

## **Executive Note**

### **The Protected Trust Deeds (Scotland) Regulations 2008 SSI/2008/143**

This instrument will if approved be made in exercise of the powers conferred by paragraph 5(1) of Schedule 5 of the Bankruptcy (Scotland) Act 1985 (“the 1985 Act”), as amended by section 20(1) of the Bankruptcy and Diligence etc. (Scotland) Act 2007 (“the 2007 Act”). The instrument is subject to affirmative resolution procedure.

### **Policy Objectives**

This instrument replaces the current rules on Protected Trust Deeds (“PTDs”) contained in Schedule 5 to the 1985 Act. The instrument largely reproduces the current conditions for determining when a trust deed will be protected. It introduces changes to support the effective administration of PTDs, including clarification of the date of protection and new rules to provide for the discharge of debtors. It contains provisions to support the supervisory role of the Accountant in Bankruptcy (“AiB”) as introduced by section 23 of the 2007 Act. It also contains a provision to carry across new rules on student loan debts in bankruptcies to PTDs.

### ***Purpose of PTDs***

PTDs are an alternative to bankruptcy. A trust deed is a voluntary agreement which transfers a person’s assets to a trustee to be administered for the benefit of creditors and the payment of debts. There is a long history of trust deeds as private agreements between debtors and creditors in Scotland. The most famous example is a trust deed signed by Sir Walter Scott in 1826. Because a trust deed is a voluntary agreement it can be wrecked by one dissenting creditor even if the proposal suits the majority. PTDs were introduced by the 1985 Act to provide that a trust deed meeting specified criteria would be binding on all creditors. Until 1993, the numbers of PTDs remained low. Following reforms made to Scottish bankruptcy law by the Bankruptcy (Scotland) Act 1993, PTDs have been increasingly popular as a form of debt relief. 8,298 PTDs were recorded in the Register of Insolvencies in the business year ending 31 March 2007.

PTDs are “protected” in the sense that creditors who do not agree to the terms of the trust deed have no higher right to recover their debts than creditors who do agree – this principle is restated in regulation 11(1)(a) of this instrument. The conditions for protection include the consent or deemed consent of a majority in number or two-thirds in value of creditors, advertisement of the trust deed in the Edinburgh Gazette, and registration of the trust deed in the Register of Insolvencies.

### ***PTDs in the context of bankruptcy reform***

Several concerns were raised about PTDs during the progress of the 2007 Act. In particular, it was noted that there have been complaints from some debtors about the administration of their PTDs and concerns from creditors about the level of dividends in some PTDs. In addition, there was specific lobbying by the Credit Union movement for better regulation of PTDs and the impact on debts owed to them.

The 2007 Act introduces a general power for AiB to supervise trustees of PTDs in the same way as trustees in sequestration. This instrument is intended to support that role and to improve debtor and creditor confidence in PTDs.

### *Specific Provisions in this Instrument*

Regulation 3 specifies that the date from which a trust deed is protected is the date it is recorded in the Register of Insolvencies. This is an improvement on the current rules where the date of protection is unclear. Registration is the last action required to complete a valid PTD.

Regulation 4 defines who may grant a trust deed. It is usually granted by a living debtor but there is scope for other entities to grant a trust deed. This provision follows the provisions for the sequestration of other entities in section 6 of the 1985 Act. A provision is included to specifically exclude limited companies. This provision is derived from sections 5(4A) and 73(1) of the 1985 Act.

Regulation 5 provides that the trustee of a PTD must be a person who could act as a trustee in a sequestration. This means that the trustee must be a qualified insolvency practitioner, that a debtor cannot be his or her own trustee and that the trustee cannot have a vested interest in the trust. Because of a consequential amendment contained in section 7(2) of the 2007 Act this provision does not require the trustee to reside in Scotland. This is derived from section 24(2) of, and paragraph 5(1)(a) of Schedule 5 to, the 1985 Act.

Regulation 6 provides two things. Firstly, that the PTD must contain a statement confirming that all of the debtor's estate is conveyed to his or her trustee, except for any assets which would be excluded from vesting in a trustee in a sequestration. Secondly, it prescribes the content of a statement to be signed by the trustee and the debtor to confirm that before a trust deed is granted the debtor has received information and advice on the consequences of granting a trust deed and the alternative options that are available. The requirements to make these statements and in accordance with Regulation 10 provide them to the AiB, are new.

Regulation 7 reproduces the provisions currently set out in paragraph 5(1)(b) and (3) of Schedule 5 to the 1985 Act and Form 10 in the Schedule to the Bankruptcy (Scotland) Regulations 1985 ("the 1985 Regulations"). These provisions specify the form of a notice in the Edinburgh Gazette to advise creditors of a proposed PTD. The form of notice is specified as Form 1 in Schedule 1 to this instrument.

Regulation 8 specifies the documents that the trustee should send to all known creditors before a trust deed can be protected. This includes information about the debtor's assets and liabilities and the prospects of a dividend. These provisions are partly derived from paragraph 5(1)(c) of Schedule 5 to the 1985 Act and partly new. This regulation prescribes a form for inviting statements of claim by creditors, specified as Form 2 in Schedule 1 to the instrument. The new form is based on the claim form used in sequestrations which is currently Form 5 in the Schedule to the 1985 Regulations. Current practice is for trustees to adapt the sequestration form but it is not entirely suitable and we consider that a dedicated PTD form is appropriate.

Regulation 9 specifies the requirements for creditor consent to the protection of a trust deed and the deeming of consent if creditors do not respond within the prescribed time. This is derived from paragraph 5(1)(d) of Schedule 5 to the 1985 Act.

Regulation 10 specifies the documents that the trustee should send to AiB at the end of the prescribed period for creditor responses. It also imposes a requirement for AiB to record the PTD in the Register of Insolvencies forthwith. This expands on the current requirement to send a copy of the PTD to AiB in paragraph 5(1)(e) of Schedule 5 to the 1985 Act by adding additional documents in order to support the supervisory function. One of the additional documents is a statement of anticipated realisations from a PTD. The form of this statement is specified in Form 3 in Schedule 1 to the instrument. This form will allow AiB to evaluate the PTD's performance against expectations and is based on the current best practice of trustees.

Regulation 10 also imposes a duty on AiB to register the PTD forthwith. We consider that this duty should be made explicit because of the new definition of the date of protection contained in regulation 3.

Regulation 11 sets out the effects of protected status. Paragraph (1) restricts the rights of creditors to pursue debts included in a PTD, whether or not they consented to it. This provision specifies the rights of creditors who dissented or who were not sent a copy of the proposed PTD. Paragraph (1)(a)-(b) is derived from paragraph 6 of Schedule 5 to the 1985 Act. Paragraph (1)(c) is derived from paragraph 5(2) of Schedule 5 to the 1985 Act.

Paragraph (2) of Regulation 11 provides that these limitations on the rights of creditors will not apply if the trustee brings the PTD to an end because the debtor has not fulfilled his obligations under it. This is a new provision to support the new process to provide a formal discharge of debtors under PTDs.

Regulation 12 deals with the limited circumstances in which a creditor is entitled to petition for the debtor's sequestration. This provision is derived from paragraph 7 of Schedule 5 to the 1985 Act.

Regulations 13 and 14 prescribe a process for a creditor in certain circumstances to apply to the Sheriff for an order that the discharge of the trustee under a PTD should not be binding on that creditor. These provisions are derived from paragraphs 11-13 of Schedule 5 to the 1985 Act.

Regulation 15 is a new provision which gives effect to AiB's power of supervision by enabling him to issue determinations to the trustee on how the trustee should conduct the administration of the trust deed. Appeal rights against such determinations are included in regulation 23.

Regulation 16 is a new provision requiring the trustee of a PTD to retain specified documents as set out in Schedule 2 to the instrument. These documents must be retained for one year after the trustee's discharge. This provision is required to support AiB's supervisory role and is analogous to the sederunt book retained by trustees in sequestrations.

Regulation 17 provides for a statement of the trustee's accounts and the trustee's report on the status of the PTD to be given to the AiB annually. This is a new provision introduced as part of the AiB's supervisory role. A form of the trustee's annual report is prescribed in Form 4 of Schedule 1 to this instrument. The form will allow AiB to evaluate performance of the PTD against the expectations given to creditors. This regulation also states that a statement of the trustee's accounts must be sent to the debtor and creditors.

Regulation 18 deals with the trustee's remuneration. This is a new provision intended to clarify what is and is not included in allowable remuneration. Paragraph (2) is intended to prevent arrangement fees for PTDs of debt management companies being treated as preferential debts. This is intended to address concerns about the business practices of such companies acting as arrangers for PTDs and their impact on the dividends to ordinary creditors. This provision will not prevent payment to third parties for work done ascertaining the facts in relation to a debtor's assets and liabilities where such work is performed on the trustee's behalf acting as an agent of the trustee. Fact-finding work properly carried out under the trustee's direction and would be paid on the basis that it is part of the trustee's role in administering the PTD. Such work will be subject to audit and supervision.

Regulation 19 provides a new process for the discharge of debtors under PTDs. Under current rules, unlike sequestrations, there are formal rules governing the discharge of trustees but no equivalent provision for debtors. We intend that the discharge of the debtor will not be automatic but conditional on the debtor's cooperation with his or her trustee in the administration of the debtor's estate. If, in the trustee's opinion, the debtor has met his or her obligations under the PTD, the new provisions provide a mechanism for the trustee to discharge the debtor. A form is provided for a letter of discharge to be sent to the debtor. This form is prescribed as Form 5 in Schedule 1 to this instrument. The debtor's discharge will be recorded in the Register of Insolvencies. The regulation provides for notification to the debtor if the trustee refuses to grant the debtor's discharge. If the debtor's discharge is refused, creditors will be able to take action to enforce any outstanding debts. The debtor has a right of appeal against a refusal of his or her discharge in regulation 23.

Regulation 20 deals with student loan debts. Section 34 of the 2007 Act introduces provisions to prevent discharge from liability to repay a student loan on discharge from sequestration. Regulation 20 of this instrument will ensure that the same provisions will apply to PTDs.

Regulation 21 deals with the trustee's discharge. In part, this regulation is derived from paragraph 9 of Schedule 5 to the 1985 Act. The regulation prescribes a form for the trustee to apply for discharge from the creditors. This form is prescribed as Form 6 in Schedule 1 to this instrument. The trustee has a right of appeal against a refusal of the creditors to grant the trustee's discharge in regulation 23.

Regulation 22 requires the trustee, following the trustee's discharge, to report to the AiB on the distribution of the debtor's estate and confirm that the trustee has obtained his or her discharge from the creditors. In part, this regulation is derived from paragraph 10 of Schedule 5 to the 1985 Act. The regulation also prescribes a form for the trustee to report on the actual distribution of the debtor's estate against the anticipated dividend previously advised to creditors. This form is prescribed as Form 7 in Schedule 1 to this instrument and is partly derived from Form 11 in the Schedule to the 1985 Regulations.

Regulation 23 provides for rights of appeal against various decisions specified in this instrument. This is a new provision.

Regulation 24 provides a general power to apply to the Sheriff for directions in respect of or in relation to the administration of a trust deed, including any order to correct defects in procedure. This is a new provision based on the analogous provision for sequestrations in section 63 of the 1985 Act.

Regulation 26 confirms that these Regulations only apply to trust deeds granted after these Regulations come into force.

### **Consultations**

A public consultation on the reform of PTDs was held from 20 January 2006 to 14 April 2006. In the consultation paper the then Scottish Government expressed the view that PTDs were a “softer” form of bankruptcy with several advantages for debtors but that this is justified if PTDs also have a demonstrable advantage for creditors. However, it was felt that the benefits to creditors had not been demonstrated for all PTDs. The consultation sought views on a number of proposals such as a minimum dividend of 30 pence per pound, a percentage cap on trustees’ fees, and a mandatory trigger for investigation if the expected dividend varies beyond a specified threshold.

There were 47 responses. The majority of responses came from the insolvency profession but there was a significant level of response from the advice sector and businesses (including Credit Unions). The majority of respondents disagreed with the proposed minimum dividend and percentage cap but supported the proposal that a change in the expected dividend should trigger some sort of investigation. There was support for the view that creditors should get value from a PTD, but it was felt that the specific proposals would limit the availability of PTDs and restrict debt relief for debtors. Several respondents felt that the realisation of equity in a debtor’s home should be more prominently addressed in the administration of a PTD. Some respondents also felt that trustees’ fees are excessive.

Concerns about the impact of PTDs on Credit Unions were raised during the Parliamentary progress of the 2007 Act and a supplementary public consultation exercise was held from 2 April 2007 to 26 June 2007. In total 74 responses were received. 50 responses were received on behalf of Credit Unions and 24 responses were received from other categories of respondent. There was a close correlation between the category of respondent and the views expressed. Almost all Credit Unions and individuals and professional bodies connected with Credit Unions were in favour of legislation to introduce new rules to protect debts owed to Credit Unions by providing that such debts should not be cancelled by a PTD. The majority of responses from outside the Credit Union community were opposed to any special provisions. The main reason given was that it would treat creditors unequally and that the case for Credit Unions to receive special treatment had not been made. Some respondents also felt that special protection would run contrary to the principles of fresh start and financial inclusion because a debtor could not be relieved of Credit Union debt except through bankruptcy.

The Scottish Government’s view is that special protection for Credit Unions is not appropriate at the present time. We consider that there is insufficient evidence at present to support a legislative change to protect the special interest of Credit Unions when that change

has the potential to act unfairly against the interests of debtors who are genuinely in need of debt relief and other creditors. However, we intend to gather more evidence on this issue and we will reconsider it following a review of the policy objectives of this instrument. to be carried out six months after commencement of the PTD regulations. A further review of the PTD policy as a whole will be undertaken during 2009/10.

### **Financial Effect**

A separate instrument will set out proposals for a supervision fee chargeable to trustees of PTDs on all trust deeds that are protected and the fee will be recoverable from the realised estate of debtors. This will be analogous to the supervision fee currently charged in sequestrations. The fee will fund the cost of work done by AiB in their role as supervisor of trustees of PTDs. We propose to look at the fee level in the review of the policy objectives of this instrument.

### **Equality Impact Assessment**

An equality impact assessment has not been completed. An assessment will be completed as part of the PTD review process during the second half of 2008 and the results of this will be included in the review report on the policy objectives of this instrument.

Accountant in Bankruptcy  
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