IVAs). Our members work with financially distressed individuals on a daily basis, and our expertise and experience relates to this element of the credit and debt cycle. We have therefore focused our response on Part Five of the Call for Evidence, entitled 'what happens when things go wrong'. The members of the working group that examined this Call for Evidence at R3 are experienced IPs who specialise in personal insolvency, including a Deputy Bankruptcy Registrar and editors of the standard work on IVAs. Our response refers to England and Wales.

The personal insolvency system was designed predominantly with trading-related insolvencies and entrepreneurship in mind. However, the vast majority of personal insolvency cases involve consumer debt. We believe that the existing personal insolvency regime should be reformed to distinguish between simple consumer insolvencies and the more complex cases, in order to ensure that there is a more accessible route to repayment for the majority of insolvent individuals.

We also believe that repayment of debts should be incentivised more effectively by recalibrating the balance between insolvency procedures that focus on repayment and those that centre on debt write off. This might include reducing the impact of an IVA on a person's credit rating or extending the discharge period in bankruptcy.

We provide evidence that suggests that individuals in financial distress are not as aware of their options as they should be and that they often receive 'bad' advice or make pressurised decisions, which results in them entering into the 'wrong' solution. To resolve these concerns, we propose that individuals in financial distress should be able to apply for a moratorium from creditor action for four weeks, during which time they are required to seek advice from impartial financial advisors. Good quality debt advice and education (in and out of insolvency procedures) would make a significant difference to the efficacy of the existing personal insolvency regime.

With these amendments, the insolvency regime can support individuals in financial distress more effectively and encourage repayment of debts wherever possible.

Section 2: What happens when things go wrong?

Q.12 What role should the court play in the debt recovery process? Should it be restricted to genuine points of law and disputes between the parties?

We believe that the role of the Court should be retained in the bankruptcy petition and order process. While we realise that this goes against current public policy which leans towards removal of the court from this process, we believe that it is important that bankruptcy does not become a purely administrative procedure but remains a judicial procedure, especially having regard to the often serious and far-reaching consequences of a bankruptcy order. The Courts also have the skills necessary to deal with the more unusual or complex cases. Finally, it is also important that the Court continues to be involved in the debt recovery process to ensure that creditors are able to enforce unpaid debts via the judicial system.

Q.13 Are court-based enforcement mechanisms fit for purpose? If not how would you like to see them improved or added to?

As discussed more fully in Q16, we believe that statutory demands should only be issued after a creditor has established a debt (e.g. via obtaining a judgement for that debt) and that the minimum amount of money which a creditor must be owed before they are able to petition for an individual's bankruptcy should be raised. This would prevent unnecessary bankruptcies for low level debts and curb intimidating creditor behaviour.

Q.14 What impact would a £25,000 threshold have on your ability to enforce unpaid debts by means of 1) charging orders and 2) orders for sale? What alternative action might you take?

Please note: when we use the term 'Orders for Sale' in this response, we are referring to the process of obtaining a Charging order and then seeking an Order for Sale.

A degree of political attention has been directed towards Orders for Sale. Hyperbolic reporting suggests that creditors use this approach to force the sale of family homes for a relatively small amount of debt. This has led to a call to safeguard the property of individuals to ensure that homes are not forcibly sold to pay off comparatively small debts.

While not wishing to diminish the impact an Order for Sale can have on an individual, we must emphasise that there are between 500-700 Orders for Sale each year (according to the recent consultation on Orders for Sale). Of these, around half are suspended - i.e. they do not 'go through'. We must also point out that the number of charging orders obtained far outstrips the number of Orders for Sale eventually made. In short: although there may be many charging orders, only around 500-700 of these convert into Orders for Sale, and only half of these Orders actually result in the sale of a property. The practice of using an Order for Sale to realise an individual's home to recover originally unsecured debt is by no means widespread.

In addition, it should be noted that if a Charging Order is made, this does not mean that creditors can immediately claim the debtor's property; the Charging Order simply guarantees that the creditor will be paid from the proceeds of sale once the house is eventually sold - even if this happens of the debtor's own volition, many years later.

We must also be clear to distinguish between 'Orders for Sale', which are obtained in connection with previously unsecured debts and are relatively low in number, and 'repossessions' which apply where an individual has defaulted on mortgage repayments and the mortgagee has sought and obtained an order for possession and sale. The latter are significantly higher in number. The two processes are often conflated, which may give the impression that there is more of a problem with Charging Orders and subsequent Orders for Sale than is the case.

The current personal insolvency system tries to ensure that anyone who 'can pay' does pay - i.e. it seeks to encourage individuals who owe money to pay it back if they have sufficient income and/or assets. The realisation of property is a part of this system, unpalatable as some may find it.

We understand concerns about realising a property for small debts, but there is already a 'check and balance' in the current system to prevent this. Orders for Sale require a court judgement, so the judge reviews the case and makes a decision on whether this would be a reasonable action in view of the level of debt. In most cases, a debtor whose only significant asset is a residential property would not lose the family home for a disproportionately low amount of debt. Case law highlights that vulnerable individuals are generally protected from the sale of their home - e.g. safeguarding the property of those with dependants.

It is as yet unclear whether the Coalition proposal to ban Orders for Sale for debts of less than £25,000 would apply to actions by Trustees in bankruptcy. If the proposal does apply to bankruptcy, it is open to abuse; if it does not it could result in more creditor petitions for bankruptcy.

If the proposal were to apply, a debtor with debts of £24,000 (just below the threshold) with substantial equity in a property (e.g. a house worth £250,000 with equity of £50,000) could avoid paying their debts by petitioning for their own bankruptcy. The trustee in Bankruptcy would be unable to realise the property to pay off the debts. Twelve months later, the debtor would be released from bankruptcy and free to run up further debts, which could then be written off by a further bankruptcy. All the while, they would retain their property. The threshold therefore enables individuals to build up significant unsecured debts (up to £25,000) and walk away from them. This is counter to common sense, responsible borrowing and public policy - i.e. that those who can pay, should pay.

It is also important to ensure that creditors have recovery tools open to them. Without these mechanisms, businesses would struggle to recover the money they are owed. This 'hole' in their finances can jeopardise their own stability, particularly where they are small businesses and sole traders. During these challenging economic times, many businesses have drawn heavily on their reserves which means they do not have the 'buffer zone' necessary to cope with significant outstanding debts. For more vulnerable businesses, an inability to recoup money owed could mean the difference between survival and insolvency.

Finally, this proposal risks a negative impact on lending. In any economy, lending is key to economic growth. To ensure that lenders are willing to lend, they have to be confident they will get their money back in the event of insolvency. Reducing lenders' options for recouping money owed to them by restricting Orders for Sale may discourage them from lending in the first place and put up the cost of borrowing.

Alternatively, if this proposal does not to apply to bankruptcy it is likely to increase the number of Bankruptcy Orders. Under the current system, creditors have a number of options open to them to recover debts. One of these is the use of Orders for Sale. If the Government introduced an Order for Sale threshold, creditors would have to find other methods of recovering their money. A likely outcome would therefore be an increase in creditors petitioning for debtors' bankruptcy to recover their debts. In effect, the threshold would be circumvented. Ironically, in an effort to protect individuals from losing their home, the introduction of this proposal could result in those same individuals being thrust into bankruptcy - a procedure that results in far more draconian and serious consequences.

While the introduction of a threshold is likely to increase the overall numbers of bankruptcies in the UK, it is impossible to determine how many more bankruptcies there would be. It would partly depend on the difference between the threshold (proposed at £25,000) and the statutory limit for petitioning for bankruptcy (which is currently £750). If the difference between these figures were lower (setting an Orders for Sale threshold at £1,000 for example), it would serve to make bankruptcy a less attractive option for creditors looking to recover their debts. If the threshold were set at £25,000 creditors would be highly likely to use bankruptcy in cases where they would previously have used an Order for Sale.

To deal with concerns about Orders for Sale, we suggest the following policy options:

- Individuals should be warned that creditors can convert their unsecured debt into a secured debt through a Charging Order, consequently putting their home at risk. This could take the form of a warning on credit agreements.

- Instead of setting a threshold based on the value of debts, it may be more appropriate to base it on the equity in the debtor's principal private residence. This would alleviate concerns about forcing the sale of the property of vulnerable individuals - e.g. if a property is worth a considerable amount of money (say £250,000 with equity of £50,000) by comparison to the debt owed (say £25,000), the property could be sold to pay off the debts. A threshold may prevent this happening in cases where the value of the house barely covers the value of the debt. This could be achieved if something akin to the 'low value property regulation' in bankruptcy were to apply to charging orders.

- To prevent an increase in bankruptcies, a suitable threshold for Orders for Sale could be the same level as the statutory limit for petitioning for bankruptcy (currently £750, but R3 recommends it is increased to £3000 - see Q.16). This would avoid a significant difference between the threshold and the statutory limit for petitioning for bankruptcy. As a result, using bankruptcy as a recovery tool would not be a worthwhile option for creditors as the money they would recoup would be minimal.

- Concerns about aggressive creditors might be dealt with by introducing a moratorium on creditor action while a debtor weighs up their options. To this end, R3 proposes a four week period where a debtor is protected from creditors and is given time to consider their options and take financial advice. Alternatively, perhaps an Order for Sale could be made, but suspended for a minimum of 12 months. This 12 month period would give the debtor an opportunity to arrange their finances to a point where the sale is no longer necessary.

Given that there are so few Orders for Sale each year and that the current system is capable of protecting vulnerable individuals, we do not believe the case for change as outlined in the Coalition agreement has been adequately made. Depending upon its scope the likely impacts of the Coalition proposal is an increase in bankruptcies, a risk to lending, and the creation of a system in which devious debtors can walk away from their debts while creditors have fewer tools to recover money from those who can afford to pay.

Q.15 How can debtors be encouraged to seek early support to help manage their debt problems?

In January 2010, R3 commissioned a piece of research among 1,193 individuals who were struggling with their debts without help. The respondents were asked why they had not yet contacted anyone for help, and were able to select a range of reasons. The most popular option was 'I don't think the problem is big enough to need help' (44%) followed by 'It's a short term problem' (25%). 21% said they did not know where to go for help and 20% said they could not afford help or advice. 14% stated that they were worried about what other people would think, 11% said they were worried about the impact it would have on their family, the same proportion said they did not trust anyone to help and 9% said they were too afraid of bankruptcy.

The same research project shows that 44% of struggling debtors believe that debt advice must always be paid for (i.e. that free debt advice is not an option). Greater awareness among the public of the sources of free advice - encompassing an initial consultation with many IPs in addition to the not-for-profit advice agencies - may well be beneficial.

R3 believes that financial education among young people would prevent accumulation of debt later on in life. Many young people across the UK are not equipped to deal with making decisions about money, and as financial products and techniques for marketing them become ever more sophisticated, it is vital that young people understand these products, how to manage their finances and where to go for help. We have long-argued that financial education should be a standalone subject on the national curriculum.

Q.16 Do the current debt relief options strike the right balance between the needs of the debtor and the rights of creditors?

There are three key areas in which R3 believes the balance has shifted towards creditors: IVA approval; monetary limits that encourage aggressive creditor behaviour; and the sheer number of debts that survive now bankruptcy.

The IVA Protocol for the consumer debt cases was intended to remove many of the obstacles to obtaining approval of IVAs in simple cases, by encouraging lenders not to insist on unhelpful modifications. Although the Protocol has had some successes, it leaves much to be desired and there remain a number of barriers to entry for individuals who might be well suited to an IVA. Under the current system, a considerable number of IVAs that IPs believe are in the best interests of debtors and creditors are refused by the banks, or modified so severely that they become unviable. According to a recent survey of over 300 Insolvency Practitioners, 30% have seen banks or Asset Based Lenders refusing a reasonable offer of repayment through an IVA because they have initiated enforcement action, and 42% have seen these lenders do so because they are the largest creditor. According to the IVA Protocol Review in December 2009, 97% of IVA proposals required modifications before they were accepted by creditors. Given the high number of rejections and the degree of modifications, many IPs refrain from advising debtors to propose IVAs in the first place, wary that the proposals will only be refused.

There are two key 'groups' of debtors that access the personal insolvency system: small, consumer debt cases; and more complex cases, including personal insolvencies as a consequence of business failures (e.g. directors who have given guarantees for bank loans and leases). We believe that the insolvency system should differentiate between these different groups, and that the simpler cases - where debts are more straightforward and quantifiable, and there are no tax liabilities - should be able to access a simple statutory solution to resolve their distress.

To address these cases, we believe that the Government should re-think its current policy and introduce the Simplified IVA (SIVA). Unlike the current IVA, which requires 75% or more creditors by value to approve the agreement and for which approval can therefore be blocked by a minority creditor with 25% of the value of the total debts, the previously proposed SIVA would only require a simple majority of creditors (over 50%) to approve the procedure, which may go some way to reducing the number of proposals which are rejected. In addition, the SIVA process would not allow modifications to the agreement before it is approved, which would reduce the number of proposals which become unviable due to severe creditor modification. We therefore believe that the introduction of the SIVA for qualifying consumer debtors would address many of the issues associated with the current IVA process for simple consumer debt cases. If introducing the SIVA is not possible, we believe a more user-friendly statutory scheme should be considered for simple consumer debt cases (e.g. a Personal Insolvency Order).

The second area in which we believe the balance has shifted too far towards creditors is monetary limits. We believe that monetary limits are currently misused by creditors, such that creditors frequently threaten to petition for an individual's bankruptcy on a low level debt. The minimum amount of money which a creditor must be owed before they are able to petition for an individual's bankruptcy is £750, which is specified by s267(4) of the Insolvency Act. We believe that this minimum threshold should be realigned and suggest that £3000 is now a more appropriate minimum amount. We also see merit in requiring creditors to have established a debt before they issue a statutory demand - i.e. that they are forced to obtain a judgement (or binding assessment in HMRC's case) beforehand. The implementation of these proposals would prevent unnecessary bankruptcies for low level debts and curb intimidating creditor behaviour.

The final area in which we believe the balance has shifted too far towards creditors is the range of debts that now survive bankruptcy. When a debtor enters bankruptcy, most of their debts are eventually written off, which enables them to make a fresh start. However, certain categories of debt survive bankruptcy - i.e. the bankrupt must still repay the debt even after they have been discharged from bankruptcy. Traditionally, this category was limited to debts arising from fraud or criminal charges. However, over the years this has been gradually been extended to cover a range of debts, including student loans and matrimonial debts. R3 believes that bankruptcy should represent a 'clean slate' and that the number of debts that survive discharge should be reviewed, preferably rolled back, and certainly not extended. This could be balanced by extending the bankruptcy discharge period to three years.

Q.17 What problems are encountered with the current range of debt solutions and how could they be improved to ensure all debtors have an option and that the choices are clear?

In order for the personal insolvency system to operate at its optimum, it is vital that financially distressed individuals enter the solution best suited to their financial situation. However, for a variety of reasons, too many individuals in financial difficulty enter solutions that are not appropriate for their circumstances. The choice between the various debt solutions is not always clear to debtors, which is a result of bad advice and a large number of options.

While there is merit in having a number of debt solutions to suit a range of circumstances, individuals should be able to take a decision about which debt remedy to pursue based on impartial and full advice; and in an environment that allows them to weigh up the full range of options before making a decision.

Evidence suggests that debtors are not always aware of the option open to them. In January 2010, R3 commissioned a piece of research among 1,961 individuals who are struggling with debt without help, 260 individuals in a DMP, 119 in an IVA and 66 undischarged bankrupts. The research found that 35% of individuals in a DMP said they were not told about other ways of dealing with their debts before their DMP began; 32% of those in an IVA said that no-one talked to them about other options before their IVA started; and 54% of bankrupts say other options were not discussed with them before they opted to go bankrupt. Almost one in ten individuals in a DMP said they were not aware that there were any alternatives for dealing with their debts (8%). These results do not appear to reflect well on the quality of advice given to debtors and emphasises the importance of ensuring that financially distressed individuals receive impartial and full advice from qualified advisors.

Evidence also suggests that creditor or solution-provider pressure can impact on the decisions made by indebted individuals. Our research among individuals in an IVA finds that more than one in ten (12%) say they were pushed into the arrangement by the company that arranged their IVA; and a survey of over 300 IPs finds that 52% have seen debtors 'pushed' into a DMP by their creditors.

In order to ensure debtors are made aware of their options and that they do not make pressurised decisions, R3 believes that individuals in financial distress should be able to apply for a moratorium from creditor action for four weeks, during which time they are required to seek advice from impartial financial advisors who do not have an interest in promoting a particular solution.

We suggest that financially distressed individuals should be able to apply either to the Court or the Insolvency Service for the moratorium. The Courts or IS would then provide them with a list of impartial advisors to approach. This 'panel' of advisors could be drawn from a range of backgrounds, including IPs, not-for-profit agencies such as the CAB, certain DMP providers or other 'approved intermediaries' (as with Debt Relief Orders). The only requirement should be that all advisors are aware of the range of options open to indebted individuals, that they do not have a financial interest in promoting a particular solution, and that they offer full and impartial advice. Advisors would discuss with the indebted individual the range of ways to deal with their debts and help them weigh up their options. Advice should be given in person wherever practical because online portals or awareness leaflets are no substitute for face-to-face advice. If individuals in the moratorium do not seek advice during this time, the moratorium would simply be lifted at its conclusion.

There are a number of options to cover the costs of setting up this initiative and running it, including a modest fee paid by the debtors, a creditor levy or a levy on credit cards. We believe the system should also apply where creditors petition for an individual's bankruptcy as well as for debtors' own bankruptcy petitions.

By way of precedent, mandatory debt advice prior to entering a formal insolvency procedure is used in other jurisdictions, such as Canada, and is intended to provide debtors with financial education and, once an insolvency process has been entered into, financial rehabilitation. In principle, we would welcome a similar requirement being built into our own insolvency regime prior to debtors entering into a particular insolvency procedure and prior to leaving it, and believe its operation in other jurisdictions merits further research.

We would welcome further discussion of this proposal with Government and stakeholders.

Q.18 Is there sufficient flexibility within the current range of debt solutions to allow for debtors changing circumstances?

There is a degree of flexibility in the current insolvency regime, with individuals moving between solutions as their circumstances change. Individuals can move from an IVA to bankruptcy; from a DMP to an IVA, bankruptcy or a DRO (if they meet the criteria); or from bankruptcy (where the bankrupt is undischarged) to an IVA. Evidence supports this: 30% of individuals in an IVA and the same proportion of undischarged bankrupts were in a DMP before entering into formal insolvency; and 14% of undischarged bankrupts say they were previously in an IVA but could not keep up the payments. However, it is worth noting that while these results demonstrate flexibility, they may also indicate inadequacies in the provision of debt advice prior to entry into an insolvency procedure.

There is also flexibility within procedures. If an individual in an IVA or DMP experiences a temporary income shock, such as a period of illness or unemployment, they may be eligible for a payment holiday of up to 6 months (though they are usually granted for about two months).

Q.19 Do the current options allow and encourage those who are in a position to repay their debts to do so? If not, why not, and how might any incentives be improved?

There are two key repayment options for those who 'can pay': a DMP (an informal repayment plan agreed by creditors, often facilitated by a third party) and an IVA (a statutory repayment plan supervised by an IP which usually lasts 5 years and involves an element of debt write off). Bankruptcy too can involve an element of repayment through income payments orders and agreements (IPAs or IPOs). While there are certainly options for those who want to repay their debts, R3 is concerned about access to IVAs (see response to Q.16).

In addition, we believe that returning the period of discharge in bankruptcy from one year to three years may merit consideration. Bankrupts are automatically discharged after 12 months, and some are discharged earlier through the early discharge process. The 2002 Enterprise Act decreased the discharge period from three years to twelve months, with the hope of promoting enterprise and rehabilitating debtors more swiftly. This was arguably misconceived because the vast majority of bankrupts are domestic, consumer bankrupts. As such, it is difficult to make the case for a short discharge period on the grounds of promoting enterprise.

There are also several reasons why an increase to a three year period may be more appropriate:

- If the bankruptcy period were extended, it would be easier to obtain more income payment orders or agreements (IPO/As) because more frequent reviews of the bankrupt's income and expenditure could be carried out over the three year period. IPO/As can only be obtained from undischarged bankrupts so if a bankrupt's financial circumstances changed during the three year period, such that they were able to start making contributions via an IPO/A, the IPO/A could be put in place prior to their discharge at the end of the bankruptcy period. Unlike in the current bankruptcy system, where discharge after 12 months (or earlier under the early discharge regime) does not always provide an adequate amount of time in which to determine whether the debtor's financial situation is liable to change for the better, a three year discharge would provide more time to perform this, therefore increasing the chance that bankrupts can make contributions to their creditors.
- Similarly, extending the discharge period to three years would increase the chances of ensuring that after-acquired property can be identified and recovered for the benefit of creditors.

- Undischarged bankrupts are able to enter into an IVA should their circumstances change, such that they are able to meet IVA contributions. If they are discharged quickly, either as part of the early discharge process or via automatic discharge after 12 months, this can preclude them from doing an IVA as their debts will have been fully discharged. Therefore any potential repayments to creditors due to improved financial circumstances may be lost. Increasing the period of discharge could therefore result in a greater opportunity to repay debts.
- Lengthening the discharge period could also incentivise repayment by effectively serving to make bankruptcy less appealing and repayment options (IVAs or DMPs) more attractive.

We also believe there should be a further incentive to encourage individuals to enter an IVA and pay off their debts, rather than going into bankruptcy. At the moment, individuals who enter IVAs and those who become bankrupt are subject to the same negative impact on their credit rating. We believe this fails to recognise key differences between these procedures. Individuals in an IVA make a concerted and prolonged effort to repay their debts, while bankruptcy involves considerable debt write-off and should be the preserve of those who cannot, or will not, repay their debts. In order to ensure that individuals who 'can pay' have an incentive to do so, the impact of an IVA on a person's credit rating should be less severe than it is for bankruptcy.

Q.20 Do the current options allow a person to deal effectively with a temporary income 'shock' and if not, what is needed?

There is flexibility within procedures to allow for a temporary income shock. If an individual in an IVA or DMP experiences a shock of this kind, such as a period of illness or unemployment, they may be eligible for a payment holiday of up to 6 months.

Q.21 Is some form of moratorium on creditor action required to a) allow a short time period for a debtor to seek and act on advice from a qualified adviser and b) allow a more extended period for a debtor suffering from a temporary difficulty to recover and start making repayments once more. If so, how might such an arrangement work?

Yes - see Q17.

Q.22 How does a person find out where to go for debt advice and assistance? What are the advantages and disadvantages of each method?

Our January survey among individuals struggling with their debts found that awareness of certain insolvency options was much higher than others. 80% were aware of bankruptcy, compared to 51% who have heard of an IVA, 41% DMP and 14% DRO.

Likewise, awareness of certain advice providers and organisations is higher than others. Our survey revealed that 94% of those struggling with their debts were aware of Citizens Advice Bureau, 37% of the National debtline, 27% of the Consumer Credit Counselling Service, 24% of Debt Free Direct, 31% of the Debt Advisory Centre, 18% of Insolvency Practitioners and 11% of the Money Advice Trust.

Q.23 How does a person know that he/she has been given the 'right' advice?

It is very difficult for a person to know whether or not they have been given the right advice. The movement of individuals between solutions may indicate that the 'right' advice is not given in all cases, and that presumably the individuals concerned are unaware that another option would have been more appropriate from the start. It is worth noting that the right solution, even if it initially seems unclear, is usually identified relatively swiftly if a proper consultation with a qualified advisor takes place. Confidence in the quality of advice should also be enhanced if an individual has taken advice from a qualified, experienced and highly regulated professional.

One of our members, a Deputy Bankruptcy Registrar, has observed he sees a worrying number of individuals entering bankruptcy mistakenly believing they will be free of all their debts at the end of the process, when this is not actually the case (e.g. that they will be free of non-provable debts such as matrimonial debts or student loans which in fact survive bankruptcy). This lack of awareness of the consequences of bankruptcy suggests that there are serious shortcomings in the advice provided to debtors, and again emphasises the importance of receiving high quality advice.

Q.24 What evidence do you have to suggest that debtors end up in the 'wrong' solution and what is the scale and impact – for the debtor, the creditors, the economy?

Our research indicates that 30% of individuals in an IVA and the same proportion of undischarged bankrupts were in a DMP before entering into formal insolvency; and 14% of undischarged bankrupts say they were previously in an IVA but could not keep up the payments. While this demonstrates the flexibility of the system (enabling individuals to move from one procedure to another), this 'journey' may also suggest that another solution may have been more appropriate from the start.

In our response to Q.16 and Q.19 we have highlighted our concerns about the number of viable IVAs that are refused by creditors. The likely consequence of this is that individuals unable to get an IVA go into a different insolvency solution, perhaps a DMP or bankruptcy, even though they may have been better suited to an IVA.

While all formal and informal insolvency procedures have their place, and DMP have a important role to play in the debt and insolvency landscape, evidence suggests that some individuals enter a DMP when it may not be the most appropriate procedure for their circumstances. R3's research among Insolvency Practitioners finds that 57% have seen individuals whose DMP had failed because the amount of debt they were in was simply too high to make a DMP a feasible option in the first place; 46% have seen DMPs fail because the monthly payments set up as part of the plan were simply unaffordable and 40% have seen DMPs fail because the repayment timescale specified in the plan was too unrealistic. These results indicate that there are certainly instances of debtors entering the 'wrong' solution. Research among individuals in DMPs also suggests that there is bad practice within the DMP industry. For example, 22% of individuals in a DMP say the organisation that set it up did not ask for proof of income and expenditure before the plan began; 15% say their DMP company made late payments to their creditors even though they had made the agreed payment at the right time; 10% of individuals in a fee-charging DMP say they were not told that they would be charged until after their plan began.

R3 calls for significant changes to the regulation of the DMP industry. The recent OFT report on compliance with the debt management guidance - which found that non-compliance of varying degrees was widespread - suggests that the OFT's regulation and enforcement activity is insufficient to tackle bad practice, mainly because the bulk of investigatory work is reactive rather than proactive (i.e. there is little to deter bad practice once a Consumer Credit Licence has been granted). While we understand the OFT is looking to take a more pro-active approach in future, we suggest that regulation of the DMP industry should lie with the Insolvency Service or the regulatory bodies responsible for regulating IPs. We find it inequitable that while IPs are subject to rigorous ongoing regulatory and compliance requirements in order to practise within the personal insolvency market, the regulation of DMP providers and the unregulated debt advisory market is far less stringent. The similarities between the provision of debt management plans as a debt relief solution, and the work undertaken by IPs in administering personal insolvency processes, ought to result in similar regulatory standards and regimes for both professions. DMPs are an important insolvency procedure and should be regulated as such.

Q.25 Is it clear in all circumstances what the 'right' solution should be?
It is not clear in all circumstances what the right solution should be, with the degree of complexity varying from case to case. R3 believes that face-to-face advice provision is irreplaceable in ensuring that individuals in financial distress receive a full analysis of their situation and available options.

Q.26 How often do debtors move from one remedy to another and could the costs be reduced in any way?

Our research may begin to quantify the degree of movement from one solution to another, finding that 30% of individuals in an IVA and the same proportion of undischarged bankrupts were in a DMP before entering into formal insolvency, and that 14% of undischarged bankrupts say they were previously in an IVA.

Q.27 Should there be more consistency on how a debtor's income, assets and expenditure are calculated and treated in different procedures?

We welcome greater consistency on how to calculate income, assets and expenditure and believe this could be achieved by the mandatory use of one common calculation standard across all insolvency procedures (such as the Common Financial Statement or CCCS budget guidelines). Such a system, however, must ensure sufficient flexibility given that debtors are individuals and as such cannot, and should not, be treated exactly the same in every case. We are particularly keen to ensure, for example, that 'allowable' expenditure is fluid enough that debtors are allowed to make their own lifestyle choices (e.g. not taking up the Sky Television allowance, but using that money instead for another activity).

Q.28 Should any changes be made to improve the consistency of investigation and enforcement action in relation to debtors entering insolvency procedures?

Other stakeholders may be better placed to answer this question. However, we have observed that in many bankruptcy cases, the Official Receiver will only conduct telephone interviews with the bankrupt and there is often no investigation of the case, even when creditor concerns are raised. In such circumstances, we believe that it is easy for a bankrupt to 'fall under the radar' and therefore crucial assets may be left unidentified and unrecovered, or culpable behaviour by the bankrupt may go unchecked. In this regard, we believe that more investigation of cases should be undertaken.

We also observe that it is the Official Receiver who currently undertakes all investigations into bankruptcy cases and that an IP will only be appointed if they receive the support of over 50% of the creditors. We believe that in cases where creditors express concerns, the Official Receiver should either undertake to complete a full investigation of the case or the case should be passed to an IP to undertake the investigation.

Q,29 What outcomes should such investigations be looking to achieve – for example, should they just relate to restrictions on future conduct or should they also impact on discharge from liabilities?

The purpose of all investigations is to ensure complete disclosure of the bankrupt's position and thereby maximise returns to creditors. In this regard, as indicated previously in Question 19, we believe that increasing the period of discharge in bankruptcy from one year to three years may merit consideration. An increase in the discharge period would not only allow more time during which an IPO/A could be obtained due to more frequent reviews of income and expenditure during the three year period, but would also allow an increased timeframe during which after-acquired property could be identified and recovered for the benefit of creditors.

Q.30 Are the practical effects of entering the different debt remedies satisfactory e.g. future access to financial services? Should this be influenced by the outcome of any investigation/enforcement?

As we have previously indicated at Q.19, we believe there should be more of an incentive to encourage individuals to enter an IVA and pay off their debts, rather than going into bankruptcy. At the moment, individuals who enter IVAs and those who become bankrupt are subject to the same negative impact on their credit rating. We believe this fails to recognise key differences between these procedures. Individuals in an IVA make a concerted and prolonged effort to repay their debts, while bankruptcy involves considerable debt write-off and should be the preserve of those who cannot or will not repay their debts. In order to ensure that individuals who 'can pay' have an incentive to do so, the impact of an IVA on a person's credit rating should be less severe than it is for bankruptcy.

Q.31 Is there a role for a "gatekeeper" to provide a common entry point to all formal insolvency procedures? If so, what would be the benefits and costs, who would perform such a function and how would the system operate?

Yes - see Q.17

<u>Section 3: Other areas of interest for R3 in the Call for Evidence:</u>

Q.3 What would be the impact of a 7-day cooling off period for store cards on a) consumer behaviour and b) store card providers?

We agree in principle that the concept of a 7-day cooling off period for store cards is a good idea, but we doubt whether it could be achieved in practice, mainly because most store cards are taken out straightaway over the shop counter so the customer can immediately benefit from the card.

Q9. Should interest rates on credit and store cards be subject to a cap? If so, should this apply to all interest rates or only those which apply to existing borrowing?

Interest charged on credit and store cards is a measure of the risk associated with lending money. We believe that a cap on interest rates charged on credit and store card would be anti-competitive.