

Personal Insolvency update

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In this issue...

Getting to grips with
consumer over-
indebtedness

Courts robust on
exceptional circumstances

Bankruptcy Restriction
Orders (BROs) and
Undertakings (BRUs)
– a real deterrent?

The IVA Protocol – saviour
or swansong?



Getting to grips with consumer over-indebtedness

The latest round of personal insolvency statistics contained few surprises but the question remaining after the last quarter's figures is "what next?". Our newspapers are full of doom and gloom about the economy and it is difficult to see many reasons to be cheerful at the moment. Personal insolvency numbers do seem to have stabilised but this is at a rate of over 100,000 a year. This number is arguably still too high when we consider that the total peaked at a little over 36,000 in the recession of the early 1990s.

'consumer credit increased by another £4.1 billion in the quarter to the end of March'

belts and borrowing less? Or, more worryingly, are we still borrowing but increasingly driven by the need to fund more basic lifestyle requirements such as to pay utility bills, for groceries and to fill up the car?

Recent figures from the Bank of England showed consumer credit increased by another £4.1 billion in the quarter to the end of March, with February being particularly high. The April figures do show a slow down, but the rate of growth in unsecured debt is increasing, reversing the trend towards the end of 2007. With lending criteria tightening, it is noteworthy that demand for so-called 'payday' loans, designed to tide workers over until they get paid at the end of the month, has apparently increased significantly. MoneySupermarket.com recently estimated that over half a million people in Britain took out such loans in the last 9 months with a typical APR of an alarming 1355%.



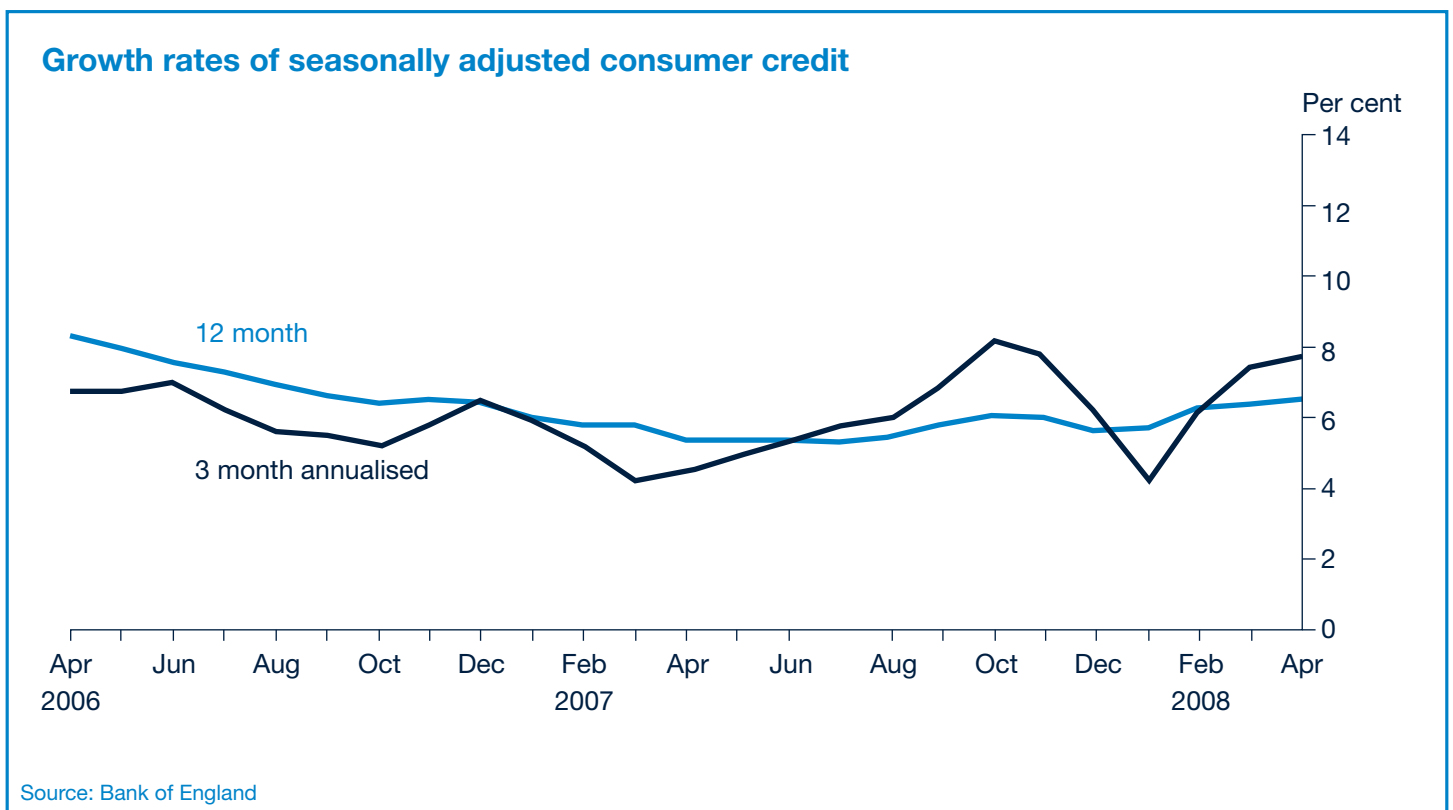
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In the first quarter of this year, the number of people who became bankrupt or entered into an Individual Voluntary Arrangement ("IVA") was 25,264. Whilst there was a very slight increase on the previous quarter, this was 13% down on the same quarter last year. This figure was made up of 15,651 bankruptcies and 9,614 IVAs. The IVA numbers had dropped on the same time last year, by a relatively significant 22%, although they are still slightly up on the previous quarter.

Provident Financial, the sub-prime lender, reported a 6.3% increase in customers in May. As their business often tends to be with those who are denied mainstream lending, this increase is another indication of the impact that the credit crunch is having. While the view we have of most debtors recently has been that they got into debt over designer goods and plasma TVs, it is concerning that increasing numbers of people are now turning to expensive sources of borrowing merely to make ends meet.

So, as a nation of consumers, are we getting to grips with consumer over-indebtedness, are we tightening our



Courts robust on exceptional circumstances



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In April 2008, in the case of *Avis v Turner*, the High Court made an important ruling concerning exceptional circumstances, which supports the rights of a Trustee in Bankruptcy to enforce an order for sale on a property contrary to the terms of a pre-existing matrimonial property / ancillary relief order postponing its sale. The ruling applies whether or not the order was by consent.

The Court of Appeal having already determined (in July 2007) that the terms of the consent order could not restrict the right of the Trustee to realise assets for the benefit of creditors, the case was referred back to the High Court for ruling on the exceptional circumstances claim put forward by Mrs Avis.

Mr and Mrs Avis divorced in 1985. Under a consent order, the matrimonial court determined that their jointly owned home would be divided 1/3 to Mr Avis and 2/3 to his former wife. The order allowed Mrs Avis to have exclusive occupation, with any sale postponed pending one of four contingencies:

- The remarriage of Mrs Avis
- The ongoing co-habitation of Mrs Avis
- A voluntary sale of the property
- The death of Mrs Avis

Mr Avis was adjudged bankrupt in 1989. At this stage the equity in the property was minimal and unfortunately attempts by the first Trustee to settle the matter were unsuccessful. By 2003, the property value had increased substantially and Charles Turner of

PricewaterhouseCoopers LLP was appointed as Trustee in Bankruptcy to realise the property interest. Again attempts to reach a settlement with Mrs Avis were unsuccessful so legal proceedings had to be issued. The Court's initial ruling accepted that the interests of creditors were paramount and that the property would have to be sold. Mrs Avis appealed that ruling but her appeal was rejected in the High Court in November 2006, and again by the Court of Appeal in July 2007.

The Court of Appeal decision relating to the consent order and the High Court decision relating to the exceptional circumstances are important for similar cases in the future. The Court accepted that joint owners should not be able to avoid the sale of a property interest in bankruptcy proceedings through the terms of a consent order. They should be in no better position than a couple who are not separated. The exceptional circumstances claimed by Mrs Avis, which included:

- The delay in appointing the Trustee to realise the property asset
- The existence of the consent order and Mrs Avis' ongoing reliance upon its terms
- The requirement for the Trustee to act fairly

were not sufficient to override the Trustee's rights in respect of realising the asset.

Looking ahead, Trustees will be helped by this judgement when realising assets in many cases where property adjustment orders are a feature.

Bankruptcy Restriction Orders (BROs) and Undertakings (BRUs) – a real deterrent?



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BROs and BRUs were introduced under the Enterprise Act to impose restrictions on bankrupts whose conduct is blameworthy, to deter fraud and to provide protection to the public and financial community. But how effective are they?

The Insolvency Service canvassed stakeholders and found many respondents lacked awareness of the provisions and there were many instances of low confidence in the level of protection that they provided.

Bankrupts are subject to restrictions for up to one year but courts can impose restrictions for up to 15 years. Almost 4000 BROs and BRUs have been made, with an average restriction period of five years. This would suggest that the

Insolvency Service is committed to using the legislation available to them to punish the culpable. Those in breach may be subject to further proceedings, including imprisonment, but the Insolvency Service relies upon the public and creditors to help police them.

Online access to those subject to BROs and BRUs can be found on the Insolvency Service website www.insolvency.gov.uk which enables lenders to refine their credit searches. It is easy to dismiss the legislation as "impossible to police", but it is in everybody's interest to protect stakeholders by helping the Insolvency Service in its role. If you have suspicions, make that search and blow the whistle on any possible breach.

The IVA Protocol – saviour or swansong?



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The Protocol came into effect on 1 February 2008, following a fairly drawn out process culminating in, at times, a rather fractious launch party. Its aims are undoubtedly laudable, with intentions to provide a standardised proposal for consumer IVAs so that creditors, debtors and IPs know what to expect. Unfortunately, it seems a bit one-sided, with IPs conforming largely to their commitments, and some creditors continuing to impose minimum dividend rates and their own fee scales. As one commentator puts it, the Protocol states that IPs will, and creditors may.

Nonetheless, it does give a degree of certainty to the process, and IPs know what fees and dividends are acceptable. The recent small increase in IVA numbers in comparison to the previous quarter probably reflects more the impact of the Protocol, rather than the general economic situation. One would hope that creditors recognise this and begin to remove some of their barriers, although it seems highly unlikely that they will change their stance on fees.

Many experts predicted the demise of the IVA following the introduction of the Enterprise Act in 2004, arguing that a perceived softer bankruptcy regime would weaken the popularity of the IVA. What was not recognised at the time was the combination of the explosion in consumer debt (it doubled in the first half of the decade), and the impact of the IVA companies' advertising campaigns.

There is no doubt that for the majority of debtors, bankruptcy is the cheaper of the options. Not only is the payment

period two years shorter, but the payment itself is not subjected to rigorous examination by the creditors - indeed they have no say whatsoever. Nevertheless, the stigma of bankruptcy remains strong, as the Insolvency Service's Attitudes to Bankruptcy Revisited survey revealed last year. Over 80% of respondents gave the advertisement of the bankruptcy as the main factor behind the stigma. There are currently, however, proposals for the removal of the advertisement rule to reduce the stigma, and proposals for the online, non-Court based petitions haven't yet gone away.

'As one commentator puts it, the Protocol states that IPs will, and creditors may.'

So, as with 2004, bankruptcy is perhaps becoming a softer option. Will it hit IVA numbers this time? There has not been the doubling of consumer debt to produce the demand, neither is the supply of IVA services likely to increase. Some IVA providers have withdrawn from the market and the cost of advertising has increased while IVA fees have fallen. The current economic situation will undoubtedly bolster numbers, but the IVA is under real threat this time. If creditors accept that they are unlikely to get better returns from other avenues, they may wish to reconsider their attitude on fees and minimum dividend rates.

Desmond Flynn

Desmond sadly died on 22 March 2008, the day after his 59th birthday, having retired only a few months earlier. Desmond, as Chief Executive of the Insolvency Service, was an innovator and a strong leader, well able and suited to standing up for the Service and its staff. Des and I were examiners together in the Official Receiver's Office in Birmingham in the 1970s and it was apparent then that he would progress in whatever field he chose. He was an intellectual, always game for a discussion and a debate, which were frequently laced with his sharp wit and humour – it was a brave person who took him on in this particular arena! Desmond is survived by his wife and two children.

Pat Boyden

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