ABCUL
Association of British Credit Unions Limited

PIR Team, Policy Team
The Insolvency Service of England and Wales
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Call for Evidence: Review of the Personal Insolvency Framework

Dear Personal Insolvency Review Team,

We welcome the opportunity to respond to this consultation. ABCUL is the primary trade association representing credit unions in England, Scotland and Wales with around two thirds of credit unions in mainland Great Britain affiliated to the Association.

Credit unions are co-operative societies who provide financial services – primarily savings and loans facilities – to their member-owners. They are registered as Co-operative Societies under the Co-operatives and Community Benefit Societies Act 2014 and the Credit Unions Act 1979. As deposit-takers they are dual-regulated by the Prudential Regulation Authority and the Financial Conduct Authority.

Credit unions have since their inception in Britain in 1964 been closely associated with anti-poverty and financial inclusion. They tend to provide savings and loans facilities to those with limited or no access to financial services from mainstream providers, generally due to their low income and / or lack of a developed credit profile. They have been a central element of numerous government and philanthropic initiatives to extend financial inclusion and address the lack of adequate provision of affordable credit and secure savings facilities for large sections of the population. They are capped in the interest that they can charge at 42.6% APR under the Credit Union Act 1979 and provide credit in competition with high-cost lenders.

They are numerous, with over 250 credit unions active in Great Britain today with more than 1.4 million members and £2.3 billion in assets under management. They range from mid-sized businesses of up to 50 staff to small voluntary organisations.

Overview of Response

This response will express our view that the current insolvency framework does not remain fit for purpose and that there is a need to fundamentally reform Individual Voluntary Arrangements as a debt solution.

We cannot emphasise enough the importance of personal insolvency reform to the credit union sector. Credit unions are driven by the purpose of supporting their members financial wellbeing and support the need for appropriate debt solutions for individuals where it is appropriate. However, we hope to raise in our response that the current set of solutions present significant harm to both credit unions and their members.

This response has been informed via consultation of our member credit unions. We have gathered the views of credit unions on the thoughts on the themes and issues of the Call for Evidence via a survey carried out in September-October 2022.

Question 1: What should be the fundamental purpose of the personal insolvency framework? Does the current framework meet that purpose?

The insolvency framework should fundamentally aim to fairly balance the needs of creditors and debtors. We believe that the framework should try to balance these interests by maximising the returns to creditors, through a ‘can pay, will pay’ approach, but also by providing debt relief to individuals where it is genuinely needed.

We believe that the ‘can pay, will pay’ should be an essential principle of the personal insolvency framework, as there is a substantial cost to responsible lenders from personal insolvency that undermines the provision of inclusive and affordable credit. When there is a low level of return to creditors from personal insolvency solutions, this can lead to a reduced provision of inclusive, affordable credit. Significant credit losses to insolvency forces ethical lenders such as credit unions to tighten lending criteria, reducing access to affordable credit from those who need it most. High losses from insolvency also threaten the financial wellbeing of credit unions, which rely on income from providing loans to fund their work on financial education and the provision of safe savings accounts to their members.

We believe that the 'fresh start' principle is also key to an effective personal insolvency framework, as the level of harm to individuals from over-indebtedness cannot be overstated.

However, we believe that the current framework does not effectively deliver on either of these objectives. We will address why the current framework does not deliver on these principles in our response to question 2.

Question 2: If 'fresh start' and 'can pay, will pay' are the right objectives for the personal insolvency regime, does the current framework get the balance right?

There is a strong consensus in the credit union sector that the current framework does not get the balance right between these two objectives. From consultation of our members, **93%** of credit unions thought that the existing framework does not fairly balance the needs of creditors and debtors.

Whilst we have concern that the fresh start objective is not being reached in many circumstances, we would like to stress that current framework is not delivering on the 'can pay, will pay' approach, particularly in relation to IVAs and DROs.

For IVAs, the return to creditors is often a miniscule proportion of the debt owed. However, this is not just a question around balancing the interests between creditors and debtors, as insolvency practioners are a key third party for IVAs. It is the common experience of the credit union sector that IVA providers will charge an extortionate amount in front-loaded fees, to the detriment to both the debtor and the creditor.

The significant amount of fees and adjustments of payments with an IVA leaves little return to creditors. It is common for our members to report that an IVA payment plan has been heavily adjusted to the point where creditors will only receive £1 each from these payments. The insignificant repayments received by creditors means that the time and effort involved in administering the IVA is disproportionately burdensome for the return received.

For IVAs, the ‘fresh start’ objective is distorted heavily by the frequency of mis-selling and the resulting rate of IVA failure. Where an IVA fails, the debtor is left in extremely difficult and disappointing circumstances. This is due to the front-loaded structure of fees. Debtors who terminate their IVA after a couple of years will often find that the vast majority of their repayments have gone towards the IVA fees and not towards reducing the outstanding balances of their debts, that they now remain liable for.

For DROs, however, we believe there is a clear ‘fresh start’ for debtors, as they have their outstanding loan balance written off in full. This debt solution is also generally considered more favourably by credit unions than IVAs, due to the disproportionate scale of issues presented by the latter.

Nevertheless, we do not believe that the ‘can pay, will pay’ objective is being utilised in practice with many DROs. DROs are intended to provide full debt relief to individuals who genuinely cannot afford to make any repayment towards their debts. However, it is reported by credit unions that there are frequent cases where their members have entered a DRO that has allowed for an unreasonable allowance for essential expenses in their budget.

Credit unions regularly find that the current SFS guidelines have been utilised so that many costs that appear non-essential have been included as essential when calculating the DRO. This undermines the principle of ‘can pay, will pay’ and is unfair to ethical lenders such as credit unions, who are able to support individuals with managing their finances. We would encourage measures that ensure access to this debt solution is restricted to those who genuinely need it.

Question 3: Please provide any evidence to show how well the objectives of ‘fresh start’ and ‘can pay, will pay’ are being met.

We would like to submit evidence provided by one of our member credit unions, that reflects the typical issues with IVAs experienced in the credit union sector.

The credit union reports that of all of their loans, they would usually write off just over 5% per year. Of these debts written off, the credit union is usually able to recover a proportion of this debt written off through members paying voluntarily, the Eligible Loan Deduction

Scheme, DMPs and IVAs. From these methods of recovery, the credit unions reports that the least value recovered in recent financial years has been from IVA repayments.

The credit union informed us that they often struggle with particular firms that are volume providers for IVAs. For example, one prominent IVA provider had referred seven IVAs to the credit union since 2018. Across these IVAs, £3,658 was owed to the credit union, but only £54 was returned through the IVA payments – representing a return of **1.5%.** There have been a number of further IVAs referred to the credit union by this firm that were invalid, most often due to the member having no outstanding debts with the credit union.

The below table represents a sample of seven IVAs recently referred to the credit union from a number of IVA providers. The fees charged on these IVAs were an average of **26%** of the individuals total debt owed to all creditors, with a range of 15%-49%.

IVA Example	Total Debts in IVA	IVA Fees	Fees as a Percentage of Total Debt	Debt Owed to Credit Union	Amount Paid to Credit Union through IVA	Notes
1	£10,311	£ 3,655	35%	£ 930	£13.56	
2	£20,418	£ 3,650	18%	£461	NIL	
3	£ 9,652	£ 4,200	44%	£1263	NIL	Member's 3rd IVA
4	£11,467	£4,400	38%	£3318	NIL	CU loan paid by member outside of IVA
5	£24,205	£ 3,650	15%	£5055	NIL	IVA Terminated
6	£ 20,688	£ 3,650	18%	£2022	NIL	
7	£ 7,518	£ 3,650	49%	£ 548	NIL	CU loan paid by member outside of IVA
TOTAL	£104,259	£26,855	26%	£13,597		

Of these IVAs, the majority have seen no repayment to the credit union for a variety of reasons. In some instances, the member has looked to repay the loan outside of IVA in order to support the credit union. Other reasons have included the termination of the IVA or due to the debtor not making payments to the IVA.

The credit union highlighted that the issue is not only the miniscule return from IVAs, but also the operational burden of time consumed

processing and responding to these IVAs where there is no benefit to the credit union. This is a common theme highlighted amongst our members.

Question 6: How effective are the current safeguards (public records, public registers, restrictions and sanctions on debtors) at protecting the integrity of the personal insolvency framework?

It is extremely important to creditors to be able to access a register of insolvency, so they can easily check for dishonest loan applications. We think that the public register is an effective safeguard and essential to protecting the integrity of the personal insolvency framework.

However, we believe the current set of restrictions and sanctions on debtors are not robust enough to protect the integrity of the personal insolvency framework from debtor misconduct. This is discussed further in our response to subsequent questions covering debtor misconduct.

It should also be noted that there are insufficient safeguards against the misconduct of insolvency firms, which has widely damaged the integrity of the personal insolvency framework. We note that the Government has already consulted on introducing regulation for insolvency firms earlier in 2022, and we strongly welcome this proposal. If this change is implemented, there should be a much higher standard of conduct required from insolvency firms through a more robust and strict set of regulations. The current method of regulation for insolvency firms that offer IVAs is deeply inadequate and has allowed widespread harm to both debtors and creditors.

Question 7: To what extent does the current enforcement regime (BROs/DRROs and criminal sanctions) adequately achieve the aims of deterring future misconduct (both individual and general) and protecting the public?

The current enforcement regime is inadequate in deterring misconduct. Firstly, IVAs are not within scope of the enforcement measures identified, meaning there are minimal protections for creditors from dishonest behaviour concerning IVAs. Secondly, is it only in a small number of cases where DRROs are actually utilised. This does not reflect the wider level of debtor misconduct concerning

DROs. We address some of the practical measures that should be considered to deter misconduct in our response to question 8.

Question 8: How, if at all, should the personal insolvency framework distinguish between honest/unfortunate and dishonest/reckless debtors?

We strongly believe that more robust measures should be introduced to distinguish between honest/unfortunate and dishonest debtors when insolvency solutions are entered. This is an area of the current framework where there should undergo a much wider review, as the current regime allows debtors to take unfairly take advantage of debt solutions.

Credit unions have raised the following changes should be considered to distinguish debtors that have acted dishonestly/recklessly:

1. A stricter process to be adopted for assessing individual’s financial circumstances. There should a more stringent assessment of income and expenditure, as well as the debtor’s wider financial circumstances. This is for two reasons. The first is to verify that the debtor has been accurate and honest in providing information on their financial circumstances. The second is to understand whether the debtor has reached this point from unfortunate circumstances or through reckless accumulation of debt. This distinction should have some bearing on the type of debt solution the debtor should be able to access.
2. Tighter restrictions and greater consequences for debtors who look to repeatedly enter a debt solution. The current system allows for debtors to enter an IVA or other debt solution for a second time and, in some cases, for a number of times. The terms of debt solutions for repeat users could be adjusted to encourage responsible behaviour.
3. The length of time between receiving the loan and entering the debt solution should be considered. It is unfair to creditors where an individual has taken out a significant amount of credit shortly before entering a debt solution. This is common occurrence for credit unions, where their members have quickly accumulated a high level of credit, only to go on to enter an IVA or DRO in a matter of days/weeks. Our members state that they often encounter this behaviour, where it is clear that the debtor did not

have the intention of paying these loans back, but the credit union has little power to take action against the IVA or DRO.

These suggested changes are not to undermine the genuine need for insolvency solutions where debt has become unmanageable, nor to ignore that there are many complex reasons that individuals will require an insolvency solution. However, there should be a greater look at how the insolvency regime can encourage responsible behaviour, rather than allow the same level of debt relief to individuals regardless of their actions.

Question 10: Who should bear the costs of entering and administering personal insolvency procedures?

It is appropriate for the cost of insolvency procedures to be borne by the debtor. There should be a strict limit placed on the amount of fees that can be charged to debtors via regulation. This is to avoid vulnerable debtors being exploited by IVA providers, who often charge an exploitative level of fees.

However, it would be appropriate for the Government to provide targeted support to cover the insolvency fees of the most vulnerable individuals, who require an insolvency solution due to unfortunate circumstances.

Creditors inherently face cost of the insolvency solution through the losses made by writing off loans and should not bear any further costs of insolvency. This loss is exacerbated by the extortionate amount charged in fees for IVAs and DMPs.

Question 11: How should the costs of entering and administering personal insolvency procedures be paid and structured between the different parties?

For insolvency solutions that involve a regular repayment plan, it is important that the payment of fees towards insolvency practioners are distributed evenly throughout the duration of the insolvency solution. This is to ensure that debtors are steadily making payments to steadily reduce the outstanding balance of debts throughout the payment. The current front-loaded structure of the majority of IVAs is highly problematic for both creditors and debtors. If the IVA is ended early – a common outcome of an IVA – the majority of payments will

have been paid directly to the IVA provider, with little of the payments used to reduce the outstanding debt balance. This leaves creditors with little return and the debtor with a similar level of debt, despite their effort to make repayments. Debtors are often unaware of this risk when entering an IVA, due to the lack of guidance and information they have been provided with.

We think it is necessary for there to be regulation that implements a set structure and fee level for all insolvency solutions. For IVAs or an equivalent insolvency solution, there should be a regulated limit on the level of fees that can be charged, alongside a set fees structure where fees are paid evenly throughout the course of the debt solution.

Question 16: Do you believe the current insolvency procedures are working as intended? Please provide any evidence you have.

We strongly believe that the current insolvency procedures are not working as they were intended. This is because they are often not delivering a fair return to creditors, nor are they providing the appropriate debt relief to individuals. Our reasoning for this has been addressed throughout our response, but particularly in our answers to questions 2 and 3.

Question 17: How well do those in financial distress navigate the current regime and could this be improved?

Vulnerable individuals in financial distress do not navigate the current insolvency regime well, as they are routinely exploited by IVA providers.

IVAs are inappropriately promoted as a quick and easy debt remedy. These advertisements are far-reaching and utilise the internet, social media, television and radio to aggressively market IVAs. For example, in October 2022 a prominent IVA provider ran an advert on popular radio channels using the phrase '*want to get rid of 80% of your debts?*'. Those in financial distress are likely to respond to this type of persuasive and misleading message that an IVA will be an easy method of eliminating their debt. These individuals are then often not been given the appropriate support and information they need to evaluate their options, or even understand the consequences of entering the IVA. It is reported by our members that often those

entering the IVA had little understanding of the consequences, such as the impact on their credit file.

There are two important ways that debtors can be supported in navigating the personal insolvency framework. First, the promotion of debt solutions, including IVAs, should be strictly regulated, similar to regulations around the promotion of financial services products. This type of regulation would be necessary to ensure that insolvency solutions are promoted fairly and honestly. Second, it should be made compulsory that to enter any debt solution a debtor should receive free, regulated and impartial debt advice. This in order to help a financially distressed individual with all the support and information they need to understand their options and make the decision that is appropriate to their circumstances.

Question 18: Are the current personal insolvency procedures the right products to service the needs of both debtors and creditors today or are new procedure(s) needed to serve debtors and creditors better?

We hope that the issues raised throughout this consultation response raise that IVAs, as they are currently structured, are an inappropriate product. We believe that the amount of change required to this insolvency solution necessitate there be being a fundamental reform of IVAs.

We have summarised some of the key issues raised with IVAs below:

1. The profitable nature of IVAs that leads to extortionate administration fees, at the expense of both the debtor and creditor.
2. The ease of accessing these solutions, allowing individuals to enter an IVA when their problem debt could have been resolved via a temporary payment break or even by better budgeting and money management.
3. The mis-selling of IVAs and lack of advice often provided when entering these debt solutions, leading to frequent failure of IVAs.
4. The front-loading of fees, which leaves debtors in a worse situation than prior to the IVA if it fails.
5. The frequent exclusion of credit unions from the Creditor’s Meeting to approve an IVA.
6. The aggressive marketing of IVAs.

7. The lack of accountability and redress for both debtors and creditors where there has been misconduct by an IVA provider.

We strongly believe that there is need for a solution similar in principle to an IVA, where debtors are supported to make regular debt repayments whilst benefitting from protections from creditors. We hope that the Government looks to consider an alternative replacement for IVA as part of its wider agenda to reform the regulation of insolvency.

If IVAs are not reformed significantly, we believe that credit unions should have a formal exclusion from IVAs implemented, in recognition of the costs IVAs present to credit unions and the impact this has on their ability to provide affordable and inclusive credit.

Question 23: How could an individual's decision to enter a particular procedure could be better informed?

We strongly believe that it should be mandatory to obtain free, regulated, and impartial debt advice in order to enter any debt solution.

Free and impartial debt advise is vital to help individuals understand their options and make an informed decision. It should not be expected for financially vulnerable individuals to have a full knowledge as to what their options are for insolvency. There is an asymmetry of knowledge between debtors and insolvency solution providers, that is too often exploited. IVA providers have a financial incentive to push for these highly profitable debt solutions and do not have robust regulation to ensure they give sound debt advice. The lack of advice provided to debtors means that many debtors do not have a full understanding of the debt solution they have entered.

In order to rectify this issue, the exemption from debt advise regulation must be removed so that IVA providers must first provide regulated debt advice before administering an IVA. In addition, the personal insolvency framework should be amended so that debtors must receive free and impartial debt advise before entering any insolvency solution.

Question 27: How could the personal insolvency framework be improved, for example, to make access easier or movement

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between procedures easier? Please provide evidence to support your answer.

It should be the primary focus to ensure the right insolvency solutions are entered in the first place by debtors. This could be achieved through introducing a mandatory requirement for free, impartial debt advice for all insolvency solutions.

Nevertheless, a debtor's circumstances can change significantly during an insolvency solution, especially for insolvency solutions that last for multiple years. For this reason, we would recommend that the Government consider introducing a centralised point to access all personal insolvency solutions. This would allow an easier movement between solutions where appropriate. In addition, a centralised point of access for personal insolvency would create the opportunity for there to be greater standardisation of assessing debtors' eligibility and suitability for the range of debt solutions available.

Please get in touch should you wish to further discuss our consultation response.

Yours sincerely,

Niamh Evans

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