ABCUL
SCOTLAND

**Protected Trust Deeds - April 2019**

We appreciate the opportunity to respond to this consultation. The Association of British Credit Unions Limited (ABCUL) is the largest trade association for credit unions in Scotland. In forming this response we have also engaged with credit unions from other associations.

Credit unions are not-for-profit, financial co-operatives owned and controlled by their members. They provide safe savings and affordable loans. According to the most recently available statistics from the Prudential Regulation Authority, Scottish credit unions have over 790,000 adult members, have £636 million in assets, and have nearly £354 million lent out to members.

Although credit unions do not necessarily experience a higher level of bad debt than other lenders, the smaller margins within which they operate (necessitated by both an interest rate cap and a desire to not profit from individuals whose credit options are limited) make it more difficult for the sector to soak up non payment in the way that other non-priority creditors do. The Scottish credit union sector has seen a steady increase in arrears since late 2016.

Firstly, we would like to welcome the Scottish Government's efforts to address recent trends in Protected Trust Deeds (PTDs). Increasingly, feedback from our members suggests this is a growing issue, both because of the impact on their balance sheets, but also because of the nature of many of the cases and the activities of some firms handling the cases.

**The consultation:**

Q1(A): Yes, we support the proposed measure to refuse to protect a PTD where the debt could be repaid in 60 months.
Q2(A): Yes, we agree with this proposal.
Q3(A): Yes, we agree in an increase in the minimum debt level.
Q3(B): We would support an increase to £8000.
Q4(A): Yes, we agree with this proposal.
Q5(A): Yes, we support this proposal.
Q5(C): Yes, we support a general power to refuse.
Q5(D): No, we feel this power should be implemented irrespective of other changes in the regulations.
Q5(E): We would accept this as being the case in instances where creditors have chosen not to engage. However, given our sector's experiences of trustees not taking care to notify the correct creditors, we feel there ought to be additional mandatory steps taken to ensure any decision not to vote is a voluntary one.

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As you will see above, we support the measures that the Accountant in Bankruptcy is proposing to address some of the trends in the Protected Trust Deed market. We also support the two areas – a minimum debt level and a general power of refusal – that appear to be subject to further consultation. We would like to see the proposals on the cases where creditors do not vote strengthened, as outlined above.

However, we remain disappointed that the reality of the voting system in PTDs is not simply considered in this consultation document, or generally by the AiB. Whilst we support the measures outlined to 'set the bar higher' in terms of creditor voting arrangements, we would urge the Scottish Government to reconsider the view it holds that the ability of creditors to refuse to support PTDs will ensure both that the legislation is upheld and that the interests of the debtors are protected – we believe strongly that this is not the case, for a number of reasons:

The larger creditors, with the deciding vote in PTDs, tend to be banks and larger institutions, and there is no reason to think this would change under the new proposals. Those institutions do not - or perhaps due to their scale, cannot - scrutinise cases individually, and so depend on a system of agents voting on their behalf based on set criteria.
Therefore, smaller creditors, such as credit unions, are typically outvoted and so completely powerless to stop some of the more excessive cases they see, which will usually gain protected status because "creditors voted for it".

The system is dependent on all creditors having an in depth knowledge of, for example, the difference between Category 1 and Category 2 disbursements, and what is allowable under various regulations.

Anecdotal evidence from our members suggests that Trustees in some firms are taking steps to ensure that any creditor who they expect to vote against a trust deed does not have the opportunity to vote – a suspiciously high amount of paperwork destined for credit unions appears to become lost on the post.
Given the above, you will appreciate why it is frustrating for the credit union sector to hear that the AiB is unwilling to take more of a proactive role in policing the excesses of the Protected Trust Deed market, on the basis that creditors can vote according to their own interests.

The reality of this is not only damaging for creditors, but those debtors who have sought advice in good faith and believe that they are being protected by an effective system of regulation. As an example of the excesses that these inadequacies can cause, a Trust Deed that one of our member credit unions was asked to vote on last year involved a single parent, with an income of around £10,000 from part time employment. The proposal would involve the debtor paying back around £7000 over 5 years – a substantial undertaking on thier part. Of that sum, around £6000

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would have been soaked up in professional fees. This included: an anti money laundering check (£72); a case management fee (£150),a case management monthly fee (£285), courier charges (£114), a credit search fee (£114), “Echosign” (£96), ID verification (£48),a packaged bank account review fee (£90), a PPI search fee (£360), and storage costs (£300). These fees were in addition to a permanent trustee fee of £1440, and a trustee fixed administration fee of £2500.

The credit union did not have the deciding vote in this instance and, as there was no intervention by the AiB, this remains an ongoing Trust Deed. As a sector that is bound by the same anti-money laundering regulations that apparently necessitate many of these fees, we simply do not recognise the various expenses listed as being reflective of actual costs – credit unions, including those that do not have the scale of the larger insolvency firms, are typically able to carry out the necessary checks for a few pounds per case.

As the AiB may be aware, the Insolvency Service, in their 2018 monitoring report, stated (in relation to the fees being charged by some firms):

“Under SIP 9, IPs are also required to explain how all their fees are fair and reasonable. We saw no evidence of this being done. There is limited evidence that many of the disbursements charged in volume operations are providing real value to either debtors or their creditors. In most cases it is not clear whether they are required at all. There is also limited, if any, explanation provided by IPs as to why they are fair and reasonable.”

The same report notes that some IPs appear to be able to carry out PPI checks for no additional sum whatsoever, whereas others apply a fee of £360. There is, therefore, public acknowledgement by the body charged with the regulation of Insolvency Practitioners that this is a problem, yet it remains the case that in Scotland IPs are able to manipulate the Scottish statutory debt solutions in this manner.

We would also like to highlight that the system is not currently acting to uphold the law as it currently stands.  For example, the legislation in Scotland requires that all Protected Trust Deed contributions are calculated according to a Common Financial Tool, currently the Common Financial Statement.

A recent example brought to us by a member involved a PTD entered into by one of their members. The credit union, despite being the largest creditor, was not invited to vote on it and so was unaware of the PTD’s existence until a year after it commenced. During this time, the debtor had continued to pay off their loan to the credit union according to the original terms. If the regulations had been applied correctly, this simply could not have happened – the trustee had an obligation to analyse the debtor’s income and spending, ensure that all non essential

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payments were stopped and that all surplus income was being divided between creditors within the PTD.

The AiB later revoked the protected status of this Trust Deed. However, after paying a substantial sum of their income into the PTD for a year, the debtor was left in a position where they still had to repay all their debts in full and with no protection under the law. Under the current regulations, in both Scotland and the UK, there is no vehicle for the debtor to claim compensation for the fees they will have paid to the trustee in exchange for handing this case, despite them having left their client in a significantly worse off position.

We would also highlight that, despite the Common Financial Tool being a statutory requirement in Scotland, increasingly credit unions are being offered a reduction in fees and charges in exchange for their support for a trust deed. If this is a possibility in some cases, it leaves us questioning why the fees are necessary in all cases.

Given the above examples, we strongly support the proposed changes to the voting system and the treatment of disbursements. We would also like to support the proposal to bring forward a requirement that those cases that can be paid off in full within 60 months are not protected, as well as the enforcement of a minimum debt level of £8000, as the AiB originally proposed when considering this issue.

As we understand it, the majority of those promoting PTDs do not have the necessary permission to offer non-insolvency based debt solutions and, separately, the Debt Arrangement Scheme requires distinct permissions. As is acknowledged in the consultation document, it would appear that a significant number of those who enter Protected Trust Deeds could fit very easily into a DAS DPP, with no detriment to the debtor. More people taking up DAS is not only preferable to creditors, who will see more of the money paid by debtors actually reach them, but also ensure that fees paid are capped, that there is more protection from the AiB, and also that the debtors are left with the ability to access credit in the future should they need it. The AiB's recent consultation on the future of the Debt Arrangement Scheme looked to how more people can be encouraged to take up the scheme and, while we support the provisions outlined within it, we feel that the most realistic means of achieving that end is to restrict access to PTDs for those who are eligible for DAS.

Though we note concerns about consumer detriment if a minimum debt level was enforced (for those on lower incomes), we cannot support the implied result of not introducing such a measure – that the Protected Trust Deed market is protecting these individuals. As creditors with sight of some particularly appalling cases we do not agree, and we note that both the Insolvency Service and organisations acting in the interests of the free money advice sector, such as Money Advice Scotland, have noted similar concerns about the trends in PTDs. We would therefore argue that there would be better protection of debtors by making Protected Trust Deeds a less frequently-used vehicle for debt repayment.

Similarly, for the reasons outlined above, we would strongly argue that the AiB needs to hold a general power to refuse to protect Trust Deeds. The regulation of the insolvency landscape is a complex one with and we fully appreciate that the Scottish Government does not currently have the necessary powers to regulate Insolvency Practitioners. However, the regulation of statutory debt solutions is devolved and we would argue that it is the role of the AiB to ensure that they are being used in a manner intended by the legislation. The clear incentive for IPs to encourage people take up solutions that are not in their best interests should have no place in a system that is supposed to protect the interests of both creditors and those who find themselves struggling with their debt, and we would ask that the AiB reconsider retaining such a power to try and address this.

Although we note concerns about the potential for debtor detriment when they are left with an unprotected Trust Deed, we feel that this is not as significant as the detriment caused to a debtor who finds themselves within a failed Trust Deed. The failure rate of Trust Deeds has grown substantially in recent years, and almost certainly reflects the lack of scrutiny of those PTDs at their outset.

Finally, though we are minded to support the proposal to protect Trust Deeds where no creditor has taken up their right to vote, we are seeking measures to ensure that this is subject to additional checks. The experiences of credit unions not receiving paperwork in those cases where they would have had a deciding vote, as outlined above, leads us to believe that this provision could be vulnerable to manipulation.

To end, we thought we should highlight the impact of some of these trends on the credit union sector. Credit unions have long been recognised, by different Governments, as a source of affordable credit for those who cannot access it elsewhere. A large number of credit union members have joined the movement because they do not have even a transactional bank account, and credit unions play a notable role in encouraging responsible lending and building up savings resilience. This was recognised late last year by the Scottish Government when it funded a public campaign encouraging credit union membership.

The last year has certainly been challenging for the sector, with the highest number of credit union failures recorded since 2010. Though the reasons for this are varied and complex, there is no doubt for us that an increase in delinquency is a growing concern within the sector. Whilst we appreciate this reflects a wide range of factors, the growth of PTDs – which appears to be

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fuelled by expensive advertising and debt free competitions – is a huge concern for credit unions for all sizes. The three largest credit unions in Scotland have calculated that they collectively had to write off more than £760,000 in a 9 month period last year because of PTDs alone. The growth and the scale of the PTD market does not reflect either the growth in bankruptcy or DAS, which has been far more modest. It also does not reflect feedback from Citizens Advice Scotland and StepChange Debt Charity, who estimate that less than 5% of the debt clients they work with meet the eligibility for a PTD.

Moving forward, the credit union sector is facing difficult decisions on how to handle this and avoid putting their own sustainability at risk. Given the interest rate cap within which credit unions operate, we may ultimately see a sector which is more risk averse and therefore increases the number of people who cannot access affordable lending.