

Stage 3 Consultation Response

Review of Scotland's Statutory Debt Solutions

July 2024



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Introduction

The Law Society of Scotland is the professional body for over 13,000 Scottish solicitors.

We are a regulator that sets and enforces standards for the solicitor profession which helps people in need and supports business in Scotland, the UK and overseas. We support solicitors and drive change to ensure Scotland has a strong, successful and diverse legal profession. We represent our members and wider society when speaking out on human rights and the rule of law. We also seek to influence changes to legislation and the operation of our justice system as part of our work towards a fairer and more just society.

The Banking, Company and Insolvency Law Sub-committee & Administrative Justice Sub-committee welcomes the opportunity to consider and respond to the Stage 3 Consultation of the Review of Scotland's Statutory Debt Solutions.

Consultation

Your organisation

Question 1. In what sector(s) does your organisation operate? Please select as many as appropriate.

- a charitable advice provider
- commercial advice provider
- local authority
- creditor
- debt collection/debt purchase
- credit union
- insolvency practitioner
- payment distributor
- consumer body
- academic
- other



Question 2. Does your organisation, or, any evidence you are submitting represent;-

- anyone in debt
- a particular client group
- a client demographic
- a specific geography. If you chose this option, is it whole of Scotland?

Yes

No

If part of Scotland, please specify -

- ethnic minority group
- particular vulnerable groups

Current provisions

Question 3. Thinking about the existing provisions:

a) What works well?

We believe that in general, sequestration in terms of full bankruptcy and Minimal Assets Process (**MAP**) works relatively well. This is also true to an extent for the debt arrangement scheme (**DAS**) and the moratorium on diligence (albeit that there may be some debate about the precise protected period for the latter).

b) What doesn't work well, and why?

Protected trust deeds (**PTDs**) have been particularly controversial and often do not work as well as other statutory debt solutions. It is true that to some extent they do the job they are intended to do and are still used in relatively large numbers. However, where they fail, the outcomes are ordinarily more negative compared to DAS.

c) What gaps, if any exist?

There are various options available in terms of statutory debt solutions, with scope for the most appropriate choice in the relevant circumstances, albeit that this may not always be achieved in reality. Informed debtor choice should be a key principle in terms of such solutions.

There are arguably a few narrow gaps. Given the impending introduction of a mental health moratorium, it may be queried whether there should be an equivalent for physical issues (serious physical incapacity). We would suggest that consideration could also be given to some type of special provision for those expecting to die in the relatively near future.



d) Any other comments you would like to make?



Question 4. In respect of the statutory solutions, how well do you feel the current provisions work?

a) Sequestration

- Very well
- Quite well
- Not very well
- Not at all well

Why did you respond as above?

We believe the precise balance between when this should be used and when MAP should be used, in terms of income, debt levels and asset levels is debatable and should be considered carefully. We also consider that there are certain technical issues regarding sequestration that could be improved as regards the trustee dealing with an individual's assets.

b) Minimal Assets Process (MAP)

- Very well
- Quite well
- Not very well
- Not at all well

Why did you respond as above? See the previous response above. Income, debt and asset levels need to be considered. There are various circumstances in which MAP may be more appropriate than ordinary sequestration.

c) Protected Trust Deed

- Very well
- Quite well
- Not very well
- Not at all well



Why did you respond as above?

While PTDs are still relatively widely used and may have some ongoing value, we believe there are various circumstances in which other solutions (including DAS and sequestration), and the protections they offer, will be more suitable.

d) Debt Arrangement Scheme

- Very well
- Quite well
- Not very well
- Not at all well

Why did you respond as above?

There are timescales in relation to, for example, confirming all debts that could be extended. We understand that there is a lot of pressure on the availability of money advisers and issues with resources in the “free” advice sector and this can have a negative impact including in the context of DAS.



Values and principles

An idea was raised at the roundtable event that received strong and broad support. This was that the personal insolvency regime in Scotland should be underpinned by a set of principles and values enshrined in legislation. These would act as the reference point for all decisions made both within the regime and in making changes to the regime. It was noted [Social Security Scotland](#) has recently introduced legislative principles and values in its model and this was a useful precedent for the insolvency regime (see section 1 of the [Social Security \(Scotland\) Act 2018](#) for more information).

Question 5. From your perspective, what do you think could be the possible advantages of this approach? Also, what could be the possible disadvantages?

We agree that an expression of principles and values in this area may be helpful. The interests of debtors and creditors, including protecting debtors and treating creditors fairly, and balancing respective interests should be at the heart of this. It is important too for the approach to be evidence-based. There would need to be a strong consensus in relation to the values and principles selected and the legal requirements surrounding them would have to be very clear to participants and stakeholders.

Question 6. If you are in support, please set out your views on what the principles and values should be, and why?

We are hesitant to identify particular principles and values at this stage. However, we think that they should be based on treating debtors and creditors with respect and care and in a fair manner, ensuring that parties involved are as well-informed as possible, and providing a public benefit and service. The system and the principles and values should also be reviewed and updated over time.



Access to insolvency

The number of people who access a statutory insolvency solution is far lower than the proportion who potentially benefit from one.

Question 7. What are the barriers to people accessing statutory debt solutions?

a) the general population

We believe there are likely to be stigma issues, as well as a lack of information and understanding. In addition, it can be difficult for people to access relevant resources and advice, especially given the current pressures on the advice sector and in terms of legal aid.

b) those with protected characteristics

The system can be intimidating, complex, and lengthy, and requires extended support, engagement and organisation.

c) individuals who are self-employed and other small business owners

We believe there is likely a reluctance to acknowledge business failure in some cases. In addition, the self-employed and small business owners will often focus on dealing with their creditors in order to resolve the issues as they arise, rather than seeking to engage with debt advisers, and in many instances tax issues mean they could not receive help from a lot of free debt advice advisors anyway.

Question 8. What are potential solutions to remove those barriers?

We believe the following would all be useful: further support for the debt advice sector; improvement of financial education at all levels; increasing access to information and guidance regarding debt solutions (including for sole traders and small business owners) and other attempts to challenge any stigma surrounding their use.



Question 9. Do you think that the stigma linked to debt or bankruptcy acts as a barrier to accessing the most appropriate insolvency solution, and if so, how?

We are of the view that this seems likely, to an extent. Bankruptcy and debt will always have a stigma surrounding them and there can be a perception of failure, but this can be lessened, in the interests of the debtor and others.

At the roundtable, an idea was raised for a single gateway to insolvency, rather than access being governed by the eligibility of the four current statutory solutions. Here, a single eligibility criterion would apply and once accessed there would be flexibility between debt relief and debt repayment options based on an individual's circumstances. This was largely welcomed at the roundtable as being easier to understand for consumers, reducing burden on advisers and being an effective way to remove gaps between the current solutions. It was noted it may also solve issues currently seen when people need to transition between solutions once already in an insolvency product (e.g. transitioning from a Protected Trust Deed to a Sequestration).

Question 10. What the potential advantages and disadvantages of a single gateway to insolvency?

We can see some advantages in terms of a single gateway as far as offering flexibility and identifying the most appropriate debt solution. However, we would require more information as to how the solution would be determined and regarding how to avoid arbitrary distinctions in adopted solutions for those in similar circumstances. We believe it may be difficult to develop an appropriate model in practice.

Question 11. What alternatives are there to a single gateway which may improve access to insolvency and / or increase flexibility once in a debt solution?

We believe that consideration could be given to making it easier to move from one solution to another if the circumstances justify it.



Access to insolvency often relies on accessing high quality and impartial money advice, as well as having the services in place to administer debt solutions once accessed.

Question 12. Do you have any concerns about how money advice and solutions administration is funded?

- Yes
- No

If yes, please outline your concerns below.

We understand that currently, funding is dependent on the “partnership” with local authorities and their ability to properly fund the money advice sector. There are significant funding constraints that may have a negative impact going forward.

Question 13. How could the funding regime be made more effective?

Money advice services are regulated by the FCA and subject (in the independent sector) to compliance with the Scottish National Standards for Information & Advice. However there is no parity across services for salary grades/pension (particularly when compared to the local authority’s own services). We believe there is a need to establish an even “playing field” for all free money advisers.

Repayments and conditions of insolvency solutions

Stakeholders at the roundtable were broadly in agreement that where a person can afford to repay their debts, they should do so. It was noted however that there was not broad agreement on what being able to pay is defined as. In some cases, people may not be able to pay anything towards their debts.

Question 14. What are your views on the most appropriate way to assess what people can afford to repay when in problem debt?

We believe the level of income is highly relevant. In addition, the source of income is important. It may not be appropriate for someone entirely reliant on benefit payments to contribute to creditors, due to the apparent need for the individual to rely on that income and given it would amount to the state indirectly paying those creditors.

We also heard in the roundtable that currently people in insolvency are not incentivised to improve their financial situation (e.g. by taking overtime or a higher paying job) due to proceeds going to creditors. A broadly supported proposal put forward was to split the proceeds of any increase in income between the client and creditors.

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Question 15. Do you agree that proceeds of increased income should be shared between client and creditors?

Yes

No

Question 15a. If yes, what proportion should go to the client and what proportion to creditors (e.g. 50/50, 40/60, 30/70, a fixed £ amount etc)?

We have mixed views about this. There is value in the repayment rate being certain for the client, enabling them to move forward with work and escaping a negative debt cycle. However, if there is a significant increase in income, fairness to creditors may dictate that they should share in this. Nevertheless, if additional income is not regular (e.g. ad hoc overtime), an individual may not be able to maintain additional payments, and this should be taken account of by relevant rules here.



Question 16. Are there other incentives that could be introduced to help people improve their financial situation while in insolvency?

As above and below.

Similarly, at the roundtable there were examples given where people were in repayment solutions for more than 15 years and sometimes, even after that time period, were having to switch to bankruptcy due to issues maintaining repayments. This situation compares to restrictions of months within a Minimal Asset Process and up to four years in a sequestration. It is clear there are very wide variances between the time people spend impacted by insolvency dependent on which solution they access, with often much longer impacts for people in solutions more strongly focussed on repayment. The current solutions take no account of the fact that a debtor may have already been on a repayment plan for many years.

Question 17. Should a previous repayment plan be taken into account?

- Yes
- No

Question 17a. If yes, how?

We believe this could be taken into account in considering when would be the most suitable time for someone to be discharged from conditions of bankruptcy. There are also questions as to when acquirenda should be exempt and to what extent. We feel it is important that the law allows someone to move on and obtain a fresh start when appropriate, whilst at the same time being fair to creditors.

Question 18. Should there be a standard timeframe, which applies to all solutions?

- Yes
- No

It is apparent from previous work carried out by the Accountant in Bankruptcy and others that treatment of the family home can be a contentious matter in insolvency. Views and evidence on this topic are welcomed.



Question 19. What are your views on what a proportionate and consistent approach to the treatment of the family home in insolvency should be?

We agree that the family home is a contentious matter. We see a need for the law to place significant limitations on removing people from family homes, due to the knock-on social, emotional and economic costs. However, it must also be recognised that such property is often the most valuable property in an estate and the interests of creditors in obtaining repayment needs to be considered. There can also be negative wider consequences if creditors are not repaid. A careful balance therefore needs to be struck.

The size and value of the property should have some bearing on whether it is to be sold, particularly if it is a smaller property and the individual and their family will have to obtain alternative accommodation funded by the state. If it is decided to exempt small properties to some extent from sale, attention should be given to whether creditors should have priority of allocation of proceeds if, for example, the property is to be sold by the debtor or a secured creditor.

We believe that the position in terms of reinvestment of the family home in the debtor could be improved. At present, many years of uncertainty can pass before the trustee seeks to sell the family home (if they have taken steps to avoid reinvestment in the debtor). This is unfair to the debtor and sometimes even to creditors. Greater clarity and ease of reinvestment in the debtor could be considered.

Access to Mortgage Rescue Schemes requires the support of a money adviser. However we understand that not every homeowner would be eligible for some due to a number of factors including the value of houses in some areas of Scotland being above the maximum local property price.



Matters linked to but broader than insolvency

It would be remiss of this review not to acknowledge the growth in the number of people now seen in money advice who are experiencing a 'deficit budget'. A significant proportion of people have outgoings greater than their income, even after working with a money adviser to increase income and reduce expenditure where possible. It would also be remiss not to recognise the huge proportion of people who are facing problem debt but also have significant linked issues, such as mental health problems, housing issues, employment problems and family issues.

Question 20. Can the insolvency regime itself do more to help people experiencing a deficit budget? If so, what?

We believe this is a wider matter in society, in terms of the role of debt, financial education and access to resources.

Question 21. How can the insolvency regime better link up with other government services and other support services to help them resolve their problems more holistically?

See our answer to the previous question.

Use of technology and other innovation

Question 22. What technology and other innovations could be utilised to make the insolvency regime more effective?

We are of the view that money advisers should be able to access online resources more easily, such as credit reports. We are uncertain as to the role that AI may play in future; however, we are currently very cautious about the use of such technology. More broadly, parties involved in debt solutions should be able to meet requirements online as far as possible, but we recognise that there will still be circumstances in which it is necessary to do something in person.

Matters not covered by other questions

Please set out any other points not raised elsewhere which link to ensuring the insolvency regime is effective in the modern Scottish economy.

I urge you to challenge yourself and colleagues by thinking “what if we had a blank piece of paper?” What would good look like?

As a large representative body, it is difficult for us to be definitive about this at the present time. We also note our suggestions above. We would be favourable towards a system that is more responsive to the reasons why parties encounter serious problems, the likely duration of such problems, and the steps necessary for them to escape those issues. There could be advantages from streamlining processes in some areas and with more flexibility. Given the important role of access to advice in the context of statutory debt solutions, there is a strong argument that it ought to be made more widely available to individuals, and a model similar to that applicable to Legal Aid could be used. It would also be helpful if the balance between different solutions and their interplay was clearer and more evidence-based.

The above questions do not focus sufficiently on the law of diligence/debt enforcement, which is strongly intertwined with insolvency law and statutory debt solutions. The law of diligence is in need of further reform and issues relating to, for example, the family home. Other assets such as pensions and digital assets also require attention in that context. There is a need for joined-up thinking between the law of debt enforcement and insolvency law, albeit that some divergences may be justified, for example more restrictions on loss of a family home where diligence is used in comparison with the position for sequestration. It can also be noted that the failure to decide how to deal with the family home (and dwellinghouses generally) in relation to diligence is also holding up reform of diligence more broadly, in terms of, for example, diligence over non-residential land and over digital assets.



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